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January 7, 1980
Bulletin No. 1980-1

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-1, page 12.

Sales tax; California. The sales tax imposed by California on the retailer and paid to the retailer by the consumer is includible in the retailer's gross income. The tax is deductible by the consumer when paid to the retailer and by the retailer when accrued or paid to the State.

Rev. Rul. 80-2, page 13.

Intangible drilling and development costs; option to deduct. Section 263 of the Code, as amended by the Energy Tax Act of 1978 to grant an option to deduct intangible drilling and development costs incurred with respect to geothermal wells, does not permit a new election for the treatment of such costs for oil and gas wells.

Rev. Rul. 80-3, page 13.

Title insurance company; title or abstract plant. A domestic title insurance company may deduct recurring expenses incurred to update its title plants.

Rev. Rul. 80-4, page 14.

Foreign tax credit; Netherlands Antilles; payment pursuant to legal liability. A payment to the Netherlands Antilles pursuant to the election described in Rev. Rul. 65-16 is a payment made pursuant to a legal liability for purposes of section 901(b) of the Code; Rev. Rul. 65-16 amplified.

Rev. Rul. 80-5, page 15.

Sale of residence; amended joint return without spouse's signature. A taxpayer and the taxpayer's spouse filed a joint return deferring the gain on the sale of their personal residence under section 1034 of the Code. They subsequently obtained a divorce. The former spouse reinvested the amount required under section 1034 and refused to sign an amended return with the taxpayer, who failed to purchase a new residence within the 18-month period. The taxpayer must file an amended joint return for the year of the sale with a letter explaining why the spouse's signature is missing.

Rev. Rul. 80-6, page 16.

Joint return; net operating loss for separate return year. The proper method is provided for computing the amount to be refunded to an unmarried taxpayer who incurred a net operating loss that was carried back or carried over to a year in which the taxpayer was married and filed a joint return; Rev. Rul. 75-368 modified.

Rev. Rul. 80-7, page 17.

Joint return; overpayment; credit against separate

(Continued on page 4)

A list of Announcements of Actions on Decisions of the Tax Court published in the Bulletin from January through December 1979 begins on page 5.

Finding List of Revenue Rulings, Revenue Procedures, Treasury Decisions, etc., published in the Bulletin from July through December 1979 begins on page 24.

Finding List of Previously Published Rulings Currently Mentioned in the Bulletin from July through December 1979 begins on page 26.

Index of Items published in the Bulletin from July through December 1979 begins on page 28.

Announcement of Voluntary Suspensions on page 22.
Announcement of Proposed Rulemaking on page 23.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue Rulings represent the conclusions of the Service on the application of the law to the entire state of facts involved. In those that are based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and confidential information are deleted to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part includes rulings and decisions based on Subpart A, Tax Conventions and related Treasury Decisions and Revenue Rulings; Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of Revenue Rulings, Revenue Procedures, and other published items, and (3) topical Indexes of Public Laws, Treasury Decisions, and Tax Conventions.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Continued

tax liability. The proper method is provided for computing the amount of an overpayment shown on a joint return that may be credited to one spouse's unpaid separate tax liability from a prior year; Rev. Rul. 67-431 amplified.

Rev. Rul. 80-8, page 19.
Joint return; amended; overypayment; single signature. The Service will accept a claim for credit or refund filed by a divorced taxpayer on a Form 1040X with respect to a joint return if the Form 1040X is signed by only one of the taxpayers and will issue a refund check in that taxpayer's name alone. The proper method is provided for computing the refund that may be made to the individual taxpayer.

T.D. 7655, page 7.
Amendments to the regulations relate to corporations that consent to application of the provisions of section 341(f)(2) of the Code in order to avoid application of the collapsible corporate provisions of section 341(a)(1).

EMPLOYMENT TAXES

T.D. 7656, page 15.
Amendments to the regulations under section 6051 of the Code relate to the requirement that employers furnish Forms W-2 to employees whose employment is terminated before the end of the year.

ADMINISTRATIVE

Announcement 80-1, page 21.
Form 1041-A, Trust Accumulation of Charitable Amounts, has been revised and is now available in Service offices.

Announcement 80-2, page 21.
A new Form 6251, Alternative Minimum Tax Computation, has been developed for use by individuals, estates, and trusts to figure their alternative minimum tax and is available at Service offices.

Cumulative List of Announcements Relating to Decisions of the Tax Court Published in the Internal Revenue Bulletin from January 1, 1979 thru December 31, 1979

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issue or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by Revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean aceptance and approval of any or all of the reasons assigned by the Court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the Tax Court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Allen, Truett E., et ux	5435-76	72	28
American Precision Metals [1]	5266-73 5267-73	66	159
Anderson, Ronald D., et ux [2]	1727-74	67	522
Austin Co., Inc.	1312-75	71	955
Boudreau, Betty Warnack	1507-77	71	541
Bruno, Dorothy [3]	7284-76	71	191
Clapham, Joan D.	2734-73	63	505
Clapham, Robert G.	2733-73		
Columbia Iron & Metal Co.	8304-71	61	5
Cottrell, Lois P. [4]	1816-77	72	489
D'Angelo Associates, Inc. [3]	4020-75	70	121
DiPalma, Agnese, Est. of, Constance Savarese, executrix [5]	5207-76	71	324
Duggar, Perry N., et ux	178-76	71	147
Dyer, Madeline G. [3]	3226-75	71	560
Engdahl, Theodore N., et ux	9912-75	72	659
Fasken, David, et ux	5823-77	71	650
Fasken, Inez G., Est. of, David Fasken, independent executor	5824-77		
Glen O'Brien Movable Partition Co., Inc.	5508-75	70	492
Gordon, Dave, et ux, Ests. of, The National Bank of Tampa, Victor Ingram & Edward I. Cutler, executors [5]	9307-76	70	404
Gray, Anne L., First National Bank of Oregon, Guardian	2381-68	71	67
Gray, Janet L., First National Bank of Oregon, Guardian	2379-68		
Gray, Joan E., First National Bank of Oregon	2378-68		
Gray, John D., et ux	2376-68		
Gray, John R., First National Bank of Oregon, Guardian	2377-68		
Gray, Laurie J., First National Bank of Oregon, Guardian	2380-68		
Greer, John L. & Est. of Russell Z. Greer, John L. Greer, executor	6912-76	70	294
Hewlett-Packard Co. [3]	3151-75	67	736
Hosking, Louis Richard [3]	8360-71	62	635
Jarvis, William D. P., an infant by Amilius Jarvis, Jr., Guardian [2]	*99227	43	439
Knott, Henry J., et ux [6]	4010-73	67	681

Taxpayer	Docket No.	Report Volume	Report Page
Koch, Carl E., et ux, Frederick W. Koch, et ux, William A. Bomberger, et ux, John J. Koch	9648-76	71	54
Langenfelder & Son, Inc., C.J.	8895-75	69	378
Larson, Phillip G.[1]	5530-72	66	159
Laure, George R., et ux[7]	1517-76	70	1087
Martino, William J., et ux	11214-77	71	456
Milliken, Arthur, Est. of, Charles B. Milliken, executor[5]	951-77	70	883
Murphy, Mary Margaret, Est. of, John Falk Murphy, personal representative[5]	3880-76	71	671
Rambo, Charles W.[3]	8691-74	69	682
Reddock, Philip, et ux	7923-78	72	2
Ritchie, Earl Russell, Jr.	12542-77	72	126
Russell, Thomas C., Est. of, Florence D. Russell, executor[5]	6282-76	70	40
Severn River Construction Co. & subsidiary companies	4011-73	67	681
Taylor, Jaquelin E., et ux	5633-74	67	1071
10-42 Corporation[8]	3720-67	55	593
Tennessee Natural Gas Lines, Inc. & subsidiary	8100-76	71	74
Tobey, Mark[9]	1144-70	60	227
VGS Corporation	6996-74 6897-74 9916-74	68	563
W-L Molding Co.[7]	1518-76	70	1087
Warnack, A. C., et ux	879-77	71	541
Westroads, Inc.	9444-76	69	682
Whitacre, Robert N., et ux	2474-76	71	346

The Commissioner does NOT ACQUIESCE in the following decisions:

Taxpayer	Docket No.	Report Volume	Report Page
Anderson, J. Irving, et ux	2090-65	52	700
Anderson, William O., et ux	2089-65		
Brent, Mary Ellen	7176-74	70	775
Burnham, Russell T., et ux	2091-65	52	700
Carson, David W. & Marjorie E.[4]	9638-74	71	252
Koch, Virgil H., et ux	2069-65	52	700
Minnis, Robert W., et ux	2363-77	71	1049
Morrow, John C., Est. of, Mellon National Bank & Trust Co. & Mildred Morrow McBride, executors[5] [10]	3554	19	1068
Noble, Glenn A., et ux	4276-76	70	916
Parodi, Roy, et ux	2088-65	52	700
Reich, Arthur E.	2066-65		
Reich, Arthur E., et ux	2065-65		
Reich, Carolyn G.	2067-65		
Smales, Fred B., et ux	3353-65 3818-66		
Thermal Power Co.	3214-66		
Walraven, James H., et ux	3152-65		
White, Allen Smith, et ux	2068-65		

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* United States Board of Tax Appeals.

[1] See Rev. Rul. 79-106, 1979-1 C.B. 448.

[2] See Rev. Rul. 79-376, 1979-47 I.R.B. 6.

[3] Acquiescence in result. Acquiescence "in result" means acceptance of the decision of the Court but disagreement with some or all the reasons assigned for the decision.

[4] Gift Tax decision.

[5] Estate Tax decision.

[6] See Rev. Rul. 79-9, 1979-1 C.B. 125.

[7] Acquiescence in result in the issue relating to whether W-L Molding's assumption of debt owed to it by a sister corporation was a constructive dividend to Laure, the controlling shareholder. (See Footnote #3).

[8] Nonacquiescence published in 1972-2 C.B. 4 is withdrawn and acquiescence is substituted therefor. See Rev. Rul. 79-157, 1979-1 C.B. 281.

[9] See Rev. Rul. 79-85, 1979-1 C.B. 246.

[10] Acquiescence published in 1954-1 C.B. 5 is withdrawn and nonacquiescence is substituted therefor.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 162.—Trade or Business Expenses

26 CFR 1.162-1: Business expenses.

Whether payments made by a title insurance company to update title and abstract plant records are deductible currently. See Rev. Rul. 80-3, page 13.

Section 263.—Capital Expenditures

26 CFR 1.263(a)-1: Capital expenditures; in general.

Whether payments made by a title insurance company to update title and abstract plant records are to be capitalized. See Rev. Rul. 80-3, page 13.

Section 341.—Collapsible Corporations

26 CFR 1.341-7: Certain sales of stock of consenting corporations.

T.D. 7655 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Collapsible corporations

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to "collapsible corporations". Changes to the applicable tax law were made by the Act of August 22, 1964 [Pub. L. 88-484, 1964-2 C.B. 605]. These regulations provide necessary guidance to taxpayers for compliance with the Act and affect certain collapsible corporations and their shareholders.

DATE: In general, the regulations are effective for transactions occurring after August 22, 1964.

FOR FURTHER INFORMATION CONTACT: Lawrence M. Axelrod of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, (202-566-3458, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On July 6, 1977, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 341(f) of the Internal Revenue Code of 1954 (42 FR 34523). The amendments were proposed to conform the regulations to sections 1(a) and 2 of the Act of August 22, 1964 (Pub. L. 88-484, 78 Stat. 596). No public hearing was requested and none was held. After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision.

Generally, section 341(f) provides that section 341(a) shall not apply to a sale of stock of a corporation if such corporation consents to recognize gain on any future disposition by it of its "subsection (f) assets" (defined, generally, as assets of the corporation other than certain capital assets, owned or held under option on the date the stock of the corporation is sold) and if the sale of stock is made within the 6-month period after the consent is filed.

This provision is intended to provide relief to shareholders who desire to sell stock of a corporation that is rapidly growing and expects to continue in business but which holds constructed or produced properties which are worth substantially more than their cost and upon which there has not been substantial realization of the profits to be derived from the properties. The shareholders, through a sale of stock, would like to capitalize on the future prospects of this growing company. However, on such a stock sale, the corporation might be regarded as falling within the definition of a collapsible corporation (under section 341(b)) if the shareholders realize gain upon the sale of stock of the corporation prior to the realization by the corporation of a substantial part of the income to be derived from the constructed or produced properties.

Section 341(f) provides that the collapsible provisions will not apply to the sale of stock in a corporation which consents to recognize gain upon later disposition of, generally, its assets other than certain capital assets. The treatment provided has the effect of assuring that ultimately there will be the same tax consequences as if the assets had been sold before the stock.

SUMMARY OF CHANGES

The Treasury decision is identical to the notice of proposed rulemaking of July 6, 1977, with the exception of the changes noted below.

Section 1.341-1 and Example (1) of § 1.341-7(e)(4) are modified to use the term "ordinary income" to conform to a change introduced by the so called "Deadwood Bill" (Title XIX, of the Tax Reform Act of 1976, Pub. L. 94-455, 1976-3 (Vol. 1) C.B. 1, 240).

In response to taxpayer comments, section 1.341-7 has been modified to make it inapplicable to shareholders who never owned (either actually or constructively) more than 5 percent in value of the outstanding stock of a corporation. Accordingly, a sale of stock of a consenting corporation, for purposes of section 341(f)(1), does not include a disposition of stock by a shareholder to which section 341(d)(1) applies. As a result, a shareholder who never owned more than a 5 percent interest in a consenting corporation and who sells stock of the corporation need not comply with the notification requirements of section 1.341-7(d). Also, the disposition of stock by such a shareholder within the 6-month period after a consent is filed will not taint the corporation's assets as "subsection (f)" assets.

In addition, a 5 percent-or-less shareholder of a consenting corporation who sold any stock in that corporation during the previous 5 years will not be barred by section 341(f)(5) from availing itself of the relief provided under section 341(f) for another consenting corporation.

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[1] This publication of the Treasury Decision contains the complete text of amendments to the regulations. The instructions for modifying the notice of proposed rulemaking have been omitted.

The term "taxpayer account number" which appeared in § 1.341-7(b)(2) and (f)(3) of the proposed regulations has been deleted and the term "employer identification number" has been substituted in its place.

Also, a new § 1.341-7(j)(5) is added dealing with a corporation that is a member of an affiliated group filing a consolidated return. The corporation is considered to have filed a consent if one is filed on its behalf by the group's common parent.

In addition, this Treasury decision corrects § 1.1502-32(d)(6) which was revised by T.D. 7637, 1979-40 I.R.B. 21, appearing at 44 FR 46838, on August 9, 1979. The amendment set forth in paragraph 4 of this document deletes "August 6, 1979," and inserts in its place "August 9, 1979,".

DRAFTING INFORMATION

The principal author of this regulation is Lawrence M. Axelrod of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the amendments published with notice of proposed rulemaking in the Federal Register for July 6, 1977 (42 FR 34523) are adopted as proposed subject to the changes set forth in paragraphs 1, 2, and 3 of this document.

Paragraph 1. Section 1.341 is deleted.

Par. 2. Section 1.341-1 is amended to read as follows:

§ 1.341-1 Collapsible corporations; in general.

Subject to the limitations contained in § 1.341-4 and the exceptions contained in § 1.341-6 and §1.341-7(a), the entire gain from (a) the actual sale or exchange of stock of a collapsible corporation, (b) amounts distributed in complete or partial liquidation of a collapsible corporation which are treated, under section 331, as payment in exchange for stock, and (c) a distribution made by a collapsible corporation which, under section 301(c)(3), is treated, to the extent it exceeds the basis of the stock, in the same manner as a gain from the sale or exchange of property, shall be considered as ordinary income.

Par. 3. There is inserted immediately after § 1.341-6 the following new section:

§ 1.341-7 Certain sales of stock of consenting corporations.

(a) *In general.* (1) Under section 341(f)(1), if a corporation consents (in the manner provided in paragraph (b) of this section) to the application of section 341(f)(2) with respect to dispositions by it of its subsection (f) assets (as defined in paragraph (g) of this section), then section 341(a)(1) does not apply to any sales of stock of such consenting corporation (other than a sale to such corporation) made by any of its shareholders within the 6-month period beginning on the date on which such consent is filed.

(2) For purposes of section 341(f)(1) and (5)—

(i) The term "sale" means a sale or exchange of stock at a gain, but only if such gain would be recognized as long-term capital gain were section 341 not a part of the Code. Thus, a sale or exchange of stock is not a "sale" within the meaning of section 341(f)(1) and (5) if there is no gain on the transaction, or if the sale or exchange gives rise to ordinary income under a provision of the Code other than section 341, or if gain on the transaction is not recognized under any provision of subtitle A of the Code.

(ii) A sale of stock in a corporation does not include any disposition of such stock by a shareholder if, by reason of section 341(d)(1), section 341(a) could not have applied to that disposition. (Under section 341(d)(1), section 341(a) does not apply except to more-than-5-percent shareholders.) Except as otherwise provided in paragraph (a)(2)(i) of this section, the term "sale" includes a disposition of stock in a corporation by a more-than-5-percent shareholder described in section 341(d)(1), even though section 341(a) did not apply to the disposition because the corporation was not collapsible or by reason of the application of section 341(d)(2), (3), or (e).

(3) A corporation which consents to the application of section 341(f)(2) does not thereby become noncollapsible, and the fact that a corporation consents to the application of section 341(f)(2) does not affect the determination as to whether it is a collapsible corporation.

(4) For limitations on the application of section 341(f)(1), see section 341(f)(5) and (6), and paragraphs (h) and (j) of this section.

(b) *Statement of consent.* (1) The consent of a corporation referred to in paragraph (a)(1) or (j)1) of this section shall be given by means of a statement, signed by any officer who is duly authorized to act on behalf of the consenting corporation, stating that the corporation consents to have the provisions of section 341(f)(2) apply to any dispositions by it of its subsection (f) assets. The statement shall be filed with the district director having jurisdiction over the income tax return of the consenting corporation for the taxable year during which the statement is filed.

(2)(i) The statement shall contain the name, address, and employer identification number of any corporation 5 percent or more in value of the outstanding stock of which is owned directly by the consenting corporation, and of any other corporation connected to the consenting corporation through a chain of stock ownership described in paragraph (j)(4) of this section. The statement shall also indicate whether such 5-percent-or-more corporation (or such "connected" corporation) has consented, within the 6-month period ending on the date on which the statment is filed, to the application of section 341(f)(2) with respect to any dispositions of its subsection (f) assets (see paragraph (j) or this section), and, if so, the district director with whom such consent was filed and the date on which such consent was filed.

(ii) If, during the 6-month period beginning on the date on which the statement is filed, the consenting corporation becomes the owner of 5 percent or more in value of the outstanding stock of another corporation or becomes connected to another corporation through a chain of stock ownership described in paragraph (j) (4) of this section, then the consenting corporation shall, within 5 days after such occurrence, notify the district director with whom it filed the statement of the name, address, and employer identification number of such corporations.

(3) A consent under section 341(f) (1) may be filed at any time and there is no limit as to the number of such consents that may be filed. If a consent is filed by a corporation under section 341(f)(1) and if a shareholder sells stock (i) in such corporation, or (ii) in another corporation a sale of whose stock is treated under section 341(f)(6) as a sale of stock in such corporation, at any time during the applicable 6-month period, then the consent cannot thereafter be revoked or withdrawn by the corporation. However, a consent may be revoked or withdrawn at any time prior to a sale during the applicable 6-month period. If no sale is made during such period, the consent will have no effect on the corporation. See paragraph (g) of this section.

(c) *Consenting corporation*. (1) A consenting corporation at the time that it files a consent under section 341(f)(1) shall notify its shareholders that such consent is being filed. In addition, the consenting corporation shall, at the request of any shareholder, promptly supply the shareholder with a copy of the consent.

(2) A consenting corporation shall maintain records adequate to permit identification of its subsection (f) assets.

(d) *Shareholders of consenting corporation*. (1) A shareholder who sells stock in a consenting corporation within the 6-month period beginning on the date on which the consent is filed shall—

(i) Notify the corporation, within 5 days after such sale, of the date on which such sale is made, and

(ii) Attach a copy of the corporation's consent to the shareholder's income tax return for the taxable year in which the sale is made.

(2) If the sale of stock in a consenting corporation is treated under section 341(f)(6) as the sale of stock in any other corporation, the consenting corporation shall notify such other corporation, within 5 days after receiving notification of a sale of its stock, of the date on which such sale was made.

(e) *Recognition of gain under section 341(f)(2)*. (1) Under section 341(f)(2), if a subsection (f) asset (as defined in paragraph (g) of this section) is disposed of at any time by a consenting corporation, then, except as provided in section 341(f)(3) and paragraph (f) of this section, the amount by which—

(i) The amount realized (in the case of a sale, exchange, or involuntary conversion), or

(ii) The fair market value of such asset (in the case of any other disposition),

exceeds the adjusted basis of such asset is treated as gain from the sale or exchange of such asset. Such gain is recognized notwithstanding any contrary nonrecognition provision of subtitle A of the Code, but only to the extent such gain is not recognized under any other provision of subtitle A of the Code (for example, section 1245(a)(1) or 1250(a)). Gain recognized under section 341(f)2) with respect to a disposition of a subsection (f) asset has the same character (*i.e.*, ordinary income or capital gain) that such gain would have if it arose from a sale of such asset.

(2) The nonrecognition provisions of subtitle A of the Code which section 341(f)(2) overrides include, but are not limited to, sections 311(a), 332(c), 336, 337, 351, 361, 371(a), 374(a), 721, 1031, 1033, 1071, and 1081.

(3) In the case of a foreign corporation which files a statement of consent pursuant to paragraph (b) of this section, such statement, in addition to the information required in paragraph (b) of this section, shall also contain a declaration that the corporation consents that any gain upon the disposition of a subsection (f) asset which would otherwise be recognized under section 341(f)(2) will, for purposes of section 882(a) (2), be considered as gross income which is effectively connected with the conduct of a trade or business which is conducted through a permanent establishment within the United States.

(4) The provisions of subparagraphs (1) and (2) of this paragraph may be illustrated by the following examples:

Example (1). Corporation X, a consenting corporation, distributes a subsection (f) asset to its shareholders in complete or partial liquidation of the corporation. The asset, at the time of the distribution, is held by the corporation primarily for sale to customers in the ordinary course of business and has an adjusted basis of $1,000 and a fair market value of $2,000. Under section 341(f)(2), the excess of the fair market value of the asset over its adjusted basis, or $1,000, is treated as ordinary income. Assuming the gain is not recognized by corporation X under another provision of the Code, corporation X recognizes the $1,000 gain as ordinary income under section 341(f)(2) even though, in the absence of section 341(f)(2), section 336 would preclude the recognition of such gain.

Example (2). Corporation Y, a consenting corporation, distributes a subsection (f) asset to its shareholders as a dividend. The asset at the time of the distribution is properly described in section 1231 and has an adjusted basis of $6,000 and a fair market value of $8,000. Assuming that no other section of the Code would require recognition of gain, under section 341 (f)(2) the excess of the fair market value of the asset over its adjusted basis, or $2,000, is recognized by corporation Y as gain from the sale or exchange of property described in section 1231 even though, in the absence of section 341(f)(2), section 311(a) would preclude the recognition of such gain.

Example (3). Assume the same facts as in example (2) except that the subsection (f) asset is section 1245 property having a "recomputed basis" (as defined in section 1245(a)(2)) of $7,200. Since the recomputed basis of the asset is lower than its fair market value, the excess of the recomputed basis over the adjusted basis, or $1,200, is recognized as ordinary income under section 1245(a)(1). The remaining amount, or $800, is recognized under section 341(f)(2) as gain from the sale or exchange of property described in section 1231.

(5) The provisions of section 341 (f)(2) apply whether or not (i) on the date on which a consent is filed or

at any time thereafter, the consenting corporation was in fact a collapsible corporation within the meaning of section 341(b), or (ii) on the date of any sale of stock of the consenting corporation, the purchaser of such stock was aware that a consent had been filed under section 341(f)(1) within the 6-month period ending on the date of such sale.

(6) Section 341(f)(2) does not apply to losses. Thus, section 341(f)(2) does not apply if a loss is realized upon a sale, exchange, or involuntary conversion of a subsection (f) asset nor does the section apply to a disposition other than by way of sale, exchange, or involuntary conversion if at the time of the disposition the fair market value of such property is not greater than its adjusted basis.

(7) For purposes of this paragraph, the term "disposition" includes an abandonment or retirement, a gift, a sale in a sale-and-leaseback transaction, and a transfer upon the foreclosure of a security interest. Such term, however, does not include a mere transfer of title to a creditor upon creation of a security interest or to a debtor upon termination of a security interest. Thus, for example, a disposition occurs upon a sale of property pursuant to a conditional sales contract even though the seller retains legal title to the property for purposes of security, but a disposition does not occur when the seller ultimately gives up his security interest following payment by the purchaser.

(8) The amount of gain required to be recognized by section 341(f)(2) shall be determined separately for each subsection (f) asset disposed of by the corporation. For purposes of applying section 341(f)(2), the facts and circumstances of each disposition shall be considered in determining whether the transaction involves more than one subsection (f) asset or involves both subsection (f) and nonsubsection (f) assets. In appropriate cases, several subsection (f) assets may be treated as a single asset as long as it is reasonably clear, from the best estimates obtainable on the basis of all the facts and circumstances, that the amount of gain required to be recognized by section 341(f)(2) is not less than the total gain under section 341(f)(2) which would be computed separately for each subsection (f) asset.

(9) In the case of a sale, exchange, or involuntary conversion of a subsection (f) asset and a nonsubsection (f) asset in one transaction, the total amount realized upon the disposition shall be allocated between the subsection (f) asset and the nonsubsection (f) asset in proportion to their respective fair market values. In general, if a buyer and seller have adverse interests as to the allocation of the amount realized between the subsection (f) asset and the nonsubsection (f) asset, any arm's-length agreement between the buyer and the seller will establish the allocation. In the absence of such an agreement, the allocation shall be made by taking into account the appropriate facts and circumstances. Some of the facts and circumstances which shall be taken into account to the extent appropriate include, but are not limited to, a comparison between the subsection (f) asset and all the property disposed of in such transaction of (i) the original cost and reproduction cost of construction, erection, or production, (ii) the remaining economic useful life, (iii) state of obsolescence, and (iv) anticipated expenditures to maintain, renovate, or modernize.

(10) See subparagraph (c)(1) of § 1.1502-14 for the deferral of gain recognized upon a distribution other than in complete liquidation made by one member of a group which files a consolidated return to another such member.

(f) *Exception for certain tax-free transactions.* (1) Under section 341(f)(3), no gain is taken into account under section 341(f)(2) by a transferor corporation on the transfer of a subsection (f) asset to another corporation (other than a corporation exempt from tax imposed by chapter 1 of the Code) if—

(i) The basis of such asset in the hands of the transferee corporation is determined by reference to its basis in the hands of the transferor by reason of the application of section 332 (relating to distributions in liquidation of an 80-percent-or-more controlled subsidiary corporation), section 351 (relating to transfers to a corporation controlled by the transferor), section 361 (relating to exchanges pursuant to certain reorganizations), section 371(a) (relating to exchanges pursuant to certain receivership and bankruptcy proceedings), or section 374(a) (relating to exchanges pursuant to certain railroad reorganizations), and

(ii) The transferee corporation agrees (as provided in subparagraph (3) of this paragraph) to have the provisions of section 341(f)(2) apply to any disposition by it of such asset.

(2) The provisions of subparagraph (1) of this paragraph may be illustrated by the following examples:

Example (1). Corporation M, in exchange for its voting stock worth $20,000 and $1,000 in cash, acquires the entire property of corporation N (an unencumbered apartment building) in a transaction which is described in section 368(a)(2)(B) and which, therefore, qualifies as a reorganization under section 368(a)(1)(C). The apartment building, which in the hands of corporation N, a consenting corporation, is a subsection (f) asset, has an adjusted basis of $15,000 and a fair market value of $21,000. The basis of the apartment house in the hands of corporation M is determined by reference to its basis in the hands of corporation N by reason of the application of section 361. Thus, under section 341(f)(3), if corporation M agrees to have the provisions of section 341(f)(2) apply to any disposition by it of the apartment house, then corporation N will recognize no gain under section 341(f)(2) but will recognize $1,000 gain under section 361(b) (assuming the cash it receives is not distributed in pursuance of the plan of reorganization). However, if corporation M does not so agree, the gain recognized by corporation N will be $6,000, that is, the gain of $1,000 recognized under section 361(b) plus $5,000 gain recognized under section 341(f)(2). In either case, if section 1245, 1250, or 1251 applies, some or all of the gain may be recognized under such sections in lieu of sections 341(f)(2) and 361(b).

Example (2). Corporation Y, a consenting corporation, is a wholly owned subsidiary of corporation X. In the complete liquidation of Y it distributes to X a subsection (f) asset which is section 1245 property. The asset at the time of the distribution has an adjusted basis of $10,000, a recomputed basis of $14,000, and a fair market value of $16,000. The basis of the asset in the hands of X is determined by reference to its basis in the hands of corporation Y by reason of the application of section 332. Thus, under section 341(f)(3), if corporation X agrees to have the provisions of section 341(f)(2) apply to any disposition by it of the subsection (f) asset, then Y will recognize no gain under section 341(f)(2) and will recognize no gain under section 1245(a)(1) by reason of the application of section 1245(b)(3). Under section 334(b)(1), the basis of the subsection (f) asset to corporation X will be the same as it would be in the hands of Y, or $10,000. However, if corporation X does not so agree, then under section 341(f)(2) $6,000 (the excess of the fair market value of the asset over its adjusted basis) will be treated as gain from the sale or exchange of the asset. Moreover, under section 1245(a)(1) $4,000 (the excess of the recomputed basis over the adjusted basis) of the $6,000 will be recognized as ordinary income. The basis of the asset to corporation X is $16,000, *i.e.*, the same as it would be in the hands of Y ($10,000) increased in the amount of gain recognized by Y on the distribution ($6,000).

(3) The agreement of a transferee corporation referred to in subparagraph (1) of this paragraph shall be filed, on or before the date on which the subsection (f) assets are transferred, with the district director having jurisdiction over its income tax return for the taxable year during which the transfer is to be made. The agreement shall be signed by any officer who is duly authorized to act on behalf of the transferee corporation (if the transfaction is one to which section 371(a) or 374(a) applies, the fiduciary for the transferee corporation, in appropriate cases, may sign the agreement) and shall apply to all the subsection (f) assets to be transferred pursuant to the applicable transaction described in section 341(f)(3). The agreement shall identify the transaction by which the subsection (f) assets will be acquired, including the names, addresses, and employer identification number of the transferor and transferee corporations, and shall contain a schedule of the subsection (f) assets to be acquired. The agreement shall also state that the transferee corporation (i) agrees to have the provisions of section 341(f)(2) apply to any disposition by it of the subsection (f) assets acquired, and (ii) agrees to maintain records adequate to permit identification of such subsection (f) assets.

(4) The transferor corporation shall attach a copy of the agreement to its income tax return for the taxable year in which the subsection (f) assets are transferred.

(g) *Subsection (f) asset defined.* (1) Under section 341(f)(4), a subsection (f) asset is any property which, as of the date of any sale of stock to which paragraph (a) or (j)(3) of this section applies, is not a capital asset and is property owned by, or subject to a binding contract or an option to acquire held by, the consenting corporation. Land or any interest in real property (other than a security interest) is treated as property which is not a capital asset. Also, unrealized receivables or fees (as defined in section 341(b)(4)) are treated as property which are not capital assets.

(2) If, with respect to any property described in subparagraph (1) of this paragraph, manufacture, construction, or production has been commenced by either the consenting corporation or another person before any date of sale of stock described in subparagraph (1) of this paragraph, a consenting corporation's subsection (f) assets include any property resulting from such manufacture, construction, or production. Thus, for example, if, on the date of any sale of stock within the 6-month period, manufacture, construction, or production has been commenced on a tract of land to be used for residential housing or on a television series, the term "subsection (f) asset" includes the residential homes or the television tapes resulting from such manufacture, construction, or production by the consenting corporation (or by a transferee corporation which has agreed to the application of section 341(f)(2)). If land or any interest in real property (other than a security interest) is owned or held under an option by the consenting corporation on the date of any sale of stock described in subparagraph (1) of this paragraph, the term "subsection (f) asset" includes any improvements resulting from construction with respect to such property (by the consenting corporation or by a transferee corporation which has agreed to the application of section 341(f)(2)) if such construction is commenced within 2 years after the date of any such sale. The property or improvements resulting from any manufacture, construction, or production is a question to be determined on the basis of the particular facts and circumstances of each individual case. Thus, for example, a building which is a part of an integrated project is a subsection (f) asset if construction of the project commenced before the date of sale or within 2 years thereafter even if construction of the building commenced more than 2 years thereafter. Similarly a television tape which is part of a series is a subsection (f) asset if production of the series was commenced on the date of sale even if production of the tape commenced after the sale.

(3) The provisions of subparagraphs (1) and (2) of this paragraph may be illustrated by the following examples:

Example (1). Corporation X files a consent to the application of section 341(f)(2) on January 1, 1965. Shareholder A owns 100 percent of the oustanding stock of the consenting corporation on January 1, 1965, and sells 5 percent of the stock on January 2, 1965, 10 percent on February 10, 1965, and 1 percent on May 1, 1965. No other sales of X stock were made during the 6-month period beginning on January 1, 1965. On such date X owns an apartment building and on March 1 X purchases an office building. X's subsection (f) assets include the apartment building owned on January 1 and the office building purchased on March 1.

Example (2). Assume the same facts as in example (1) except that on January 1, 1965, X also owns a tract of raw land. On April 1, 1965, construction of a residential housing project is commenced on the tract of land. Corporation X's subsection (f) assets will include the tract of land plus the resulting improvements to the land. This result would not be changed if construction of the residential housing project were not commenced until July 1, 1966, since the construction would have been commenced within 2 years after May 1, 1965.

Example (3). Corporation Y files a consent to the application of section 341(f)(2) on January 1, 1965. Shareholder B owns 100 percent of the outstanding stock of the consenting corporation on January 1, 1965, and sells 10 percent of the stock on June 1, 1965. On April 1, 1965, Y acquires an option to purchase a motion picture when completed. On May 1, 1965, production is started on the motion picture. On February 1, 1967, production is completed, and Y exercises its option. Y holds the option and the motion picture for use in its trade or business. Y's subsection (f) asset initially include the option and ultimately include the motion picture. However, the exercise of the option is not a disposition of the option within the meaning of section 341(f)(2).

(h) *Five-year limitation as to shareholder*. Under section 341(f)(5), section 341(f)(1) does not apply to the sale of stock of a consenting corporation if, during the 5-year period ending on the date of such sale, such shareholder (or any person related to such shareholder within the meaning of section 341(e)(8)(A)) made a sale (as defined in paragraph (a)(2) of this section) of any stock of another consenting corporation within any 6-month period beginning on a date on which a consent was filed under section 341(f)(1) by such other corporation. Section 341(f)(5) does not prevent a shareholder of a consenting corporation from receiving the benefit of section 341(f)(1) on the sale of additional shares of the stock of the same consenting corporation.

(i) [Reserved]

(j) *Special rule for stock ownership in other corporations.* (1) Section 341(f)(6) provides a special rule applicable to a consenting corporation which owns 5 percent or more in value of the outstanding stock of another corporation. In such a case, a consent filed by the consenting corporation shall not be valid with respect to a sale of its stock during the applicable 6-month period unless each corporation, 5 percent or more in value of the outstanding stock of which is owned by the consenting corporation on the date of such sale, files (within the 6-month period ending on the date of such sale) a valid consent under section 341(f)(1) with respect to sales of its own stock.

(2) The provisions of subparagraph (1) of this paragraph may be illustrated by the following example:

Example. Corporation X files a consent under section 341(f)(1) on November 1, 1965. On January 1, 1966, the date on which a shareholder of corporation X sells stock of X, X owns 80 percent in value of the outstanding stock of corporation Y. In order for the consent filed by corporation X to be valid with respect to the sale of its stock on January 1, 1966, corporation Y must have filed, during the 6-month period ending on January 1, 1966, a valid consent under section 341(f)(1) with respect to sales of its stock.

(3) For purposes of applying section 341(f)(4) (relating to the definition of a subsection (f) asset) to a corporation 5 percent or more in value of the outstanding stock of which is owned by the consenting corporation, a sale of stock of the consenting corporation to which section 341(f)(1) applies shall be treated as a sale of stock of such other corporation. Thus, in the example in subparagraph (2) of this paragraph, the subsection (f) assets of corporation Y would include property described in section 341(f)(4) owned by or held under an option by corporation Y on January 1, 1966.

(4) In the case of a chain of corporations connected by the 5-percent ownership requirement described in subparagraph (1) of this paragraph, rules similar to the rules described in subparagraphs (1) and (3) of this paragraph shall apply. Thus, in the example in subparagraph (2) of this paragraph, if corporation Y owned 5 percent or more of the stock of corporation Z on January 1, 1966, then Z must have filed a valid consent during the 6-month period ending January 1, 1966, in order for the consent filed by X to be valid with respect to the sale of its stock on January 1, 1966. In such case any sale of stock of either X or Y is treated as a sale of stock of Z for purposes of applying section 341(f)(4) to Z.

(5) If a corporation is a member of an affiliated group (as defined in section 1504(a)) that files a consolidated return, a corporation will be considered to have filed a consent if a consent is filed on its behalf by the common parent under § 1.1502-77(a).

(k) *Effective date.* Paragraphs (b), (c), (e)(3), and (f)(3) of this section apply only with respect to statements and notifications filed more than 30 days after July 6, 1977. Paragraph (d) applies only with respect to sales of stock made more than 30 days after July 6, 1977. All other provisions of this section apply with respect to transactions after August 22, 1964.

Par. 4. Section 1.1502-32(d)(6) is amended by deleting "August 6, 1979," and inserting in its place "August 9, 1979,".

This Treasury decision is issued under the authority contained in sections 341(f), 1502 and 7805 of the Internal Revenue Code of 1954 (78 Stat. 596, 68A Stat. 637, 68A Stat. 917; 26 U.S.C. 341(f), 1502, 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved November 20, 1979.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

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Section 612.—Basis for Cost Depletion

26 CFR 1.612-4: Charges to capital and to expense in case of oil and gas wells.

Whether section 263(c) of the Code as amended by the Energy Tax Act of 1978, section 402(a), 1978-3, Vol. 2 C.B. 27, grants a new option to charge to capital or to expense intangible drilling and development costs incurred in the drilling and development of oil and gas properties. See Rev. Rul. 80-2, page 13.

Section 902.—Credit for Corporate Stockholder in Foreign Corporation

26 CFR 1.902-1: Credit for domestic corporate shareholder of a foreign corporation.

A payment to the Netherlands Antilles pursuant to the election described in Rev. Rul. 65-16, 1965-1 C.B. 626, will be considered a payment made pursuant to a legal liability for purposes of the foreign tax credit provided in section 901(b) of the Code under the United States-Netherlands Income Tax Convention, 1950-1 C.B. 92, as extended to the Netherlands Antilles, 1956-2 C.B. 1116. See Rev. Rul. 80-4, page 14.

Section 1034.—Rollover of Gain on Sale of Principal Residence

26 CFR 1.1034-1: Sale or exchange of residence.

Type of amended return to be filed when taxpayer fails to purchase new residence within 18 months of sale of old residence. See Rev. Rul. 80-5, page 15.

Section 164.—Taxes

26 CFR 1.164-3: Definitions and special rules.

Sales tax; California. The sales tax imposed by California on the retailer and paid to the retailer by the consumer is includible in the retailer's gross income. The tax is deductible by the consumer when paid to the retailer and by the retailer when accrued or paid to the State.

Rev. Rul. 80-1

The California State sales tax levied under section 6051 of the Cal. Rev. & Tax Code (West Supp. 1978) (California Code) is imposed on the retailer for purposes of section 164(a) (4) of the Internal Revenue Code and section 1.164-1(a) of the Income Tax Regulations. Thus, the sales tax paid to the retailer by the consumer must be included in the retailer's gross income for federal income tax purposes and is deductible by the retailer (when paid or accrued by the retailer) as a tax under section 164(a)(4).

Although the California State sales tax is imposed on the retailer, sections 6052 and 6052.5 of the California Code provide for its collection from the consumer. The law provides that the retailer have a separate statement of the sales tax in a "sales tax reimbursement schedule" available for inspection by the consumer or post a notice to consumers that the sales tax computed on the basis of such schedule is included in the posted or advertised price of an item. Therefore, the tax is a separately stated general sales tax within the meaning of section 164(b)(5) of the Code. Thus, when the sales tax is paid to the retailer by the consumer (other than in connection with his or her trade or business), the consumer may deduct such tax if either the consumer itemizes deductions or the sales tax is attributable to property held for the production of rents or royalties. See sections 62(5) and 63 of the Code.

In *Diamond National Corp. v. State Board of Equalization,* 425 U.S. 268 (1976) (*per curiam*), the Supreme Court of the United States held that the incidence of the California sales tax was on the purchaser national bank, and not the retailer because the California sales tax required the retailer to pass on the tax to the consumer. In *Diamond National* the issue was whether the California sales tax was imposed on a purchaser national bank in the violation of the bank's immunity from state taxation under the former 12 U.S.C. section 548 (1964) (current version at 12 U.S.C. section 548 (1976)). The *Diamond National* case does not involve the incidence of a state sales tax for purposes of section 164(a)(4) of the Code and thus does not control the incidence of the California sales tax for purposes of section 164(a)(4) of the Code.

For a statement of the tax results when the sales tax is paid by a consumer with respect to items used in connection with the consumer's trade or business, see Rev. Rul. 77-465, 1977-2 C.B. 61 at 63.

Section 263.—Capital Expenditures

26 CFR 1.263(c)-1: Intangible drilling and development costs in the case of oil and gas wells.
(Also Section 612; 1.612-4.)

Intangible drilling and development costs; option to deduct. Section 263 of the Code, as amended by the Energy Tax Act of 1978 to grant an option to deduct intangible drilling and development costs incurred with respect to geothermal wells, does not permit a new election for the treatment of such costs for oil and gas wells.

Rev. Rul. 80-2

FACTS

Section 263(c) of the Internal Revenue Code, as amended by the Energy Tax Act of 1978, section 402(a), 1978-3 (Vol. 2) C.B. 27, provides that the Secretary shall prescribe regulations that grant an option to deduct intangible drilling and development costs (IDC) incurred by an operator in the drilling of geothermal wells. The election to charge to capital or to expense IDC incurred in the drilling of geothermal wells is separate from the election provided for oil and gas wells. *S. Rep. No. 95-1324,* 95th Cong., 2d Sess. 72 (1978), 1978-3 (Vol. 2) C.B. 344, 345.

HOLDING

Section 263(c) of the Code, as amended, grants an option to charge to capital or to expense IDC incurred in the drilling and development of geothermal wells, but does not permit a new election for the treatment of IDC for oil and gas wells. See section 1.612-4(e) of the Income Tax Regulations for the treatment of IDC incurred in the drilling and development of oil and gas properties.

Section 832.—Insurance Company Taxable Income

26 CFR 1.832-4: Gross income.
(Also Sections 162, 263; 1.162-1, 1.263(a)-1.)

Title insurance company; title or abstract plant. A domestic title insurance company may deduct recurring expenses incurred to update its title plants.

Rev. Rul. 80-3

ISSUE

Are payments made by a title insurance company to update title and abstract plants deductible by the title company under section 832(c) of the Internal Revenue Code?

FACTS

T, a domestic corporation taxable under section 831 of the Code, was in the business of insuring title to real property in 1977. As a title insurance underwriter, *T* must search the title to real property before issuing a policy thereon.

To obtain necessary information, *T* utilizes title or abstract plants, which are an integral part of *T*'s operations. Title plants contain the records, proofs, abstracts, legal opinions and surveys that *T* has accumulated. These materials are carefully indexed in order to facilitate a rapid and accurate search of history of title to a particular parcel of real estate.

T incurs recurring updating expenses to microfilm, post, index and file data on a daily basis with respect to transactions affecting title to all real estate located within designated localities, whether or not there is a request for a title insurance policy. When issuing title policies, it is common for title examiners to make use of any previously prepared title reports as a starting point and to update them to the current period.

LAW AND ANALYSIS

Section 162(a) of the Code allows a deduction for ordinary and necessay expenses paid or incurred during the taxable year to carry on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered.

Section 263(a)(1) of the Code provides that no deduction shall be allowed for any amount paid out for permanent improvements made to increase the value of any property. Section 263(a)(2) provides that no deduction shall be allowed for any amount expended in restoring property or in making good the exhaustion thereof for which an allowance is or has been made.

Section 832(c)(1) of the Code provides that all ordinary and necessary expenses incurred, as provided in section 162, shall be allowed as a deduction under section 832(c) in computing the taxable income of an insurance company subject to the tax imposed by section 831.

Section 1.263(a)-1(b) of the Income Tax Regulations provides that the amounts referred to in section 263(a) of the Code include amounts paid or incurred to add to the value, or to substantially prolong the useful life, of property owned by the taxpayer such as plant or equipment, or to adapt property to a new or different use. Amounts paid or incurred for incidental repairs and maintenance of property are not capital expenditures.

In *Bay Counties Title Guaranty Co. v. Commissioner,* 34 T.C. 29 (1960), *aff'd,* 288 F.2d 187 (9th Cir. 1961), a title insurance company had established a title plant, which is a complex of the records that a title insurance company owns and uses in making searches of titles and preparing abstracts of titles to all of the real estate within the area of a company's operations. In addition to its regular accumulation of records of various matters affecting title to real property, the company followed the practice of purchasing copies of preliminary, or "starter" reports and of old title policies from real estate concerns, real estate brokers, lending institutions, and others. The title reports and title policies did not directly relate to any current searches and examinations of title insurance policies; therefore, such documents were filed for such future use, if any, as might develop. The company deducted the cost of these "starter" reports on its federal income tax return.

In holding that these expenditures were made for the purchase of business assets, rather than for maintenance of the title plant, the Tax Court of the United States said:

> It is admitted that the value of the starter reports extends beyond the year of purchase and continues until such time in some indeterminate future year as petitioner shall have the occasion to write an abstract on a title covered up to a point by a starter report. . . . We think it is clear beyond any doubt that the starter reports have an economic life extending beyond the year of purchase and that they represented additions and supplements to the plant which increased its value. It is a generally accepted rule that an amount expended for an asset having a useful life which is not consumed in the year of the expenditure is usually to be classified as a capital item.

In *Bay Counties,* the expenditures were incurred for the purchase of starter reports and old policies of real estate title insurance that represented the acquisition of substantial new capital assets. The expenditures incurred by *T,* however, were for updating existing records, similar to maintenance costs incurred to keep the title plants in normal working order. The amounts expended merely permitted the title plants to continue operating at a current level.

HOLDING

T's recurring payments to update the plants are ordinary and necessary business expenses deductible under section 832(c)(1) of the Code.

Section 901.—Taxes of Foreign Countries and of Possessions of United States

26 CFR 1.901-1: Allowance of credit for taxes.
(*Also Section 902; 1.902-1.*)
(*Also Part II, T.D. 5778, 1950-1 C.B. 92.*)

Foreign tax credit; Netherlands Antilles; payment pursuant to legal liability. A payment to the Netherlands Antilles pursuant to the election described in Rev. Rul. 65-16 is a payment made pursuant to a legal liability for purposes of section 901(b) of the Code; Rev. Rul. 65-16 amplified.

Rev. Rul. 80-4

ISSUE

Is a payment to the Netherlands Antilles pursuant to the election described in Rev. Rul. 65-16, 1965-1 C.B. 626, a payment made pursuant to a legal liability for purposes of the foreign tax credit provided in section 901(b) of the Internal Revenue Code?

LAW

Rev. Rul. 65-16 holds that a Netherlands Antilles corporation electing to be taxed under Article 8A of the National Ordinace on Profit Tax of 1940 of the Netherlands Antilles, as added by the National Ordinance of December 30, 1963, may be entitled to the tax benefits that are accorded by Articles VII, VIII, and IX of the United States-Netherlands Income Tax Convention, 1950-1 C.B. 92, as extended to the Netherlands Antilles, 1956-2 C.B. 1116.

Section 901(b) of the Code generally allows qualifying United States taxpayers to claim a foreign tax credit for the amount of any income taxes paid or accrued during the taxable year to any foreign country subject to certain limitations.

Section 902(a) of the Code provides generally that domestic corporations owning at least 10 percent of the stock of a foreign corporation from which it receives dividends paid out of accumulated profits shall be deemed to have paid a certain portion of any creditable foreign income tax paid or deemed to have been paid by such foreign corporation on or with respect to such accumulated profits.

For purposes of claiming a credit under section 901(b) of the Code for the payment or accrual of an amount to a foreign government, such payment or accrual must constitute a tax liability to the foreign government. *See* Rev. Rul. 76-215, 1976-1 C.B. 194. Only the taxpayer liable for the tax may claim a credit under section 901 and only in the amount for which the taxpayer is liable. *See* Rev. Ruls. 72-370, 1972-2 C.B. 437 and 59-101, 1959-1 C.B. 189. When a credit is being claimed pursuant to section 902 (a) by a domestic parent corporation for amounts paid or accrued to a foreign government by its foreign subsidiary, such amounts must also constitute a tax liability to the foreign government. A payment of an amount to a foreign government that is not made pursuant to a legal tax liability could be a contribution to such government rather than a payment of a tax. *See* Rev. Rul. 76-508, 1976-2 C.B. 225.

HOLDING

A payment to the Netherlands Antilles pursuant to the election described in Rev. Rul. 65-16 will be considered a payment made pursuant to a legal liability for purposes of the foreign tax credit provided in section 901 (b) of the Code under the United States-Netherlands Income Tax Convention as extended to the Netherlands Antilles.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 65-16 is amplified.

Section 6013.—Joint Returns of Income Tax by Husband and Wife

26 CFR 1.6013-1: Joint returns.
(Also Section 1034; 1.1034-1.)

Sale of residence; amended joint return without spouse's signature. A taxpayer and the taxpayer's spouse filed a joint return deferring the gain on the sale of their personal residence under section 1034 of the Code. They subsequently obtained a divorce. The former spouse reinvested the amount required under section 1034 and refused to sign an amended return with the taxpayer, who failed to purchase a new residence within the 18-month period. The taxpayer must file an amended joint return for the year of the sale with a letter explaining why the spouse's signature is missing.

Rev. Rul. 80-5

ISSUE

What type of return must be filed by a taxpayer who previously filed a joint return without reporting the gain on the sale of a residence and subsequently failed to meet the reinvestment requirement of section 1034 of the Internal Revenue Code when the taxpayer is now divorced and the ex-spouse refuses to sign an amended return?

FACTS

A taxpayer and spouse filed a joint federal income tax return without reporting the gain on the sale of their jointly-owned principal residence because they expected to purchase a new principal residence within 18 months of the sale and defer recognition of the gain under section 1034 of the Code. They were divorced in the next year and the ex-spouse purchased a new principal residence within the 18 month period and reinvested the amount required to defer the ex-spouse's portion of the gain realized on the sale of the old residence. The taxpayer, however, did not purchase a new residence within the 18 month period. The ex-spouse refused to sign an amended joint return.

LAW AND ANALYSIS

Section 1034 of the Code provides that no gain from the sale of property used by a taxpayer as a principal residence shall be recognized if the taxpayer purchases and uses as a principal residence a new residence within 18 months of the sale at a cost equal to or in excess of the sales price realized by the taxpayer on the old residence, less the aggregate of the expenses for work performed on the old residence to assist in its sale.

Section 1.1034-1(i) of the Income Tax Regulations provides that if a taxpayer fails to purchase a new residence within the 18 month period, any gain from the sale of the old residence that is required to be recognized shall be included on an amended return for the year in which the gain from the sale of the old residence was realized in order to reflect the inclusion in gross income for that year of gain required to be recognized in connection with such sale.

Section 1.6013-1(a)(1) of the regulations provides that for any taxable year with respect to which a joint return has been filed, separate returns shall not be made by the spouses after the time for filing the return of either has expired.

HOLDING

The taxpayer must file an amended joint income tax return, using the joint return tax rates for the year of the original return, and paying the additional tax with the amended return. The taxpayer should attach a letter to the amended return explaining why the spouse's signature cannot be obtained.

Section 6051.—Receipts for Employees

26 CFR 31.6051-1: Statements for employees.

T.D. 7656

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 31.—EMPLOYMENT TAXES; APPLICABLE ON OR AFTER JANUARY 1, 1955

Wage and tax statements furnished to employees

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the requirement that employers furnish Form W-2, Wage and Tax Statement, to employees whose employment is terminated before the end of the year.

DATE: The amendments are effective November 29, 1979.

FOR FURTHER INFORMATION CONTACT: David B. Cubeta of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3926).

BACKGROUND AND EXPLANATION

On July 2, 1979, the Federal Register published a proposed amendment to the Employment Tax Regulations (26 CFR Part 31) under section 6051 of the Internal Revenue Code of 1954 concerning the time within which employers must furnish Forms W-2 to employees whose employment is terminated before the end of the calendar year. The amendment was proposed to change the rule that the employer must furnish the form to the employee within 30 days of the last payment of wages. The rule contained in the proposed regulations provides that the employer may furnish the form at any time after the termination of employment but no later than January 31 of the following calendar year. However, if the employee requests that the form be furnished at an earlier time, the rule requires that the form be furnished within 30 days of the request or within 30 days after the last payment of wages, whichever is later.

Although no public hearing was requested or held, numerous written comments were received. Nearly all of the commentators supported the new rule and urged its adoption because of the reduction in paperwork and cost that would result from the preparation and mailing of the form at the end of the year. However, a few comments were critical of the proposed rule for requiring the employer to comply with an employee's request that the form be furnished at an earlier time. This requirement has been retained in the final regulations because it appears that Congress in enacting section 6051(a) contemplated that an employee whose employment is terminated before the end of the calendar year should be able to obtain the Form W-2 prior to the end of the year.

Another comment suggested that the proposed rule be changed to require the employee's request to be in writing in order to enable the employer to document his compliance with the rules. This suggestion has not been adopted because it is believed that the potential benefits of a written request requirement are outweighed by the paperwork burden that the rule would impose.

Therefore, after consideration of all comments received, this Treasury decision adopts the amendments as proposed. The effectiveness of this regulation will be monitored through comments received from the public and from within the Internal Revenue Service.

DRAFTING INFORMATION

The principal author of these regulations is David B. Cubeta of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 31 is amended as follows:

Paragraph 1. Section 31.6051 is deleted.

Par. 2. Paragraph (d) of § 31.6051-1 is amended by deleting subparagraph (2)(ii), by redesignating subparagraph (2)(i) as subparagraph (2), and by revising subparagraph (1) to read as follows:

(d) *Time for furnishing statements*—(1) *In general.* Each statement required by this section for a calendar year and each corrected statement required for the year shall be furnished to the employee on or before January 31 of the year succeeding such calendar year. If an employee's employment is terminated before the close of such calendar year, the employer, at his option, shall furnish the statement to the employee at any time after the termination but no later than January 31 of the year succeeding such calendar year. However, if an employee whose employment is terminated before the close of such calendar year requests the employer to furnish him the statement at an earlier time, and if there is no reasonable expectation on the part of both employer and employee of further employment during the calendar year, then the employer shall furnish the statement to the employee on or before the later of the 30th day after the day of the request or the 30th day after the day on which the last payment of wages is made. For provisions relating to the filing of the Internal Revenue Service copies of the statement, see § 31.6051-2.

This Treasury decision is issued under the authority contained in sections 6051(c) and 7805 of the Internal Revenue Code of 1954.

Jerome Kurtz,
Commissioner of Internal Revenue.

Approved November 19, 1979.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on November 28, 1979, 8:45 a.m., and published in the issue of the Federal Register for November 29, 1979, 44 F.R. 68465)

Section 6402.—Authority to Make Credits or Refunds

26 CFR 301.6402-1: Authority to make credits or refunds.

Joint return; net operating loss for separate return year. The proper method is provided for computing the amount to be refunded to an unmarried taxpayer who incurred a net operating loss that was carried back or carried over to a year in which the taxpayer was married and filed a joint return; Rev. Rul. 75-368 modified.

Rev. Rul. 80-6

ISSUE

What is the proper method of determining the amount of a spouse's individual refund, if the spouse incurs a net operating loss in a separate return year that is carried back or carried over to a year in which a joint return was filed?

FACTS

The taxpayer and spouse were divorced in 1969. Prior to their divorce, they had always filed joint income tax returns. In 1970, the taxpayer filed a return as an unmarried individual. During that year, the taxpayer sustained a net operating loss. In 1973, the taxpayer remarried and filed a joint tax return. In 1973, the taxpayer filed claims for refund of taxes paid in 1967, 1968 and 1971.

LAW AND ANALYSIS

In Rev. Rul. 75-368, 1975-2 C.B. 480, which is based on the same set of facts, the penultimate paragraph states:

> In the instant case, the net operating loss occurred in 1970, when the taxpayer filed his return as an unmarried individual. The net operating loss deduction for 1967, 1968, and 1971 will be carried back and carried over only to the taxpayer's portion of the income shown on his joint returns. The joint tax rates will be applied to the reduced taxable income. The amount of the taxpayer's overpayment on each return will be the excess of the tax paid on these returns over the recomputed tax for that return, limited to the amount of the tax actually paid by the taxpayer that is attributable to his portion of the taxable income originally reported on the return.

The method of calculating the taxpayer's individual refund in Rev. Rul. 75-368 is inconsistent with the method employed in Rev. Rul. 80-7 for determining a spouse's individual interest in an overpayment, if both spouses file a joint return. In order to be consistent with Rev. Rul 80-7, the Internal Revenue Service will apply the separate tax method of allocation in order to determine a spouse's individual refund, if a separate net operating loss is carried back or carried over to a joint return year.

In Rev. Rul. 67-431, 1967-2 C.B. 411, the Service stated that the taxpayer may carry back an investment tax credit attributable to investments made by the taxpayer that was reported on a joint return filed by the taxpayer and his second wife to that portion of the tax attributable to him on a joint return filed by the taxpayer and his first wife. The Service stated that the refund with respect to the joint return filed by the taxpayer and his first wife will be made to the taxpayer because the Service has no knowledge of circumstances indicating that taxes were paid by anyone other than the taxpayer. Rev. Rul. 80-7 amplifies Rev. Rul. 67-431 by providing the method for determining the amount of the joint taxes attributable to the taxpayer and by providing a method for determining the amount to be refunded to the taxpayer.

HOLDING

The penultimate paragraph of Rev. Rul. 75-368 is modified to state as follows:

> In the instant case, the net operating loss occurred in 1970, when the taxpayer filed a return as an unmarried individual. The net operating loss deduction will be carried back and carried over only to the income that would have been reported by the taxpayer, if a separate return would have been filed. The joint rates will be applied to the reduced joint taxable income. The amount of the taxpayer's individual refund will be calculated by determining the taxpayer's recomputed share of the joint liability according to the separate tax formula:
>
> $$\frac{\text{taxpayer's recomputed separate tax liability}}{\text{both spouses' recomputed separate tax liability}} \times \text{recomputed joint tax liability}$$
>
> and subtracting that amount from the taxpayer's contribution determined in accordance with Rev. Rul. 80-7. The amount of the overpayment refunded to the taxpayer will be limited to the amount of the joint overpayment. In computing each taxpayer's separate tax liability, the tax rates for married individuals filing separate returns should be used. *See* section 1(d) of the Code for such rates.

Rev. Rul. 75-368 is modified.

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26 CFR 301.6402-1: Authority to make credits or refunds.

Joint return; overpayment; credit against separate tax liability. The proper method is provided for computing the amount of an overpayment shown on a joint return that may be credited to one spouse's unpaid separate tax liability from a prior year; Rev. Rul. 67-431 amplified.

Rev. Rul. 80-7

ISSUE

If a taxpayer and spouse file a joint return in which an overpayment is reported, what is the proper method of determining the amount that may be credited to a spouse's separate liability?

FACTS

A and *B* are married and filed a joint 1977 Federal income tax return showing a liability of $13,004. *A* reported $20,000 of wages, from which $6,000 was withheld, and $10,000 of other income. *B* reported $10,000 of wages, from which $2,000 was withheld, and $5,000 of other income. *A* and *B* filed a joint estimated tax declaration and paid $8,000 in estimated tax payments. *A* has an unpaid separate liability of $5,000 from a prior year.

LAW AND ANALYSIS

Section 6402(a) of the Internal Revenue Code provides that in the case of any overpayment, the Secretary may within the applicable period of limitations credit the amount of the overpayment including any interest allowed thereon, against any liability in respect of an Internal Revenue tax on the part of the person who made the overpayment and shall refund the balance to such person.

In Rev. Rul. 74-611, 1974-2 C.B. 399, the Internal Revenue Service ruled that when a husband and wife file a joint return each spouse has a separate interest in the jointly reported income and a separate interest in any overpayment.

Section 20.2053-6(f) of the Estate and Gift Tax Regulations provides the method for determining the estate tax deduction allowed for income taxes paid on a decedent's final income tax return. Section 20.2053-6(f) provides that if the decedent's final return is a joint return, then the decedent's liability will be determined according to the following formula:

$$\frac{\text{decedent's separate tax}}{\text{both separate taxes}} \times \begin{array}{l}\text{joint tax}\\ \text{shown}\\ \text{on the}\\ \text{return}\end{array}$$

Section 1.6654-2(e) of the Income Tax Regulations, relating to declarations of estimated tax by individuals and the applicability of exceptions to an underpayment of estimated tax, contains the same separate tax formula for allocating the tax shown on the joint return for the preceding taxable year, and for allocating the tax computed on the basis of the facts shown on a joint return for the preceding taxable year but using current year's rates and exemptions, in the event joint returns were filed in the preceding year and separate returns are filed for the current taxable year. Therefore, if a husband and wife file a joint return, the Service, in order to be consistent with similar allocation provisions, will apply the separate tax formula in section 20.2053-6(f) of the Estate Tax Regulations and section 1.6654-2(e) of the Income Tax Regulations in order to determine each spouse's share of the joint tax liability.

Section 20.2053-6(f) of the Estate Tax Regulations also provides that if the decedent and his spouse are entitled to a refund, then, in the absence of a provision of local law providing to the contrary, the decedent's share of the refund shall be the amount by which the decedent's contribution toward the payment of the joint tax exceeds the decedent's liability determined in accordance with the separate tax formula. Again, in order to be consistent, the Service will also determine a spouse's individual refund in accordance with the method in section 20.2053-6(f). Therefore, a spouse's individual refund will be determined by subtracting the spouse's individual liability determined in accordance with the separate tax formula from the spouse's contribution toward that liability.

Section 20.2053-6(f) of the regulations does not provide a method for determining a spouse's contribution toward the payment of the joint liability. However, sections 1.31-1 and 1.6015(b)-1(b) of Income Tax Regulations provide a method for allocating payments made by a taxpayer in certain situations. Therefore, the Service will determine a spouse's contribution toward the payment of the joint liability by reference to sections 1.31-1 and 1.6015(b)-1(b).

Section 1.31-1 of the regulations provides that the recipient of wages upon which a withholding tax was deducted shall be allowed a credit for the taxes withheld. In a community property state, each spouse is considered the recipient of one-half of the wages upon which taxes are withheld and thus is entitled to a credit for one-half of the taxes that are withheld. Since withholding tax credits can be attributed directly to the recipient of income, a spouse's contribution will include the withholding tax credits reported by the spouse with respect to the spouse's income. Therefore, if a husband and wife file a joint return and do not file an estimated declaration and/or make a payment with their joint return, then each spouse's contribution toward the joint liability will be equal to the withholding tax credits attributed to the spouse, plus any applicable section 6401(b) credits.

Section 6401(b) of the Code provides that any withholding tax credit under section 31, earned income credit under section 43, and gasoline credit under section 39, in excess of tax imposed by subtitle A are to be treated as overpayments of tax. Consequently, in addition to the withholding tax credit, an attributable portion of both the earned income credit and the gasoline credit may comprise part of a spouse's contribution for purposes of determining an individual's share of a joint overpayment.

If a husband and wife file a joint return and file an estimated declaration of tax and/or make a payment with their return, then each spouse's contribution will be determined, in part, by an analogy to section 20.2053-6(f) of the Estate Tax Regulations and section 1.6015(b)-1(b) of the Income Tax Regulations. Section 1.6015(b)-1(b) provides the method for allocating joint estimated tax payments between a husband and wife in the event they file separate income tax returns. It provides that in the event the spouses cannot agree on the allocation of the estimated tax payments, the estimated tax payments will be allocated according to the following formula:

$$\frac{\text{separate tax liability}}{\text{both separate tax liabilities}} \times \text{estimated tax payments}$$

In Rev. Rul. 76-140, 1976-1 C.B. 376, the Service stated that section 1.6015(b)-1(b) would also apply if a husband and wife filed a joint income tax return and elected under section 301.6402-3(b)(2) of the Administrative and Procedural Regulations to have their overpayment credited to their estimated tax liability for the subsequent year but failed to file a declaration of estimated tax for the subsequent year and filed separate returns in the subsequent year. Therefore, if neither spouse reports any income subject to withholding and the spouses file a joint declaration of estimated income tax and/or make a payment with their joint return, then in the absence of clear and convincing evidence to the contrary, each spouse's contribution will be determined in accordance with the formula in section 1.6015(b)-1(b) of the Income Tax Regulations.

If the spouses have income subject to withholding and they file a joint declaration of estimated tax and/or make a payment with their joint return then each spouse's contribution should be determined by combining the two contribution methods. Each spouse's contribution will include the withholding tax credits reported by the spouse on the joint return. In addition, in the absence of clear and convincing evidence to the contrary, the formula in section 1.6015(b)-1(b) of the regulations shall be used to allocate to the spouses the estimated tax payments and/or payments with the joint return.

Applying the above principles to the spouses' joint liability of $13,004, the total refund due the spouses is $2,996 ($16,000 — $13,004). If the spouses filed separate returns, *A*'s liability would have been $10,302 and *B*'s liability would have been $3,334, if the tax is calculated in accordance with section 1(d) of the Code. Each spouse's contribution will be determined as follows:

A's deemed portion of the estimated tax payments.

$$\frac{\$10{,}302}{\$10{,}302 + \$3{,}334} \times \$8{,}000 = \$6{,}044$$

B's deemed portion of the estimated tax payments.

$$\frac{\$3{,}334}{\$10{,}302 + \$3{,}334} \times \$8{,}000 = \$1{,}956$$

A's total contribution is $12,044 ($6,000 + $6,044).

B's total contribution is $3,956 ($2,000 + $1,956).

Having thus determined each spouse's contribution, each spouse's share of the joint overpayment will be the difference between each spouse's liability and each spouse's contribution as determined above. However, the overpayment credited to a spouse in the spouse's individual capacity can not exceed the joint overpayment. *See* section 6013(d) of the Code.

A's share of the joint liability

$$\frac{\$10,302}{\$10,302 + \$3,334} \times \$13,004 = \$9,825$$

B's share of the joint liability

$$\frac{\$3,334}{\$10,302 + \$3,334} \times \$13,004 = \$3,179$$

A's individual credit or refund is $2,219 ($12,044 — $9,825).

B's individual credit or refund is $777 ($3,956 — $3,179).

HOLDING

If the spouses file a joint return showing an overpayment then the amount that may be credited to one spouse's separate liability is computed by subtracting the spouse's share of the joint liability, determined in accordance with the separate tax formula, from the spouse's contribution toward the joint liability. The amount credited cannot exceed the amount of the joint overpayment. In this case, $2,219 of the $2,996 joint overpayment will be credited against *A*'s outstanding separate liability. The balance of the joint overpayment will be refunded.

In Rev. Rul. 67-431, 1967-2 C.B. 411, the Service stated that the taxpayer may carry back an investment tax credit attributable to investments made by the taxpayer that was reported on a joint return filed by the taxpayer and his second wife to that portion of the tax attributable to him on a joint return filed by the taxpayer and his first wife. The Service stated that the refund with respect to the joint return filed by the taxpayer and his first wife will be made to the taxpayer because the Service has no knowledge of circumstances indicating that taxes were paid by anyone other than the taxpayer.

Rev. Rul. 67-431 is amplified.

26 CFR 6402-1: Authority to make credits or refunds.

Joint return; amended; overpayment; single signature. The Service will accept a claim for credit or refund filed by a divorced taxpayer on a Form 1040X with respect to a joint return if the Form 1040X is signed by only one of the taxpayers and will issue a refund check in that taxpayer's name alone. The proper method is provided for computing the refund that may be made to the individual taxpayer.

Rev. Rul. 80-8

ISSUES

(1) Whether the Internal Revenue Service will accept a claim for credit or refund filed by a divorced taxpayer on a Form 1040X, Amended U.S. Individual Income Tax Return, with respect to a jointly filed return, if the Form 1040X is signed by only one of the taxpayers and whether the refund can be isued only in the name of the taxpayer who filed the Form 1040X.

(2) What is the proper method of determining the amount of a taxpayer's individual refund, if only the taxpayer signs a Form 1040X, Amended U.S. Individual Income Tax Return, with respect to the joint return year and the taxpayer requests the refund be issued in his name alone?

FACTS

A and *B*, a married couple residing in a noncommunity property state, filed a joint 1977 Federal income tax return reporting a tax liability of $6,668. *B* reported $20,000 of wages and withholding tax credits of $5,028. *A* erroneously reported a $10,000 tax-free stipend and reported withholding tax credits of $1,640. In 1978, *A* and *B* were divorced. Subsequent to their divorce *A* filed a Form 1040X for 1977, showing a tax liability of $3,484, which correctly reported the tax-free stipend *A* received in 1977. Only *A* signed the Form 1040X and *A* requested the refund check be issued in *A*'s name alone.

LAW AND ANALYSIS

Section 6402(a) of the Internal Revenue Code provides in the case of any overpayment, the Secretary may within the applicable period of limitations credit the amount of the overpayment, including any interest allowed thereon, against any liability in respect of an Internal Revenue Tax on the part of the person who made the overpayment and shall refund the balance to such person.

In Rev. Rul. 74-611, 1974-2 C.B. 399, the Service ruled that when a husband and wife file a joint return each spouse has a separate interest in the jointly reported income and a separate interest in any overpayment.

Rev. Rul. 80-7 holds that a spouse's share of a joint overpayment will be determined by subtracting the spouse's share of the joint liability, determined in accordance with the separate tax formula, from the spouse's contribution toward the joint liability. However, the ruling states that the amount of the overpayment paid to any one spouse can not exceed the amount of the joint overpayment.

In order to be consistent with Rev. Rul. 80-7 the Service will apply the separate tax method of allocation in order to determine a spouse's share of a joint overpayment that results from the filing of a separate claim for refund. Therefore, the taxpayer's individual refund will be calculated by determining the taxpayer's individual liability according to the separate tax formula:

$$\frac{\text{taxpayer's recomputed separate tax liability}}{\text{both spouses recomputed separate tax liability}} \times \text{recomputed joint tax liability (amount shown on 1040X)}$$

and subtracting the taxpayer's individual liability from the taxpayer's contribution determined in accordance with Rev. Rul. 80-7. The amount of the overpayment refunded to the taxpayer will be limited to the amount of the joint overpayment.

HOLDINGS

(1) The Service will accept a claim for credit or refund filed by a divorced taxpayer on a Form 1040X with re-

spect to a jointly filed individual income tax return if the Form 1040X is signed by only one of the taxpayers, and the Service will issue a refund check in the name of the taxpayer that filed the Form 1040X.

(2) The amount of the taxpayer's individual refund will be determined by recomputing the taxpayer's share of the joint liability and subtracting that amount from the taxpayer's contribution toward the joint liability. The amount of the overpayment refunded to the taxpayer will be limited to the amount of the joint overpayment.

In the present case, *A*'s and *B*'s joint tax liability as originally reported was $6,668. *A*'s and *B*'s joint liability as reported on the Form 1040X, filed by *A* is $3,484. The total joint refund is $3,184 ($6,668 — $3,484). *B*'s recomputed separate tax liability is $5,350 and *A*'s recomputed separate liability is zero.

A's recomputed individual liability is

$$\frac{0}{0 + \$5{,}350} \times \$3{,}484 = 0$$

B's recomputed individual liability is

$$\frac{\$5{,}350}{0 + \$5{,}350} \times \$3{,}484 = \$3{,}484$$

A's individual refund is $1,640 ($1,640 — 0).

B's individual refund would be $1,544 ($5,028 — $3,484).

The total of *A*'s and *B*'s individual refunds equals the amount of the joint refund. The Service will issue *A* an individual refund of $1,640.00 upon the filing of a Form 1040X with only *A*'s signature. Upon the filing of a Form 1040X by *B*, the Service will issue an individual refund to *B* of $1,544.

Part IV. Items of General Interest

Form 1041-A, U.S. Information Return—Trust Accumulation of Charitable Amounts, Revised

Announcement 80-1

Form 1041-A, U.S. Information Return—Trust Accumulation of Charitable Amounts, has been revised as of October 1979. This latest revision contains a number of changes (terminology, etc.) similar to those made to the 1979 Form 1041, U.S. Fiduciary Income Tax Return. For example, line 5 was changed from gross to net rent and royalty income. Also, the sequence of lines 14 and 15 was reversed to follow the sequence on Form 1041.

The revised Form 1041-A will be available in most Service offices in January 1980. It should be filed for tax years ending on or after December 31, 1979. The prior version, dated October 1978, should not be used.

New Form 6251, Alternative Minimum Tax Computation

Announcement 80-2

A new Form 6251, Alternative Minimum Tax Computation, has been developed for use by individuals, estates, and trusts to figure their alternative minimum tax. The alternative minimum tax was enacted by the Tax Reform Act of 1978, Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1.

Individuals may be liable for the Alternative Minimum Tax if the total of (a) their entry on Form 1040, line 34, and (b) tax preference items for excluded capital gains and adjusted itemized deductions, is more than $23,300 ($12,700 if married filing separately). An estate or trust may be liable if its taxable income plus its tax preference items is more than $10,000.

Taxpayers with other tax preference items may find that they are liable for both the alternative minimum tax and the regular minimum tax.

The form is now available at Internal Revenue Service offices.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants and Enrolled Agents from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following persons have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Richard O. Bertoli	Sparkhill, NY	Certified Public Accountant	Indefinite effective November 2, 1979
Slathern E. Gassiott	Port Arthur, TX	Certified Public Accountant	Thirty months effective November 19, 1979
Leonard M. Bernes	Atlanta, GA	Certified Public Accountant	Indefinite effective December 5, 1979

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.167(a)-11 amended.	Application of conventions under the Class Life Asset Depreciation Range System (CLADR System).	Nov. 15, 1979	Jan. 14, 1980
26 CFR 31.3402(q)-1 added.	Withholding of tax on certain payments of gambling winnings.	Nov. 15, 1979	Jan. 14, 1980
26 CFR 1.412(b)-5 added.	Procedures for electing an alternative amortization method of funding certain pension plans.	Nov. 23. 1979	Jan. 21, 1980
26 CFR 1.1033(a)-1, 1.1033(a)-2, 7.0, amended; 1.1033(g)-1 redesignated as 1.1033(h)-1 and amended; 1.1033(f)-1 redesignated as 1.1033(g)-1 and amended.	Election to treat outdoor advertising displays as real property.	Dec. 11, 1979	Feb. 11, 1980
26 CFR 1.461-3, 1.6151-1—1.6302-2 and intermediate sections, 31.6071(a)-1—31.6302(c)-3 and intermediate sections, 36.3121(1)(10)-4, 46.6071(a)-1, 46.6151-1, 46.6302(c)-1, 48.6071(a)-1, 48.6151-1, 48.6302(c)-1, 49.6151-1, 49.6302(c)-1, 154.2-1, 301.6302-1, 301.6402-4, 301.7502-1, 601.401 amended; 301.7502 deleted; 301.7502-2 added	Timeliness of tax returns, payments and deposits.	Dec. 11, 1979	Feb. 11, 1980

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[1] A cumulative list of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1979-1 through 1979-26 will be found in Internal Revenue Bulletin 1979-27, dated July 2, 1979.

Finding List of Current Action on Previously Published Rulings[1]

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* Denotes entry since last publication

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Key to Abbreviations:

RR	Revenue Ruling
RP	Revenue Procedure
TD	Treasury Decision
CD	Court Decision
PL	Public Law
EO	Executive Order
DO	Delegation Order
TDO	Treasury Department Order
TC	Tax Convention
SPR	Statement of Procedural Rules
PTE	Prohibited Transaction Exemption

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INTERNAL REVENUE CUMULATIVE BULLETINS

______	1927–1	$6.90
______	*1927–2*	*2.95*
______	1928–1	6.95
______	1928–2	9.50
______	*1929–1*	*2.50*
______	*1929–2*	*3.15*
______	1930–1	7.30
______	1930–2	9.50
______	*1931–1*	*3.60*
______	*1931–2*	*3.25*
______	*1932–1*	*2.80*
______	1932–2	8.65
______	*1933–1*	*3.35*
______	*1933–2*	*3.45*
______	*1934–1*	*3.70*
______	*1934–2*	*4.10*
______	1935–1	6.90
______	*1935–2*	*4.00*
______	*1936–1*	*3.55*
______	*1936–2*	*3.90*
______	*1937–1*	*3.75*
______	1937–2	7.70
______	*1938–1*	*4.05*
______	*1938–2*	*3.50*
______	1939–1–1	8.25
______	1939–1–2	10.90
______	1939–2	9.40
______	1940–1	5.55
______	1940–2	14.00
______	1941–1	*$6.95*
______	*1941–2*	*3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
______	*1944*(*)	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*2.65*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
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______	1955–2	13.00
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______	1974–1	11.00
______	1974–2	9.95
______	*1974–3*	*8.20*
______	1974–3 Supp.	10.00
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January 14, 1980
Bulletin No. 1980-2

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-9, page 5.
Armed Forces readjustment payment; retroactive disability determination. A taxpayer received a lump-sum readjustment payment under 10 U.S.C. section 687(a). Later, the Veterans' Administration awarded the taxpayer retroactive disability compensation, which will be withheld until the Veterans' Administration has recouped 75 percent of the readjustment payment. The taxpayer may not exclude any portion of the readjustment payment from gross income under section 104(a)(4) of the Code and may not deduct any portion of the amount recouped by the Veterans' Administration as a loss under section 165. Rev. Rul. 78-161 distinguished.

Rev. Rul. 80-10, page 6.
Industrial development bonds; use of proceeds. A political subdivision proposes to issue $750,000 of industrial development bonds to finance the $500,000 rehabilitation of an individual's substandard rental units and the removal of an existing $250,000 lien against the property. Substantially all of the proceeds will not be used to provide an exempt facility, the exception of section 103(b)(4)(A) of the Code will not apply, and the bond interest will not be excludable under section 103(a)(1).

Rev. Rul. 80-11, page 7.
Industrial development bonds; gas distribution system; additions, improvements, and replacements. Certain specified additions, improvements, and replacements relating to an existing gas distribution system qualify as facilities for the local furnishing of gas within the meaning of section 103(b)(4)(E) of the Code, and the interest on industrial development bonds issued to finance these items is excludable from gross income.

Rev. Rul. 80-12, page 8.
Industrial development bonds; exempt small issue; capital expenditures. A proposed exempt small issue of industrial development bonds will be used to finance an interstate motor vehicle transportation company's maintenance and service center, at which it will overhaul its tractors and trailers that are used in numerous states. None of the tractors or trailers are assigned to a particular terminal or service center, and trailers are interchanged with other companies. The overhauling expenditures will not be considered capital expenditures within the meaning of section 103(b)(6)(D) of the Code.

Rev. Rul. 80-13, page 9.
Arbitrage bonds; yield restrictions; state funds and bond proceeds. A political subdivision of a state proposes to issue certain bonds to finance a feasibility study. The state is expected to appropriate funds yearly, in an amount at least equal to the cost of the study for that year, that will be placed in an escrow fund. Both the bond proceeds and the escrow fund amounts will be invested in acquired obligations yielding a materially higher amount than the bonds. Such investment earn-

(Continued on page 4)

Finding Lists begin on page 53.
Announcement of Voluntary Suspensions on page 50.
Announcement Relating to Notices of Proposed Rulemaking on page 51.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue Rulings represent the conclusions of the Service on the application of the law to the entire state of facts involved. In those that are based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and confidential information are deleted to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part includes rulings and decisions based on Subpart A, Tax Conventions and related Treasury Decisions and Revenue Rulings; Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of Revenue Rulings, Revenue Procedures, and other published items, and (3) topical Indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

ings may be used to finance the study. The issue by the subdivision will not comply with the arbitrage yield restrictions of section 103(c) of the Code.

Rev. Rul. 80-14, page 12.
Disability benefits; firefighters. Duty disability payments paid under a municipal statute to disabled firefighters prior to their reaching normal retirement age are excludable from gross income under section 104(a)(1) of the Code. If the disabled firefighter dies prior to normal retirement age the benefits paid under the statute to the surviving spouse are also excludable for the surviving spouse's life.

T.D. 7657, page 13.
Amendments to the regulations under section 166 of the Code relate to the treatment of losses resulting from payments made in discharge of certain guarantee agreements.

Announcement 80-3, page 48.
Form 4970, Tax on Accumulation Distribution of Trusts, and Form 1116, Computation of Foreign Tax Credit, have been revised to provide a year designation (1979). Previous revisions should not be used for tax years beginning in 1979. Both new forms are available in Service offices.

EXEMPT ORGANIZATIONS

Announcement 80-4, page 48.
A listing is given of organizations now classified as private foundations.

TAX CONVENTIONS

Rev. Rul. 80-15, page 16.
Italy; foreign corporation's domestic trust; suit to recover U.S. royalties. An Italian corporation set up a domestic trust to commence and conduct a civil suit against a domestic corporation to recover patent royalties payable by the domestic corporation. The trust agreement limits the authority of the trustee, a U.S. citizen and resident, to commencing and maintaining the legal action, settling the claim, and receiving all sums of money due as a result of the claim. The trustee received and remitted to the Italian corporation a sum of money in settlement of the claim. The trust is not a permanent establishment under Article II(1)(c) of the United States-Italy Income Tax Convention, and the payment to the trust is treated as royalties within the meaning of Article VIII.

Hungary, page 17.
The convention between the United States and Hungary with respect to taxes on income is reproduced.

ADMINISTRATIVE

Announcement 80-5, page 49.
Form 3115, Application for Change in Accounting Method, has been revised and is available at Service offices. Applications filed after January 31, 1980, should be made on the revised form.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-2: Compensation for services, including fees, commissions, and similar items.
(Also Sections 104, 165; 1.104-1, 1.165-1.)

Armed Forces readjustment payment; retroactive disability determination. A taxpayer received a lump-sum readjustment payment under 10 U.S.C. section 687(a). Later, the Veterans' Administration awarded the taxpayer retroactive disability compensation, which will be withheld until the Veterans' Administration has recouped 75 percent of the readjustment payment. The taxpayer may not exclude any portion of the readjustment payment from gross income under section 104(a)(4) of the Code and may not deduct any portion of the amount recouped by the Veterans' Administration as a loss under section 165. Rev. Rul. 78-161 distinguished.

Rev. Rul. 80-9

ISSUES

1. May a taxpayer by reason of a retroactive disability compensation determination by the Veterans' Administration, exclude from gross income in 1976, under section 104(a)(4) of the Internal Revenue Code, any part of a lump-sum readjustment payment?

2. Are any deductions allowable under section 165 of the Code in computing the taxpayer's income tax liability for the taxable years in which the Veterans' Administration deducts amounts from the disability compensation?

FACTS

A taxpayer who served as a reserve officer on active duty with the United States Army for eight years was involuntarily released on January 2, 1976, and received a lump-sum readjustment payment based on years of service. On January 3, 1976, the taxpayer filed a claim with the Veterans' Administration for disability compensation. On December 12, 1976, the taxpayer was awarded compensation based on 20 percent disability retroactive to January 3, 1976. However, pursuant to law and an agreement with the Veterans' Administration, the taxpayer will not receive the disability payments until the Veterans' Administration has recouped 75 percent of the readjustment payment.

LAW AND ANALYSIS

Section 687(a) of title 10 U.S.C. provides for a lump-sum readjustment payment based on years of service where a reserve member is involuntarily released from active service provided such member has completed at least five years continuous active duty prior to release.

Section 687(b)(6) of title 10 U.S.C. provides that section 687(a) does not apply to a member who, upon release from active duty, is immediately eligible for disability compensation under a law administered by the Veterans' Administration and who elects to receive that compensation. However, a member covered by section 687(b)(6) may receive a readjustment payment under this section and disability compensation if an amount equal to 75 percent of the readjustment payment is deducted from the disability compensation. In addition, a member who elects to receive a readjustment payment under this section is not prevented from becoming entitled to disability compensation after making that election.

Section 3010(a) of title 38 U.S.C. provides, in part, that payments due or to become due under any law administered by the Veterans' Administration shall be exempt from taxation.

With respect to 10 U.S.C. section 687(b)(6), in S. Rep. No. 1096, 87th Cong., 1st Sess. 4 (1961), the Senate Finance Committee states, in part:

> Under existing law a reserve is required to choose between readjustment pay and disability compensation from the Veterans' Administration. This election has been held to be irrevocable so that a person who has received readjustment pay cannot receive compensation from the Veterans' Administration to which he may subsequently become entitled. Since at the time of their release from active duty some persons have latent disabilities without realizing that these disabilities will later be found to be service connected, this irrevocable election has created hardships. The proposed solution is to permit receipt of the VA compensation after deduction of three-fourths of the readjustment pay previously received. The fractional recovery is proposed in order to take into account the tax paid on the original payment and to avoid recoupment of an amount in excess of the net received as readjustment pay. Section 3 of this bill prevents retroactive payments of compensation from the Veterans' Administration but permits prospective receipt of this compensation subject to the deduction of three-fourths of the readjustment pay previously received.

Section 61(a) of the Code provides that unless otherwise excluded by law, gross income means all income from whatever source derived, including compensation for services.

Rev. Rul. 67-350, 1967-2 C.B. 58, holds that the readjustment pay received by a member of the armed forces who is involuntarily released from active duty is includible in gross income in the taxable year received.

Section 104(a)(4) of the Code and the regulations thereunder provide, with certain exceptions not pertinent to this case, that gross income does not include amounts received as a pension, annuity, or similar allowance for personal injuries or sickness resulting from active service in the armed forces of any country.

Section 104(b)(2)(B) of the Code provides, for tax years beginning after December 31, 1975, that section 104(a)(4) shall continue to apply to an individual who, on September 24, 1975, was a member of any organization referred to in section 104(a)(4) or under a binding commitment to become such a member.

Section 104(b)(4) of the Code, effective for tax years beginning after December 31, 1975, provides that in the case of any individual described in section 104(b)(2), the amount excludable under section 104(a)(4) for any period with respect to any individual shall not be less than the maximum amount which such individual, on application therefor, would be entitled to receive as disability compensation from the Veterans' Administration.

Section 165(a) of the Code allows a deduction for any loss sustained during the taxable year which is not compensated for by insurance or otherwise.

With respect to individuals, section 165(c) of the Code limits the deduction under section 165(a) to losses incurred in a trade or business, losses incurred in transactions entered into for profit, and casualty losses.

The United States Tax Court has consistently held that a taxpayer may not take a loss with respect to an income item, as distinguished from a capital item, unless the income has been actually received and previously reported on a tax return. *See* e.g. *Alsop v. Commissioner*, 34 T.C. 606 (1960), *aff'd*, 290 F.2d 726 (2d Cir. 1961); and *O'Meara v. Commissioner*, 8 T.C. 622 (1947).

Rev. Rul. 78-161, 1978-1 C.B. 31, announced that the Internal Revenue Service will follow the decision of the United States Court of Appeals for the Fourth Circuit in *Strickland v. Commissioner*, 540 F.2d 1196 (4th Cir. 1976), as precedent in the disposition of similar cases involving section 104(a)(4) of the Code.

In *Strickland*, the court held that the Veterans' Administration's retroactive determination that the taxpayer was eligible for disability benefits was controlling. Thus, the taxpayer was entitled to exclude from gross income, under section 104(a)(4) of the Code, part of the payments previously received as retirement pay based on the rank and length of service.

This case is distinguishable from *Strickland* because the readjustment pay was not intended by the military and the taxpayer to be one of a series of periodic payments. Section 104(a)(4) of the Code does not exclude amounts if they are not received as a pension, annuity, or similar allowance; and an amount is not received for the purposes of section 104(a)(4), as a pension, annuity, or similar allowance if it was not intended by its payor to be one of a series of periodic payments.

This case is also distinguishable from *Strickland* because with respect to readjustment pay, the legislative history of 10 U.S.C. section 687(b)(6) indicates that Congress intended that a retroactive award of Veterans' Administration disability compensation would not allow a taxpayer to obtain a double tax benefit by excluding from gross income any readjustment pay received from the military. See S. Rep. No. 1096. There is no such language in the case of retirement pay.

Finally, section 104(b)(4) of the Code does not apply to this case because the reference in that section to amounts that are excludable for any period does not include an amount that is not intended by the payor and recipient to be one of a series of periodic payments.

The taxpayer is considered as never having received the withheld disability compensation. This position is consistent with Rev. Rul. 67-350, 1967-2 C.B. 58, which deals with a reduction in military retirement pay to offset a previously received lump-sum readjustment payment, under a law similar to 10 U.S.C. 687(b)(6). It was there held that there was no constructive receipt of the withheld retirement pay. Because the disability compensation is not received by the taxpayer, the taxpayer cannot take a loss deduction as a result of the withholding of any disability compensation.

Furthermore, even if the withheld disability compensation were regarded as the taxpayer's repayment *pro tanto* of the severance pay previously received and subjected to tax, a loss may nevertheless not be allowed.

S. Rep. No. 1096 indicates that Congress intended that taxpayers would not be able to take any deductions as a result of the recoupment of readjustment pay. Congress limited the recoupment to 75 percent of the readjustment pay so as to avoid recoupment of an amount in excess of the net amount after tax received by a taxpayer, assuming an average tax bracket of 25 percent. Such a limitation would not have been necessary if the recoupment were to give rise to a loss deduction.

HOLDINGS

ISSUE 1

The taxpayer may not exclude from gross income under section 104(a)(4) of the Code, as a result of the Veterans' Administration award, any portion of the readjustment pay that was received from the military.

ISSUE 2

Because the taxpayer has suffered no deductible loss as a result of the Veterans' Administration recoupment provision, the taxpayer is not allowed any deduction under section 165 of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 78-161 is distinguished.

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26 CFR 1.61-2: Compensation for services, including fees, commissions, and similar items.

Whether retirement benefits paid to disabled firefighters are includible in gross income. See Rev. Rul. 80-14, page 12.

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26 CFR 1.61-7: Interest.

Whether interest income from industrial development bonds issued to finance the rehabilitation of rental property is excludable. See Rev. Rul. 80-10, this page.

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26 CFR 1.61-7: Interest.

Whether interest on obligations of a city will be exempt from tax. See Rev. Rul. 80-12, page 8.

Section 103.—Interest on Certain Governmental Obligations

26 CFR 1.103-1: Interest upon obligations of a State, Territory, etc.

Whether interest to be paid on obligations of a political subdivision of a state will be excludable from gross income. See Rev. Rul. 80-10, this page.

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26 CFR 1.103-1: Interest upon obligations of a State, Territory, etc.

Whether interest on obligations of a city will be excludable from the gross incomes of the bondholders. See Rev. Rul. 80-12, page 8.

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26 CFR 1.103-8: Interest on bonds to finance certain exempt facilities.
(Also 1.103-1.)
(Also Section 61; 1.61-7.)

Industrial development bonds; use of proceeds. A political subdivision proposes to issue $750,000 of industrial development bonds to finance the $500,000 rehabilitation of an individual's substandard rental units and the removal of an existing $250,000 lien against the

property. Substantially all of the proceeds will not be used to provide an exempt facility, the exception of section 103(b)(4)(A) of the Code will not apply, and the bond interest will not be excludable under section 103(a)(1).

Rev. Rul. 80-10

ISSUE

Will section 103(a)(1) of the Internal Revenue Code exclude from the gross incomes of the bondholders the interest on industrial development bonds to be issued to finance the rehabilitation of rental property under the circumstances described below?

FACTS

A, an individual taxpayer, owns 50 substandard rental units situated on land within city *M*. There is an outstanding lien of $250,000 against the property. *A* desires to rehabilitate the rental units at an estimated cost of $10,000 per unit and rent the units to low-income families. *A* requested *M* to issue bonds to finance the cost of rehabilitation. *M* agreed to provide financing but will require that the existing lien be removed so that *M* will hold the first lien.

M proposes to issue $750,000 of industrial development bonds described in section 103(b)(2) of the Code and to loan the bond proceeds to *A* for removal of the existing lien and rehabilitation of the rental units. The security for the bonds will be the rehabilitated property and the loan payments to be made by *A*. *M* proposes to treat the bonds as issued to provide exempt facilities described in section 103(b)(4)(A) (residential real property for family units). The bonds are not arbitrage bonds as defined in section 103(c)2). Because certain prior exempt small issues issued in 1975 are outstanding, *M* did not elect to issue an exempt small issue under section 103(b)(6).

On May 1, 1979, *M* took "some other similar official action," within the meaning of section 1.103-8(a)(5) of the Income Tax Regulations, toward the issuance of the bonds. *M* proposes to issue the bonds on July 2, 1979, and rehabilitation will commence on August 1, 1979.

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include interest on obligations of a political subdivision of a state.

Section 103(b)(1) of the Code provides that, with certain exceptions, the interest on "industrial development bonds" is not excludable from gross income.

Section 103(b)(4)(A) of the Code provides that section 103(b)(1) shall not apply to industrial development bonds if substantially all of the bond proceeds are to be used to provide residential real property for family units.

The "substantially all" test in section 103(b)(4) of the Code will be satisfied if 90 percent or more of the proceeds of an issue of governmental obligations are used to provide an exempt facility. Section 1.103-8(a)(1)(i) of the regulations.

In Situation 2 of Rev. Rul. 77-317, 1977-2 C.B. 32, a political subdivision proposes to issue $4,800,000 of industrial development bonds, $4,000,000 of which will be used to acquire facilities to be leased to a nonexempt lessee, unrelated to the previous owner, and $800,000 of which will be used to retire the lessee's existing indebtedness. The political subdivision proposes to elect to treat the bonds as an exempt small issue under section 103(b)(6)(D) of the Code. The Revenue Ruling concludes that because $800,000 of the bond proceeds will be used to provide the lessee with working capital by retirement of the lessee's debt, substantially all (90 percent or more) of the bond proceeds will not be used to acquire land and property subject to depreciation. Therefore, the bonds will not qualify as an exempt small issue under section 103(b)(6)(D) and the interest on the bonds will not be excludable from the gross incomes of the bondholders under section 103(a)(1).

In this case, 33⅓ percent ($250,000/$750,000) of the bond proceeds will be used to remove *A*'s outstanding lien against the rental units. This amount of the bond proceeds will be used to refinance *A*'s debt and not to provide an exempt facility within the meaning of section 103(b)(4)(A) of the Code. Therefore, because substantially all (90 percent or more) of the bond proceeds will not be used to provide an exempt facility, the bonds will not qualify for the exception provisions of section 103(b)(4)(A).

HOLDING

The interest on *M*'s bonds will not be excludable from the gross incomes of the bondholders under the provisions of section 103(a)(1) of the Code.

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26 CFR 1.103-8: Interest on bonds to finance certain exempt facilities.

Industrial development bonds: gas distribution system; additions, improvements, and replacements. Certain specified additions, improvements, and replacements relating to an existing gas distribution system qualify as facilities for the local furnishing of gas within the meaning of section 103(b)(4)(E) of the Code, and the interest on industrial development bonds issued to finance these items is excludable from gross income.

Rev. Rul. 80-11

ISSUE

Are certain specified additions, improvements, and replacements of portions of an existing gas distribution system facilities for the local furnishing of gas within the meaning of section 103(b)(4)(E) of the Internal Revenue Code so that interest on industrial development bonds that finance these items is excludable from gross income?

FACTS

The Development Authority of county *X* (the Authority), a political subdivision of state *Y*, is authorized under state law to issue revenue bonds for the purpose of promoting industrial development in the county.

The Authority issued industrial development bonds for the purpose of acquiring and constructing property to be used by the local public utility in its business of furnishing gas to its customers that are located solely within two contiguous counties. All property acquired or constructed will be of a character subject to the allowance for depreciation provided in section 167 of the Code. A financing agreement between the county and the local public utility provides for aggregate basic payments sufficient to pay the principal and interest on the bonds. In addition, the taxpayer has complied with the timing limitations of section 1.103-8(a)(5)(iii) of the Income Tax Regulations. Construction will be done under the supervision of the public utility.

The bond proceeds will be expended for the following items, all of which are capital expenditures:

(1) Improvement and expansion of the distribution system due to demands for new service.

(2) Relocation of existing main and service pipelines where the old piping systems have to be removed or abandoned due to conflict with local zoning or building codes.

(3) Installation of measuring, regulating, and pressure control equipment. Included herein is electronic telemetry equipment to allow remote control of the regulators in the distribution system, as well as gas meters and regulators for customer service.

(4) Installation of cathodic protection for corrosion control as required by the office of pipeline safety. This includes a new rectifier system and newly installed anodes as protective devices on both a new and previously installed pipe.

(5) Improvements to the propane-air peak shaving plant. This includes additional protective structures, as required by local governmental agencies, as well as additional electronic and telemetry equipment to facilitate remote control of the plant.

(6) Miscellaneous line stopping equipment and tools purchased for use in the expansion and improvement of the system.

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include the interest on the obligations of a state, or any of its political subdivisions.

Section 103(b)(1) of the Code provides that industrial development bonds shall not be treated as an obligation described in section 103(a)(1) unless substantially all of the proceeds are used to provide the facilities exempt by section 103(b)(4).

Section 103(b)(4)(E) of the Code designates one of the exempt categories as those used for the local furnishing of gas.

Section 1.103-8(f)(2)(iii) of the regulations defines "facilities for the local furnishing of electric energy or gas" as property that:

> (a) Is either property of a character subject to the allowance for depreciation provided in section 167 or land,
> (b) Is used to produce, collect, generate, transmit, store, distribute, or convey electric energy or gas,
> (c) Is used in the trade or business of furnishing electric energy or gas, and
> (d) Is a part of a system providing service to the general populace of one or more communities or municipalities, but in no event more than two contiguous counties. . . .

Section 1.103-8(a)(3) of the regulations provides that an exempt facility includes land, buildings, and other property functionally related and subordinate to the facility.

In the instant case, the items of property financed with bond proceeds will become part of the existing system used to produce, collect, generate, transmit, store, distribute, or convey gas. Each item of property qualifies under section 1.103-8(f)(2)(iii) of the regulations as a facility for the local furnishing of gas or as property that is functionally related and subordinate to such a facility within the meaning of section 1.103-8(a)(3).

HOLDING

The specified additions, improvements, and replacements of portions of the existing gas distribution system described above are facilities for the local furnishing of gas within the meaning of section 103(b)(4)(E) of the Code. The interest on industrial development bonds that finance these items is excludable from gross income under the provisions of section 103.

26 CFR 1.103-10: Exemption for certain small issues of industrial development bonds.
(Also Section 61; 1.61-7, 1.103-1.)

Industrial development bonds; exempt small issue; capital expenditures. A proposed exempt small issue of industrial development bonds will be used to finance an interstate motor vehicle transportation company's maintenance and service center, at which it will overhaul its tractors and trailers that are used in numerous states. None of the tractors or trailers are assigned to a particular terminal or service center, and trailers are interchanged with other companies. The overhauling expenditures will not be considered capital expenditures within the meaning of section 103(b)(6)(D) of the Code.

Rev. Rul. 80-12

ISSUE

Does section 103(a)(1) of the Internal Revenue Code exclude from the gross incomes of bondholders the interest on industrial development bonds to be issued to finance a major maintenance and service center for road tractors and trailers under the circumstances described below?

FACTS

Corporation *X* is engaged in the business of transportation of general commodities by motor vehicle in interstate commerce. *X* operates a large fleet of road tractors and trailers throughout numerous states. None of the tractors or trailers are assigned to any of the numerous terminals or service centers operated by *X*. Trailers belonging to *X* may be interchanged with trailers owned by others in the transportation business in accordance with industry practice.

X desires to acquire land and construct and operate a major maintenance and service center in city *M*. Approximately 60 percent of *X*'s tractors and trailers will be routed periodically to the center for minor maintenance or major overhauling. The expenditures for the major overhauling of tractors and trailers will be chargeable to *X*'s capital account.

M proposes to issue industrial development bonds to finance the construction of *X*'s major maintenance and service center. Prior to the issuance of the bonds, *M* will elect to treat the issue as a $10,000,000 exempt small issue under section 103(b)(6)(D) of the Code. There will be no prior exempt small issues outstanding at the time the bonds will be issued and no capital expenditures will have been paid or incurred by *M* or *X* with respect to the proposed center or other facilities of *X* located in *M* during the 3-year period prior to the issuance of the bonds. The bonds will not be arbitrage bonds within the meaning of section 103(c).

On May 31, 1979, the governing body of *M* adopted a resolution to have bonds issued. *M* proposes to issue the bonds on July 31, 1979, and acquisition of land and construction of the center will begin on August 31, 1979.

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include interest on obligations of a state or political subdivision thereof.

Section 103(b)(1) of the Code provides that, except as otherwise provided in section 103(b), any industrial development bond shall be treated as an obligation that is not described in section 103(a)(1).

Section 103(b)(6)(D) of the Code provides that, at the election of the issuer, section 103(b)(1) shall not apply to obligations issued in an aggregate face amount of $10,000,000 or less and substantially all of the proceeds of which are to be used for the acquisition or construction of land or property of a character subject to the allowance for depreciation. For purposes of determining the aggregate face amount of such bond issue, there must be taken into account the face amount of the bonds to be issued, the outstanding face amount of any prior exempt small issues, and the aggregate amount of capital expenditures with respect to certain facilities.

Section 1.103-10(b)(2)(ii) of the Income Tax Regulations provides that an expenditure (regardless of how paid, whether in cash, notes, or stock in a taxable or nontaxable transaction) is a section 103(c)(6)(D) (redesignated as section 103(b)(6)(D)) capital expenditure if:

(a) The capital expenditure was financed other than out of the proceeds of issues taken into account.

(b) The capital expenditures were paid or incurred during the 6-year period that begins 3 years before the date of issuance of the issue and ends 3 years after such date.

(c) The principal user of the facility in connection with which the property resulting from the capital expenditures is used and the principal user of the facility financed by the proceeds of the issue in question is the same person or are two or more related persons.

(d) Both facilities referred to in (c) were located in the same incorporated municipality or in the same county (outside of the incorporated municipality in such county), and

(e) The capital expenditures were properly chargeable to the capital account of any person or state or local governmental unit (whether or not such person is the principal user of the facility or a related person).

In Rev. Rul. 77-281, 1977-2 C.B. 31, a city proposed to issue industrial development bonds to finance the acquisition of railroad rolling stock for use by a nonexempt corporation in its rail operation. The rolling stock would be used to provide rail service between two cities located in different states and may be interchanged with other railroads throughout the country. The revenue ruling sets forth two preconditions for qualifying as an exempt small issue under section 103(b)(6)(D) of the Code: (1) the location of facilities to be financed with an exempt small issue must be established within an incorporated municipality or within a county, and (2) the facility financed by the bonds must be located within the boundaries of the issuer (or within the boundaries of the political subdivision in which the issuer is located). A facility will be regarded as being located within the boundaries of the issuer if it has a substantial connection therein. The revenue ruling concludes that the proposed bonds will not qualify as an exempt small issue under section 103(b)(6)(D) because the rolling stock will not satisfy the two preconditions.

In this case, substantially all of the bond proceeds will be used to acquire land and construct property subject to the allowance for depreciation. Therefore, the bonds will qualify for the exception provisions of section 103(b)(6)(D) of the Code as an exempt small issue.

Contrast Example (11) of section 1.103-10(f) of the regulations in which the purchase of tractor-trailers and other automotive equipment that were *based* in the same city as the bond-financed facilities was considered to be a capital expenditure within the meaning of section 103(b)(6)(D) of the Code.

Because the tractors and trailers owned by *X* are constantly used throughout *X*'s operating system and the trailers are interchanged with other transportation companies, the location of *X*'s tractors and trailers cannot be established in *M* or in any other political subdivision. Further, the tractors and trailers have no substantial connection within *M*. See Rev. Rul. 77-281. Therefore, the expenditures made at *X*'s major maintenance and service center with respect to overhauling tractors and trailers will not be considered capital expenditures, within the meaning of section 103(b)(6)(D) of the Code and section 1.103-10(b)(2)(ii) of the regulations, for purposes of determining if the aggregate face amount of the bonds will exceed the exempt small issue limitation of $10,000,000.

HOLDING

The interest on *M*'s bonds will be excludable from the gross incomes of the bondholders under the provisions of section 103(a)(1) of the Code.

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26 CFR 1.103-13: Arbitrage bonds.

Arbitrage bonds; yield restrictions; state funds and bond proceeds. A political subdivision of a state proposes to issue certain bonds to finance a feasibility study.

The state is expected to appropriate funds yearly, in an amount at least equal to the cost of the study for that year, that will be placed in an escrow fund. Both the bond proceeds and the escrow fund amounts will be invested in acquired obligations yielding a materially higher amount than the bonds. Such investment earnings may be used to finance the study. The issue by the subdivision will not comply with the arbitrage yield restrictions of section 103(c) of the Code.

Rev. Rul. 80-13

ISSUE

Will an authority that is a political subdivision of a state fail to comply with the arbitrage yield restrictions of section 103(c) of the Internal Revenue Code with respect to an issue of its obligations in the circumstances described below?

FACTS

Authority *A* is a political subdivision of the state of *M* that was created by *M* to construct, acquire, finance and operate power facilities in *M*. Under the law of *M*, *A* may issue bonds to finance power projects, but such bonds are not permitted to be secured by the full faith and credit of *M*.

Since *A* is a newly created political subdivision of *M*, *A* has no revenues or assets. The first project that will be undertaken by *A* is a study that will determine the feasibility of constructing a hydroelectric power plant in *M*. *A* plans to finance the feasibility study through the issuance of $50,000,000 of its eight-year term bonds. Since *A* has no revenues with which it may pay interest on the bond issue, $23,000,000 of bond proceeds will be used to pay the annual interest due on the bonds. The remaining bond proceeds will be used to pay for the costs of the feasibility study.

In addition, the legislature of *M* will be requested, in each of its annual sessions, to appropriate funds in an amount at least equal to the cost of the feasibility study for that year. *A* will place the amounts it receives from the annual appropriations made by the legislature of *M* in an escrow fund. *A* anticipates that the initial state appropriation will be made concurrently with the issuance of the bonds. The bond indenture states that no funds appropriated by the legislature of *M* may be used to conduct the feasibility study. The amounts deposited in the escrow fund and that portion of the $50,000,000 of bond proceeds not used to pay for the cost of the feasibility study will be used to repay the bondholders if *A* defaults on its bond issue, or if as a result of the study, *A* determines that the hydroelectric power plant should not be built.

Both the original proceeds of the bonds and the amounts deposited in the escrow fund will be invested in acquired obligations, the yield on which will be materially higher, within the meaning of section 1.103-13(b)(5)(iv) of the Income Tax Regulations, than the yield on the bonds. The investment earnings from the bond proceeds and the escrow fund will be deposited in bond accounts and may be used to finance the cost of the feasibility study. However, the bond indenture provides that the original proceeds of the bonds may be used to pay for the feasibility study only so long as the sum of (1) the balance of original and investment bond proceeds and (2) the balance of the escrow fund and earnings thereon total not less than the principal amount of the bonds outstanding.

The bonds will not be industrial development bonds within the meaning of section 103(b)(2) of the Code.

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include interest on the obligations of a state, a territory, or a possession of the United States, or any political subdivision of the foregoing, or of the District of Columbia.

Section 103(c)(1) of the Code provides that, with certain minor exceptions, the interest on any arbitrage bond will not be excludable from gross income.

Section 103(c)(2) of the Code provides that the term "arbitrage bond" means any obligation that is issued as part of an issue all or a major portion (more than 15 percent) of the proceeds of which are reasonably expected to be used directly or indirectly (A) to acquire securities or obligations that may be reasonably expected at the time of issuance of such issue, to produce a yield over the term of the issue that is materially higher than the yield on obligations of such issue, or (B) to replace funds that were used directly or indirectly to acquire securities or obligations described in section 103(c)(2)(A).

Section 1.103-13(b)(5)(iv) of the regulations defines the term "materially higher" in those situations in which it is reasonably expected that the original proceeds of an issue will exceed the amount necessary for the governmental purpose or purposes of the issue by more than 5 percent of such amount. Any portion of the issue issued solely for the purpose of investing such portion at a materially higher yield as less than a major portion is not issued for a governmental purpose. The yield produced by acquired obligations acquired with the proceeds of such issue (including any acquired obligations held during the temporary periods described in section 1.103-14(b), any amounts invested in the reserve or replacement fund as defined in section 1.103-14(d), and any investments of less than a major portion of such proceeds as described in section 1.103-13(b)(1)) is materially higher than the yield produced by an issue of governmental obligations if the yield produced by the acquired obligations is higher than $Y + [(\$5{,}000 \times Y) \div P]$ where "Y" stands for the yield on the issue and "P" stands for the amount of the original proceeds of the issue. Nothing in this subdivision implies that a deliberate over-issuance of less than 5 percent will not be treated as an artifice or device in section 1.103-13(j).

Section 1.103-13(j) of the regulations provides that if an artifice or device is employed in connection with the issuance of a governmental obligation, such obligation will be considered an arbitrage bond within the meaning of section 103(c)(2) of the

Code. For purposes of this section, the term "artifice or device" means a transaction or a series of transactions that attempts to circumvent the provisions of section 103(c) of the Code or sections 1.103-13, -14, or -15 of the regulations—(1) enabling the issue to exploit the difference between tax-exempt and taxable interest rates to gain a material financial advantage and (2) increasing the burden on the market for tax-exempt obligations.

Section 1.103-13(j) of the regulations further provides that examples of increased burdens on the market for tax-exempt obligations include selling obligations that would not otherwise be sold, selling more obligations than would otherwise be necessary, and issuing obligations sooner or allowing them to remain outstanding longer than would otherwise be necessary.

Rev. Rul. 78-348, 1978-2 C.B. 95, discusses the application of the replacement theory of section 103(c)(2)(B) of the Code. The replacement theory is based on the principle that an issuer that borrows to invest in higher yielding securities and one that borrows against such securities already owned are in virtually the same position. The revenue ruling provides that a requisite nexus or sufficiently direct relationship must exist between the bonds and higher yielding securities in order to apply section 103(c)(2)(B). Such a nexus or relationship does exist where the securities are pledged as collateral for the bonds. Although a pledge of collateral need not be cast in a particular legal form, there must be a reasonable assurance that the collateral will be available if needed to pay debt service even if the issuer encounters financial difficulties.

Section 1.103-13(b)(1)(i)(B) of the regulations refers to example (1) in section 1.103-14(e)(7)(ii) to illustrate the application of the replacement theory of section 103(c)(2)(B) of the Code. In that example, a city issued $11,000,000 in bonds to refund a prior issue of $10,000,000 for which there was no reserve or replacement fund. However, the city accumulated a reserve fund of $800,000 for the refunding issue that was pledged as collateral for that issue. In addition the city could not withdraw amounts from the reserve fund during the term of the refunding issue except to pay debt service on the issue. Based on these facts, the regulation concludes that the bond proceeds replace the amounts held in the reserve fund and that the amounts held in the reserve fund are subject to the same arbitrage yield restrictions and generally have the same status as proceeds of the refunding issue. See also Rev. Rul. 78-348, for similar examples of the replacement theory under section 103(c)(2)(B).

M has provided *A* with an Escrow Fund that may be used only to pay the holders of *A*'s bonds if *A* defaults on the bonds or if *A* concludes that the power plant should not be built. Therefore, under section 103(c)(2)(B) of the Code, *A*'s bonds will be issued to replace the amounts in the escrow fund. The fact that the escrow fund will not be fully funded at the time the bonds are issued is not distinguishable from Rev. Rul. 78-348 in which the bond proceeds replaced investment securities already owned by the governmental units.

Under section 1.103-13(b)(5)(iv) of the regulations, the issuance of bonds solely to derive an arbitrage profit is not for a governmental purpose. See Rev. Rul. 79-108, 1979-1, C.B. 75, which concludes that a city issued bonds solely to derive an arbitrage profit and thus made an overissuance of bonds when it obtained from a securities dealer a 60-day loan of 300*x* dollars that was secured by city-owned U.S. Treasury Notes and invested the proceeds of the loan in a local government investing pool that paid interest at a yield higher than the rate of interest the city paid on its obligation to the securities dealer. Similarly, the issuance of bonds solely to replace funds that are used solely to derive an arbitrage profit is not for a governmental purpose.

In this case, the bond indenture restricts use of original proceeds for the feasibility study to the amount by which the balance of original and investment bond proceeds and the balance in the escrow fund and earnings thereon exceeds the principal amount of the bonds outstanding. During each of the years that the bonds are outstanding only that portion of the original bond proceeds that is matched by investment proceeds and funds appropriated by the legislature and deposited in the escrow fund and the earnings thereon may be used to finance the annual cost of the study. Thus, at no time after the bonds are issued will the sum of the amounts held in the bond accounts and escrow fund, be less than $50,000,000, the face amount of the bonds. In addition, the bondholders will look to the escrow fund and the bond funds and not *A* for payment of principal and interest on the bonds as is evidenced by the fact that *A* has no revenues or assets with which it may pay the bondholders in the event of default or a decision not to build the power plant. Therefore, although the form of the transaction is that the bond proceeds will be used to fund the feasibility study, the substance of the transaction is that the feasibility study will be funded only by the earnings on the original bond proceeds and amounts appropriated by the legislature of *M* and the earnings thereon, and none of the original bond proceeds will be spent for the study. Thus the transaction is the equivalent of *M* issuing the bonds and placing the proceeds in escrow and financing the feasibility study on a year to year basis with the amounts appropriated by the legislature and the earnings on both the appropriations and the original bond proceeds.

If *M* had actually issued bonds, and placed the bond proceeds in escrow and invested them for the purpose of obtaining arbitrage profits, the issuance would be considered to have no governmental purpose within the meaning of section 1.103-13(b)(5)(iv) of the regulations. *See* Rev. Rul. 79-108. The fact that the form of the transaction is that *A* is issuing the bonds does not change the substance of the transaction that the bonds are being issued for no governmental purpose.

Consequently, it is reasonably expected that the issuance by *A* of

$50,000,000 of its bonds to replace the amounts deposited in the escrow fund will exceed the amount necessary for the governmental purpose of such issue by more than 5 percent of such amount within the meaning of section 1.103-13(b)(5)(iv) of the regulations. Further, *A* is investing the bond proceeds at a materially higher yield within the meaning of section 1.103-13(b)(5)(iv). Thus, *A* has failed to comply with the arbitrage yield restrictions of section 103(c)(2)(A) of the Code.

Further, because the expected annual legislative appropriations of *M* will be sufficient to conduct the feasibility study, the bonds will not be issued for a governmental purpose, and issuance of the bonds is not necessary. Under section 1.103-13(j) of the regulations, the issuance of bonds that are not necessary creates a burden on the market for tax-exempt bonds. Because the bond proceeds will be invested at a materially higher yield, *A* will be able to exploit the difference between tax-exempt and taxable interest rates to gain a material financial advantage. Therefore, *A* is employing an artifice or device in connection with the issuance of the bonds.

Because the amounts deposited in the escrow fund will be replaced by the proceeds of *A*'s bonds, the amounts invested in the escrow fund have the same status and are subject to the same yield restrictions as the bond proceeds. In this case, since the bond proceeds are subject to the yield restrictions of section 1.103-13(b)(5)(iv) of the regulations the amounts deposited in the escrow fund are subject to the same yield restrictions. Since amounts in the escrow fund will be invested at a yield materially higher than that of the bonds, *A* has failed to comply with the arbitrage yield restrictions of section 103(c)(2)(B).

HOLDING

The issue of *A*'s obligations will not comply with the arbitrage yield restrictions of section 103(c)(2) of the Code, and thus the bonds will be arbitrage bonds within the meaning of section 103(c)(2). Accordingly, interest on the issue of *A*'s obligations will not be excludable from gross income under section 103(a)(1). The result would be the same if *M* had made an appropriation for the entire cost of the feasibility study on the date of issue.

Section 104.—Compensation for Injuries or Sickness

26 CFR 1.104-1: Compensation for injuries or sickness.
(Also Section 61; 1.61-2.)

Disability benefits; firefighters. Duty disability payments paid under a municipal statute to disabled firefighters prior to their reaching normal retirement age are excludable from gross income under section 104(a)(1) of the Code. If the disabled firefighter dies prior to normal retirement age the benefits paid under the statute to the surviving spouse are also excludable for the surviving spouse's life.

Rev. Rul. 80-14

ISSUES

1. Are benefits paid to disabled firefighters, under the circumstances described below, excludable from gross income under section 104(a)(1) of the Internal Revenue Code?

2. Are benefits paid to a firefighter's surviving spouse, under the circumstances described below, excludable from gross income under section 104(a)(1) of the Code?

FACTS

Under statutes adopted by City *M*, any firefighter in active service who becomes permanently and totally incapacitated for duty as the natural and proximate result of an injury occurring in the actual performance of duty will, upon filing a request for retirement, be entitled to a duty disability retirement allowance provided the medical council after a medical examination of the firefighter certifies that the firefighter is mentally or physically incapacitated for further duty as a result of the injury, the incapacity is likely to be permanent, and the firefighter should be retired.

The statutes provide that any firefighter eligible for duty disability retirement will have the right to receive a benefit during the period of such disability of an amount equal to 75 percent of the current actual salary for the position the firefighter held at the time of the injury. If the firefighter dies while receiving the duty disability allowance, the firefighter's spouse will receive 70 percent of the amount of the allowance the firefighter received at the time of death.

Disabled firefighters continue to receive a duty disability allowance during their period of eligibility until they reace age 62, at which time they begin to receive a normal retirement pension based on years of service with service credit given for time spent on duty disability.

LAW AND ANALYSIS

Section 61(a) of the Code provides that gross income means all income from whatever source derived, unless otherwise excluded by law, including compensation for services.

Section 104(a)(1) of the Code provides, with certain exceptions not relevant to this case, that gross income does not include amounts received under workmen's compensation acts as compensation for personal injuries or sickness.

Section 1.104-1(b) of the Income Tax Regulations provides that section 104(a)(1) of the Code excludes from gross income amounts received by an employee under a workmen's compensation act, or a statute in the nature of a workmen's compensation act which provides compensation to employees for personal injuries or sickness incurred in the course of employment. Section 104(a)(1) also applies to compensation that is paid under a workmen's compensation act to the survivor or survivors of a deceased employee. However, section 104(a)(1) does not apply to a retirement pension or annuity to the extent that it is determined by reference to the employee's age or length of service, or the employee's prior contributions, even though the employee's retirement is occasioned by an occupational injury or sickness.

The disability benefits in this case are authorized by a statute that provides benefits to a class restricted to employees with service-incurred disabilities. These benefits are thus payments for those disabilities. Therefore, the statute qualifies as a statute in the nature of a workmen's compensation act. Compare Rev. Rul. 72-291, 1972-1 C.B. 36; Rev. Rul. 72-44, 1972-1 C.B. 31.

Disability benefits received by a disabled firefighter prior to conversion to normal retirement benefits therefore qualify for exclusion under section 104(a)(1). Benefits received after conversion, however, do not qualify for exclusion from gross income because they are determined with reference to years of service and age.

If a disabled firefighter dies while receiving duty disability benefits, the statutes of *M* authorize payment of a percentage of those benefits to the surviving spouse. The spouse's payments are merely a continuation of the excludable disability benefits received by the decedent and are part of the benefit package granted to an employee as compensation for the employee's occupational disability.

HOLDINGS

Issue 1

Duty disability benefits paid by *M* to disabled firefighters prior to the time of their conversion to normal retirement are excludable from gross income under section 104(a)(1) of the Code. Benefits paid to disabled firefighters after their conversion to normal retirement are not excludable under section 104(a)(1).

Issue 2

If a disabled firefighter dies prior to the firefighter's conversion to normal retirement the benefits paid to the surviving spouse during that spouse's lifetime are excludable from gross income under section 104(a)(1) of the Code.

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26 CFR 1.104-1: Compensation for injuries or sickness.

Effect of a retroactive disability determination by the VA on a lump-sum military readjustment payment. See Rev. Rul. 80-9, page 5.

Section 165.—Losses

26 CFR 1.165-1: Losses.

Whether any deductions are allowable as a result of the recoupment of military readjustment pay by the VA. See Rev. Rul. 80-9, page 5.

Section 166.—Bad Debts

26 CFR 1.166-8: Losses of guarantors, endorsers, and indemnitors incurred on agreements made before January 1, 1976.

T.D. 7657

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Treatment of losses from certain guarantee agreements

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the treatment of losses resulting from payments made in discharge of certain guarantee agreements. Changes to the applicable law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. Vol. 1) 1]. These regulations would provide the public with the guidance needed to comply with the changes.

DATES: The new regulations are effective for losses incurred on guarantee agreements made after December 31, 1975, in taxable years beginning after that date.

FOR FURTHER INFORMATION CONTACT: Douglas W. Charnas of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3346).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On September 15, 1978, proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 166 of the Internal Revenue Code of 1954 were published in the Federal Register (43 F.R. 41237). These amendments were proposed to conform the regulations to section 605 of the Tax Reform Act of 1976 (90 Stat. 1575) (hereinafter referred to as "the Act") and are issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805). No public hearing was requested or held. After consideration of all comments received regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision.

DESCRIPTION OF CHANGES

Certain technical changes have been made to the proposed amendments in response to public comments. Paragraphs (a) and (b) of § 1.166-9 are amended to clarify several points. This section applies to taxpayers who enter into an agreement in the course of their trade or business to act as a guarantor, endorser, or indemnitor, or to act in a manner essentially equivalent to a guarantor, endorser, or indemnitor or other secondary obligor. Both the principal and interest amounts of a debt on which the taxpayer is a guarantor, endorser, or indemnitor are subject to this section. The interest on the debt may not be deducted under section 163 of the Code.

Paragraph (c) is amended to make clear that the rules of paragraph (c) relating to obligations issued by corporations apply to payments whenever made, and not just to payments resulting in losses incurred on guarantee agreements made after December 31, 1975. Paragraph (d)(3) is amended to make clear that an agreement is considered as entered into before the obligation became worthless (or partially worthless) if, at the time the agreement was entered into, there was a reasonable expectation on the part of the taxpayer that the taxpayer would not be called upon to pay the debt (subject to such agreement) without full reimbursement. A new paragraph (e)(4) is added to make clear that the regulations under section 166 apply to all taxpayers, and not just to taxpayers who are individuals.

DRAFTING INFORMATION

The principal author of these final regulations is Douglas W. Charnas of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the final regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to 26 CFR Part 1 are hereby adopted:

Paragraph 1. Section 1.166 and the historical note are deleted.

Par. 2. Section 1.166-5 is amended by revising paragraph (c) to read as follows:

§ 1.166-5 Nonbusiness debts.

* * * * *

(c) *Guaranty of obligations.* For provisions treating a loss sustained by a guarantor of obligations as a loss resulting from the worthlessness of a debt, see §§ 1.166-8 and 1.166-9.

Par. 3. Section 1.166-8 is amended by revising the caption and adding a new paragraph (d) at the end of the section. As revised, the section reads as follows:

§ 1.166-8 Losses of guarantors, endorsers, and indemnitors incurred on agreements made before January 1, 1976.

* * * * *

(d) *Effective date.* This section applies only to losses, regardless of the taxable year in which incurred, on agreements made before January 1, 1976.

Par. 4. The following new section is added immediately after § 1.166-8:

§ 1.166-9 Losses of guarantors, endorsers, and indemnitors incurred, on agreements made after December 31, 1975, in taxable years beginning after such date.

(a) *Payment treated as worthless business debt.* This paragraph applies to taxpayers who, after December 31, 1975, enter into an agreement in the course of their trade or business to act as (or in a manner essentially equivalent to) a guarantor, endorser, or indemnitor of (or other secondary obligor upon) a debt obligation. Subject to the provisions of paragraphs (c), (d), and (e) of this section, a payment of principal or interest made during a taxable year beginning after December 31, 1975, by the taxpayer in discharge of part or all of the taxpayer's obligation as a guarantor, endorser, or indemnitor is treated as a business debt becoming worthless in the taxable year in which the payment is made or in the taxable year described in paragraph (e)(2) of this section. Neither section 163 (relating to interest) nor section 165 (relating to losses) shall apply with respect to such a payment.

(b) *Payment treated as worthless nonbusiness debt.* This paragraph applies to taxpayers (other than corporations) who, after December 31, 1975, enter into a transaction for profit, but not in the course of their trade or business, to act as (or in a manner essentially equivalent to) a guarantor, endorser, or indemnitor of (or other secondary obligor upon) a debt obligation. Subject to the provisions of paragraphs (c), (d), and (e) of this section, a payment of principal or interest made during a taxable year beginning after December 31, 1975, by the taxpayer in discharge of part or all of the taxpayer's obligation as a guarantor, endorser, or indemnitor is treated as a worthless nonbusiness debt in the taxable year in which the payment is made or in the taxable year described in paragraph (e)(2) of this section. Neither section 163 nor section 165 shall apply with respect to such a payment.

(c) *Obligations issued by corporations.* No treatment as a worthless debt is allowed with respect to a payment made by the taxpayer in discharge of part or all of the taxpayer's obligation as a guarantor, endorser, or indemnitor of an obligation issued by a corporation if, on the basis of the facts and circumstances at the time the obligation was entered into, the payment constitutes a contribution to capital by a shareholder. The rule of this paragraph (c) applies to payments whenever made (see paragraph (f) of this section).

(d) *Certain payments not treated as worthless debts.* A payment in discharge of part or all of a taxpayer's agreement to act as guarantor, endorser, or indemnitor of an obligation is to be treated as a worthless debt only if—

(1) The agreement was entered into in the course of the taxpayer's trade or business or a transaction for profit;

(2) There was an enforceable legal duty upon the taxpayer to make the payment (except that legal action need not have been brought against the taxpayer); and

(3) The agreement was entered into before the obligation became worthless (or partially worthless in the case of an agreement entered into in the course of the taxpayer's trade or business). See §§ 1.166-2 and 1.166-3 for rules on worthless and partially worthless debts. For purposes of this paragraph (d)(3), an agreement is considered as entered into before the obligation became worthless (or partially worthless) if there was a reasonable expectation on the part of the taxpayer at the time the agreement was entered into that the taxpayer would not be called upon to pay the debt (subject to such agreement) without full reimbursement from the issuer of the obligation.

(e) *Special rules*—(1) *Reasonable consideration required.* Treatment as a worthless debt of a payment made by a taxpayer in discharge of part or all of the taxpayer's agreement to act as a guarantor, endorser, or indemnitor of an obligation is allowed only if the taxpayer demonstrates that reasonable consideration was received for entering into the agreement. For purposes of this paragraph (e)(1), reasonable consideration is not limited to direct consideration in the form of cash or property. Thus, where a taxpayer can demonstrate that the agreement was given without direct consideration in the form of cash or property but in accordance with normal business practice or for a good faith business purpose, worthless debt treatment is allowed with respect to a payment in discharge of part or all of the agreement if the conditions of this section are met. However, consideration received from a taxpayer's spouse or any individual listed in section 152 (a) must be direct consideration in the form of cash or property.

(2) *Right of subrogation.* With respect to a payment made by a taxpayer in discharge of part or all of the taxpayer's agreement to act as a guarantor, endorser, or indemnitor where the agreement provides for a right of subrogation or other similar right against the issuer, treatment as a worthless debt is not allowed until the taxable year in which the right of subrogation or other similar right becomes totally worthless (or partially worthless in the case of an agreement which arose in the course of the taxpayer's trade or business).

(3) *Other applicable provisions.* Unless inconsistent with this section, other internal revenue laws concerning worthless debts, such as section 111 relating to the recovery of bad debts, apply to any payment which, under the provisions of this section, is treated as giving rise to a worthless debt.

(4) *Taxpayer defined.* For purposes of this section, except as otherwise provided, the term "taxpayer" means any taxpayer and includes individuals, corporations, partnerships, trusts and estates.

(f) *Effective date.* This section applies to losses incurred, on agreements made after December 31, 1975, in taxable years beginning after such date. However, paragraph (c) of this section also applies to payments, regardless of the taxable year in which made, under agreements made before January 1, 1976.

JEROME KURTZ,
Commissior of
Internal Revenue.

Approved November 16, 1979.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on November 28, 1979; 8:45 a.m., and published in the issue of the Federal Register for November 29, 1979, 44 F.R. 68463)

Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners

26 CFR 1.671-1: Grantors and others treated as substantial owners; scope.

Whether a domestic trust set up to commence and conduct a civil suit is a "permanent establishment" under Article II(1) (c) of the United States-Italy Income Tax Convention (the Convention), 1956-2 C.B. 1096, and whether an amount received in a settlement agreement involving a contract suit to receiver patent royalties is treated as the payment of "royalties" within the meaning of Article VIII of the Convention. See Rev. Rul. 80-15, page 16.

Section 676.—Power to Revoke

26 CFR 1.676(a)-1: Power to revest title to portion of trust property in grantor; general rule.

Whether a domestic trust set up to commence and conduct a civil suit is a "permanent establishment" under Article II(1)(c) of the United States-Italy Income Tax Convention (the Convention), 1956-2 C.B. 1096, and whether an amount received in a settlement agreement involving a contract suit to recover patent royalties is treated as the payment of "royalties" within the meaning of Article VIII of the Convention. See Rev. Rul. 80-15, page 16.

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions

United States-Italy Income Tax Convention

1956-2 C.B. 1096

(*Also Part I, Sections 671, 676; 1.671-1, 1.676(a)-1.*)

Italy; foreign corporation's domestic trust; suit to recover U.S. royalties. An Italian corporation set up a domestic trust to commence and conduct a civil suit against a domestic corporation to recover patent royalties payable by the domestic corporation. The trust agreement limits the authority of the trustee, a U.S. citizen and resident, to commencing and maintaining the legal action, settling the claim, and receiving all sums of money due as a result of the claim. The trustee received and remitted to the Italian corporation a sum of money in settlement of the claim. The trust is not a permanent establishment under Article II(1)(c) of the United States-Italy Income Tax Convention, and the payment to the trust is treated as royalties within the meaning of Article VIII.

Rev. Rul. 80-15

ISSUES

(1) Whether a domestic trust set up to commence and conduct a civil suit is a "permanent establishment" under Article II(1)(c) of the United States-Italy Income Tax Convention (the Convention), 1956-2 C.B. 1096.

(2) Whether an amount received in a settlement agreement involving a contract suit to recover patent royalties is treated as the payment of "royalties" within the meaning of Article VIII of the Convention.

FACTS

A is a citizen and resident of the United States. *X* is an Italian corporation that has its principal place of business in Italy. *Y* is a domestic corporation engaged in manufacturing. In 1970 *X* and *Y* entered into a written agreement that described the procedure to be used for the payment by *Y* to *X* of patent royalties as they accrue.

At the request of *X*, *A*, acting as trustee, and *X*, acting as settlor, executed a trust agreement to institute a legal claim by *X* against *Y* for certain patent royalties. The trust agreement provides that the settlor may revoke, modify or amend the trust in whole or in part. The authority of *A* as trustee is limited to (1) commencing and maintaining a legal action against *Y* on behalf of *X*; (2) settling the claim of *X* against *Y*; and (3) receiving all sums of money due as a result of such claim.

Subsequent to the execution of the trust, *A*, as trustee, instituted a civil action against *Y* for recovery of the patent royalties that were subject to the trust. Later, *X* and *Y* entered into a settlement agreement and *A*, as trustee, received a check from *Y* for the sum of 12*x* dollars. *A* remitted the 12*x* dollars to *X*.

LAW AND ANALYSIS

Section 676 of the Code provides that a grantor of a trust shall be treated as owner of any portion of a trust, where at any time the power to revest title in the trust to the grantor is exercisable by the grantor.

Section 671 of the Code provides that when the grantor of a trust is treated as the owner of the trust, items of taxable income of the trust are included in computing the taxable income of the grantor.

Article VIII of the Convention provides that royalties and other amounts received as consideration for the right to use copyrights, patents and other like property from sources within the United States by an Italian corporation not having a permanent establishment in the United States shall be exempt from taxation within the United States.

Article II(1)(g) of the Convention defines the term "Italian corporation" to mean a corporation created or organized in Italy or under Italian laws.

Article II(1)(c) of the Convention defines the term "permanent establishment" to mean a branch, office, factory, warehouse or other fixed place of business. The term "permanent establishment" does not include an agency unless the agent has and exercises a general authority to negotiate and conclude contracts on behalf of an enterprise.

In Rev. Rul. 64-206, 1964-2 C.B. 591, a citizen and a resident of Switzerland, who did not maintain a place of business in the United States or conduct any business through a "permanent establishment" situated in the United States, owned a United States patent. That citizen was awarded a judgment for damages and interest for the infringement of this patent within the United States. Rev. Rul. 64-206 holds that the damages awarded were amounts received as consideration for the right to use the patent, and thus were exempt as royalties from United States income tax under Article VIII of the United States-Swiss Confederation Income Tax Convention.

Under Article II(1)(c) of the Convention, an agency will not constitute a "permanent establishment" in the United States unless the agent has and exercises a general authority to negotiate and conclude contracts. In this revenue ruling, *A*, as trustee for *X*, does not have the general authority to negotiate or conclude contracts on behalf of *X*. Rather, *A*'s authority is limited by the terms of the trust agreement.

Because *X* is treated as owner of the trust under section 676 of the Code, any income paid to the trust is taxable to *X* under section 671 unless otherwise excluded by law or treaty provision.

The amount paid to the trust under the settlement agreement between *X* and *Y* was in lieu of the amount *X* would have realized under the patent agreement between *X* and *Y*.

HOLDINGS

(1) The domestic trust established by an Italian corporation (*X*) for the limited purpose of conducting a breach of contract suit to recover patent

royalties is not a "permanent establishment" within the United States under Article II(1)(c) of the Convention.

(2) The amount paid to the trust on *X*'s behalf under the settlement agreement between *X* and *Y* is treated as the payment of royalties within the meaning of Article VIII of the Convention and therefore is exempt from United States income tax.

United States-Hungary Income Tax Convention[1]

Convention signed at Washington February 12, 1979;
Ratification advised by the Senate of the United States of America July 9, 1979;
Ratified by the President of the United States of America August 7, 1979;
Notes exchanged at Budapest September 18, 1979;
Proclaimed by the President of the United States of America November 28, 1979;
Entered into force September 18, 1979.

BY THE PRESIDENT OF THE UNITED STATES OF AMERICA

A PROCLAMATION

CONSIDERING THAT:

The Convention between the Government of the United States of America and the Government of the Hungarian People's Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income was signed at Washington on February 12, 1979, together with a related exchange of notes, the texts of which are hereto annexed;

The Senate of the United States of America by its resolution of July 9, 1979, two-thirds of the Senators present concurring therein, gave its advice and consent to ratification of the Convention and related exchange of notes;

The Convention and related exchange of notes were ratified by the President of the United States of America on August 7, 1979, in pursuance of the advice and consent of the Senate, and was approved on the part of the Hungarian People's Republic;

The parties notified one another at Budapest on September 18, 1979, that their respective constitutional requirements had been met, and accordingly the Convention, with related exchange of notes, entered into force on September 18, 1979, effective as specified in Article 25;

NOW, THEREFORE, I, Jimmy Carter, President of the United States of America, proclaim and make public the Convention with related exchange of notes, to the end that they be observed and fulfilled with good faith on and after September 18, 1979, by the United States of America and by the citizens of the United States of America and all other persons subject to the jurisdiction thereof.

IN TESTIMONY WHEREOF, I have signed this proclamation and caused the Seal of the United States of America to be affixed.

DONE at the city of Washington this twenty-eighth day of November in the year of our Lord one thousand nine hundred seventy-nine and of the Independence of the United States of America the two hundred fourth.

By the President: JIMMY CARTER

CYRUS VANCE
Secretary of State

CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE HUNGARIAN PEOPLE'S REPUBLIC FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME

The Government of the United States of America and the Government of the Hungarian People's Republic, desiring to further expand and facilitate mutual economic relations, have resolved to conclude a convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income, and have agreed as follows:

Article 1

PERSONAL SCOPE

1. This Convention shall apply to persons who are residents of one or both of the Contracting States, except as otherwise provided in this convention.

2. Notwithstanding any provision of this Convention except paragraph 3 of this Article, a Contracting State may tax its residents (as determined under Article 4 (Fiscal Domicile)) and citizens (including, in the case of the United States, former citizens) as if this Convention had not come into effect.

3. The provisions of paragraph 2 shall not affect:

(*a*) The benefits conferred by a Contracting State under paragraph 2 of Article 15 (Pensions), Articles 20 (Relief from Double Taxation), 21 (Non-discrimination), and 22 (Mutual Agreement Procedure); and

(*b*) The benefits conferred by a Contracting State under Articles 16 (Government Service), 17 (Teachers), 18 (Students and Trainees) and 24 (Effect of Convention on Diplomatic and Consular Officials, Domestic Laws, and Other Treaties), upon individuals who are neither citizens of, nor have immigrant status in, that State.

Article 2

TAXES COVERED

1. This Convention shall apply to taxes on income imposed on behalf of each Contracting State.

2. The existing taxes to which this Convention shall apply are:

(*a*) In the case of the United States, the Federal income taxes imposed by the Internal Revenue Code and the excise taxes imposed on insurance premiums paid to foreign insurers and with respect to private foundations, but excluding the accumulated earnings tax and the personal holding company tax.

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[1] Treaties and Other International Act Series (TIAS 9560). Pertinent excerpts from Senate Report No. 96-8, page 25; Treasury Department Technical Explanation, page 36; Senate Executive X is not published.

(*b*) In the case of the Hungarian People's Republic:

(i) The general income tax.

(ii) The income tax on intellectual activities,

(iii) The profit tax,

(iv) The profit tax on economic associations with foreign participation,

(v) The enterprises special tax,

(vi) The levy on dividends and profit distributions of commercial companies,

(vii) The profit tax on state-owned enterprises, and

(viii) The contribution to communal development, but only to the extent imposed in respect of income taxes covered by this Convention.

3. The Convention shall apply also to any identical or substantially similar taxes which are imposed by a Contracting State after the date of signature of this Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any changes which have been made in their respective taxation laws and shall notify each other of any official published material concerning the application of this Convention, including explanations, regulations, rulings, or judicial decisions.

4. For the purpose of Article 21 (Non-discrimination), this Convention shall also apply to taxes of every kind and description imposed by a Contracting State or a political subdivision or local authority thereof. For the purpose of Article 23 (Exchange of Information), this Convention shall also apply to taxes of every kind imposed by a Contracting State.

Article 3

GENERAL DEFINITIONS

1. In this Convention, unless the context otherwise requires:

(*a*) The term "person" includes an individual, a partnership, a company or juridical person, an estate, a trust, and any other body of persons;

(*b*) The term "company" means any body corporate or any entity which is treated as a body corporate for tax purposes;

(*c*) The terms "enterprise of a Contracting State" and "enterprise of the other Contracting State" means respectively an enterprise carried on by a resident of a Contracting State and an enterprise carried on by a resident of the other Contracting State;

(*d*) The term "nationals" means:

(i) All individuals possessing the citizenship of a Contracting State, and

(ii) All legal persons, partnerships and associations deriving their status as such from the law in force in a Contracting State;

(*e*) The terms "international traffic" means any transport by a ship or aircraft, except where such transport is solely between places in the other Contracting State;

(*f*) The term "competent authority" means:

(i) In the case of the United States, the Secretary of the Treasury or his delegate, and

(ii) In the case of the Hungarian People's Republic, the Minister of Finance or his delegate;

(*g*)(i) The term "United States" means the United States of America, and

(ii) When used in a geographical sense, the term "United States" does not include Puerto Rico, the Virgin Islands, Guam, or any other United States possession or territory; and

(*h*) The term "Hungarian People's Republic", when used in a geographical sense, means the territory of the Hungarian People's Republic.

2. As regards the application of this Convention by a Contracting State any term not otherwise defined shall, unless the context otherwise requires and subject to the provisions of Article 22 (Mutual Agreement Procedure), have the meaning which it has under the laws of that Contracting State relating to the taxes which are the subject of this Convention.

Article 4

FISCAL DOMICILE

1. For purposes of this Convention, the term "resident of a Contracting State" means any person who, under the law of that State, is liable to taxation therein by reason of his domicile, residence, citizenship, place of management, place of incorporation, or any other criterion of a similar nature; provided, however, that:

(*a*) This term does not include any person who is liable to tax in that Contracting State in respect only of income from sources therein or capital situated in that State; and

(*b*) In the case of income derived or paid by a partnership, estate, or trust, this term applies only to the extent that the income derived by such partnership, estate, or trust is subject to tax as the income of a resident of the Contracting State, either in its hands or in the hands of its partners or beneficiaries.

2. Where by reason of the provisions of paragraph 1 an individual is a resident of both Contracting States, then the individual's tax status shall be determined as follows:

(*a*) The individual shall be deemed to be a resident of the Contracting State in which the individual has a permanent home available to him. If the individual has a permanent home available to him in both Contracting States or in neither Contracting State, the individual shall be deemed to be a resident of the Contracting State in which the individual's center of vital interests is located;

(*b*) If the Contracting State in which the individual's center of vital interests is located cannot be determined, the individual shall be deemed to be a resident of that Contracting State in which the individual has an habitual abode;

(*c*) If the individual has an habitual abode in both Contracting States or in neither of them, the individual shall be deemed to be a resident of the Contracting State of which the individual is a national; and

(*d*) If the individual is a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

3. Where by reason of the provisions of paragraph 1 a company is a resident of both Contracting States, then if it is created or organized under the laws of a Contracting State or a political subdivision thereof, it shall be treated as a resident of that State.

4. Where by reason of the provisions of paragraph 1 a person other than an individual or a company is a resident of both Contracting States, the competent authorities of the Con-

tracting States shall by mutual agreement endeavor to settle the question and to determine the mode of application of the Convention to such person.

5. For purposes of this Convention, an individual who is a national of a Contracting State shall also be deemed to be a resident of that State if (a) the individual is an employee of that State or an instrumentality thereof in the other Contracting State or in a third State; (b) the individual is engaged in the performance of governmental functions for the first-mentioned State; and (c) the individual is subjected in the first-mentioned State to the same obligations in respect of taxes on income as are residents of the first mentioned State. The spouse and minor children residing with the employee and subject to the requirements of (c) above shall also be deemed to be residents of the first-mentioned State.

Article 5

PERMANENT ESTABLISHMENT

1. For the purposes of this Convention, the term "permanent establishment" means a fixed place of business or production through which the activities of an enterprise are wholly or partially carried on.

2. The term "permanent establishment" shall include especially:

(*a*) A place of management;

(*b*) A branch;

(*c*) An office;

(*d*) A factory;

(*e*) A workshop; and

(*f*) A mine, an oil or gas well, a quarry, or any other place of extraction of natural resources.

3. A building site or construction or installation project, or an installation or drilling rig or ship used for the exploration or development of natural resources, shall constitute a permanent establishment only if it lasts more than 24 months.

4. Notwithstanding the preceding provisions of this Article, the term "permanent establishment" shall be deemed not to include:

(a) The use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

(b) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

(c) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(d) The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise;

(e) The maintenance of a fixed place of business solely for the purpose of carrying on for the enterprise any other activity if it has a preparatory or auxiliary character; and

(f) The maintenance of a fixed place of business solely for any combination of the activities mentioned in subparagraphs a) to e) of this paragraph.

5. Notwithstanding the provisions of paragraphs 1 and 2, where a person—other than an agent of an independent status to whom paragraph 6 applies—is acting on behalf of an enterprise and has, and habitually exercises in a Contracting State, an authority to conclude contracts in the name of such enterprise, that enterprise shall be deemed to have a permanent establishment in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in paragraph 4 which, if exercised at a fixed place of business, would not make this place of business a permanent establishment under the provisions of that paragraph.

6. An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

7. The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either company a permanent establishment of the other.

Article 6

INCOME FROM IMMOVABLE PROPERTY (REAL PROPERTY)

1. Income derived by a resident of a Contracting State from immovable property (real property) situated in the other Contracting State may be taxed in that other State.

2. The term "immovable property" shall have the meaning which it has under the law of the Contracting State in which the property in question is situated. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting land property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property.

3. The provisions of paragraph 1 shall apply to income derived from the direct use, letting, or use in any other form of immovable property.

4. The provisions of paragraphs 1 and 3 shall also apply to the income from immovable property of an enterprise and to income from immovable property used for the performance of independent personal services.

Article 7

BUSINESS PROFITS

1. The business profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the business profits of the enterprise may be taxed in that other State but only so much of them as is attributable to that permanent establishment.

2. Subject to the provisions of paragraph 3, where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the business profits which it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions.

3. In the determination of the business profits of a permanent establishment, there shall be allowed as deductions those expenses which are incurred for the purposes of the permanent establishment, including a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the purposes of the enterprise as a whole (or the part thereof which includes the permanent establishment), whether incurred in the State in which the permanent establishment is situated or elsewhere.

4. No business profits shall be attributed to a permanent establishment by reason of:

(*a*) The mere purchase by that permanent establishment of goods or merchandise for the enterprise, or

(*b*) The mere delivery to the permanent establishment of goods or merchandise for its use.

5. Where business profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

Article 8

SHIPPING AND AIR TRANSPORT

1. Profits of an enterprise of a Contracting State from the operation in international traffic of ships or aircraft shall be taxable only in that State.

2. For purposes of this Article, profits from the operation of ships or aircraft in international traffic include profits derived from the rental on a full or bareboat basis of ships or aircraft operated in international traffic if such rental profits are incidental to other profits described in paragraph 1.

3. Profits of an enterprise of a Contracting State from the use, maintenance or rental of containers (including trailers and related equipment for the transport of containers) used for the transport of goods or merchandise in international traffic shall be taxable only in that State.

4. The provisions of this Article shall also apply where the enterprise has an agency in the other State for the transportation of goods or persons, but only to the extent of activities directly connected with the business of shipping and aircraft transportation, including auxiliary activities connected therewith.

Article 9

DIVIDENDS

1. Dividends paid by a company which is a resident of a Contracting State to a resident of the other Contracting State may be taxed in that other State.

2. However, such dividends may be taxed in the Contracting State of which the company paying the dividends is a resident, and according to the law of that State, but if the beneficial owner of the dividends is a resident of the other Contracting State, the tax so charged shall not exceed:

(*a*) Five percent of the gross amount of the dividends if the beneficial owner is a company which owns, directly or indirectly, at least 10 percent of the voting stock of the company paying the dividends;

(*b*) In all other cases, 15 percent of the gross amount of the dividends.

This paragraph shall not affect the taxation of the company in respect of the profits out of which the dividends are paid.

3. The term "dividends" as used in this Article means income from shares or other rights, not being debt-claims, participating in profits, as well as income from other corporate rights which is subjected to the same taxation treatment as income from shares by the taxation law of the State of which the company making the distribution is a resident.

4. The provisions of paragraphs 1 and 2 shall not apply if the recipient of the dividends, being a resident of a Contracting State, carries on business in the other Contracting State, of which the company paying the dividends is a resident, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base. In such case, the provisions of Article 7 (Business Profits) or Article 13 (Independent Personal Services), as the case may be, shall apply.

5. Where a company is a resident of a Contracting State, the other Contracting State may not impose any tax on the dividends paid by the company, except insofar as:

(*a*) Such dividends are paid to a resident of that other State,

(*b*) The holding in respect of which the dividends are paid is effectively connected with a permanent establishment or a fixed base situated in that other State, or

(*c*) Such dividends are paid out of profits attributable to a permanent establishment which such company had in that other State, provided that at least 50 percent of such company's gross income from all sources was attributable to a permanent establishment which such company had in that other State.

Where subparagraph (c) applies and subparagraphs (a) and (b) do not apply, any such tax shall be subject to the limitations of paragraph 2.

Article 10

INTEREST

1. Interest arising in a Contracting State and paid to a resident of the other Contracting State shall be taxable only in that other State.

2. The term "interest" as used in this Convention means income from debt-claims of every kind, whether or not secured by mortgage, and whether or not carrying a right to participate in the debtor's profits, and in particular, income from government securities and income from bonds or debentures, including premiums or prizes attaching to bonds or debentures.

3. The provisions of paragraph 1 shall not apply if the person deriving the interest, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the debt claim in respect of which the interest is paid is effectively connected with such permanent establishment or fixed base. In such a case, the provisions of Article 7 (Business Profits) or Article 13 (Independent Personal Services), as the case may be, shall apply.

Article 11

Royalties

1. Royalties arising in a Contracting State and paid to a resident of the other Contracting State shall be taxable only in that other State.

2. The term "royalties" as used in this Article means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including cinematographic films or films or tapes used for radio or television broadcasting, any patent, trade mark, design or model, plan, secret formula or process, or other like right or property, or for information concerning industrial, commercial or scientific experience.

3. The provisions of paragraph 1 shall not apply if the person deriving the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment or fixed base. In such a case the provisions of Article 7 (Business Profits) or Article 13 (Independent Personal Services), as the case may be, shall apply.

Article 12

Capital Gains

1. Gains derived by a resident of a Contracting State from the alienation of immovable property, as defined in paragraph 2 of Article 6 (Immovable Property), situated in the other Contracting State may be taxed in that other State.

2. Gains from the alienation of movable property forming part of the business property of a permanent establishment which an enterprise of a Contracting State has in the other Contracting State or of movable property pertaining to a fixed base available to a resident of a Contracting State in the other Contracting State for the purpose of performing independent personal services, including such gains from the alienation of such a permanent establishment (alone or together with the whole enterprise) or of such a fixed base, may be taxed in the other State. However, gains derived by an enterprise of a Contracting State from the alienation of ships, aircraft or containers operated by such enterprise in international traffic shall be taxable only in that State.

3. Gains from the alienation of any property other than those mentioned in paragraphs 1 and 2, shall be taxable only in the Contracting State of which the alienator is a resident.

Article 13

Independent Personal Services

1. Income derived by an individual who is a resident of a Contracting State from the performance of personal services in an independent capacity shall be taxable only in that State unless such services are performed in the other Contracting State and—

(*a*) The individual is present in that other State for a period or periods aggregating more than 183 days in the taxable year concerned, or

(*b*) The individual has a fixed base regularly available to him in that other State for the purpose of performing his activities, but only so much of the income as is attributable to that fixed base.

2. The term "personal services" includes, especially, independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists, artistes, athletes and accountants.

Article 14

Dependent Personal Services

1. Subject to the provisions of Article 15 (Pensions) and 16 (Government Service), salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

2. Notwithstanding the provisions of paragraph 1, remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

(*a*) The recipient is present in the other State for a period or periods not exceeding in the aggregate 183 days in the taxable year concerned, and

(*b*) The remuneration is paid by, or on behalf of, an employer who is not a resident of the other State, and

(*c*) The remuneration is not borne by a permanent establishment or a fixed base which the employer has in the other State.

3. Notwithstanding the preceding provisions of this Article, remuneration in respect of an employment as a member of the regular complement of a ship or aircraft operated by an enterprise of a Contracting State in international traffic may be taxed only in that Contracting State.

Article 15

Pensions

Subject to the provisions of paragraph 2 of Article 16 (Government Services),

1. Pensions and other similar remuneration beneficially derived by a

resident of a Contracting State in consideration of past employment shall be taxable only in that State, and

2. Social security payments and other public pensions paid by a Contracting State to an individual who is a resident of the other Contracting State or a citizen of the United States shall be taxable only in the first-mentioned Contracting State.

Article 16

GOVERNMENT SERVICES

1(*a*) Remuneration other than a pension, paid by a Contracting State or a political subdivision or a local authority thereof to any individual in respect of services rendered to that State or subdivision or local authority thereof shall be taxable only in that State.

(*b*) However, such remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the recipient is a resident of that other Contracting State who:

(i) Is a national of that State; or

(ii) Did not become a resident of that State solely for the purpose of performing the services.

2(*a*) Any person paid by, or out of funds created by, a Contracting State or a political subdivision or a local authority thereof to any individual in respect of services rendered to that State or subdivision or local authority thereof shall be taxable only in that State.

(*b*) However, such pension shall be taxable only in the other Contracting State if the recipient is a national of and a resident of that State.

3. The provisions of Article 13 (Independent Personal Services), 14 (Dependent Personal Services), and 15 (Pensions), as the case may be, shall apply to remuneration and pensions in respect of services rendered in connection with any business carried on by a Contracting State or a political subdivision or a local authority thereof.

Article 17

TEACHERS

1. Where a resident of one of the Contracting States is invited by the Government of the other Contracting State, a political subdivision or a local authority thereof, or by a university or other recognized educational institution in that other Contracting State to come to that other Contracting State for a period not expected to exceed 2 years for the purpose of teaching or engaging in research, or both, at a university or other recognized educational institution, and such resident comes to that other Contracting State primarily for such purpose, his income from personal services for teaching or research at such university or educational institution shall be exempt from tax by that other Contracting State for a period not exceeding 2 years from the date of his arrival in that other Contracting State.

2. This Article shall not apply to income from research if such research is undertaken not in the public interest but primarily for the private benefit of a specific person or persons.

Article 18

STUDENTS AND TRAINEES

1. Payments which a student, apprentice or business trainee who is, or was immediately before visiting a Contracting State, a resident of the other Contracting State and who is present in the first-mentioned Contracting State for the purpose of his full-time education or training receives for the purposes of his maintenance, education or training shall not be taxed in that State provided that such payments are made to him from sources outside that State.

2. An individual to whom paragraph 1 applies may elect to be treated for tax purposes as a resident of the first-mentioned State. The election shall apply to all periods during the taxable year of the election and subsequent taxable years during which the individual qualifies under paragraph 1, and may not be revoked except with the consent of the competent authority of that State.

Article 19

ALL OTHER INCOME

Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State.

Article 20

RELIEF FROM DOUBLE TAXATION

1. In the case of the United States, double taxation shall be avoided as follows: In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a resident or citizen of the United States as a credit against the United States tax on income the appropriate amount of tax paid to the Hungarian People's Republic; and, in the case of a United States company owning at least 10 percent of the voting stock of a company which is a resident of the Hungarian People's Republic from which it receives dividends in any taxable year, the United States shall allow as a credit against the United States tax on income the appropriate amount of income tax paid to the Hungarian People's Republic by that company with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of income tax paid to the Hungarian People's Republic, but the credit shall not exceed the limitations (for the purpose of limiting the credit to the United States tax on income from sources outside of the United States) provided by United States law for the taxable year. For purposes of applying the United States credit in relation to tax paid to the Hungarian People's Republic, the taxes referred to in paragraphs 2(b) and 3 of Article 2 (Taxes Covered) shall be considered to be income taxes.

2. In the case of the Hungarian People's Republic, double taxation shall be avoided as follows:

(*a*) Where a resident of the Hungarian People's Republic:

(i) Derives income which, in accordance with the provisions of this Convention other than paragraph 2 of Article 1 (Personal Scope), may be taxed in the United States, or

(ii) Derives income from sources within the United States which may be taxed only by reason of paragraph 2 of Article 1 (Personal Scope),

the Hungarian People's Republic shall, subject to the provisions of subparagraphs (b) and (c), exempt such income from tax.

(*b*) Where a resident of the Hungarian People's Republic derives items of income which, in accordance with the provisions of paragraph 2 of Article 9, may be taxed in the United States, the Hungarian People's Republic shall allow as a deduction from the tax on the income of that resident an amount equal to the tax paid in the United States. Such deduction shall not, however, exceed that part of the tax, as computed before the deduction is given, which is attributable to such items of income derived from the United States.

(*c*) Where in accordance with any provision of the Convention income derived by a resident of the Hungarian People's Republic is exempt from tax in the Hungarian People's Republic, the Hungarian People's Republic may nevertheless, in calculating the amount of tax on the remaining income of such resident, take into account the exempted income.

Article 21

NON-DISCRIMINATION

1. The nationals of a Contracting State, whether or not they are residents of one of the Contracting States, shall not be subjected in the other State to any taxation or any requirement connected therewith, which is more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected. For purposes of the preceding sentence, nationals who are subject to tax by a Contracting State on worldwide income are not in the same circumstances as nationals who are not so subject.

2. The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favorably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities. This Article shall not be construed as obliging a Contracting State to grant to residents of the other Contracting State any personal allowances, reliefs and reductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

3. Interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable profits of such enterprise, be deductible under the same conditions as if they had been paid to a resident of the first-mentioned State. Similarly, any debts of an enterprise of a Contracting State to a resident of the other Contracting State shall, for the purpose of determining the taxable capital of such enterprise, be deductible under the same conditions as if they had been contracted to a resident of the first-mentioned State.

4. Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned Contracting State to any taxation or any requirement connected therewith which is more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

5. In this Article the term "taxation" means taxes of every kind and description imposed by a Contracting State or a political subdivision or local authority thereof.

Article 22

MUTUAL AGREEMENT PROCEDURE

1. Where a resident or national of a Contracting State considers that the actions of one or both of the Contracting States result or will result for it in taxation not in accordance with this Convention, it may, notwithstanding the remedies provided by the national laws of those States, present its case to the competent authority of the Contracting State of which it is a resident or national.

2. The competent authority shall endeavor, if the objection appears to it to be justified and if it is not itself able to arrive at an appropriate solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State with a view to the avoidance of taxation not in accordance with the Convention. Any agreement reached shall be implemented notwithstanding any time limits in the national laws of the Contracting States.

3. The competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. They may also consult together for the elimination of double taxation in cases not provided for in the Convention.

4. The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of the preceding paragraphs.

5. The competent authorities of the Contracting States may prescribe regulations to carry out the purposes of this Convention.

Article 23

EXCHANGE OF INFORMATION

1. The competent authorities of the Contracting States shall exchange such information as is necessary for the carrying out of this Convention or of the domestic laws of the Contracting States concerning taxes covered by this Convention insofar as the taxation thereunder is not contrary to this Convention. The exchange of information is not restricted by Article 1 (Personal Scope). Any information received by a Contracting State shall be treated as secret in the same manner as information obtained under the domestic laws of that State and shall be disclosed only to persons or authorities (including courts and administrative bodies) involved in the assessment or collection of, the enforcement or prosecution in respect of, or the determination of appeals in relation to, the taxes which are the subject of the Convention. Such persons or authorities shall use the information only for such pur-

poses. These persons or authorities may disclose the information in public court proceedings or in judicial decisions.

2. In no case shall the provisions of paragraph 1 be construed so as to impose on one of the Contracting States the obligation:

(*a*) To carry out administrative measures at variance with the laws and administrative practice of that or of the other Contracting State;

(*b*) To supply particulars which are not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

(*c*) To supply information which would disclose any trade, business, industrial, commercial or professional secret or trade process, or information, the disclosure of which would be contrary to public policy (order public).

3. If information is requested by a Contracting State in accordance with this Article, the other Contracting State shall obtain the information to which the request relates in the same manner and to the same extent as if the tax of the first-mentioned State were the tax of that other State and were being imposed by that other State. If specifically requested by the competent authority of a Contracting State, the competent authority of the other Contracting State shall provide information under this Article in the form of depositions of witnesses and copies of unedited original documents (including books, documents, statements, records, accounts, or writings), to the same extent such depositions and documents can be obtained under the laws and administrative practices of such other State with respect to its own taxes.

Article 24

EFFECT OF CONVENTION ON DIPLOMATIC AND CONSULAR OFFICIALS, DOMESTIC LAWS, AND OTHER TREATIES

1. Nothing in this Convention shall affect the taxation privileges of diplomatic or consular officials under the general rules of international law or under the provisions of special agreements.

2. This Convention shall not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded—

(*a*) By the laws of either Contracting State, or

(*b*) By any other agreement between the Contracting States.

Article 25

ENTRY INTO FORCE

1. This Convention shall be subject to ratification or approval in accordance with the applicable procedures of the Governments of the Contracting States and it shall enter into force as soon as the parties have notified one another that their respective constitutional requirements have been met.

2. The provisions of this Convention shall have effect:

(*a*) In respect of tax withheld at the source, to amounts paid or credited on or after the first day of the second month next following the date on which this Convention enters into force,

(*b*) In respect of other taxes, to taxable periods beginning on or after the first day of January next following the date on which this Convention enters into force.

Article 26

TERMINATION

This Convention shall remain in force until terminated by the Government of one of the Contracting States. The Government of either Contracting State may terminate the Convention at any time after 5 years from the date on which this Convention enters into force provided that at least 6 months' prior notice of termination has been given through diplomatic channels. In such event, the Convention shall cease to have effect:

1. In respect of tax withheld at the source, to amounts paid or credited on or after the first day of January next following the expiration of the 6 months' period;

2. In respect of other taxes, to taxable periods beginning on or after the first day of January next following the expiration of the 6 months' period.

Done at Washington in duplicate, both in the English and Hungarian languages, the two texts having equal authenticity, this 12th day of February 1979.

W. MICHAEL BLUMENTHAL,
Secretary of the Treasury.

For the Government of the Hungarian People's Republic:

LAJOS FALUVEGI,
Minister of Finance.

FEBRUARY 12, 1979.

His Excellency
W. MICHAEL BLUMENTHAL,
Secretary of the Treasury,
United States of America.

EXCELLENCY: In connection with the Income Tax Convention signed today, I should like to state our understanding of the agreement reached by the delegations of the United States of America and of the Hungarian People's Republic concerning the application of certain provisions of the Convention:

1. In connection with Article 9, subparagraph 5(c), it is understood that Hungary will not impose a tax in such cases.

2. Income (other than income from immovable property) will be taxed in accordance with the provisions of Article 7 and Article 13, rather than in accordance with the provisions of Article 19, if the person deriving the income, being a resident of one Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base.

3. In the case of dealings between an enterprise of one Contracting State and a related enterprise of the other Contracting State that involve conditions that differ from those that would have been made between independent enterprises, each Contracting State may apply its internal law to distribute, apportion or allocate income, deductions, credits and allowances be-

tween the related enterprises, to reflect any profits which would, but for those conditions, have accrued to one of the enterprises. The internal law of each Contracting State may also be applied to restrict the exemption of interest provided in paragraph 1 of Article 10 and of royalties provided in paragraph 1 of Article 11 to the amount of interest and royalties that would have been agreed upon between unrelated parties in cases where interest and royalties are paid by an enterprise of one Contracting State to a related enterprise in the other Contracting State.

4. It is agreed that each of the Contracting States shall endeavor to collect on behalf of the other Contracting State such amounts as may be necessary to ensure that relief granted by the present Convention from taxation imposed by such other Contracting State does not enure to the benefit of persons not entitled thereto. This agreement shall not impose upon either of the Contracting States the obligation to carry out administrative measures which are of a different nature from those used in the collection of its own tax, or which would be contrary to its sovereignty, security, or public policy.

I have the honor to propose to you that the present note and Your Excellency's reply thereto constitute the agreement of our two Governments on these points.

Accept, Excellency, the assurances of my highest consideration.

Sincerely yours,

LAJOS FALUVEGI,
Minister of Finance,
Hungarian People's Republic.

FEBRUARY 12, 1979.

His Excellency LAJOS FALUVEGI,
Minister of Finance,
Hungarian People's Republic.

EXCELLENCY: I have the honor to refer to your letter of today's date concerning the Income Tax Convention signed today reading as follows:

In connection with the Income Tax Convention signed today, I should like to state our understanding of the agreement reached by the delegations of the United States of America and of the Hungarian People's Republic concerning the application of certain provisions of the Convention:

1. In connection with Article 9, subparagraph 5(c), it is understood that Hungary will not impose a tax in such cases.

2. Income (other than income from immovable property) will be taxed in accordance with the provisions of Article 7 and Article 13, rather than in accordance with the provisions of Article 19, if the person deriving the income, being a resident of one Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base.

3. In the case of dealings between an enterprise of one Contracting State and a related enterprise of the other Contracting State that involve conditions that differ from those that would have been made between independent enterprises, each Contracting State may apply its internal law to distribute, apportion or allocate income, deductions, credits and allowances between the related enterprises, to reflect any profits which would, but for those conditions, have accrued to one of the enterprises. The internal law of each Contracting State may also be applied to restrict the exemption of interest provided in paragraph 1 of Article 10 and of royalties provided in paragraph 1 of Article 11 to the amount of interest and royalties that would have been agreed upon between unrelated parties in cases where interest and royalties are paid by an enterprise of one Contracting State to a related enterprise in the other Contracting State.

4. It is agreed that each of the Contracting States shall endeavor to collect on behalf of the other Contracting State such amounts as may be necessary to ensure that relief granted by the present Convention from taxation imposed by such other Contracting State does not enure to the benefit of persons not entitled thereto. This agreement shall not impose upon either of the Contracting States the obligation to carry out administrative measures which are of a different nature from those used in the collection of its own tax, or which would be contrary to its sovereignty, security or public policy.

I wish to inform you that I agree with the contents of your letter. Accept, Excellency, the assurance of my highest consideration.

Sincerely yours,

W. MICHAEL BLUMENTHAL.

Senate Executive Report No. 96-8

[Bracketed numerals indicate official report page numbers]

TAX CONVENTION WITH THE HUNGARIAN PEOPLE'S REPUBLIC

JUNE 15, 1979

Mr. CHURCH, from the Committee on Foreign Relations, submitted the following report to accompany Ex. X, 96th Cong., 1st sess.

The Committeee on Foreign Relations, to which was referred the Tax Treaty with the Hungarian People's Republic ("Hungary")[1] for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income (Executive X), as amplified by a concurrent Exchange of Notes (collectively referred to as the proposed treaty), having considered the same, reports favorably thereon without reservation and recommends that the Senate give its advice and consent to ratification thereof.

I. PURPOSE

There is presently no income tax treaty in force between the United States and Hungary. The proposed treaty is intended to reduce or eliminate double taxation of income earned in one country by residents of the other country and deals with administrative matters between the United States and Hungary, and to promote closer economic cooperation and more active trade between the two countries.

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[1] Page 17; Technical Explanation, page 36; Senate Executive X is not published.

The proposed treaty with Hungary was signed on February 12, 1979, and was amplified by an Exchange of Notes signed the same day. The Tax Treaty and the Exchange of Notes were transmitted to the Senate on May 9, 1979.

[2] III. SUMMARY OF TREATY

The proposed treaty is similar to other recent U.S. income tax treaties and to the model income tax treaty of the Organization of Economic Cooperation and Development (OECD) in virtually all respects.

As in other U.S. tax treaties, the objectives of the treaty are principally achieved by each country's agreeing to limit, in certain specified situations, its right to tax income derived from its territory by residents of the other. For example, the treaty contains the standard tax treaty provision that neither country will tax the business income derived from sources within that country by residents of the other unless the business activities in the taxing country are substantial enough to constitute a branch or other permanent establishment or fixed base (*Article 7*). Similarly, the treaty contains standard "commercial visitor" exemptions under which residents of one country performing personal services will not be required to file tax returns and pay tax in the other unless their contacts with the other exceed certain specified minimums (*Articles 13 through 18*). Also, the proposed treaty provides that interest, royalties, capital gains and certain other income derived by residents of either country from sources within the other are generally to be taxed only by the country of residence and not by the country of source (*Articles 10, 11, 12 and 19*), and that dividends received by residents of one country from sources within the other are to be taxed at reduced rates by the country of source (*Article 9*).

In situations where the country of source retains the right under the proposed treaty to tax income derived by residents of the other country, the treaty generally provides for the relief by the country of residence of the potential double taxation (*Article 20*) through a foreign tax credit (in the case of the United States) or an exemption (in the case of Hungary).

The treaty contains the standard provision (the "saving clause") contained in U.S. tax treaties that each country retains the right to tax its citizens and residents as if the treaty had not come into effect (*Article 1*). In addition, it contains the standard provision that the treaty will not be applied to deny any taxpayer any benefits he would be entitled to under the domestic law of either country or under any other agreement between the two countries (*Article 24*); that is, the treaty generally will be applied only to the benefit of taxpayers.

The treaty also contains standard nondiscrimination provisions and provides for exchanges of information and administrative cooperation between the tax authorities of the two countries to avoid double taxation and prevent fiscal evasion with respect to income taxes.

[3] IV. DATE OF ENTRY INTO FORCE AND TERMINATION

Entry into force

The proposed treaty will enter into force as soon as the United States and Hungary notify each other that their constitutional requirements for ratification have been met (in the case of the United States, upon its presentation of an instrument of ratification). With respect to taxes withheld at source, it will apply to income paid or credited on or after the first day of the second month following the date on which it enters into force. This would apply to dividends (*Article 9*), interest (*Article 10*), royalties (*Article 11*), and annuities and other fixed and determinable annual or periodic income which is not specifically covered by any article (*Article 19*). With respect to all other taxes, it will become effective for taxable years beginning on or after January 1 of the year following the date on which the proposed treaty comes into force.

Termination

The proposed treaty will continue in force indefinitely, but either country may terminate it at any time after 5 years from its entry into force by giving at least 6 months' prior notice through diplomatic channels. If terminated, the termination will be effective with respect to income of taxable years beginning (or, in the case of withholding taxes, payments of income made) on or after January 1 next following the expiration of the 6-month period.

V. COMMITTEE ACTION

The Committee on Foreign Relations held a public hearing on the proposed treaty and other tax treaties on June 6, 1979. The Committee considered the proposed treaty on June 12, 1979 and ordered it favorably reported by a vote of 13 yeas, no nays, with the recommendation that the Senate give its advice and consent to ratification of the treaty.

VI. BUDGET IMPACT

The Committee estimates that the effect of the proposed treaty on budget receipts will be negligible.

In accordance with the objectives of section 403 of the Budget Act, the Committee advises that the Director of the Congressional Budget Office has examined the Committee's budget estimate and agrees that the effect on budget receipts will be negligible. In keeping with section 308(a) of the Budget Act, and after consultation with the Director of the Congressional Budget Office, the Committee states that the treaty does not provide any new budget authority or any new or increased tax expenditures.

[4] VII. EXPLANATION OF TREATY PROVISIONS

Set forth below is a comprehensive article-by-article explanation of the proposed income tax treaty between the United States and Hungary.

Article 1. Personal scope

The proposed treaty applies generally to residents of the United States and to residents of Hungary, with specific exceptions designated in other articles. This follows other U.S. income tax treaties and the OECD model income tax treaty.

The proposed treaty contains the "saving clause" contained in all U.S. income tax treaties which provides, with specified exceptions, that the treaty is not to affect the taxation by the United States of its citizens and residents or the taxation by Hungary of its citizens and residents. Residents for purposes of the treaty (and thus for purposes of the saving clause) include corporations and other entities as well as individuals (*Article 4. Fiscal domicile*). In the case of the United States, the saving clause also extends to former citizens. (Under section 877 of the Internal Revenue Code, an individual who gives up U.S. citizenship is subject to U.S. tax on his U.S.-source income as if he were still a U.S. citizen if one of his principal purposes in giving up U.S. citizenship was to avoid U.S. tax.)

Exceptions to the saving clause are provided for the benefits conferred by the articles dealing with pensions (*Article 15*), relief from double taxation (*Article 20*), nondiscrimination (*Article 21*), and mutual agreement procedures (*Article 22*); thus, the benefits of those articles will be conferred by each country on its own citizens and residents as well as the citizens and residents of the other. In addition, the benefits conferred by the articles dealing with the taxation of income received by government employees (*Article 16*), teachers (*Article 17*), students and trainees (*Article 18*), and diplomatic and consular officials (*Article 24*) are to be provided for each country to its residents provided those residents are neither citizens of, nor have immigrant status in, that country.

Consequently, except for the exceptions to the saving clause set forth above, U.S. citizens and residents generally benefit under the treaty as the result of the agreement by Hungary to reduce its rate of tax on their income or exempt their income from tax rather than as the result of reductions in tax or exemptions by the United States. Even in this situation, if the tax which is foregone by Hungary could have otherwise been claimed in full by the U.S. taxpayers as a foreign tax credit, the real beneficiary of the reduction or elimination of the Hungarian tax would, as a practical matter, be the U.S. Treasury rather than the U.S. taxpayer. Similarly, except as noted above, Hungarian citizens and residents benefit under the treaty only to the extent that the United States agrees to reduce its tax on their income or to exempt their income from tax.

[5] *Article 2. Taxes covered*

In the case of the United States, the proposed treaty applies to the Federal income taxes imposed under the Internal Revenue Code and to the excise taxes imposed on insurance premiums paid to foreign insurers and with respect to private foundations. However, it does not apply to the accumulated earnings tax or the personal holding company tax. In the case of Hungary, the treaty applies to the general income tax, the income tax on intellectual activities, the profit tax, the profit tax on economic associations with foreign participation, the enterprises special tax, the levy on dividends and profit distributions of commercial companies, the profit tax on state-owned enterprises, and the contribution to communal development (but only to the extent that the contribution is required in respect of income taxes covered by the treaty).

The proposed treaty also contains a provision generally found in U.S. income tax treaties to the effect that it will apply to substantially similar taxes which either country may subsequently impose. Each country is obligated under the treaty to notify the other of any changes it makes in its tax laws and of any official published material concerning the treaty, including explanations, regulations, rulings, and judicial determinations.

Additionally, the nondiscrimination provisions (*Article 21*) of the treaty apply to all taxes of every kind imposed at the national, state, or local level by the United States or Hungary. The exchange of information provisions (*Article 23*) of the proposed treaty will also apply to all taxes of every kind imposed by the two countries at the national level.

Article 3. General definitions

Certain of the standard definitions found in most U.S. income tax treaties are contained in the proposed treaty.

Under the proposed treaty, the term "United States" when used in a geographical sense does not apply to Puerto Rico, the Virgin Islands, Guam or any other possession or territory of the United States.

A "national" of either country is defined to include both a citizen of that country and also any legal entity such as a corporation, trust, estate, partnership, or association which is established under the laws of that country. A "company" is defined as a corporation or other entity treated as a corporation for tax purposes. An enterprise of a country is defined as an enterprise carried on by a resident of that country. Although the treaty does not define the term "enterprise," it would have the same meaning that it has in other U.S. tax treaties—the trade or business activities undertaken by an individual, partnership, corporation, or other entity.

The proposed treaty also contains the standard provision that, unless the context otherwise requires or the competent authorities of the two countries establish a common meaning, any terms are to have the meaning which they have under the applicable tax laws of the country applying the treaty.

Article 4. Fiscal domicile

The benefits of the proposed treaty generally are available only to residents of the two countries. Under the treaty, a person (either an [6] individual or an entity such as a corporation or partnership) is considered to be a resident of either country if, under the laws of that country, the person is subject to taxation by that country because it is the country of domicile, residence, citizenship, place of management, place of incorporation, or other criterion of similar nature. A person will not be considered to be a resident of a country if he is only taxable on his income from sources within that country or on his assets located in that country. A partnership, estate, or trust will be considered to be a resident of either country only to the extent that the income it derives is subject to tax, either in its hands or in the hands of its partners or beneficiaries, as the income of a resident of the country.

This provision of the proposed treaty is generally based on the fiscal domicile article of the OECD model tax treaty and is similar to the provisions found in other U.S. tax treaties. However, a significant difference between the definition of resident in this treaty and the definition in other recent U.S. income tax treaties, and consequently a significant difference in the coverage of the treaty, is that the term resident includes an individual who is subject to worldwide taxation on the basis of citizenship. As a result, U.S. citizens residing overseas (in countries other than Hungary) are entitled to the benefits of the treaty as U.S. residents. (Moreover, if they reside in Hungary, they are still allowed the benefits afforded U.S. residents which are unaffected by the saving clause.) Since Hungary generally taxes on a residency basis rather than on a citizenship basis, this broadened definition of resident does not benefit citizens of Hungary who are not Hungarian residents. However, Hungary does tax certain of its nationals who work overseas for the Hungarian Government (or its instrumentalities), and a special rule is provided under which these individuals and their families are treated as residents of Hungary entitled to the benefits of the treaty.

A set of rules is provided to determine residence in the case of a person who, under the basic treaty definition, would be considered to be a resident of both countries (e.g., a U.S. citizen and resident in Hungary). In the case of a dual resident individual, the individual will be deemed for all purposes of the treaty to be a resident only of the country in which he has his permanent home (where an individual dwells with his family), his center of vital interests (his closest economic and personal relations), his habitual abode, or his citizenship. If the residence of an individual cannot be determined by these tests, applied in the order stated, the competent authorities of the countries will settle the question by mutual agreement. In the case of a dual resident corporation which is created or organized under the laws of either country (or a political subdivision), the corporation will be treated as a resident only of that country. In the case of a dual resident person, other than an individual or a corporation (e.g., a dual resident partnership, trust, or estate), the residence of the person and the mode of application of the treaty will be determined by the competent authorities.

Article 5. Definition of permanent establishment

The proposed treaty contains a definition of permanent establishment which follows the pattern of other recent U.S. income tax treaties and the OECD model tax treaty. The permanent establish-[7]ment concept is one of the basic devices used in income tax treaties to avoid double taxation. Generally, a resident of one country is not taxable on its business profits by the other country unless those profits are attributable to a permanent establishment of the resident in the other country. In addition, the permanent establishment concept is used to determine whether the reduced rates of, or exemptions from, tax provided for dividends, interest, and royalties are applicable.

In general, a fixed place of business through which a resident of one country engages in business in the other country is considered a permanent establishment. This includes a place of management; a branch; an office; a factory; a workshop; or a mine, an oil or gas well, a quarry, or other place of extraction of natural resources. It also includes any building site, construction or installation project, or an installation or drilling rig or ship used for the exploration or development of natural resources, but only if the site, project, etc., lasts for more than 24 months.

This general rule is modified to provide that a fixed place of business which is only used for any or all of a number of specified activities will not constitute a permanent establishment. These activities include the use of facilities for storing, displaying, or delivering merchandise belonging to the resident; the maintenance of a stock of goods belonging to the resident for purposes of storage, display, delivery, or processing by another person, or the purchase of goods or merchandise, collection of information, or any other preparatory or auxiliary activities for the resident.

If a resident of one country maintains an agent in the other country who has, and regularly exercises, the authority to enter into contracts in that other country in the name of the resident, then the resident will be deemed to have a permanent establishment in the other country with respect to the activities which the agent undertakes on its behalf. This rule does not apply where the contracting authority is limited to those activities (described above) such as storage, display, or delivery of merchandise which are excepted from the definition of permanent establishment. The proposed treaty contains the usual provision that the agency rule will not apply if the agent is a broker, general commission agent, or other agent of independent status acting in the ordinary course of its business.

The fact that a company which is a resident of one country controls or is controlled by a company which is a resident of the other country or which carries on business in that other country (whether through a permanent establishment or otherwise), will not of itself constitute either company a permanent establishment of the other.

Article 6. Income from immovable property (real property)

The proposed treaty provides that income from real property may be taxed in the country where the real property or natural resources are located. For purposes of the treaty, real property will generally have the meaning provided under the laws of the country where the property is located, but will in any case include property which is accessory to real property, livestock and equipment used in agriculture and forestry, and rights to real property. Ships, boats, and aircraft will not be considered real property.

[8] Income from real property includes income from the direct use or renting of the property. It also includes royalties and other payments in respect of the exploitation of natural resources (e.g., oil wells) and gains on the sale, exchange, or other disposition of the royalty rights or the underlying natural resources. It does not include interest on loans secured by real property. Under Article 12 (*Capital gains*), gains on the sale, exchange, or other disposition of the property may also be taxed by the country where the property is located.

Article 7. Business profits

Under the proposed treaty, business profits of an enterprise of one country are taxable in the other country only to the extent they are attributable to a permanent establishment in the other country through which the enterprise carries on business.

The business profits of a permanent establishment are determined on an arm's-length basis. Thus, there is to be attributed to it the business profits which would reasonably be expected to have been derived by it if it were an independent entity engaged in the same or similar activities under the same or similar conditions and dealing at arm's-length with the resident of which it is a permanent establishment.

In computing taxable business profits, deductions are allowed for all expenses, wherever incurred, which are incurred for purposes of the permanent establishment. These deductions include a reasonable allocation of executive and general administrative expenses, interest, and other expenses which are incurred for purposes of the enterprise as a whole (or for purposes of that part of the enterprise which includes the permanent establishment). Thus, for example, a U.S. company which has a branch office in Hungary but which has its head office in the United States will, in computing the Hungarian tax liability of the branch, be entitled to deduct a portion of the executive and general administrative expenses incurred in the United States by the head office for purposes of administering the Hungarian branch. Business profits will not be attributed to a permanent establishment merely by reason of the purchase of merchandise by the permanent establishment for the account of the enterprise, or by reason of the delivery to the permanent establishment of goods or merchandise for its use. Thus, where a permanent establishment purchases goods for its head office, the business profits attributed to the permanent establishment with respect to its other activities will not be increased by a profit element on its purchasing activities.

Where business profits include items of income which are dealt with separately in other articles of the treaty, those other articles, and not this business profits article, will govern the treatment of those items of income.

Article 8. Shipping and air transport

The proposed treaty provides that income which is derived by an enterprise of either country from the operation of ships and aircraft in international traffic shall be exempt from tax by the other country. International traffic means any transportation by ship or aircraft, except where the transportation is solely between places in the other country (*Article 3(1)(e). Definitions*). The exemption applies whether or not the ships or aircraft are registered in the first country.

[9] The exemption for shipping and air transport profits applies to profits from the rental on a full or bareboat basis of ships or aircraft operated in international traffic if such rental profits are incidental to the actual operation of ships and aircraft in international traffic. (Rental on a full or bareboat basis refers to whether the ships or aircraft are leased fully equipped, manned and supplied or not.) Income from the operation in international traffic of ships or aircraft also includes income derived from the use, maintenance, or rental of containers, trailers for the inland transportation of containers, and other related equipment where the equipment is used to transport goods and merchandise.

The shipping and air transport exemption also applies where an enterprise has an agency in the other country for the transportation of goods or persons (e.g., an airline office), but the exemption only applies to the extent of activities directly connected with the business of shipping and aircraft transportation (including auxiliary activities).

Article 9. Dividends

Each country may tax dividends paid by its companies to shareholders resident in the other (i.e., they may impose a dividend withholding tax on shareholders resident in the other country), but the rate of tax may not exceed 15 percent if the beneficial owner is a resident of the other country. (In the absence of a treaty limitation, the statutory U.S. withholding tax rate on dividends paid by U.S. corporations to foreign shareholders is generally 30 percent.) The withholding tax rate is limited to 5 percent in the case of dividends paid to a company which directly or indirectly owns at least 10 percent of the voting stock of the company making the dividend distribution.

Neither country can tax dividends paid by companies of the other except insofar as (a) the dividends are paid to residents of the country imposing the tax, (b) the dividends are effectively connected with a permanent establishment or a fixed base in the taxing country, or (c) at least 50 percent of the company's gross income was attributable to a permanent establishment in the taxing country. In this last situation, however, the tax can be imposed only to the extent the dividends are paid out of the profits derived from the permanent establishment and, in addition, the rate of tax on the taxable portion is limited to 15 percent or 5 percent under the rules (described above) applicable to dividends paid by companies of the taxing country. As set forth in the Exchange of Notes, this last exception does not apply to Hungary because Hungary does not tax dividends paid for by foreign corporations regardless of the extent to which the dividends were derived from Hungarian source profits of the distributing foreign corporation. The United States, however, does impose its withholding tax on the U.S. source portion of dividends distributed to foreign shareholders by foreign corporations which derive more than 50 percent of their gross income for the preceding 3-year period from U.S. sources. This last exception permits the United States to continue to do so.

The reduced rates of tax on dividends will apply unless the recipient has a permanent establishment (or fixed base in the case of an individual performing independent personal services) in the source country [10] and the dividends are effectively connected with the permanent establishment (or fixed base). Dividends effectively connected with a permanent establishment are to be taxed as business profits (*Article 8*). Dividends effectively connected with a fixed base are to be taxed as income from the performance of independent personal services (*Article 13*).

Article 10. Interest

Interest derived by a resident of one country from sources within the other country is generally exempt from tax by the source country. (In the absence of a treaty limitation, the United States generally imposes a 30-percent withholding tax on interest paid by U.S. debtors—other than banks—to foreign lenders.)

The exemption from tax on interest will apply unless the recipient has a permanent establishment or fixed base in the source country and the interest is effectively connected with the permanent establishment or fixed base. In that event, the interest will be taxed as business profits (*Article 7*) or income from the performance of independent personal services (*Article 13*).

The proposed treaty defines interest as income from debt claims of every kind, whether or not secured and whether or not carrying a right to participate in profits. In particular, it includes income from government securities and from bonds or debentures, including premiums or prizes attaching to bonds or debentures.

Article 11. Royalties

Under the proposed treaty, royalties derived by a resident of one country from sources within the other are exempt from tax by the source country. (In the absence of a treaty limitation, the United States generally imposes a 30-percent withholding tax on royalties paid to foreigners not engaged in a U.S. business.) Royalties are defined for this purpose as payments of any kind received as consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work, including films, radio or television tapes, any patents, trade marks, designs or models, plans, secret formulas or processes, or any other similar rights or property. Royalties also include payments for information concerning industrial, commercial, or scientific experience (e.g., "know-how"). However, this article does not apply to mineral royalties (which are covered by *Article 6*).

The exemption does not apply where the recipient is an enterprise with a permanent establishment in the source country or an individual performing personal services in an independent capacity through a fixed base in the source country, and the royalties are effectively connected with the permanent establishment or fixed base. In that event the royalties will be taxed as bussiness profits (*Article 7*) or income from the performance of independent personal services (*Article 13*).

Article 12. Capital gains

The proposed treaty generally provides that capital gains derived by a resident of one country will be exempt from tax by the source country. Under the Code, capital gains derived from U.S. sources by foreign investors are generally exempt from U.S. tax.

The exemption does not apply in two situations, and in those situations the gains may be taxed by both countries (with relief from double [11] taxation provided pursuant to *Article 20*). First, gains from the sale or exchange of real property may be taxed in the country where the property is located. Second, gains on the sale or exchange of property which forms a part of the business property of a permanent establishment or a fixed base (including gains on the disposition of the permanent establishment or the fixed base itself) may be taxed in the country where the permanent establishment or fixed base is located. This second exception does not apply to gains from the sale or exchange of ships, aircraft or containers operated by an enterprise of the other country in international traffic; such gains are only taxable by the country of residence.

Article 13. Independent personal services

Under the proposed treaty, income from the performance of independent personal services (i.e., services performed as an independent contractor, not as an employee) in one country by a resident of the other country is exempt from tax in the country where the services are performed, unless (1) the person performing the personal service is present in the country where the services are performed for more than 183 days during the taxable year or (2) the individual has a fixed base regularly available to him in that country for the purpose of performing the services. If the second requirement (but not the first) is met, the source country can only tax that portion of the individual's income which is attributable to the fixed base. Independent services include independent scientific, literary, artistic, educational or teaching activities as well as the independent activities of physicians, lawyers, engineers, architects, dentists, artistes, athletes and accountants.

Article 14. Dependent personal services

Under the proposed treaty, income from services performed as an employee in one country (the source country) by a resident of the other country will not be taxable in the source country if three requirements are met: (1) the individual is present in the source country for not more than 183 days during the taxable year; (2) his employer is not a resident of the source country; and (3) the compensation is not borne by a permanent establishment or fixed base of the employer in the source country.

Compensation derived by an employee aboard a ship or aircraft operated by a resident of one country in international traffic is exempt from tax by the other country, provided that the compensation is in respect of employment as a member of the regular complement of the ship or aircraft.

This article does not apply to pensions and social security payments (*Article 16*).

Article 15. Pensions

Under the proposed treaty, private pensions (and other similar compensation for past services) beneficially derived by residents of either country are exempt from tax in the other country, regardless of the source of pensions.

Social security payments and other public pensions paid by either country to a resident of the other (or to U.S. citizens) are only taxable by the country making payments. This rule does not apply in the case [12] of pensions which are paid to resident nationals of one country attributable to service performed by that individual to government entities of the other. (*Article 16(2)(b). Government service*).

Article 16. Governmental service

Under the proposed treaty, compensation paid by one country, its political subdivisions or local authorities, to an individual for labor or personal services performed for the paying governmental entity is exempt from tax by the other country. However, this exemption does not apply if the services are performed in the other country and the individual is a national of that country or did not become a resident of that country solely for the purpose of performing the service. In that situation, the compensation is only taxable by the country where the services are performed. Thus, an individual performing services for a Hungarian governmental entity ordinarily will only be taxable by Hungary. However, if he performs the services in the United States and is a U.S. citizen, or is a U.S. resident whose reasons for becoming a U.S. resident were not solely to work for that Hungarian governmental agency, he will be taxable by the United States.

Pensions paid for services to a governmental entity of either country will generally only be taxable by that country. However, if the recipient is a resident national of the other country, the pension will only be taxable by that other country.

The governmental service rules do not apply in situations where the compensation or pensions are paid in connection with any business carried on by any governmental entity of either country. In such situations, the provisions applicable to the private sector apply: Article 13 (***Independent personal services***), 14 (***Dependent personal services***), and 15 (***Pensions***).

Article 17. Teachers

The proposed treaty provides that if a teacher or researcher who is a resident of one country is invited to teach or engage in research in the other, he will be exempt from tax by the host country on income from teaching or engaging in research if he is present in that country for a period not expected to exceed 2 years. The exemption only applies if the individual comes to the other country primarily for the purpose of teaching or engaging in research pursuant to an invitation of the host country (or political subdivision or local authority) or a recognized educational institution in the host country. It is not to apply with respect to income from research which is undertaken primarily for the private benefit of a specific person or persons.

If the teacher or researcher remains in the other country for a period exceeding 2 years, the exemption only applies to income earned during the 2-year period. The exemption does not apply if the individual is a citizen of, or acquires immigrant status in, the host country (***Article 1(3)***). Income may be exempt under this Article even though it would be taxable under Article 13 (***Independent Personal Services***).

Article 18. Students and trainees

Under the proposed treaty, a resident of one country who becomes a full-time student, apprentice, or business trainee in the other country will generally be exempt from tax in the host country on payments from abroad used for maintenance, education, or training.

[13] A full-time student, apprentice or business trainee who qualifies for the exemption from tax by the host country may instead elect under the treaty to be treated for tax purposes as a resident of the host country. The election applies for the entire period that the individual is a full-time student, apprentice, or business trainee, and it may not be revoked except with the consent of the competent authority of the host country. The purpose of the election is to permit foreign students, apprentices, and business trainees present in the United States to qualify for benefits such as the standard deduction (the zero bracket amount), and for the dependency deductions (if applicable). For example, for U.S. tax purposes nonresident aliens are limited to one personal deduction and they are not permitted to claim the standard deduction or the dependency deduction. By electing to be taxed as U.S. residents, they may claim these deductions but, as a consequence, they are subject to U.S. tax on their worldwide income. This election would generally be advantageous for those foreign students, apprentices, and business trainees who do not have any substantial income from sources without the United States.

Article 19. All other income

Any item of income, regardless of its source, which is derived by a resident of either country and which is not dealt with in one of the other articles of the treaty will be taxable only by the country of residence. However, such an item of income which is received by a resident of one country who is a citizen of the other may be taxed by both countries (***Article 1. Personal scope***), subject to a foreign tax credit for taxes paid to the other if the other country is the country of source (***Article 20. Relief from double taxation***). Items covered by this article would include, for example, annuities, alimony, child support, and certain income from the rental of personal property.

Article 20. Relief from double taxation

United States

Under the proposed treaty, the United States agrees to provide its citizens and residents with a foreign tax credit against their U.S. income tax for the appropriate amount of taxes paid to Hungary. The credit allowed for U.S. tax purposes is in accordance with the provisions and subject to the limitations of U.S. law applicable to the year in question. Under present law, the United States only allows a credit for foreign income taxes (sec. 901 of the Internal Revenue Code), or foreign taxes imposed in lieu of income taxes (Code sec. 903), and the credit is limited to the amount of the pre-credit U.S. tax which is attributable to foreign source income (Code secs. 904 and 907).

The proposed treaty also provides that a deemed-paid foreign tax credit will be made available to a U.S. corporation with respect to dividends from a Hungarian corporation in which it owns, directly or indirectly, at least 10 percent of the voting stock. In this case, a credit will be allowed for the Hungarian tax paid by the Hungarian corporation on the earnings out of which the dividend is paid. A deemed-paid foreign tax credit satisfying the treaty requirements is presently provided under the Internal Revenue Code (sec. 902).

[14] This article provides that all the Hungarian taxes covered by the treaty (*Article 2. Taxes covered*) are to be considered to be income taxes for purposes of the U.S. foreign tax credit. Accordingly, all the Hungarian taxes covered by the treaty will be eligible for the U.S. foreign tax credit. These taxes would probably be creditable for U.S. tax purposes in the absence of the proposed treaty.

Hungary

The treaty generally provides for the relief by Hungary of double taxation of income received by its residents which is taxable under the treaty by the United States through the use of an exemption with progression. Hungary, like the United States and most other countries, has a progressive rate structure for its income tax (i.e., the tax rate becomes higher as taxable income increases). Under the exemption with progression, the exempt income is not subject to Hungarian tax, but it is taken into account in determining the effective rate on the resident's other income which is subject to tax. (By increasing the income taken into account, the effective rate becomes higher because of the progressive rate structure.)

With the exception of dividend income for which a foreign tax credit is allowed (described below), the exemption is available with respect to income derived by the Hungarian residents which under the treaty may be taxed by the United States (other than income which under the treaty may be taxed by the United States solely because the Hungarian resident receiving the income is also a citizen of the United States). Income eligible for the exclusion would include, for example, income from U.S. real property, business profits attributable to a U.S. permanent establishment, or compensation for personal services performed in an independent capacity through a U.S. fixed base. The treaty exemption is also available with respect to income from sources within the United States which would not be taxable by the United States under the treaty but for the fact the recipient is a U.S. citizen. This would include U.S.-source interest and royalties received by U.S. citizens resident in Hungary.

A Hungarian foreign tax credit rather than the exemption with progression will be provided under the treaty with respect to dividends received by Hungarian residents from U.S. companies where the dividends qualify for the reduced 15-percent or 5-percent treaty rate for the U.S. withholding tax (*Article 9*). Although Hungary does not have a statutory foreign tax credit, the treaty provides that such dividends from U.S. companies will be taxable by Hungary and that the Hungarian residents will be entitled to reduce their Hungarian tax by the 5-percent or 15-percent U.S. withholding tax imposed on the dividends. It was necessary to provide a credit in this situation rather than an exemption because the U.S. withholding tax rate under the treaty is substantially lower than the regular income tax rates of both countries. Therefore, an exemption would have more than offset any potential double taxation of the dividends.

Consequently, the only income received by a U.S. citizen resident in Hungary which would not qualify for either the exemptions from, or the credit against, the Hungarian tax pursuant to this provision would be non-U.S.-source income. There would not be double taxation in this situation, however, because the Hungarian tax could be claimed [15] as a foreign tax credit against the U.S. tax on that foreign source income.

Article 21. Nondiscrimination

The proposed treaty contains a comprehensive nondiscrimination provision relating to all taxes of every kind imposed at the national, state, or local level. It is similar to provisions which have been embodied in other recent U.S. income tax treaties.

Under this provision, neither country can discriminate by imposing more burdensome taxes (or other requirements connected with taxes) on citizens of the other country than it imposes on its own citizens who are in the same circumstances. For this purpose, citizens taxable on their worldwide income are not to be considered to be in the same circumstances as citizens who are not. Thus, for example, the United States would not be required to tax in the same way a U.S. citizen and a Hungarian citizen, neither of whom are residents of the United States, because the U.S. citizen is taxed by the United States on his worldwide income while the Hungary citizen is not. This provision does not, however, require either country to grant to residents of the other country the personal allowances, reliefs, or deductions for taxation purposes on account of personal status or family responsibilities which it grants to its own residents.

Similarly, neither country may tax a permanent establishment of an enterprise of the other country less favorably than it taxes its own enterprises carrying on the same activities. In determining the taxable income of an enterprise of either country, both countries are reqiured to allow the enterprise to deduct interest, royalties, and other disbursements paid by the enterprise to residents of the other country under the same conditions that they allow deductions for such amounts paid to residents of the same country as the enterprise. Similarly, for purposes of determining the taxable capital of an enterprise of one country, debts owed to residents of the other country are to be deductible under the same conditions as if they were owed to residents of the same country as the enterprise. The nondiscrimination provision also applies to corporations of one country which are owned by residents of the other country.

Articles 22 and 23. Administrative provisions

The proposed treaty contains various administrative provisions generally along the lines of the provisions contained in other U.S. tax treaties. In general, the proposed treaty provides—

(1) for consultation and negotiation between the tax authorities of the two countries to resolve differences arising in the application of the proposed treaty and also to resolve claims by taxpayers that they are being subjected to taxation contrary to the terms of the proposed treaty; and

(2) for the exchange between the countries of information pertinent to carrying out the provisions of the proposed treaty and of the domestic laws of the countries concerning taxes covered by the proposed treaty.

Article 24. Diplomatic and consular officials; Domestic laws and other treaties

The proposed treaty contains the rule found in other U.S. tax treaties that its provisions are not to affect the taxation privileges of [16] diplomatic and consular officials under the general rules of international law or the provisions of special agreements.

The proposed treaty also contains the rule found in other U.S. tax treaties that its provisions will not restrict in any manner any exclusion, exemption, deduction, credit or other allowance otherwise accorded by the domestic laws of either country or any other agreement between the two countries. In other words, the treaty (other than the exchange of information provisions) can only be applied to the benefit of taxpayers of the two countries, and the taxing authorities cannot apply it to increase a taxpayer's tax liability.

Article 25. Entry into force

The proposed treaty will enter into force as soon as the United States and Hungary notify each other that their constitutional requirements for ratification have been met (in the case of the United States, upon its presentation of an instrument of ratification). With respect to taxes withheld at source, it will apply to income paid or credited on or after the first day of the second month following the date on which it enters into force. This would apply to dividends (*Article 9*), interest (*Article 10*), royalties (*Article 11*), and annuities and other fixed and determinable annual or periodic income which is not specifically covered by any article (*Article 19*). With respect to all other taxes, it will become effective for taxable years beginning on or after January 1 of the year following the date on which the proposed treaty comes into force.

Article 26. Termination

The proposed treaty will continue in force indefinitely, but either country may terminate it at any time after 5 years from its entry into force by giving at least 6 months' prior notice through diplomatic channels. Such a termination will be effective with respect to income of taxable years beginning (or, in the case of withholding taxes, payments of income made) on or after January 1 next following the expiration of the 6-month period.

EXCHANGE OF NOTES

In an exchange of identical letters signed together with the treaty, the two countries set forth certain agreements concerning the application of certain provisions of the treaty. The interpretations and understanding set forth in the Notes have the same force and effect as if they were contained in articles of the treaty.

First, although the dividend article (Article 9(5)(c)) would permit it, Hungary will not impose a tax on dividends paid to U.S. shareholders by corporations deriving more than 50 percent of their profits from Hungary in situations where the distributing corporation is not resident in Hungary. The United States imposes its withholding tax on dividends paid by foreign corporations to foreign investors where the distributing corporation derives 50 percent or more of its income from United States sources during the 3-year period preceding the distribution. Under the treaty, the United States may continue to tax dividends paid by Hungarian corporations in such situations.

Second, where a resident of one country carries on business through a permanent establishment in the other, income (other than income [17] from real property) will be taxed as business profits (Article 7) rather than other income (Article 19) if the right or property in respect of which the income is paid is effectively connected with the permanent establishment. Similarly, where a resident of one country performs independent personal services through a fixed base in the other, income (other than income from real property) will be taxed as independent personal services income (Article 13) rather than other income if the right or property in respect of which the income is paid is effectively connected with the fixed base. The consequences of this understanding is that the income in these situations will be taxed by the country of the permanent establishment or fixed based rather than only by the country of residence.

Third, the Notes recognize the right of each country to apply the provisions of its internal law to distribute, apportion, or allocate income, deductions, credits, and allowances between related enterprises in order to reflect properly their arm's-length profit in situations where the dealings between the related enterprises involve conditions different from those that would have been made between independent enterprises. In addition, the Notes also provide that the internal law of each country may be applied to limit the exemption provided in the treaty for interest (*Article 10*) and royalties (*Article 11*) so that it only applies to the extent that the interest or royalty does not exceed the arm's-length amount that would have been paid between unrelated parties. Thus, the treaty does not in any way limit the authority of the Internal Revenue

Service to allocate or apportion income, deductions, credits, or allowances between related parties under section 482 of the Internal Revenue Code in situations where it determines that the allocation is necessary in order to prevent the evasion of taxes or clearly to reflect the income of the related parties. This authority is not limited by the treaty even where the allocation is between related parties which are not enterprises or where the related parties have not had dealings with each other.

Finally, the Notes set forth an agreement, similar to provisions in other recent U.S. income tax treaties, that each country will assist the other in collecting taxes imposed by the other country to the extent necessary to insure that the treaty benefits are only enjoyed by persons entitled to them. This agreement does not obligate either country to carry out administrative measures which are of a different nature from those used in the collection of its own tax or measures which would be contrary to its sovereignty, security, or public policy.

[18] VIII. TEXT OF RESOLUTION OF RATIFICATION

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RESOLUTION OF RATIFICATION

Resolved (two-thirds of the Senators present concurring therein), That the Senate advise and consent to the ratification of the Convention Between the Government of the United States of America and the Government of the Hungarian People's Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, together with an exchange of notes relating thereto, done at Washington on February 12, 1979 (Ex. X, Ninety-sixth Congress, first session).

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[75] APPENDIX C

Written Responses by Treasury to Questions by the Committee Staff

Department of the Treasury,
Washington, D.C., June 8, 1979.

Hon. **Frank Church,**
Chairman, Committee on Foreign Relations,
U.S. Senate, Washington, D.C.

Dear Mr. Chairman: To follow up my testimony at the June 6 hearings concerning the six tax conventions or protocols involving the United Kingdom, France, Hungary and Korea, I want to assure you that Article I of the Third Protocol of the proposed US-UK Income Tax Treaty gives full effect to the Senate's reservation on Article 9(4) of that treaty. Let me also assure you that there is no similar state tax issue in any of the other five treaties which were considered by the Committee yesterday.

Again let me emphasize our view that each of these treaties is important to the United States and that their prompt approval is desirable.

I am also enclosing answers to the written questions submitted to me by your staff at the hearings as well as copies of my answers to questions from Senator Helms and Senator Javits.

Sincerely,

Donald C. Lubick,
Assistant Secretary (Tax Policy).

Enclosures.

Questions for Assistant Secretary for Tax Policy Donald C. Lubick

General Questions*

Question 1. On page three of your testimony, you mentioned that the public was able to make presentations to the Treasury concerning particular private sector concerns in the area of international taxation, could you explain how the notice of such public meetings is made, what the participation level has been and any changes in tax treaties or negotiations that have been affected by this public participation?

Answer. The public meetings, referred to in the testimony, are announced by Treasury Press Releases and notices in the Federal Register. These announcements are reported in publications which are widely read in the international tax community. Public participa-[76]tion in these meetings varies, depending on the degree of interest in the particular country being discussed. The meeting to discuss the Canadian treaty was attended by well in excess of 100 individuals; a recent meeting to discuss a proposed treaty with Norway was attended by about 20 people. All of the reports we have received from the public regarding these meetings have been favorable.

It is difficult to point to particular changes in treaties under negotiations as a result of these meetings. In most cases, there has not yet been a further round of negotiations following the meeting. The meetings have clearly served to sharpen the negotiators' awareness and understanding of some of the complex issues involved.

Questions 2 and 3. The group of six treaties or protocols the Committee is conducting hearings on today, will they result in a net loss or gain for the U.S. from tax revenues? If a loss, how much and why; if again, how much and why?

Answer. In general, these treaties and protocols tend to balance out revenue losses and gains, leaving the overall revenue effect roughly neutral. For example, where the treaty partner is required to reduce or eliminate its tax on U.S. taxpayers, this results in a reduction in the U.S. foreign tax credit and an increase in U.S. revenue. These increases are roughly offset by reductions in U.S. revenues resulting from reductions in U.S. tax on taxpayers resident in the other country.

In most cases, data on international flows and transactions are not available in sufficient detail to permit precise estimation of the revenue effects of particular treaty provisions.

Question 4. Please describe the personnel from the Department of the Treasury and other agencies of the U.S. Government involved in negotiating tax treaties or protocols. Please detail the prospective relationships between the IRS, Department of the Treasury and the Department of State.

Answer. The Office of the Assistant Secretary for Tax Policy in the Treasury has the principal responsibility for the negotiation of tax treaties. The actual negotiations are normally conducted by members of the Office of International Tax Affairs, which combines the Office of International Tax Counsel (Attorneys) and the International Tax Staff of Tax Analysis (Economists). The delegations are headed either by the Assistant Secretary for Tax Policy or by a senior member of the Office of International Tax Affairs.

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* The questions and answers relating specifically to the other protocols and treaties considered at the June 6, 1979 hearings are set forth in the committee reports relating to those treaties.

The Internal Revenue Service is often represented on delegations. The nature and extent of this representation depends on the specific issues that are likely to arise. For example, if there are problems regarding the exchange of information, representatives of the IRS Office of International Operations, which is responsible for these exchanges, will participate in the discussions. In many cases, when negotiations are held abroad, the Revenue Service Representative assigned to that country will participate.

The State Department is invited to participate in all discussions. Country desk officers will sometimes attend a part or all of the discussions held in Washington. When negotiations are held abroad, the economic or commercial officers in the U.S. Embassy frequently participate. The State Department generally handles correspondence be-[77]tween the U.S. and foreign negoitators and is often called upon to follow up with representatives of the other country on issues which arise in the negotiations.

There is close coordination between Treasury, IRS and the State Department throughout the negotiating process. The State Department advises the Treasury on political issues and IRS advises on administrative matters. The State Department is responsible for the arrangements for signing treaties and their transmittal to the Senate.

Question 5. The U.S. Treasury, in 1977, finalized a "model convention" for international tax treaties, could you please explain the status of this model and in particular, any changes that have been made to it?

Answer. For many years, the Treasury had used an informal "model" as a basis for negotiations. This model evolved and changed as the negotiators gained experience with it. In 1976 a decision was made to publish the U.S. model. Following the 1977 publication of the revised OECD Model Convention, the Treasury revised its model to conform it to the OECD Model, where possible, and the revised model was published in May of 1977.

The model is sent to potential treaty partners prior to the commencement of negotiations, and it normally serves as the discussion draft during the first round of negotiations. Many changes are made in the model during negotiations to reflect particular problems which arise in attempting to mesh two tax systems. Changes may be made to reflect the needs of the other country. For example, where negotiations are with a developing country, many of the model provisions (designed for treaties between two developed countries) are inappropriate. The U.S. negotiators are generally quite flexible in modifying the model for treaties with developing countries. These changes occur most frequently in the provisions dealing with permanent establishments or the taxation of personal service income, in which cases a somewhat lesser degree of economic contact or penetration is required for the host country to be able to tax the income of a resident of the other country. Similarly, with the taxation of dividends, interest, and royalties, less of a reduction in withholding tax rates is generally required of developing countries. The U.S. interest in these cases is to avoid rates which are so high as to generate excess foreign tax credits for U.S. income recipients.

Questions 6 and 7. In the third protocol proposed to the U.S.-U.K. Income Tax Treaty, the definition of permanent establishment has been changed. Please explain the basis of this change. Were the affected U.S. drilling companies contacted concerning the proposed change? If they were contacted, please give the details of when, by whom, and what resulted from such contact. Why was the permanent establishment definition selected as the item to be changed in the tax area?

Answer. In our discussions with the British subsequent to the Senate reservation on Article 9(4) of the proposed treaty, the United Kingdom specifically requested the inclusion in the protocol of a provision clarifying their taxing rights with respect to exploration and exploitation connected activities. This requested clarification was not unusual in light of the original negotiations in 1975 over the permanent estab-[78]lishment definition. In those negotiations, the United States agreed to delete from the twelve month permanent establishment exclusion contained in subparagraph (2)(f) of the proposed treaty any reference to "an installation or drilling rig or ship used for the exploration or development of natural resources" as a result of the British insistence that there be no limitation on their right to tax such activities. This deletion left the application of the permanent establishment definition to these activities somewhat uncertain, although as the United Kingdom authorities believe, a strong argument exists that these activities could be taxed even without the clarification of the new protocol.

We agreed to the inclusion of this provision in the Third Protocol because it was reasonable to expect the British to request some additional concession for the loss of the benefits of Article 9(4); because the terms of the provision were reasonable in light of our own statutory tax policy (we would generally tax these kinds of activities conducted in the United States, even if they were of a shorter duration than 30 days); and because it could be viewed as little more than a clarification of a reasonable interpretation taken by the British of their taxing rights under the proposed treaty without the protocol provision.

The drilling industry was clearly aware of the precise terms of the protocol provision at least one month prior to the signing of the Protocol on March 15, 1979. On February 16, 1979, Mr. Arnold W. Bramlett, Chairman of the Accounting and Taxation Committee of the International Association of Drilling Contractors (IADC), wrote to the International Tax Counsel, Mr. H. David Rosenbloom, expressing general concern over the provision. Subsequently, there were telephone conversations between Mr. Rosenbloom and Mr. Bramlett in which the Treasury sought specific information as to the nature of the activities and the harm which was alleged would occur. These requests were confirmed in a letter from Mr. Rosenbloom to Mr. Bramlett on March 5, 1979, still 10 days before the Protocol was signed. To date, the Treasury has not received from the IADC, or any of its members, specific information detailing any specific adverse effects of the protocol provision.

QUESTIONS ON THE U.S.-HUNGARY INCOME TAX TREATY

Question 1. How does the 1977 model convention of the Organization of Economic Cooperation and Development (OECD) *differ* from the U.S. model income tax convention? [1]

Answer: Among the primary differences between the U.S. and OECD models are that the United States reserves its right under its model to tax U.S. citizens in accordance with U.S. law even if they are residents of the other treaty country and that U.S. treaties cover only Federal income taxes except for purposes of nondiscrimination where all taxes are covered. The OECD model deals with taxation of residents of each country and does not make an exception for nonresident citizens, and covers state and local income and capital taxes as well as those at the national level. In addition, the U.S. model provides for exemption at source on interest (taxation only in the country of resi-[79]dence) whereas the OECD model allows a 10 percent tax at source. The U.S. model includes somewhat broader provisions for adjusting the income of related persons and exchanging information and provides for limited assistance in collecting taxes reduced on payments to persons not entitled to the treaty reductions. There are a number of lesser differences, primarily technical in nature. A summary comparison of the two models is given in the attached memorandum.

Question 2. Will the proposed Hungarian Convention result in a net loss or gain to the U.S. tax revenues? If gain, how much? If loss, how much? What are the underlying policy reasons for any projected loss or gain?

Answer. The revenue consequences of the treaty for the foreseeable future are negligible. The reductions in Hungarian tax will primarily benefit U.S. investors by reducing excess credits of joint ventures and eliminating the need to file tax returns by individuals and companies whose contacts with Hungary are limited. The U.S. rate reductions on outgoing dividends, interest and royalties represent a potential revenue cost but the level of such payments is insignificant.

Question 3. The submittal letter from the Secretary of State to the President mentions that the convention provides "for exchange of information and administrative cooperation between the tax authorities of the two countries to avoid double taxation," how, or in what form will this exchange and/or cooperation take place?

Answer. The exchange of information and administrative cooperation provisions are taken from the U.S. model treaty and appear in several other U.S. treaties. The tax authorities agree to cooperate with each other in applying the convention to avoid double taxation and prevent tax evasion. The United States would furnish Hungary with copies of withholding forms on payments of U.S. income, such as dividends and interest subject to withholding, to residents of Hungary (not U.S. citizens). Safeguards are provided to protect secrecy and avoid undue administrative burdens. The tax authorities may consult by letter or in person whenever a question arises.

Question 4. Will the ratification of U.S.-Hungary Income Tax Treaty encourage private U.S. capital investment or activity in Hungary? If yes, have there been any projections or studies as to the level of investment or activities?

Answer. The ratification of the treaty would signal to U.S. and Hungarian investors that familiar tax rules apply and sound tax relations exist between the two countries. This would support and encourage the interest of investors in both countries, but it is one factor and cannot be quantified separately. Interest already exists. For example, Control Data, Katy Industries (shoes) and Levi Strauss are already actively in Hungary and Hungarian companies are producing light bulbs, marketing pharmaceuticals, and engaging in a joint venture with Corning Glass in the United States. The treaty would help the expansion of these activities by clarifying the tax rules in advance.

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TREASURY DEPARTMENT TECHNICAL EXPLANATION[1] OF THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE HUNGARIAN PEOPLE'S REPUBLIC FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME[2]

This treaty was negotiated on the basis of the U.S. Model Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital published on May 18, 1976. A revised version of that Model was published on May 1977. In nearly all respects the two versions are substantially the same. The May 1977 version reflects the revised Model Double Taxation Convention on Income and Capital published by the Organization for Economic Cooperation and Development (OECD) in January 1977 which modified the 1963 OECD Model. Many of those revisions were available at the time this treaty was negotiated and were also taken into account.

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[1] Page 17.

[1] It is the practice of the Treasury Department to prepare for the use of the Senate and other interested persons a Technical Explanation of the tax conventions which are submitted to the Senate for its advice and consent to ratification.

An Income Tax Convention with Hungary was signed February 12, 1979, and submitted by the President to the Senate on May 9, 1979. On June 6, 1979, the Senate Committee on Foreign Relations held hearings and this Technical Explanation was presented. The Senate voted its advice and consent on 1979, and instruments of ratification were exchanged on September 18, 1979.

[2] Page 17; pertinent excerpts from Senate Executive Report No. 96-8, page 25; Senate Executive X is not published.

Article 1. PERSONAL SCOPE

This Article identifies the persons who come within the scope of the Convention (hereinafter referred to as "the treaty").

Paragraph 1 is taken directly from the U.S. Model Income Tax Convention (hereafter "the U.S. Model") of May 1977, but with the wording revised so that the general rule is stated first and the exception follows. The general rule is that the treaty applies to residents of one or both of the Contracting States. The term "resident" is defined in Article 4 (Fiscal Domicile). The exception is that in certain cases the treaty may also apply to residents of third countries because of their relationship to a resident of a Contracting State. For example under paragraph 5 of Article 9 (Dividends) the treaty refers to dividends derived by residents of third countries, and Article 23 (Exchange of Information) may apply to residents of third countries.

Paragraph 2 contains the traditional "saving clause" under which each Cotracting State reserves the right to tax its residents, as determined under Article 4 (Fiscal Domicile), and its citizens as if the treaty had not come into effect. In the case of the United States the "saving clause" applies to former citizens as well as to current citizens. This is standard U.S. treaty policy (see Revenue Ruling 79-152). A former U.S. citizen whose loss of citizenship had as one of its principal purposes the avoidance of income tax will continue to be subject to U.S. income tax, in accordance with the provisions of section 877 of the Internal Revenue Code, for a period of ten years following the loss of citizenship. The substance of this paragraph is the same as that of paragraph 2 of Article 1 of the U.S. Model of May 1977. The saving clause is drafted reciprocally because in certain cases the Hungarian People's Republic also taxes on the basis of citizenship. The Hungarian income tax on intellectual activities applies at graduated rates of 6 to 60 percent on royalties derived by Hungarian citizens wherever resident. However, since the reference to former citizens has no effect under the laws of the Hungarian People's Republic, that clause was simplified by making the reference applicable only to former citizens of the United States.

Paragraph 3 sets forth certain exceptions to the application of the saving clause where other provisions of the treaty reflect overriding policies. For example, the saving clause does not affect the benefits provided under paragraph 2 of Article 15 (Pensions). Social security benefits and other public pensions paid by the Hungarian People's Republic are taxable only by the Hungarian People's Republic even though the recipient may be a resident or citizen of the United States, and conversely. Similarly, the benefits provided under Article 20 (Relief from Double Taxation), Article 21 (Non-Discrimination), and Article 22 (Mutual Agreement Procedure) are available to residents and citizens of the Contracting States notwithstanding the saving clause.

In some other cases the saving clause overrides benefits conferred by the treaty to citizens or persons having immigrant status in a Contracting State, but does not override those benefits as applied to residents who are not citizens and do not have immigrant status in that State. This second category of exceptions to the saving clause refers to the benefits conferred by a Contracting State under Article 16 (Government Service), Article 17 (Teachers), Article 18 (Students and Trainees), and Article 24 (Effect of Convention on Diplomatic and Consular Officials, Domestic Laws and Other Treaties).

This paragraph follows closely paragraph 3 of Article 1 of the U.S. Model of May 1977. It differs only in omitting a cross reference to child support payments under subparagraph (a) and in adding a cross reference to teachers under subparagraph (b). The U.S. Model of May 1977 contains a specific rule on child support payments not found in this treaty, and does not include an article on teachers such as the one found in this treaty.

Article 2. TAXES COVERED

Paragraph 1 states the general rule that the treaty applies to income taxes imposed on behalf of a Contracting State. Except for Articles 21 (Non-Discrimination) and 23 (Exchange of Information), the Convention does not apply to taxes on capital, and it applies to income taxes imposed only at the national level. Capital taxes were omitted because, since the United States does not have such taxes at the national level there is no double taxation, including them would be non-reciprocal and there is no U.S. tax against which to credit Hungarian taxes on capital. Moreover, the Hungarian taxes on capital are not major taxes; they apply primarily to housing, vacant land and farm property. The Hungarian People's Republic does not now have any local income taxes. Only the national government imposes income taxes, although the revenue from some of those taxes is turned over to the county governments.

Paragraph 2 designates the existing taxes to which the Convention shall apply. In the case of the United States these are the Federal income taxes imposed by the Internal Revenue Code, the excise tax on insurance premiums paid to foreign insurers (Code section 4371) and the excise tax with respect to private foundations (Code section 4940). The accumulated earnings tax (Code 531) and the personal holding company tax (Code section 541) are not covered by the treaty. These provisions, which are found in subparagraph (a), are identical to paragraph 2(a) of the U.S. Model of May 1977.

In the case of the Hungarian People's Republic, there are eight existing income taxes covered by the treaty: the general income tax, the income tax on intellectual activities, the profit tax, the profit tax on economic associations with foreign participation, the enterprises' special tax, the levy on dividends and profit distributions of commercial companies, the profit tax on state-owned enterprises, and the contribution to communal development to the extent that it is imposed in respect of income taxes covered by the treaty. The contribution to communal development is imposed as a surtax to the general income tax and the income tax on intellectual activities. It was agreed that it will be covered by the treaty to the extent that it is imposed on those or any other income tax covered by the treaty, but not if it should be imposed as a surtax to a tax not so covered. Under paragraph 1 of Article 20 (Relief from Double Taxation), the United States agrees that the Hungarian taxes enumerated in paragraphs 2(b) and 3 of this Article are income taxes for purposes of the U.S. foreign tax credit.

Paragraph 3 provides that the treaty shall also apply to subsequently imposed taxes which are substantially similar to the existing taxes covered by the treaty. The competent authorities agree to notify each other of changes in their respective tax laws and any official published material relating to the application of the treaty. This provision is identical to paragraph 3 of the U.S. Model of May 1977.

Paragraph 4 provides that for some purposes the treaty also applies to taxes other than national income taxes. For the purposes of Article 21 (Non-Discrimination), the treaty applies to taxes of all kinds imposed at all levels of government. For the purposes of Article 23 (Exchange of Information), the treaty applies to taxes of every kind imposed at the national level. These provisions also correspond to those found in the U.S. Model of May 1977.

Article 3. GENERAL DEFINITIONS

Paragraph 1 defines the principal terms used throughout the treaty. Unless the context otherwise requires, the terms defined in this paragraph have a uniform meaning throughout the treaty. It should be noted that a number of important terms are defined in other Articles. For example the terms "resident" and "permanent establishment" are defined in Articles 4 (Fiscal Domicile) and 5 (Permanent Establishment), respectively, and the terms "dividends" and "interest" are defined in Articles 9 (Dividends) and 10 (Interest).

Paragraph 1 follows paragraph 1 of the U.S. Model of May 1977 in defining the terms "person", "company", "enterprise of a Contracting State", "international traffic", "competent authority", and the term "United States". The definition of the United States includes the continental shelf of the United States in accordance with section 638 of the Internal Revenue Code and the regulations thereunder. The term "Hungarian People's Republic" is defined to include the territory of the Hungarian People's Republic. Hungary does not have a territorial sea or continental shelf.

The only departure in this paragraph from the U.S. Model of May 1977 is the definition of the term "nationals," which is relevant for purposes of Article 21 (Non-Discrimination). In this treaty "national" is defined to mean an individual citizen of a Contracting State and any legal person, partnership, and association deriving its status as such from the law in force in a Contracting State. The definition of "national" as an individual citizen is found in the U.S. Model in Article 24 (Non-Discrimination), paragraph 2. The additional definition of legal persons, partnerships and associations as nationals of a Contracting State is taken from the OECD Model Draft Income Tax Convention of January, 1977, where it appears in Article 24 (Non-Discrimination).

Paragraph 2 is from the U.S. Model of May 1977. It provides that terms not defined in the treaty shall have the meaning which they have under the laws of the Contracting State relating to the taxes to which the treaty applies, unless the context of the treaty requires otherwise and unless the competent authorities agree on an acceptable definition under the terms of Article 22 (Mutual Agreement Procedure).

Article 4. FISCAL DOMICILE

This article sets forth rules for determining the residence of individuals, corporations, and other persons for purposes of the treaty. A definition of residence is important because, except as otherwise provided in the treaty, only a resident may claim the benefits of the treaty.

Paragraphs 1 through 5 of this Article correspond to paragraphs 1 through 5 of Article 4 (Resident) of the U.S. Model of May 1977. Paragraph 6 of the U.S. Model does not appear because it is relevant only with respect to countries which impose tax on a remittance basis, and that is not the case in the Hungarian People's Republic.

Paragraph 1 lists a number of criteria which may be used under the laws of a Contracting State to determine residence, such as domicile, residence, citizenship, place of management, or place of incorporation. Thus, a U.S. citizen living in a third country is a resident of the United States under this treaty. A person liable to tax in a Contracting State only on income from sources in that State is not considered to be a resident of that State for purposes of the treaty. For example, a diplomat of the Hungarian People's Republic or of a third country stationed in the United States is not a resident of the United States for purposes of the treaty.

When applied with respect to income derived by a partnership, estate, or trust, the term "resident" applies only to the extent that the income derived by such partnership, estate, or trust is subject to tax as the income of a resident of a Contracting State either in its hands or in the hands of the partners or beneficiaries. For example, if a Hungarian partnership which is comprised of one partner resident in Hungary and another partner resident in a third country derives dividends from the United States, the limitation of U.S. tax under the provisions of Article 9 (Dividends) of this treaty apply only to the portion of the dividend attributable to the partner who is a resident of Hungary.

Paragraph 2 provides a series of tie-breakers for assigning a single residency to a person who under paragraph 1 would be a resident of both countries. The first test is where the individual has a permanent home. If this test is inconclusive because the individual has a permanent home in both countries or in neither of them, the second test is where his center of vital interests is located, in other words, where his personal and economic relations are closer. If this test does not provide a satisfactory answer, the third criterion is where the individual has an habitual abode; and if he has an habitual abode in both countries or in neither of them, he is deemed to be a resident of the State of which he is a national. Should the individual be a national of both countries or of neither of them, then it is left to the competent authorities of the Contracting States to settle the question by mutual agreement.

Paragraph 3 provides that a company, which under paragraph 1 is a resident of both Contracting States, shall be considered a resident only of the Contracting State under the laws of which it is created or organized, whether at the national level or under the laws of a political subdivision. Thus, a corporation incorporated under the laws of a state of the United States is a resident only of the United States for purposes of the treaty.

Paragraph 4 provides that if a person other than an individual or a company is a dual resident of the Contracting States, the competent authorities shall attempt to agree on a single residence in one of the Contracting States for such person.

Paragraph 5 provides that an individual national of one of the Contracting States shall also be considered to be a resident of that State if that individual is employed by that Contracting State or an instrumentality thereof and is engaged in the performance of governmental functions for the employing State and remains subject to income tax by the employing State as if he continued to be a resident thereof. This provision also applies to the spouse and minor children residing with such an employee if they are also subject to income tax by the sending state. This paragraph is not found in the OECD Model. It is provided in the U.S. Model of May 1977. Under its terms, a U.S. diplomat or other employee of the United States government performing governmental functions for the United States outside of the United States is considered to be a resident of the United States for purposes of this treaty and therefore entitled to the benefits provided in the treaty for residents of the United States, such as the reduced rate of Hungarian withholding tax with respect to dividends and the exemption from Hungarian tax of interest and royalties paid to residents of the United States. And conversely, a Hungarian diplomat stationed in the United States is a resident of the People's Republic of Hungary for purposes of the treaty.

Article 5. PERMANENT ESTABLISHMENT

This Article defines the term "permanent establishment," which is relevant to the taxation of business profits under Article 7 (Business Profits). With only a few minor exceptions, this Article is the same as Article 5 (Permanent Establishment) of the U.S. Model of May 1977.

In paragraph 1 the term "or production" was inserted after the phrase "fixed place of business" at the request of the Hungarian delegation, because in the Hungarian language "business" does not encompass all trade or business activities but has a more limited meaning. For the same reason, it was also decided to change the reference "through which the business of an enterprise is wholly or partly carried on" to "through which the activities of an enterprise are wholly or partly carried on." The term "fixed place of business" appears also in subparagraphs (d), (e) and (f) of paragraph 4 and in paragraph 5. However, it was not necessary to insert the term "or production" in those paragraphs because they do not pertain to production activities.

The term "place of management" was inserted in paragraph 2 at the request of the Hungarian delegation to provide greater unifromity with the OECD model. The U.S. Model of May 1977 excludes this term because it lacks clarity and in any event a place of management would normally require an office, which is specifically listed.

Paragraph 3 is the same as in the U.S. Model of May 1977. It provides that a building site or construction or installation project or an installation or drilling rig or ship used for the exploration or development of natural resources constitutes a permanent establishment only if it lasts more than 24 months. In such a case, it constitutes a permanent establishment from the first day.

Paragraph 4 lists a number of exceptions to the general rule that a fixed place of business or production through which the activities of an enterprise are carried on constitutes a "permanent establishment." Paragraph 4 is the same as paragraph 4 of Article 5 of the U.S. Model of May 1977. It is also the same as the comparable paragraph in the 1977 OECD Model, with the exception that subparagraph (f) of this treaty provides that the maintenance of a fixed place of business solely for any combination of the activities mentioned in subparagraphs (a) through (e) does not constitute a permanent establishment, whereas under subparagraph (f) of the OECD Model (paragraph 4 of Article 5) there is an additional condition that the overall activity of the fixed place of business resulting from this combination must be of a preparatory or auxiliary character for the enterprise.

Paragraphs 5 and 6 refer to the use of agents. Under paragraph 5 a dependent agent acting on behalf of an enterprise who habitually exercises an authority to conclude contracts in the name of the enterprise is deemed to constitute a permanent establishment of that enterprise except to the extent that his activities are limited to those mentioned in paragraph 4, which would not constitute a permanent establishment when carried on at a fixed place of business. Paragraph 6 provides that merely because an enterprise of one Contracting State makes use in the other Contracting State of a broker or other agent of independent status acting in the ordinary course of business, it will not therefore be considered to have a permanent establishment in that other State.

Paragraph 7 states that the fact that a corporation which is a resident of one Contracting State is either the subsidiary or the parent of a corporation which is a resident of the other Contracting State is not in itself relevant in determining whether the corporation has a permanent establishment in the other Contracting State. What is relevant is whether the subsidiary or parent corporation carries on an activity which, within the provisions of the article, would constitute a permanent establishment of the other company. The same rules apply to two or more subsidiaries of the same company.

ARTICLE 6. INCOME FROM IMMOVABLE PROPERTY (Real Property)

This Article provides that income from real property, including income from agriculture and forestry, may be taxed by the Contracting State where the property is situated. This rule does not confer an exclusive right of taxation to the State where the property is situated, but simply confirms that the situs State has the primary right to tax such income regardless of whether the income is derived through a permanent establishment in that State. This Article is identical to paragraphs 1 through 4 of Article 6 of the U.S. Model of May 1977.

Paragraph 5 of the U.S. model providing for a binding election to be taxed on a net basis was deleted as unnecessary; such an election is available under U.S. law, and the Hungarian People's Republic taxes income from real property on a net basis in any event.

This Article, except for the addition of the parenthetical reference to real property, is identical to Article 6 of the OECD Model of January 1977.

Article 7. BUSINESS PROFITS

This Article provides rules for the taxation by a Contracting State of income from business activity carried on in that State by a resident of the other State.

Paragraph 1 provides that business profits of an enterprise of one Contracting State shall be taxable only in that State except to the extent that such profits are attributable to a permanent establishment through which the enterprise carries on business activities in the other Contracting State. This rule is also found in the U.S. Model of May 1977 and the OECD Model of January 1977.

Paragraphs 2 and 3 are also taken from the U.S. Model of May 1977. Paragraph 2 provides that the profits to be attributed to a permanent establishment are those which it might be expected to make if it were a distinct and independent enterprise engaged in the same or similar activities under the same or similar conditions. Paragraph 3 provides that there shall be allowed as deductions those expenses incurred for the purposes of the permanent establishment, whether incurred in the State where the permanent establishment is located or elsewhere. The deductible expenses include a reasonable allocation of administrative expenses, research and development expenses, interest, and other expenses incurred for the purposes of the enterprise as a whole or the part thereof which includes the permanent establishment.

Paragraph 4(a) is the same as paragraph 4 of Article 7 of the U.S. Model of May 1977. It provides that the mere purchase by a permanent establishment of goods or merchandise for the enterprise shall not result in profiles being attributed to the permanent establishment. Paragraph 4(b) adds that the mere delivery to the permanent establishment of goods or merchandise for its use shall not give rise to the attribution of profit to the permanent establishment. Paragraph 4(b) was added at the request of the Hungarian delegation because they have had difficulty with other countries assessing profits to a permanent establishment in such cases.

Paragraph 5 provides that where business profits include items of income dealt with separately in other Articles of the treaty, then the provisions of those separate articles override the provisions of this Article. Thus, for example, the taxation of income of shipping and aircraft companies dealt with in Article 8 (Shipping and Air Transport) is governed by that Article and not by this Article. Similarly the taxation of dividends, interest, and royalties is controlled by Articles 9 (Dividends), 10 (Interest), and 11 (Royalties): however, the terms of those articles provide that where dividends, interest, or royalties derived by a resident of a Contracting State are effectively connected with a permanent establishment or fixed base of that resident in the other Contracting State, then the provisions of this Article or of Article 13 (Independent Personal Services) shall apply.

This Article does not include two paragraphs which appear in Article 7 of the U.S. Model of May 1977. One such paragraph (paragraph 5) of the U.S. Model provides that the method for determining the profits attributable to a permanent establishment shall be used each year unless there is good and sufficient reason to change. This provision was inserted in the U.S. Model only for uniformity with the OECD Model; its deletion is not of any consequence. The second such deletion is paragraph 7 of Article 7 of the U.S. Model which provides a definition of "business profits". The primary purpose of that definition is to state that film rentals and rentals of tangible personal property are business profits, and therefore subject to the provisions of Article 7, with the result that such income derived by a resident of one Contracting State may not be taxed by the other Contracting State except to the extent attributable to a permanent establishment in the latter State. The Hungarian delegation objected to defining such rentals as business profits. However, they were willing to provide for exemption at source on royalties and on income not expressly mentioned when not attributable to a permanent establishment in Hungary. Consequently, it was agreed to delete the definition of business profits and to deal with film rentals under Article 11 (Royalties) and rentals of tangible personal property under Article 19 (All Other Income).

Article 8. SHIPPING AND AIR TRANSPORT

Paragraph 1 provides that profits of an enterprise of one of the Contracting States from operating ships or aircraft in international traffic shall be taxable only in that Contracting State.

Paragraphs 2 and 3 clarify what income is to be considered profits from the operation of ships or aircraft. Paragraph 2 states that profits from the rental on a full or bareboat basis of ships or aircraft operated in international traffic are covered by the exemption at source provided in paragraph 1 if such rental profits are incidental to operating profits. The lessee need not be a resident of a Contracting State. Paragraph 3 states that profits from the use, maintenance, or rental of containers and related equipment for the transport of goods or merchandise in international traffic are also covered by the exemption at source provided in paragraph 1.

Paragraphs 1 through 3 of this Article are taken directly from the U.S. model income tax convention of May 1976. In the U.S. model of May 1977, the exemption of rental income was broadened to include the rental on a full or bareboat basis of ships or aircraft if such rental profits are incidental to the operating profits or if the lessee operates the ships or aircraft in international traffic, in which case it is not necessary that such profits be incidental to operating profits to qualify for the exemption. That revision had not been made at the time that this treaty was being negotiated.

Paragraph 4 was inserted at the request of the Hungarian delegation to make certain that the income derived from the ticket sales of offices in the United States of Malev Airlines would not be subject to United States tax, although attributable to a permanent establishment in the United States, and conversely for ticket sales of U.S. airlines and shipping companies in Hungary. It is taken from the income tax treaty between Hungary and Austria.

Article 9. DIVIDENDS

Article 9 in the U.S. Model deals with associated enterprises. In this treaty, that topic is dealt with in an exchange of notes accompanying the treaty. Consequently, beginning with Article 9 the numbering of this treaty is not consistent with that of the U.S. Model.

This Article limits the rate of tax which may be imposed by either Contracting State on dividends paid by a company which is a resident of that State to a shareholder resident in the other Contracting State.

Such dividends may be taxed in the State of residence of the recipent. They may also be taxed in the State of which the company paying the dividends is a resident, but at rates which shall not exceed 5 percent of the gross amount of the dividends when the beneficial owner is a company resident in the other Contracting State and owns, directly or indirectly, at least 10 percent of the voting stock of the company paying the dividends, and 15 percent of the gross amount of the dividends in all other cases. These rules are also found in Article 10 of the U.S. Model of May 1977.

The Hungarian People's Republic imposes under its levy on dividends and profit distributions (paragraph 2(b)(vi) of Article 2 (Taxes Covered)) a "remittance" tax on dividends paid by a Hungarian joint venture. The tax is imposed on the distributing entity at a statutory rate of 20 percent. Technically, the definition of dividends does not cover the Hungarian "remittance" tax because it is imposed on the distribution rather than on the receipt of dividends. However, Hungary agrees that under this paragraph the rate of remittance tax will be reduced to 5 percent or 15 percent on distributions to U.S. residents.

Paragraph 3 defines "dividends" as income from shares or other rights participating in profits, but not debt-claims, and income from other corporate rights taxed in the same way as income from shares under the tax law of the State of which the company making the distribution is a resident. This definition is also found in the U.S. Model of May 1977.

Paragraph 4 provides that where the shares or holding in respect of which the dividends are paid is effectively connected with a permanent establishment or fixed base of the recipient in the country of which the company paying the dividends is a resident, then the dividends are taxable in accordance with the provisions of Article 7 (Business Profits) or Article 13 (Independent Personal Services), rather than under the other provisions of this article.

Paragraph 5 provides that, in general, a Contracting State may not impose tax on dividends paid by a company which is a resident of the other Contracting State as a general rule, but that there are three execptions to this rule: (1) where the dividends are paid to a resident of the first-mentioned State, (2) where the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or fixed base in the first State, or (3) where the dividends are paid out of profits attributable to a permanent establishment in the first State of the company paying the dividends, provided that at least 50 percent of that company's gross income from all sources was attributable to a permanent establishment of the company in that first State. Where only the third of these three conditions applies, the rate of tax which may be imposed on such dividends is subject to the limitations provided in paragraph 2 of this article when the dividends are paid to a resident of the other Contracting State.

For example, if a corporation created under the laws of the Hungarian People's Republic and doing business in the United States pays dividends, those dividends could be taxed by the United States if paid to a resident of the United States. They could also be taxed by the United States if the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or a fixed base in the United States. And, finally, they could be taxed by the United States if the dividends are paid out of profits attributable to a permanent establishment of the Hungarian corporation in the United States, but only if at least 50 percent of the company's gross income from all sources was attributable to a permanent establishment in the United States. The final case preserves the United States tax on dividends paid by a foreign corporation which are considered to be of U.S. source under section 861(a)(2)(B) of the Internal Revenue Code. If paid to residents of the Hungarian People's Republic, such dividends would be subject to U.S. tax at the reduced rates provided in paragraph 2.

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does not have a comparable source rule to that of section 861(a)(2)(B) of the U.S. Internal Revenue Code. To make it clear that Hungary will not impose its remittance tax twice, once on the remittance by a joint venture to a U.S. partner under paragraph 2, and again under paragraph 5(c) on the dividend paid by the U.S. partner to its U.S. parent, a statement was included in the exchange of notes that Hungary will not impose its remittance tax under paragraph 5(c).

Article 10. INTEREST

This article deals with the taxation by one Contracting State of interest derived by a resident of the other Contracting State.

Paragraph 1 provides the rule found in the U.S. Model of May 1977 that interest shall be exempt from tax at source and taxable only in the state of residence. However, the wording of the U.S. Model which refers to interest "derived and beneficially owned" by a resident of a Contracting State was changed at the request of the Hungarian delegation to the language of the OECD Model (Article 11, paragraph 1) which refers to interest "arising in a Contracting State and paid to a resident of the other Contracting State."

Paragraph 2 contains the definition of interest found in the U.S. Model of May 1976. It differs from the U.S. Model of May 1977 and from the OECD Model only by not specifically excluding penalty charges for late payment from the definition of interest. This is not a difference of substance.

Paragraph 3 provides that where the debt claim in respect of which the interest is paid is effectively connected with a permanent establishment or fixed base which the recipient of the interest maintains in the other Contracting State, then the interest is taxable in accordance with the provisions of Article 7 (Business Profits) or Article 13 (Independent Personal Services) rather than under this Article.

The exchange of notes includes a provision with respect to interest not at arm's length paid between related persons.

Article 11. ROYALTIES

Paragraph 1 contains the rule found in the U.S. model of May 1977 (Article 12) which gives the exclusive right of taxation of royalties to the state of residence of the recipient. However, the wording was revised to conform to the language of the 1963 OECD Model (Article 12), which parallels the language of the 1977 OECD Model with respect to interest (Article 11), to read "Royalties arising in a Contracting State and paid to a resident of the other Contracting State shall be taxable only in that other State."

Paragraph 2 contains a definition of royalties, taken from the U.S. model of 1977 (Article 12, paragraph 2) but including rather than excluding cinematographic films or films or tapes used for broadcasting. The last sentence of the definition of royalties found in the U.S. Model, relating to gains derived from the alienation of property which are contingent upon the productivity, use or disposition of such rights or property was deleted, at the request of the Hungarian delegation.

Paragraph 3 provides that where the right or property in respect of which the royalties are paid is effectively connected with a permanent establishment or fixed base maintained by the recipient of the royalties in the other Contracting State, then the royalties shall be taxed in accordance with the provisions of Article 7 (Business Profits of Article 13 (Independent Personal Services) rather than in accordance with the provisions of this article.

Paragraph 4 of the U.S. model of May 1977 dealing with royalties paid at other than arm's-length between related persons was deleted because the Article on associated enterprises was deleted. The substance of this paragraph is found in the exchange of notes accompanying the treaty.

Article 12. CAPITAL GAINS

This article contains the same provisions as found in the U.S. Model of May 1977 (Article 13) with the exception that the reference to gains from the disposition of rights or property contingent on the productivity, use or disposition of the property as described in Article 12 (Royalties) was deleted to correspond to the deletion of that sentence from Article 12.

Paragraph 1 provides that gains from the alienation of immovable property are taxable in the state where the property is situated.

Paragraph 2 provides that a Contracting State may tax gains from the alienation of movable property which is part of the property of a permanent establishment or fixed base in that State of a resident of the other Contracting State. However, gains derived by an enterprise of one Contracting State from the alienation of ships, aircraft, or containers which it operates in international traffic are taxable only in the state of residence of that enterprise. This latter provision relating to ships, aircraft and containers is also found in the U.S. Model but in a separate paragraph (paragraph 3 of Article 13).

Paragraphs 1 and 2 do not confer an exclusive right to tax. Such gains may also be taxed by the State of residence, subject to the provisions of Article 20 (Relief from Double Taxation). Paragraph 3 provides that gains from the alienation of any property other than property identified in paragraphs 1 and 2 are taxable only in the State of which the recipient is a resident.

Article 13. INDEPENDENT PERSONAL SERVICES

The treaty provides separate articles dealing with the taxation of income from independent and dependent personal services. Independent personal services are services performed by an individual for his own account where he receives the income and bears the losses arising from such services. Income from services in which capital is a material income-producing factor, however, will generally be governed by the provisions of Article 7 (Business Profits). Generally, services rendered as a director of a corporation, or by physicians, lawyers, engineers, architects, dentists, artistes, athletes, and accountants who perform personal services as sole proprietors or partners are independent personal services, whereas services performed as an employee or as an officer of a corporation constitute dependent personal services.

This article is the same as Article 14 of the U.S. Model of May 1977, with the addition of paragraph 2 which illustrates the kinds of services covered by this article. Paragraph 2 is based on paragraph 2 of Article 14 of the OECD Model, but the term used in that model, "professional services" has been changed to "personal services," and artistes and athletes have been added to the list of examples because in this treaty, unlike in the OECD model, they are treated under the general rules for independent or dependent personal services rather than in a special article.

The rule provided in this Article is that income derived by an individual who is a resident of a Contracting State from the performance of personal services in an independent capacity shall generally be taxable only in that State. However, such income may also be taxed in the other Contracting State if such services are performed in that other State and either a) the individual is present in that other state for more than 183 days in the taxable year, or b) the income is attributable to a fixed base in that other state which the individual has regularly available there for the purpose of performing his activities.

Article 14. DEPENDENT PERSONAL SERVICES

This article is the same as Article 15 of the U.S. Model of May 1977. It provides that, subject to the provisions relating to pensions (Article 15) and income for government services (Article 16), remuneration derived by a resident of a Contracting State in respect of an employment may be taxed by that other State only to the extent that the remuneration is for employment exercised in that other State. Even in that event, the remuneration is taxable only in the recipient's state of residence if the recipient is present in the other state for not more than 183 days in the taxable year, is paid by or on behalf of an employer who is not a resident of the other State, and the remuneration is not borne by a permanent establishment or fixed base of the employer in the other State.

Paragraph 3 provides a special rule for crew members of ships or aircraft operated in international traffic. Remuneration for such services is taxable only in the Contracting State of which the enterprise operating the ship or aircraft is a resident.

Article 15. PENSIONS

This article corresponds to paragraph 1 of Article 18 of the U.S. model of May 1977. It provides that, subject to the provisions of paragraph 2 of Article 16 (Government Services), pensions and similar remuneration beneficially derived by a resident of one Contracting State in consideration of past employment are taxable only in the state of residence of the recipient, but that social security payments and other public pensions paid by one of the Contracting States to a resident of the other state or to a United States citizen are taxable only in the paying state. The first paragraph deals with pensions in consideration of private employment. The second paragraph deals with retirement benefits which are not related to prior employment, such as social security payments and U.S. railroad retirement benefits. Pensions in consideration of government employment are covered under Article 16 (Government Services).

The U.S. Model (Article 18) provides additional paragraphs 2, 3 and 4 which deal respectively with annuities, alimony, and child support payments. Those paragraphs were deleted in this treaty. Annuities, alimony, and child support payments therefore come under Article 19 (All Other Income).

Article 16. GOVERNMENT SERVICE

With one exception this article is the same as Article 19 of the U.S. Model of May 1977.

Paragraph 1 provides as a general rule that remuneration other than pensions paid by a Contracting State or a political subdivision or local authority thereof to any individual for services rendered shall be taxable only in that State. It also provides an exception, however. The exception is that such remuneration shall be taxable only in the other Contracting State if the services are rendered in that other State and the individual is a resident of that other State and either is also a national of that State or did not become a resident of that State solely for the purpose of performing the services (for example, if the individual was a local resident when hired by the first State). This rule and the exception to it are also found in the OECD Model of January 1977.

The U.S. Model also includes a special provision for the spouse of dependent children of an individual employed by one of the Contracting States and sent to perform governmental services in the other Contracting State and who is not a national of that other Contracting State. In such a case under the U.S. Model, if the spouse or a dependent child of such an individual were to also become employed by the first Contracting State after having become resident in the other Contracting State that spouse or child would also be exempt from tax by that other Contracting State on the remuneration for those services. The purpose of this special rule is to cover the case where the wife or child of a U.S. embassy employee in Budapest, for example, also becomes employed by the U.S. Embassy in Budapest after having established residence there. However, this relatively modest purpose is not immediately clear from the complicated language inserted in at the end of paragraph 1 in the U.S. Model. Moreover, it is unnecessary in this case because under paragraph 5 of Article 4 (Fiscal Domicile) such an individual would be considered a resident of the United States (the country of nationality) for all purposes of the treaty. Consequently, that additional language was deleted.

Paragraphs 2 and 3 of Article 16 are the same as paragraphs 2 and 3 of the U.S. Model of May 1977. Paragraph 2 provides that a pension paid by a Contracting State or a political subdivision or a local authority thereof to any individual as consideration for services rendered to that State or subdivision or local authority is taxable only in that State unless the recipient is both a national and a resident of the other State, in which case such income is taxable only in the other Contracting State. Paragraph 3 provides that the provisions of this article apply only to remuneration and pensions in respect of governmental services. Remuneration and pensions in respect of services performed in connection with a business carried on by a Contracting State or a political subdivision or local authority thereof are taxable under the provisions of Articles 13 (Independent Personal Services), 14 (Dependent Personal Services), and 15 (Pensions), as the case may be.

Article 17. TEACHERS

At the request of the Hungarian delegation, this article was inserted. It is the same as Article 17 of the income tax treaty between the United States and Poland.

The article provides that when a resident of one of the Contracting States goes to the other Contracting State for a period not expected to exceed two years for the purpose of teaching or engaging in research or both at a university or other recognized educational institution in that other State, at the invitation of that other State or of a recognized educational institution in that State, the income for personal services of teaching or research at that educational institution shall be exempt from tax by the host State for a period not exceeding two years from the date of arrival in that State. This exemption does not apply to income from research carried on primarily for private benefit. If the two year period is exceeded, the exemption is not lost retroactively; it will still apply to the first two years. However, to qualify for the exemption, the individual must have gone to the other Contracting State for a period which was not expected to exceed the two years.

Article 18. STUDENTS AND TRAINEES

This article is substantially the same as Article 20 in the U.S. Model of May 1977. It provides that a resident of one of the Contracting States who goes to the other Contracting State for the purpose of full-time education or training shall be exempt from tax in that other Contracting State on payments made to him from sources outside that State for the purpose of his maintenance, education, or training. It further provides that such a student or trainee may elect to be treated for tax purposes as a resident of the State which he is visiting for the purposes of education or training. Under this rule, a Hungarian student or trainee in the United States may elect to be taxed on his world-wide income in the United States and to claim the same deductions and personal exemptions which are available to U.S. residents. Such an election would benefit a student or trainee with limited income, especially if he is supporting dependents, since a nonresident alien is only allowed one personal exemption and may not use the zero bracket amount. The election would presumably not be made by a student or trainee with a large amount of foreign source income. Once the election is made, it may not be revoked during the time when this article is applicable, except with the consent of the competent authority of the host State.

Article 19. ALL OTHER INCOME

This article conforms to paragraph 1 of Article 21 of the U.S. Model of May 1977. It provides that any income of a resident of a Contracting State which is not covered by other articles of this treaty shall be taxable only in the residence State.

The items of income covered by this Article include annuities, alimony, child support payments, and rentals of tangible personal property.

The U.S. Model of May 1977, like the OECD Model of January 1977, contains a second paragraph which excepts from the rule of paragraph 1 income derived by a resident of a Contracting State which is effectively connected with a permanent establishment or fixed base of that resident in the other Contracting State; in such cases, the income is covered instead under the provisions of the articles dealing with business profits or independent personal services. The Hungarians agreed with this rule, but felt that it was self-evident and therefore did not wish to include specific language in this article which they would have to explain to their tax authorities and taxpayers. It was agreed that the substance of this rule would be put instead in the exchange of notes.

Article 20. RELIEF FROM DOUBLE TAXATION

Paragraph 1 of this article is taken from the U.S. Model of May 1977. It provides that the United States shall give a foreign tax credit for income taxes paid to the Hungarian People's Republic, subject to the limitations provided in U.S. law. The taxes referred to in paragraphs 2(b) and 3 of Article 2 (Taxes Covered) are considered income taxes for purposes of the credit. The treaty guarantee of a foreign tax credit is independent of the statutory grant of a credit under the Internal Revenue Code, but the amount of the credit to be allowed is determined in accordance with the limitations provided in the Internal Revenue Code. The article provides a credit both for taxes imposed on the recipient and an indirect credit for taxes paid with respect to the profits of a corporation of the Hungarian People's Republic out of which dividends are paid to a United States corporation owning at least 10 percent of the voting stock of the Hungarian corporation paying the dividends.

Paragraph 2 provides that the Hungarian People's Republic shall, with the exception of dividends from United States corporations, exempt from tax United States source income derived by residents of the Hungarian People's Republic. In the case where a resident of the Hungarian People's Republic is a United States citizen, the exemption applies to all income derived from sources within the United States; in the case of other residents of the Hungarian People's Republic, the exemption applies to income which may be taxed by the United States in accordance with the provisions of this treaty other than the "saving" clause of paragraph 2 of Article 1 (Personal Scope). In the case of dividends which may be taxed in the United States in accordance with the provisions of paragraph 2 of Article 9 (Dividends), the Hungarian People's Republic will allow a foreign tax credit for the amount of tax imposed by the United States, up to the Hungarian tax attributable to such dividends. This credit is available with respect to the United States withholding tax; Hungary was not prepared to extend the credit to also cover the underlying corporate tax on the profits out of which dividends are paid in the case of dividends from a United States subsidiary to a Hungarian parent corporation. As a practical matter, cases of Hungarian corporations deriving dividends from U.S. subsidiaries are uncommon. In the absence of a treaty, the Hungarian People's Republic taxes the worldwide income of residents and provides no statutory relief from double taxation.

The Hungarian People's Republic may take into account exempt income in determining the amount of tax on the taxable portion of income derived by residents of the Hungarian People's Republic. This method of avoiding double taxation, often referred to as "exemption with progression," is provided for in the OECD Model of January 1977 and is commonly used by countries which choose the exemption method of avoiding double taxation.

Article 21. NON-DISCRIMINATION

The provisions of this article are substantially the same as those of paragraph 1 and paragraphs 3 through 6 of Article 24 of the U.S. Model of May 1977. Paragraph 2 of Article 24 of the U.S. Model contains a definition of the term "nationals" which in this treaty appears in Article 3 (General Definitions) and is broadened to include legal persons.

Paragraph 1 provides that nationals, including legal persons as well as individuals, shall not be treated less favorably with respect to taxation and connected requirements by the other Contracting State than are nationals of that other Contracting State in the same circumstances. Nationals who are subject to tax on their worldwide income by a Contracting State are not in the same circumstances as nationals not taxed on their worldwide income by their State of nationality. Thus, United States citizens who are not residents of the United States are not in the same circumstances with respect to United States taxation as nationals of the Hungarian People's Republic who are not citizens of the United States, and therefore, the United States taxation of nationals of the Hungarian People's Republic as nonresident aliens may differ from the United States taxation of United States citizens resident in the Hungarian People's Republic without violating this provision.

Paragraph 2 provides that a Contracting State may not impose more burdensome taxes on a permanent establishment of an enterprise of the other State than it imposes on its own enterprises carrying on the same activities.

Paragraph 3 prohibits discrimination in the matter of deduction. Interest, royalties, and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State must be deductible for determining taxable profits under the same conditions as if they had been paid to a resident of the first-mentioned State. The U.S. Model contains language explaining that the term "other disbursements" includes a reasonable allocation of executive and general administrative expenses, research and development expenses, and other expenses incurred for the benefit of a group of related enterprises. That sentence was deleted from this treaty as excessively detailed and not necessary. The paragraph also provides that debts incurred by an enterprise of a Contracting State to a resident of the other Contracting State shall be deductible in determining taxable capital under the same conditions as if the debts had been contracted to a resident of the first-mentioned State.

Paragraph 4 requires that a Contracting State not impose more burdensome taxation on a subsidiary corporation owned by residents of the other Contracting State than it imposes on similar corporations which are locally owned.

Paragraph 5 repeats the statement of paragraph 4 of Article 2 (Taxes Covered) that this Article applies to taxes of every kind and description imposed by all levels of government.

Article 22. MUTUAL AGREEMENT PROCEDURE

This article is substantially the same as Article 25 of the U.S. Model of May 1977. It does not include the illustrative material in paragraph 3 of that Article which gives examples of the types of matters the competent authorities may agree to, such as a common attribution or allocation of income, deductions or credits. That elaboration, which is not found in the OECD Model, was deleted at the request of the Hungarian delegation to preserve greater uniformity with the OECD Model and because it was considered to be self-evident. Its deletion does not narrow the scope of the article.

Paragraph 1 provides that a taxpayer who considers that the actions of one or both of the Contracting States result in taxation not in accordance with the treaty, may present his case to the competent authority of the State of which he is a resident or national.

Paragraph 2 provides that the competent authority, if it considers the objection to be justified, and if it is not able to arrive at a solution itself, shall endeavor to resolve the case by mutual agreement with the competent authority of the other Contracting State. Any agreement reached shall be implemented without regard to any statutory time limits of the Contracting States. Thus, for example, if it is agreed that tax liability should be adjusted downward, a refund of the excess tax paid will be made even though the ordinary statute of limitations may have expired.

Paragraph 3 provides that the competent authorities shall endeavor by mutual agreement to resolve any difficulties or doubts which may arise in the interpretation of application of the treaty. They may also consult together to eliminate double taxation in cases not foreseen in the treaty. This language is identical to that of paragraph 3 of the OECD Model of January 1977. The same language is also found in paragraph 3 of the U.S. Model of May 1977, but as indicated above that paragraph also includes additional language giving examples of questions which might be resolved through the mutual agreement procedure.

Paragraphs 4 and 5 provide that the competent authorities may communicate with each other directly for the purpose of reaching agreements in accordance with this article and that they may prescribe regulations to carry out the purposes of the treaty. Both paragraphs are identical to paragraphs 4 and 5 of the U.S. Model of May 1977.

Article 23. EXCHANGE OF INFORMATION

The three paragraphs of this Article are identical to paragraphs 1 through 3 of Article 26 of the U.S. Model of May 1976. Except for minor language changes, these paragraphs are the same as paragraphs 1 through 3 of Article 26 of the U.S. Model of May 1977. Paragraphs 4 and 5 of the U.S. Model (both the 1976 and 1977 versions) deal with assistance in collection where treaty benefits accrue to persons not covered by the treaty. Undertaking such a collection obligation is a departure from Hungarian practice, and they preferred to deal with this issue in the exchange of notes rather than in the Article itself.

Paragraph 1 provides that the competent authorities shall exchange such information as is necessary for carrying out the provisions of the treaty or of their domestic laws concerning taxes covered by the treaty. It also provides assurances that information so exchanged will be protected in the same manner as information obtained under domestic laws with respect to secrecy and disclosure.

Paragraph 2 explains that the obligation undertaken in paragraph 1 to exchange information does not require a Contracting State to carry out measures contrary to the laws and administrative practice of either State or to supply information not obtainable under its laws or in the normal course of its administration, or to supply information which would disclose trade secrets or other information the disclosure of which is contrary to public policy.

Paragraph 3 states that when information is requested by a Contracting State in accordance with this Article, the other State shall obtain the information as if the tax in question were a tax of that other State, whether or not the case involves a tax liability in that other State. Further, the paragraph specifies that the State to which a request has been made shall provide information in forms usable in the judicial practice of the requesting State, such as depositions of witnesses and copies of unedited original documents, to the extent that such forms of information can be obtained under the laws and practices of the State to which the request is made when enforcing its own taxes.

In accordance with paragraph 4 of Article 2 (Taxes Covered) this Article applies to all taxes at the national level.

Article 24. EFFECT OF CONVENTION ON DIPLOMATIC AND CONSULAR OFFICIAL, DOMESTIC LAWS AND OTHER TREATIES

This Article corresponds to Article 27 of the U.S. Model of May 1977. Paragraph 1 provides that this treaty shall not affect taxation privileges of diplomatic or consular officials under other special agreements or under international law.

Paragraph 2 provides that the treaty shall not restrict any benefit provided by the laws of either Contracting State or by any other agreement between the Contracting States. Thus, for example, a Contracting State may not impose a tax by virtue of a provision of this treaty which allows it to tax if such a tax is not provided for under its internal law.

Article 25. ENTRY INTO FORCE

In the Hungarian People's Republic an international agreement concluded by the Government does not require ratification. Therefore, the usual wording of this Article was changed to refer to ratification "or approval" and to specify that the treaty enters into force when the parties have notified one another that their respective constitutional requirements have been met. On the United States side, this requires approval by the Senate, in which case an instrument of ratification will be signed and provided to the Hungarian People's Republic. In exchange, the Hungarian People's Republic will provide us with a notice of approval of the treaty by their Government.

Once the treaty enters into force it will have effect with respect to withholding taxes on income paid or credited on or after the first day of the second month following the entry into force of the treaty, and with respect to other taxes on income of taxable periods beginning on or after January 1 of the year following the entry into force. Thus, for example, if the treaty were to enter into force on December 1, 1979, the reduction or elmination of withholding tax at source on dividends, interest, and royalties would apply with respect to such income paid or credited begining on February 1, 1980, and the provisions concerning taxes not withheld at the source would apply as of January 1, 1980. These timing provisions are taken from Article 28 of the U.S. Model of May 1977.

Article 26. TERMINATION

The treaty shall remain in force indefinitely unless terminated by the Government of one of the Contracting States. The Government of either Contracting State may terminate the treaty after five years from the date on which it enters into force by giving at least six months' prior notice through diplomatic channels. In that event, the treaty will cease to have effect with respect to taxes withheld at the source for income paid or credited beginning on January 1 of the following year, provided that the six months' period of notice has expired by that time (i.e., if notice is given by June 30 of one year, the termination will be effective on January 1 of the following year). With respect to other taxes, the termination would be effective with respect to taxable periods beginning on or after January 1 of the following year, again providing that the six months' period has expired by that time.

EXCHANGE OF NOTES

As indicated in the respective Articles, it was agreed that a number of points would be covered in an exchange of notes to accompany the treaty rather than in the body of the treaty articles themselves. The primary reason for moving these points to an exchange of notes was to simplify the text of the treaty by removing from it a number of points which were considered elaborations of points already made or implicit in the articles. In one case with reference to assistance in collection, the provision was moved to the exchange of notes because it is regarded by Hungary as an exception to its ordinary treaty policy; no similar provision is included in the OECD Model and the issue had not previously been encountered by the Hungarian People's Republic. The exchange of notes constitutes a part of the treaty and is legally binding on the parties.

Paragraph 1 simply states that the Hungarian People's Republic will not impose a tax on dividends paid by a U.S. corporation out of profits of a joint venture in Hungary. The remittance tax provided under Hungarian law will be imposed, at the reduced rates provided in paragraph 2 of Article 9 (Dividends), on distributions to U.S. partners in joint ventures; no second tax will be imposed on such distributions.

Paragraph 2 provides the same rule with respect to the income covered under Article 19 (All Other Income) that is provided separately in Articles 9 (Dividends), 10 (Interest), and 11 (Royalities), to the effect that when such income is effectively connected with a permanent establishment or fixed base of the recipient of the income in the other Contracting State, it will be taxed in accordance with the provisions of Article 7 (Business Profits) or Article 13 (Independent Personal Services).

Paragraph 3 states that each Contracting State may apportion or allocate income, deductions, credits, and allowances between related enterprises of the two Contracting States in accordance with its internal law. The United States will apply its rules and procedures under section 482 of the Internal Revenue Code. The wording of this provision, which refers to "enterprises" and "dealings" and considers only related enterprises of the two Contracting States is not intended to limit the scope of application of section 482. It was agreed that both Contracting States would deal with non-arm's-length transactions in accordance with the provisions of its internal law. However, the Hungarian delegation objected to spelling out the scope of such laws in the treaty, finding the language of both the U.S. Model and the OECD Model on this point excessively complex. It was therefore decided to simply refer to internal law in the exchange of notes and allow each State to apply its law as it would do in the absence of a treaty. Similarly, the treatment of excessive interest or royalties paid between related persons will be resolved in accordance with internal law.

Paragraph 4 contains the rules usually found in paragraphs 4 and 5 of the Article on exchange of information and administrative assistance (Article 26 in the U.S. Model of May 1977). The Hungarian People's Republic agrees to attempt to collect on behalf of the United States the additional tax due to the United States when a resident of a third country receives dividends, interest, or royalties in Hungary from which U.S. tax has been withheld at the reduced treaty rate or waived under the treaty when the recipient, not being a resident of Hungary, is not entitled to the benefits of the treaty. The provision is worded reciprocally, but is probably less relevant for Hungary which imposes its dividend tax on the distributing entity and does not withhold tax on interest paid abroad, so that the only relevant case would be with respect to the Hungarian tax on royalty payments. It is agreed that neither Contracting State in fulfilling this commitment is required to carry out administrative measures different from those used to collect its own taxes or contrary to its sovereignty, security or public policy.

Part IV. Items of General Interest

Revision to Form 4970, Tax on Accumulation Distribution of Trusts and Form 1116, Computation of Foreign Tax Credit

Announcement 80-3

Forms 4970 and 1116 have been revised in order to provide a year designation (1979). Previously, both forms were revised only periodically. They will now be revised each year.

Form 1116 was also revised to eliminate the need for a separate Form 1116 if income from sources within U.S. possessions is received in addition to foreign source income.

The Form 4970 (Revised October 1978) and Form 1116 (Revised November 1978) should not be used for tax years beginning in 1979.

Both new forms are now available in Service offices.

Foundation Status of Certain Organizations

Announcement 80-4

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contribtors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3) of the Code, eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

A New Day, Inc., Albuquerque, NM
Action Ministry, Montclair, NJ
Action Research Corp., Princeton, NJ
Alumni and Booster Club of Warren, The, Warren, RI
Animal Welfare Association of Valencia County, Inc., Los Lunas, NM
Artisans Bettering Livelihood and Education, Inc., South Boston, MA
Association for the Reformation of Alcoholism, Inc., New Bern, NC
Association for Urban Recording Arts and Sciences, Newark, NJ
Bindery, Inc., The, Jersey City, NJ
Birthright of Knoxville, Inc., Knoxville, TN
Boys' Club of Beeville, Inc., Beeville, TX
Bridge Ministries, Inc., The, Delanco, NJ
Buffalo-Johnson County Council of Fine Arts, Buffalo, NY
Christian Counseling and Psychotherapy Service, Houston, TX
City Studio Theater, Inc., Northampton, MA
Coastal Home Health Agency, Inc., Cherry Hill, NJ
Colorado Native Plant Society, The, Boulder, CO
Community Help and Involvement in Low Income Decisions, Warwick, RI
Community Operational Project Foundation, Newark, NJ
Consumer Action Board, Bloomfield, NJ
Cooperating Campus Ministries of Union County, Inc., Westfield, NJ
Corporation for Educational Research, Inc., Dallas, TX
Crossroads of Life, The, Denver, CO
Current Abstracts in the Neurosciences, Princeton, NJ
Dayton Area Citizens Committee for Special Education, Dayton, OH
Deaf Social Service Agency for the Tri-State, Inc., Evansville, IN
Doctors Fund for Health Services, Hartford, CT
Downtown Urban Housing Association, Jersey City, NJ
Environmental Action Institution, Inc., North Plainfield, NJ
Exceptional Citizens of Old Bridge, Matawan, NJ
Fine Arts Gallery at Wright State University, Dayton, OH
Fondo San Isidro, Inc., Pueblo, CO
For the Benefit of Concerned People Through Entertainment, Inc., Bricktown, NJ
Friends of the Paul Sawyer Public Library, Inc., Frankfort, KY
Goodwill Industries of KYOWVA Area, Inc., Huntington, WV
Gospel Evangelistic Temple, Newark, NJ
Great American Basketball League, Inc., Overland Park, KS
Greater South Texas Economic Programs, Inc., Hebbronville, TX
Gulf Breeze High School Athletic Association, Inc., Gulf Breeze, FL
Handicapped Association of Louisiana, Alexandria, LA
Hear Foundation, Summit, NJ
Here's Life Golden Triangle, Inc., Orange, TX
Here's Life, Monroe, Inc., Monroe, LA
Historical Society of Hopkins County, Inc., Madisonville, KY
Home of Peace Foundation, Trenton, NJ
Institute of Holography, Inc., The, Parlin, NJ
Inter.-Ed, Inc., New Haven, CT
Jewish Federation Housing, Inc., Cherry Hill, NJ
MAIR, Inc., Dayton, OH
Madison County Council on Aging, Inc., Richmond, KY
Madison County Opportunities Industrial Centers (OIC), Anderson, IN
Marion Press, Francis, Florence, SC
Marriage Encounter of Georgia, Inc., Atlanta, GA
Mendham Township Athletic Association, Inc., Brookside, NJ
Merry-Maker (Christian Coffee House), Hiram, GA
Mid-Coast Radio Project, Inc., Kansas City, MO
Montgomery Theatre Guild, Montgomery, AL
Music Club of Greenville, The, Greenville, SC
New England Lenderships, Inc., Hanover, MA

New Haven Dance Theatre Co., Inc., New Haven, CT

New Jersey Town Opera, South Orange, NJ

Northwest Florida Environmental Enhancement Foundation, Inc., Pensacola, FL

Norwich Soviet Jewry Resettlement Committee, Inc., Norwich, CT

Ocean County Association for Children with Learning Disabilities, Inc., Island Heights, NJ

Ohio Association for Areawide Health Planning, Cincinnati, OH

Ohio Coalition of Runaway Youth and Family Crisis Services, Inc., Columbus, OH

Operation Youth, Inc., Brunswick, OH

Our Lady of Hope Society, Toledo, OH

Passaic River Basin Archaeological Survey, Newark, NJ

Pennyrile Performing Arts Association, Inc., Madisonville, KY

Preventive Medicine Association, Mount Holly, NJ

Princeton Journal of the Arts of Sciences c/o Princeton University, The, Princeton, NJ

Professional Association for Comprehensive Evaluation and Remediation, Inc., Boulder, CO

Promise, Mooresville, NC

Puerto Rican Unity for Progress, Camden, NJ

Rabat American School Association, Inc., Princeton, NJ

Rahway Senior Housing Corp., East Orange, NJ

Rape Crises Center of Southeast Texas, Inc., Beaumont, TX

Rathbun Area Health Services, Inc., Centerville, IA

Reynolds Circle, The, Hillside, NJ

Rockwall County's Helping Hands, Rockwall, TX

Rocky Hill Theatre Guild, Inc., Rocky Hill, CT

Sexual Assault Crisis Center Fox Cities, Inc., Appleton, WI

Sharaqua Publishing Company, Beachwood, OH

Society for the Prevention of Animal Experimentation, The, South Plainfield, NJ

Social and Economic Assistance Corporation, Albuquerque, NM

South Jersey Information Service, Cherry Hill, NJ

South Texas Cleft Palate and Cranio-Facial Anomalies Team, Inc., Corpus Christi, TX

Southeastern Association for the Handicapped, Inc., Augusta, GA

Southern Center for Military and Veterans Rights, Atlanta, GA

Sullivan County Historical Society, Blountville, TN

Swedish Challenge for the Americas Cup, Inc., West Hartford, CT

Task Force for Children and Youth, Inc., Canon City, CO

Texas Southmost College Alumni Association, Brownsville, TX

Texas Wendish Heritage Society, Inc., Giddings, TX

Theatre Lab West, Denver, CO

Turn On To Denver, Denver, CO

Universal Temple, Inc., McAllen, TX

Waldwick, New Jersey Chapter of American Field Service, Waldwick, NJ

Western Reserve Humane Society, Mentor, OH

Wholistic Living Center, Inc., Brookline, MA

Winchester Art Guild, Inc., The, Winchester, KY

Women's Image Takeover, Inc., Northampton, MA

Yancey Evangelistic Association, Inc., Rex, Tupelo, MS

Youngstown Leukemia Fund, Inc., Youngstown, OH

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Revised Form 3115

Announcment 80-5

Form 3115, Application for Change in Accounting Method, has been revised to provide faster and more efficient processing of applications. The revised Form 3115 can be identified by the legend "(Rev. Nov. 1979)" in the upper left corner. Applications filed after January 31, 1980, should be made on the new form.

When an obsolete or incomplete Form 3115 is filed, the Internal Revenue Service will send a notice to the applicant identifying those items that have to be corrected along with a current blank form where appropriate. The Service will generally grant up to 30 days for time to submit additional information.

Form 3115 is available at Service offices.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants and Enrolled Agents from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following persons have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Richard O. Bertoli	Sparkhill, NY	Certified Public Accountant	Indefinite effective November 2, 1979
Slathern E. Gassiott	Port Arthur, TX	Certified Public Accountant	Thirty months effective November 19, 1979
Leonard M. Bernes	Atlanta, GA	Certified Public Accountant	Indefinite effective December 5, 1979

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.412(b)-5 added.	Procedures for electing an alternative amortization method of funding certain pension plans.	Nov. 23, 1979	Jan. 21, 1980
26 CFR 1.461-3, 1.6151-1—1.6302-2 and intermediate sections, 31.6071(a)-1—31.6302(c)-3 and intermediate sections, 36.3121(1)(10)-4, 46.6071(a)-1, 46.6151-1, 46.6302(c)-1, 48.6071(a)-1, 48.6151-1, 48.6302(c)-1, 49.6151-1, 49.6302(c)-1, 154.2-1, 301.6302-1, 301.6402-4, 301.7502-1, 601.401 amended; 301.7502 deleted; 301.7502-2 added.	Timeliness of tax returns, payments and deposits.	Dec. 11, 1979	Feb. 11, 1980
26 CFR 1.1033(a)-1, 1.1033(a)-2, 7.0, amended; 1.1033(g)-1 redesignated as 1.1033(h)-1 and amended; 1.1033(f)-1 redesignated as 1.1033(g)-1 and amended.	Election to treat outdoor advertising displays as real property.	Dec. 11, 1979	Feb. 11, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

Numerical Finding List[1]

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1, dated January 7, 1980.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1 I.R.B., dated January 7, 1980.

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______	1930–2	9.50
______	*1931–1*	*3.60*
______	*1931–2*	*3.25*
______	*1932–1*	*2.80*
______	1932–2	8.65
______	*1933–1*	*3.35*
______	*1933–2*	*3.45*
______	*1934–1*	*3.70*
______	*1934–2*	*4.10*
______	1935–1	6.90
______	*1935–2*	*4.00*
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______	*1937–1*	*3.75*
______	1937–2	7.70
______	*1938–1*	*4.05*
______	*1938–2*	*3.50*
______	1939–1–1	8.25
______	1939–1–2	10.90
______	1939–2	9.40
______	1940–1	5.55
______	1940–2	14.00
______	1941–1	*$6.95*
______	*1941–2*	*3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
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______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*2.65*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$10.10
______	1957–2	13.00
______	1958–1	9.60
______	1958–2	13.00
______	1958–3	15.00
______	1959–1	15.00
______	1959–2	9.60
______	1960–1	9.00
______	1960–2	11.50
______	1961–1	14.00
______	1961–2	10.00
______	1962–1	6.20
______	1962–2	7.15
______	1962–3	15.00
______	1963–1	9.00
______	1963–2	10.75
______	1964–1–1	10.00
______	1964–1–2	11.00
______	1964–2	9.80
______	1965–1	10.70
______	1965–2	12.25
______	1966–1	9.25
______	1966–2	14.05
______	1967–1	10.00
______	1967–2	10.00
______	1968–1	14.00
______	1968–2	11.75
______	1969–1	7.50
______	1969–2	6.50
______	1969–3	$12.50
______	1970–1	11.00
______	1970–2	14.00
______	1971–1	10.55
______	1971–2	8.50
______	1972–1	13.50
______	1972–2	13.70
______	1973–1	13.20
______	1973–2	8.30
______	1974–1	11.00
______	1974–2	9.95
______	*1974–3*	*8.20*
______	1974–3 Supp.	10.00
______	1975–1	13.25
______	1975–2	13.00
______	1976–1	11.00
______	1976–2	10.25
______	1976–3–1	9.50
______	1976–3–2	16.00
______	1976–3–3	10.00
______	1977–1	10.75
______	1977–2	11.75
______	1978–1	11.75
______	1978–2	13.00
______	1978–3–1	12.25
______	1978–3–2	9.00
______	1979–1	14.00

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CUMULATIVE BULLETINS

The contents of the weekly Bulletin are consolidated semiannually into a permanent, indexed, Cumulative Bulletin. These are sold on a single copy basis and *are not* included as part of the subscription to the Internal Revenue Bulletin. Subscribers to the weekly Bulletin are notified when copies of the Cumulative Bulletin are available. Certain issues of Cumulative Bulletins are out of print and are not available. Persons desiring available Cumulative Bulletins, which are listed on the reverse, may purchase them from the Superintendent of Documents.

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January 21, 1980
Bulletin No. 1980-3

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Internal Revenue
bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-17, page 5.
Losses; foreign confiscation of property; resident alien. A citizen of a foreign country left that country under a limited exit visa to become a U.S. resident, leaving behind assets of a personal service business and corporate stock. The policy of the foreign country was to prevent those leaving on such a visa from receiving or enjoying property left there. Upon failure to return at the visa's expiration, the foreign citizen's property was confiscated under the foreign country's law. The foreign citizen's enjoyment of ownership rights (including the right to receive income from the property) terminated on departure from that country prior to becoming a U.S. resident, and no loss deduction is allowable. Rev. Ruls. 62-197 and 64-149 distinguished.

Rev. Rul. 80-18, page 7.
Contracts; long-term; engineering services. A taxpayer providing engineering services is not entitled to adopt or use either the completed contract or percentage of completion method of accounting.

Rev. Rul. 80-19, page 9.
Farmer; Commodity Credit Corporation loan; wheat pledged as collateral. A cash method wheat farmer obtained a loan from the Commodity Credit Corporation pledging that year's crop as collateral. The farmer elected under section 77 of the Code to include the loan proceeds in gross income. The next year the loan was repaid and the crop pledged as collateral was redeemed. Thirteen months later the redeemed crop was sold at a price that exceeded the amount of the loan. The crop was not a capital asset, and the excess sale price for the crop over its basis, as adjusted under section 1016(a)(8), is includible in the farmer's gross income as ordinary income.

Rev. Rul. 80-22, page 15.
Information returns; hail crop insurance proceeds. A mutual casualty insurance company is not required to file an information return to report hail crop insurance proceeds paid to a farmer if the farmer is required to capitalize expenses pursuant to section 278 or 477 of the Code and has informed the company that the expenses have been capitalized; Rev. Rul. 78-110 clarified.

T.D. 7659, page 8.
Amendments to the regulations under section 1212 of the Code relate to the allowable period to which a regulated investment company must carry forward a net capital loss.

EMPLOYEE PLANS

Rev. Rul. 80-16, page 6.
Profit-sharing plans; cash or deferred; distribution and forfeitability requirements; change to separate accounts. A corporation's qualified profit-sharing plan requires each employee to make an irrevocable election, prior to the end of

(Continued on page 4)

Finding Lists begin on page 25.
Announcement of Voluntary Suspensions on page 22.
Announcement Relating to Notices of Proposed Rulemaking on page 23.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue Rulings represent the conclusions of the Service on the application of the law to the entire state of facts involved. In those that are based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and confidential information are deleted to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part includes rulings and decisions based on Subpart A, Tax Conventions and related Treasury Decisions and Revenue Rulings; Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

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Highlights of this Issue—Continued

(Continued from page 1)

EMPLOYEE PLANS—Cont'd

the year, to take the employee's share of the current year's profits in cash, on a deferred basis, or half cash and half deferred. The plan was amended, effective for 1980, so that deferred employer contributions are held in accounts subject to the restrictions on distributions and forfeitability required by section 401(k)(2)(B) and (C) of the Code, but amounts attributable to contributions made for plan years beginning before 1980 are maintained in separate accounts that are not subject to such restrictions. The plan will be considered to include a "qualified cash or deferred arrangement" within the meaning of section 401(k)(2). Rev. Ruls. 56-497, 63-180, and 68-89 obsoleted.

Announcement 80-6, page 21.
The tax treatment is set forth for certain employer contributions, made pursuant to an employee election, to qualified profit-sharing or stock bonus plans that contain a cash or deferred arrangement and that do not meet the requirements of section 401(k) of the Code.

EXCISE TAXES

Rev. Rul. 80-20, page 10.
Exemption; educational organization; vocational rehabilitation center. A nonprofit corporation operates a vocational rehabilitation center for handicapped individuals that provides classroom training, on-the-job training and employment in its sheltered workshops and retail stores, and related services. Neither the corporation nor its workshops, retail stores, and related services qualify as nonprofit educational organizations under sections 4041(g)(4), 4221(a)(5), and 4253(j) of the Code. However, the classroom training program, including instruction given in the workshops as part of the program, does qualify. Rev. Rul. 64-264 clarified and superseded.

Rev. Rul. 80-21, page 12.
Exemption; educational organization; wilderness camping program for adolescents. A nonprofit corporation that operates a wilderness camping program to rehabilitate and provide counseling to adolescents who have emotional and behavioral problems is not a nonprofit educational organization for purposes of sections 4041(g)(4) and 4221(a)(5) of the Code.

T.D. 7658, page 13.
Amendments to the regulations under sections 4041 and 4081 of the Code relate to the exemption from motor fuels excise taxes for gasohol.

ADMINISTRATIVE

Statement of Procedural Rules, page 17.
Additions to the Statement of Procedural Rules relate to cooperative agreements the Service will enter into with private or public non-profit agencies or organizations to establish a network of trained volunteers to provide free tax information and return preparation assistance to the elderly.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-4: Gross income of farmers.

Whether sale of a wheat crop that was redeemed after being pledged as collateral for a Commodity Credit Croporation loan was a sale of a capital asset. See Rev. Rul. 80-19, page 9.

Section 77.—Commodity Credit Loans

26 CFR 1.77-1: Election to consider Commodity Credit Corporation loans as income.

Whether sale of a wheat crop that was redeemed after being pledged as collateral for a Commodity Credit Corporation loan was a sale of a capital asset. See Rev. Rul. 80-19, page 9.

Section 165.—Losses

26 CFR 1.165-1: Losses.
(Also Sections 871, 873; 1.871-1.)

Losses; foreign confiscation of property; resident alien. A citizen of a foreign country left that country under a limited exit visa to become a U.S. resident, leaving behind assets of a personal service business and corporate stock. The policy of the foreign country was to prevent those leaving on such a visa from receiving or enjoying property left there. Upon failure to return at the visa's expiration, the foreign citizen's property was confiscated under the foreign country's law. The foreign citizen's enjoyment of ownership rights (including the right to receive income from the property) terminated on departure from that country prior to becoming a U.S. resident, and no loss deduction is allowable. Rev. Ruls. 62-197 and 64-149 distinguished.

Rev. Rul. 80-17

ISSUE

Is a resident alien allowed an income tax deduction under section 165 of the Internal Revenue Code as a result of a confiscation of property by a foreign government under the circumstances described below?

The taxpayer, *A*, is a citizen of foreign country *X*. *A* decided to leave *X* to become a resident of the United States, in order to escape the political conditions existing in *X*. On May 31, 1978, *A* left *X* under a limited exit visa. There was little likelihood that the political conditions in *X* would change to satisfy *A* during the period of the exit visa.

X maintains strict control over persons and property leaving and entering its territory. When *A* departed, *A* left behind in *X* property consisting of the assets of a personal service business and stock of a corporation incorporated in *X*. The law of *X* provided that any citizen who had not returned to *X* at the expiration of a limited exit visa would be considered to have abandoned *X*, and the property of such citizen would be considered nationalized. Although the statutes of *X* were silent on the subject, it was *X*'s policy to prevent persons out of the country on a limited visa from receiving or otherwise enjoying property or the income from property in *X* during the period of their absence from *X*.

On June 1, 1978, *A* entered the United States and became a resident alien. *A* did not return to *X*.

In 1978, after the expiration of *A*'s visa, country *X* confiscated all of *A*'s property in *X*.

In the period June 1, 1978, through December 31, 1978, *A* started and operated a new business in the United States that was unrelated to the property left behind in *X*. On *A*'s federal income tax return for the 7-month period ending December 31, 1978, *A* claimed a loss for the 1978 confiscation by *X* of the property consisting of the assets of the personal service business and the stock.

LAW AND ANALYSIS

Section 165(a) of the Code provides for the deductibility of losses sustained during the taxable year and not compensated for by insurance or otherwise.

Section 165(c) of the Code provides that the deduction for losses in the case of an individual is limited to (1) losses incurred in a trade or business, (2) losses incurred in any transaction entered into for profit, though not connected with a trade or business, and (3) losses of property not connected with a trade or business if such losses arise from fire, storm, shipwreck, or other casualty, or from theft.

Section 873 of the Code provides that a nonresident alien is allowed the deductions provided by section 165(c) (1) and (2), but only if and to the extent that the deductions are connected with income that is effectively connected with the conduct of a trade or business within the United States.

Losses sustained through confiscation or seizure of property under the laws of a foreign country are not casualty or theft losses within the meaning of section 165(c)(3) of the Code. See *Powers v. Commissioner,* 36 T.C. 1191 (1961). Thus, the instant revenue ruling is limited to determining whether the losses are incurred either in a trade or business under section 165(c)(1) or in a transaction entered into for profit under section 165(c)(2).

A was a nonresident alien until *A* arrived in the United States and *A*'s property in *X* had no connection with the conduct by *A* of a trade or business in the United States. Therefore, because of section 873 of the Code, it follows that if *A*'s loss occurred while *A* was a nonresident alien, *A* cannot qualify for a loss deduction under section 165(c)(1) or (2).

When *A* departed from *X* on May 31, 1978, with the intention of becoming a resident of the United States, *A*'s reason for doing so was to escape the political conditions existing in *X*. There was little likelihood that these conditions would change during the period of the exit visa. Based on these facts, it may reasonably be inferred that *A* intended not to return to *X* to resume operation and control of the property or recover the income before the expiration of *A*'s visa to the United States. Thus, for practical purposes, *A*'s enjoyment of ownership rights in the property in country *X* terminated at the time *A* departed from *X*. Therefore, the loss of *A*'s property occurred before *A* became a United States resident alien.

However, even if *A* is considered to have incurred the loss by reason of the confiscation of the property in *X*, after *A* became a resident alien of the United States, a deduction for a section 165(c)(1) or (2) loss is still disallowed under *A*'s circumstances.

Allowance of a loss deduction under both section 165(c)(1) and (2) of the Code have been held by various courts to have the common prerequisite that there be a good faith expectation of profit from the business or investment venture that generated the loss. *See Mercer v. Commissioner,* 376 F.2d 708 (9th Cir. 1967). The courts reason that a loss deduction is allowed under section 165(c)(1) or (2), if the profit, had there been any, would have been taxable. *See Heiner v. Tindle,* 276 U.S. 582 (1928), VII-2 C.B. 272 (1928). It reasonably follows that no loss deduction is permitted when the facts indicate that there was little likelihood that the profits would have been taxable had the business produced profits instead of losses. The taxpayer's expectation is not material for this determination.

Thus, two requirements exist for a loss deduction under section 165(c)(1) or (2). There must be a good faith expectation of profit. There must also be a likelihood that if there had been profits instead of losses, they would have been taxable by the United States.

Normally, when a nonresident alien individual changes status to that of citizen or resident of the United States, income from the individual's foreign business and investment property will be subject to United States income tax. *A*, however, could not receive or otherwise enjoy *A*'s property or the income from such property in *X* unless *A* gave up United States residency and returned to *X* before the visa expired. If *A* did return to *X* before the visa expired, *A* would be subject to *X*'s control and the income from *A*'s property would not be subject to United States taxation because *A* would be a nonresident alien and the income would not be from a source within the United States. See section 1.871-1 of the regulations.

HOLDING

A is not allowed a reduction for the loss of property in *X* under section 165(c)(1) or (2) of the Code, because the loss occurred while *A* was a nonresident alien and such a deduction for a nonresident alien is precluded by section 873. Further, *A* is not allowed a deduction under section 165(c)(1) or (2) of the Code for the confiscation of the property in *X* in 1978, because if that property had produced profits, those profits would not have been subject to United States income tax.

Rev. Rul. 62-197, 1962-2 C.B. 66, and Rev. Rul. 64-149, 1964-1 (Part I) C.B. 233, which hold that the confiscation of property of United States citizens or residents by foreign governments is a deductible loss, are distinguishable from the instant situation. In the situations described in those revenue rulings the confiscated property had been owned by a United States citizen or resident prior to the existence of any facts indicating that such property or the income therefrom would be confiscated. Therefore, the loss was incurred by a United States citizen or resident, not a nonresident alien. Furthermore, up until shortly before the loss occurred, there was no indication that the income from the property would not have been subject to United States taxation.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 62-197 and Rev. Rul. 64-149 are distinguished.

Section 278.—Capital Expenditures Incurred in Planting and Developing Citrus and Almond Groves; Certain Capital Expenditures of Farming Syndicates

26 CFR 1.278-1: Capital expenditures incurred in planting and developing citrus and almond groves.

Whether a mutual casualty insurance company is required to file a Form 1099-MISC to report the payment of hail crop insurance proceeds to a farmer if the farmer informs the insurance company that expenses have been capitalized pursuant to either section 278 or 447 of the Code. See Rev. Rul. 80-22, page 15.

Section 401.—Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401-1: Qualified pension, profit sharing and stock bonus plans.

Profit-sharing plans; cash or deferred; distribution and forfeitability requirements; change to separate accounts. A corporation's qualified profit-sharing plan requires each employee to make an irrevocable election, prior to the end of the year, to take the employee's share of the current year's profits in cash, on a deferred basis, or half cash and half deferred. The plan was amended, effective for 1980, so that deferred employer contributions are held in accounts subject to the restrictions on distributions and forfeitability required by section 401(k)(2)(B) and (C) of the Code, but amounts attributable to contributions made for plan years beginning before 1980 are maintained in separate accounts that are not subject to such restrictions. The plan will be considered to include a "qualified cash or deferred arrangement" within the meaning of section 401(k)(2). Rev. Ruls. 56-497, 63-180, and 68-89 obsoleted.

Rev. Rul. 80-16 [1]

Advice has been requested whether a profit-sharing plan includes a "qualified cash or deferred arrangement" within the meaning of section 401(k) of the Internal Revenue Code, under the circumstances described below.

In 1973 the *M* corporation established a profit-sharing plan and trust that qualified under section 401(a) of the Code. The portion of the company's profits to be shared is allocated among participants in proportion to their annual compensation. Prior to the close of the calendar year, each eligible employee is required to make an irrevocable election whether to take the employee's share of the current year's profits (1) in cash, (2) at a future date under the terms of the profit-sharing plan, or (3) one-half in cash and one-half deferred. After the close of the year, a cash payment is made to all employee participants who elect to receive cash, and the balance is contributed to the trust for the benefit of employee participants who elect to have their shares deferred.

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[1] Also released as News Release, IR-2191, dated December 28, 1979.

The *M* corporation amended the plan effective for 1980. Under the plan, as amended, amounts accumulated by the trust which are attributable to or derived from employer contributions made for plan years beginning after December 31, 1979, and which are attributable to the employee's election described above are held in accounts subject to the restrictions on distributions and forfeitability required by section 401(k)(2)(B) and (C) of the Code. However, the amended plan provides that amounts attributable to contributions made for plan years beginning *before* January 1, 1980, are maintained in separate accounts which are not subject to the restrictions of section 401(k)(2)(B) and (C).

Section 401(k) of the Code, effective for plan years beginning after December 31, 1979, provides certain special rules for a qualified profit-sharing plan that contains a "qualified cash or deferred arrangement". To be a "qualified cash or deferred arrangement" under section 401(k)(2), such an arrangement must, in accordance with section 401(k)(2)(A), provide an election for covered employees to have the employer make payments as contributions either to the trust or directly to the employee in cash, and contain the restrictions on distributions and forfeitability enumerated in section 401(k)(2)(B) and (C).

For plan years beginning after 1979, a profit-sharing plan and trust containing a cash or deferred arrangement will not be required to impose the restrictions of section 401(k)(2)(B) and (C) of the Code on any participant's separate account that is attributable to plan years beginning before 1980 in order to satisfy the requirements of section 401(k).

In this case the plan contains an arrangement that satisfies the requirements of section 401(k)(2)(A). Further, it satisfies section 401(k)(2)(B) and (C) because the amounts attributable to pre-1980 contributions which are not subject to the restrictions of section 401(k)(2)(B) and (C) are held in separate accounts.

Accordingly, this profit-sharing plan includes a "qualified cash or deferred arrangement" within the meaning of section 401(k)(2) of the Code.

Rev. Rul. 56-497, 1956-2 C.B. 284, held that a cash or deferred profit-sharing arrangement could qualify as a profit-sharing trust under section 401(a) of the Code. Rev. Rul. 63-180, 1963-2 C.B. 189, and Rev. Rul. 68-89, 1968-1 C.B. 402 provided guidelines as to the income tax and estate tax treatment of cash or deferred profit-sharing plans.

In view of the enactment of section 401(k) of the Code, Rev. Rul. 56-497, Rev. Rul. 63-180, and Rev. Rul. 68-89 are obsoleted for plan years beginning after December 31, 1979.

Section 446.—General Rule for Methods of Accounting

26 CFR 1.446-1: General rule for methods of accounting.

Whether a taxpayer that is engaged in providing engineering services is entitled to adopt or use the completed contract or the percentage of completion method of accounting provided under section 1.451-3 of the regulations in reporting its income. See Rev. Rul. 80-18, this page.

Section 447.—Method of Accounting for Corporations Engaged in Farming

Whether a mutual casualty insurance company is required to file a Form 1099-MISC to report the payment of hail crop insurance proceeds to a farmer if the farmer informs the insurance company that expenses have been capitalized pursuant to either section 278 or 447 of the Code. See Rev. Rul. 80-22, page 15.

Section 451.—General Rule for Taxable Year of Inclusion

26 CFR 1.451-3: Long-term contracts. (Also Section 446; 1.446-1.)

Contracts; long-term; engineering services. A taxpayer providing engineering services is not entitled to adopt or use either the completed contract or percentage of completion method of accounting.

Rev. Rul. 80-18

ISSUE

Is a taxpayer that is engaged in providing engineering services entitled to adopt or use either the completed contract or the percentage of completion method of accounting provided under section 1.451-3 of the Income Tax Regulations in reporting its income?

FACTS

The taxpayer is engaged in the business of providing engineering and related services and has entered into a contract with a foreign government that provides for payment on an agreed fixed rate basis. The contract was not completed in the taxable year in which it was entered into, and the method of payment to the taxpayer is an amount based on a fixed-rate per person-month. This amount was negotiated for each type of employee needed by the taxpayer to perform under the contract. This negotiated fixed rate included the taxpayer's labor cost, overhead, and profit. During the life of the contract the taxpayer billed the foreign government at the negotiated fixed rate for labor performed, subject to a specified overall limitation as to the total amount which can be billed on the contract.

The services required of the taxpayer under this contract were divided into three categories: pre-design operations, design services, and supervision of the construction. The pre-design operations included drilling operations, soil sampling and testing, aerial photogrammetric operations, and oceanographic operations. The supervision of construction on this contract included training and supervision of the contractors who perform the actual construction on the projects. The allocation by the taxpayer of the total contract price to be paid between these three categories of services was approximately as follows: 15 percent for pre-design, 35 percent for design, and 50 percent for supervision of construction.

LAW AND ANALYSIS

Section 451 of the Internal Revenue Code provides that the amount of any item of gross income shall be included in gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for in a different period.

Section 1.446-1(a)(2) provides that no uniform method of accounting can be prescribed for all taxpayers and that each taxpayer shall adopt such forms and systems as are, in the taxpayer's judgment, best suited to the taxpayer's needs. However, no method of accounting is acceptable unless, in the opinion of the Commissioner, it clearly reflects income.

Section 1.451-3(a)(1) of the regulations provides that income from a long-term contract may be included in gross income in accordance with one of the two long-term contract methods, namely, the percentage of completion method or the completed contract method.

Section 1.451-3(b)(1)(i) of the regulations provides that the term "long-term contract" means a building, installation, construction or manufacturing contract which is not completed within the taxable year in which it is entered into.

Rev. Rul. 70-67, 1970-1 C.B. 117, holds that an architect is not entitled to report income on the completed contract method. The basis of this ruling is that the architect's contracts do not qualify as long-term contracts because an architect does not build or construct anything, but simply draws the plan and supervises the work of construction. Rev. Rul. 70-67 also explains that one of the reasons why permission to report on a completed contract basis is given in the case of building, installation, and construction contracts is the fact that there are changes in the price of articles to be used, losses and increased cost due to strikes, weather, etc., penalties for delay, and unexpected difficulties in laying foundations which makes it impossible for any construction contractor, no matter how carefully the contractor may estimate, to tell with any certainty whether the contractor has derived a gain or sustained a loss until a particular contract is completed. This situation, however, does not apply to the taxpayer in the instant case. The taxpayer is not affected by the foregoing problems affecting the contractor.

The services which the taxpayer in the present situation performs under its contract are primarily engineering services and supervision of construction. Like the architect's services in Rev. Rul. 70-67, the contract the taxpayer entered into did not require the taxpayer to actually construct or build anything even though the taxpayer's services are functionally related to activities which may be the subject of long-term contracts as defined in section 1.451-3(b)(1)(i) of the regulations.

HOLDING

The taxpayer's engineering contract does not qualify as a long-term contract within the meaning of section 1.451-3(b)(1)(i) of the regulations, and the taxpayer is not entitled to adopt or use either the completed contract or percentage of completion method provided under section 1.451-3.

Section 871.—Tax on Nonresident Alien Individual

26 CFR 1.871-1: Classification and manner of taxing alien individuals.

Whether a resident alien under described circumstances is allowed an income tax deduction for a confiscation of property by a foreign government. See Rev. Rul. 80-17, page 5.

Section 873.—Deductions

Whether a resident alien under described circumstances is allowed an income tax deduction for a confiscation of property by a foreign government. See Rev. Rul. 80-17, page 5.

Section 1016.—Adjustments to Basis

26 CFR 1.1016-5: Miscellaneous adjustments to basis.

Whether sale of a wheat crop that was redeemed after being pledged as collateral for a Commodity Credit Corporation loan was a sale of a capital asset. See Rev. Rul. 80-19, page 9.

Section 1212.—Capital Loss Carrybacks and Carryovers

26 CFR 1.1212-1: Capital loss carryovers and carrybacks.

T.D. 7659

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Capital loss carryovers for regulated investment companies

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the allowable period to which a regulated investment company must carry forward a net capital loss. Changes to the applicable tax law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1]. The regulations provide the public with the guidance needed to comply with these changes.

DATES: The amendment pertaining to the extension of the capital loss carryover period for regulated investment companies is effective for taxable years ending after December 31, 1969. The amendment pertaining to the term "capital gain net income" is effective for taxable years beginning after December 31, 1976.

FOR FURTHER INFORMATION CONTACT: Kent J. Schreiner of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202/566-3803).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On July 6, 1979, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 1212 of the Internal Revenue Code of 1954 (44 FR 39476). These amendments were proposed to conform the regulations to sections 1403 and 1901(b)(33)(O) of the Tax Reform Act of 1976 (90 Stat. 1733, 1802). No comments were received with respect to the proposed amendments, and no public hearing was requested or held. The proposed amendments are adopted by this Treasury decision without change.

EXPLANATION

The Tax Reform Act of 1976 amends section 1212(a) of the Internal Revenue Code by increasing the 5-year carryover period allowed for net capital losses sustained by corporations to 8 years for regulated investment companies, as defined in section 851. The amendments adopted by this Treasury decision make it clear that regulated investment companies have a maximum of 9 years in which to deduct their capital losses. This specified 9-year period must be reduced under certain prescribed conditions.

The Tax Reform Act substituted the term "capital gain net income" for the term "net capital gain". The proposed amendments conform the regulations under section 1212 to this change in terminology.

The final regulations adopted by this Treasury decision impose no new reporting or recordkeeping requirements. The principal effect of the final regulations is to conform existing regulations under section 1212 of the Code to changes made by the Tax Reform Act of 1976. Evaluation of the effectiveness of these regulations after issuance will be based upon comments received from offices within Treasury and the Internal Revenue Service, other governmental agencies, and the public.

DRAFTING INFORMATION

The principal author of this regulation is Kent J. Schreiner of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended as follows:

Paragraph 1. Section 1.1212 and the historical note are deleted.

Par. 2. Paragraph (a) of §1.1212-1 is amended by striking out "net capital gain(s)" each place it appears in subparagraphs (2)(i) and (3)(ii) and (iii) and inserting in lieu thereof "capital gain net income (net capital gain(s) for taxable years beginning before January 1, 1977)", and by adding subdivision (*g*) to subparagraph (3)(iii). The added provision reads as follows:

§ 1.1212-1 Capital loss carryovers and carrybacks.

(a) *Corporations; other taxpayers for taxable years beginning before January 1, 1964.* * * *

(3) *Regular net capital loss sustained by a corporation for taxable years beginning after December 31, 1969.* * * *

(iii) *Special rules.* * * *

(*g*) A regulated investment company (as defined in section 851) sustaining a net capital loss shall carry over that loss to each of the 8 taxable years succeeding the loss year. However, the 8-year period prescribed in the preceding sentence shall be reduced (but not to less than 5 years) by the sum of (*1*) the number of taxable years to which the net capital loss must be carried back pursuant to subdivision (i)(*a*) of this subparagraph (as limited by subdivision (iii)(*e*) of this subparagraph) and (*2*) the number of taxable years, of the 8 taxable years succeeding the loss year, that the corporation failed to qualify as a regulated investment company as defined in section 851. This subdivision shall not extend the carryover period prescribed in subdivision (i)(*b*) of this subparagraph to a year in which a corporation is not a regulated investment company as defined in section 851.

* * * * *

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved December 7, 1979.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on December 14, 1979, 8:45 a.m., and published in the issue of the Federal Register for December 17, 1979, 44 F.R. 73019)

Section 1221 —Capital Asset Defined

26 CFR 1.1221-1: Meaning of terms.
(Also Sections 61, 77, 1016; 1.61-4, 1.77-1, 1.1016-5.)

Farmer; Commodity Credit Corporation loan; wheat pledged as collateral. A cash method wheat farmer obtained a loan from the Commodity Credit Corporation pledging that year's crop as collateral. The farmer elected under section 77 of the Code to include the loan proceeds in gross income. The next year the loan was repaid and the crop pledged as collateral was redeemed. Thirteen months later the redeemed crop was sold at a price that exceeded the amount of the loan. The crop was not a capital asset, and the excess sale price for the crop over its basis, as adjusted under section 1016(a)(8), is includible in the farmer's gross income as ordinary income.

Rev. Rul. 80-19

ISSUE

If a farmer pledges wheat as collateral for a loan from the Commodity Credit Corporation and elects, under section 77 of the Internal Revenue Code, to include the loan proceeds in gross income, is the wheat a capital asset of the farmer when it is redeemed by repayment of the loan?

FACTS

The taxpayer is a wheat farmer who uses the cash method of accounting.

In 1976, the taxpayer obtained a loan from the Commodity Credit Corporation, pledging the 1976 crop as collateral. The taxpayer elected section 77 of the Code to include the loan proceeds in gross income for 1976. The taxpayer had not previously elected to apply section 77.

The taxpayer repaid the loan in 1977, and redeemed the wheat that was pledged as collateral. Prior to the redemption, the taxpayer had no basis in the wheat. Thirteen months later, in 1978, the redeemed wheat was sold at a price that exceeded the amount of the loan.

Aside from the fact that the 1976 crop was pledged as collateral and subsequently redeemed in connection with the Commodity Credit Corporation loan, the circumstances show that the crop was primarily held by the taxpayer for sale in the ordinary course of business.

LAW AND ANALYSIS

Section 1.61-4(a) of the Income Tax Regulations provides that a farmer using the cash method of accounting shall include in gross income the amount received from the sale of livestock and produce raised by the farmer. Section 1.61-4(a) also provides that profits from the sale of livestock or other items which were purchased by a farmer is ascertained by subtracting the cost from the sale price in the year the sale is made.

Under section 77 of the Code, a taxpayer who has obtained a crop loan from the Commodity Credit Corporation may elect to include the loan proceeds in gross income in the taxable year in which the loan is made.

Section 1016(a)(8) of the Code and section 1.1016-5(e) of the regulations require that the basis of property pledged to the Commodity Credit Corporation as collateral for a loan be increased by the amount of the loan proceeds, if the proceeds were included in gross income in the year received pursuant to an election under section 77.

The Senate Finance Committee report for the predecessor of section 77 of the Code states that loans by the Commodity Credit Corporation on agricultural commodities "should be treated for income-tax purposes as though such commodities had been sold in the year of the loan for the amount of the loan." S. Rep. No. 648, 76th Cong., 1st Sess. 8 (1939), 1939-2 C.B. 524, 529.

Therefore, if an election is made under section 77 of the Code, the crop is treated as being sold when it is pledged as collateral for the loan and it is treated as being repurchased when it is redeemed by repayment of the loan. *United States v. Isaak,* 400 F.2d 869 (9th Cir. 1968).

Under section 1221 of the Code, property held by a taxpayer is a capital asset unless it is described in paragraphs (1) through (6) of section 1221. Under paragraph (1), property that is "held by the taxpayer primarily for sale to customers in the ordinary course of his trade or business" is not a capital asset. The determination of whether property is held primarily for sale in the ordinary course of business is a factual problem that must be resolved on a case-by-case basis. *Gamble v. Commissioner,* 242 F.2d 586 (5th Cir. 1957).

In the present case, the taxpayer redeemed the 1976 wheat crop by repaying the Commodity Credit Corporation loan. In view of the Senate Finance Committee report and the *Isaak* case, the crop redemption must be treated as a purchase for income tax purposes because the taxpayer elected under section 77 of the Code to include the loan proceeds in gross income for 1976. The taxpayer's basis in the crop after the redemption was equal to the loan amount, under section 1016(a)(8).

Application of section 77 of the Code does not determine whether the repurchased wheat is a capital asset in the hands of the taxpayer. The taxpayer's 1976 wheat crop thus continued to be held primarily for sale in the ordinary course of business, as described in section 1221(1), even though the taxpayer's election to apply section 77 and to redeem the crop requires the redemption to be treated as a repurchase.

HOLDING

The taxpayer's 1976 wheat crop was not a capital asset in the hands of the taxpayer. The excess of the 1978 sale price for the wheat over its basis, as adjusted pursuant to section 1016(a)(8), is includible in the taxpayer's gross income for 1978 as ordinary income.

Section 4041.—Imposition of Tax [Special Fuels]

26 CFR 48.4041-13: Tax-free retail sales to certain nonprofit educational organizations.
(Also Sections 4221, 4253; 48.4221-6.)

Exemption; educational organization; vocational rehabilitation center. A nonprofit corporation operates a vocational rehabilitation center for handicapped individuals that provides classroom training, on-the-job training and employment in its sheltered workshops and retail stores, and related services. Neither the corporation nor its workshops, retail stores, and related services qualify as nonprofit educational organizations under sections 4041(g)(4), 4221(a)(5), and 4253(j) of the Code. However, the classroom training program, including instruction given in the workshops as part of the program, does qualify. Rev. Rul. 64-264 clarified and superseded.

Rev. Rul. 80-20

Advice has been requested whether sales of taxable fuels and articles to, and amounts paid for communication services furnished to, the nonprofit corporation described below come within the federal excise tax exemptions for a nonprofit educational organization under sections 4041(g)(4), 4221(a)(5), and 4253(j) of the Internal Revenue Code.

The nonprofit corporation is primarily a vocational rehabilitation center that provides employment and on-the-job training in a sheltered workshop and in a retail store renovating and selling household goods and clothing and providing services. The center provides classroom training, personal counseling, vocational evaluation, medical treatment, and unemployment placement services.

The center conducts a classroom training program that consists of regularly scheduled classes taught by a staff of qualified instructors on a year-round basis. Instruction is provided to regularly enrolled student/trainees in subjects such as merchandising, welding, shoe repair, carpentry, elementary

English, writing, and arithmetic. Classes for blind student/trainees include instruction in Braille, use of a cane, sewing, shopping and handling money. Classes such as welding and carpentry, although part of the classroom training program, are conducted in a workshop setting rather than in the classroom. Class programs vary from three to nine months depending upon the student's level of competence.

When the unemployed handicapped individuals complete their classroom training program, they are placed in the sheltered workshops or retail stores where they receive on-the-job instruction and training. After completing such training, they continue to work in the shops or stores along with other workers while awaiting outside employment for which they have been trained. If they are unable to obtain outside employment, they remain in the workshops or stores as permanent employees. During the course of their regular employment, persons in the workshops and stores are periodically instructed further by their supervisors in areas relating to their job skills and efficiency.

The corporation is exempt from federal income tax under section 501 (a) of the Code as an organization described in section 501(c)(3).

Section 4041(g)(4) of the Code provides that under regulations prescribed by the Secretary, no retailers excise tax shall be imposed with respect to the sale of any taxable liquid to a nonprofit educational organization for its exclusive use, or with respect to the use by a nonprofit educational organization of any liquid as a fuel.

Section 4221(a)(5) of the Code provides that under regulations prescribed by the Secretary no manufacturers excise tax shall be imposed with respect to the sale by the manufacturer of a taxable article to a nonprofit educational organization for its exclusive use.

Section 4253(j) of the Code provides that, under regulations prescribed by the Secretary no tax shall be imposed under section 4251 on any amount paid by a nonprofit educational organization for communications services or facilities furnished to such organization.

Under the provisions of sections 4041(g), 4221(d)(5), and 4253(j) of the Code, the term "nonprofit educational organization" means an educational organization described in section 170(b)(1)(A)(ii) that is exempt from income tax under section 501(a), and also includes a school operated as an activity of an organization described in section 501(c)(3) that is exempt from income tax under section 501(a), if such school normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

Section 170(b)(1)(A)(ii) describes an educational organization as an organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. In addition, under the provisions of section 1.170A-9(b)(1) of the Income Tax Regulations, pertaining to section 170 (b)(1)(A)(ii), and sections 48.4041-13(b) and 48.4221-6(b) of the Excise Tax Regulations pertaining to Manufacturers and Retailers Excise Taxes, respectively, such nonprofit organization must have as its primary function the presentation of formal instruction. Moreover, such nonprofit organizations do not include an organization engaged in both educational and noneducational activities unless the latter are merely incidental to the educational activities.

Rev. Rul. 64-264, 1964-2 C.B. 438, describes a training and rehabilitation program for handicapped persons operated by a nonprofit organization. The program, which is referred to as a "training school," consists of courses in driver training, salesmanship, woodworking, small appliance repairing, typewriter repairing, upholstering, use of prosthesis, and speech therapy. Also, elementary subjects, such as reading, writing, and arithmetic, are taught to certain individual participants in the program who have been unable to attend public schools. Usually, the latter courses are necessary to prepare such individuals for the vocational-type course.

The training school is operated approximately 250 days each year, and enrollment therein is usually for a period of three years. A regular staff of instructors is maintained for the training school. In conjunction with the training school, the organization operates a store and a lodging home for persons receiving training in the store.

Rev. Rul. 64-264 concludes that the training school meets the prescribed requirement of normally maintaining a regular faculty and curriculum and normally having a regularly enrolled body of pupils or students and, therefore, is a nonprofit educational organization exempt from the manufacturers excise tax under section 4221 (a)(5) of the Code. Consequently, articles sold by the manufacturer to the organization for the exclusive use of the training school are concluded to be exempt. While not specifically stated in that revenue ruling, articles sold to the organization for the use of the retail store and lodging home are not exempt.

In this case, as in Rev. Rul. 64-264, the primary function of the organization is not the presentation of formal instruction but, rather, the operation of a vocational rehabilitation center involving employment, educational, and social service activities. The fact that the center provides classroom training services and maintains an on-the-job training program in its workshops and stores is insufficient, in itself, to bring the corporation's primary purpose within the scope of sections 1.170A-9(b)(1), 48.4041-13(b) and 48.4221-6(b) of the regulations.

In addition, while the on-the-job training program described above is educational in nature, it does not have a regular faculty and curriculum, and an enrolled student body in attendance. The shop and store activities are not formal instruction.

Accordingly, neither the corporation nor its workshops and retail stores meet the prescribed requirements to qualify as nonprofit educational organizations as that term is used in sections 4041(g), 4221(a)(5), and 4253 (j) of the Code. Nor would the personal counseling, vocational evaluation, medical treatment, and employment placement services meet the prescribed requirements as they are services that relate to the corporation's overall rehabilitation functions.

However, the classroom training program of the center is an educational activity that meets the requirements of the statute and regulations in that its primary purpose is the presentation of formal instruction, and it has a curriculum and a regularly enrolled student body in attendance at a designated place where instruction is normally provided by a regular faculty at regular sessions. Therefore, the classroom training program is a school operated as an activity of an exempt organization so as to be a nonprofit educational organization within the meaning of the statute. Furthermore, any instruction given in the shops (such as welding, woodworking, or shoe repair) that is part of the classroom training program would be included in the school activity for purposes of the excise tax exemptions.

Accordingly, the exemptions from the special fuels taxes and the manufacturers excise taxes provided by sections 4041(g)(4) and 4221(a)(5) of the Code, and the exemption from the communications taxes provided by section 4253(j), apply to sales of taxable articles, or communication services furnished to the corporation for the exclusive use of its school. See Rev. Rul. 75-314, 1975-2 C.B. 442, for an example of the application of the communications tax exemption in the case of a school operated as an activity of an exempt organization.

Rev. Rul. 64-264 is clarified and superseded.

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26 CFR 48.4041-13: Tax-free retail sales to certain nonprofit educational organizations.
(Also Section 4221; 48.4221-6.)

Exemption; educational organization; wilderness camping program for adolescents. A nonprofit corporation that operates a wilderness camping program to rehabilitate and provide counseling to adolescents who have emotional and behavioral problems is not a nonprofit educational organization for purposes of sections 4041(g)(4) and 4221(a)(5) of the Code.

Rev. Rul. 80-21

ISSUE

Whether the organization described below is a "nonprofit educational organization" for purposes of the exemptions from the special fuels excise taxes and the manufacturers excise taxes provided by sections 4041(g)(4) and 4221(a)(5), respectively, of the Internal Revenue Code.

FACTS

A nonprofit corporation, formed for educational and charitable purposes, operates a wilderness camping program to rehabilitate adolescents having various emotional and behavioral problems. Such problems include poor self image, excessive aggression, drug experimentation, inability to relate to peers or adults, and the inability to face or solve problems in general.

The adolescents are referred to the organization by the local public school district, social service agencies, juvenile authorities and various religious organizations.

The organization's program, operated 10 months a year, provides supervised 26 day hiking and camping trips through wilderness areas. Each trip is attended by 10 or more adolescents, and is conducted by three of the organization's counselors. The counselors are selected for their maturity and ability to relate to adolescents, previous work experience, and their academic credentials in the social sciences and mental health fields. Some counselors are certified teachers with degrees in education, psychology or sociology.

The organization's program is designed to develop self confidence, and positive attitudes through group living in a survival atmosphere. It consists of daily demonstrations, and practical exercises in coping, adjustment, and problem solving skills or capabilities necessary for survival in a wilderness setting. In addition, the adolescents participate in informal group counseling sessions and are instructed in the necessary hiking and camping skills for wilderness terrain.

The organization is exempt from income tax under section 501(a) of the Code as an organization described in section 501(c)(3).

LAW AND REGULATIONS

Under sections 4041(g)(4) and 4221(a)(5) of the Code, exemptions from the retailers and manufacturers excise taxes are provided for fuels and articles sold to a nonprofit educational organization for its exclusive use.

Under the provisions of sections 4041(g) and 4221(d)(5) of the Code, the term "nonprofit educational organization" means an educational organization described in section 170(b)(1)(A)(ii) that is exempt from income tax under section 501(a). Section 170(b)(1)(A)(ii) describes an educational organization as an organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on. Section 1.170A-9(b)(1) of the Income Tax Regulations provides that such nonprofit educational organization must have as its primary function the presentation of formal instruction.

ANALYSIS

The fact that an organization may have been granted exemption from federal income tax as an organization described in section 501(c)(3) of the Code does not, of itself, determine the applicability of the exemptions from the aforementioned excise taxes. In order for these exemptions to apply, the organization must meet the prescribed requirements of section 170(b)(1)(A)(ii) and the regulations as a "nonprofit educational organization."

In this case, the organization's primary function is the rehabilitation of adolescents who have behavioral problems and the counseling of those adolescents through peer group encounter sessions and counselor intervention. There is no formal education in the instructive sense and there is no purposeful effort at a systematic and detailed transfer of knowledge. Therefore, the organization does not provide a curriculum. See Rev. Rul. 62-23, 1962-1 C.B. 200, superseded by Rev. Rul. 79-167, 1979-2 C.B. 335, which holds that diffuse instruction in a variety of fields does not constitute a curriculum.

HOLDING

Since the organization's primary purpose is not the presentation of formal instruction and since its program is not a curriculum within the meaning of the statute, the organization is not a "nonprofit educational organization." Accordingly, the organization does not come within the exemptions from the special fuels and manufacturers excise taxes.

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26 CFR 48.4041-14: Fuels containing alcohol.
(Also Section 4081; 48.4081-2.)

T.D. 7658[1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 48.—MANUFACTURERS AND RETAILERS EXCISE TAXES

Exemption from Motor Fuels Excise Taxes for Certain Alcohol Fuels

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the exemption from motor fuels excise taxes for certain alcohol fuels. Changes in the applicable tax law were made by the Energy Tax Act of 1978 [Pub. L. 95-618, 1979-3 C.B. (Vol. 2) 1]. These regulations affect certain producers and sellers of motor fuels and provide them with the guidance needed to comply with the law.

EFFECTIVE DATE: These regulations apply generally to sales after December 31, 1978, and prior to October 1, 1984.

FOR FURTHER INFORMATION CONTACT: Robert H. Waltuch of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T), 202-566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION

BACKGROUND

On June 19, 1979, the Federal Register published proposed amendments to the Excise Tax Regulations (26 CFR Part 138) under sections 4041 (k) and 4081(c) of the Internal Revenue Code of 1954 (Code) (44 FR 35247). The amendments were proposed to conform the regulations to section 221 of the Energy Tax Act of 1978 (Pub. L. 95-618, 92 Stat. 3185). No public hearing was held.

Two written comments were received. One of the comments dealt with the lack of a refund or credit when taxpaid gasoline is sold for use in producing gasohol. Since the Code does not provide for a refund or credit in such a situation, no change in the regulation could be made. The second comment contained six recommendations relating to the proposed rules for qualifying as a producer of gasohol and the recordkeeping requirements. After consideration of all comments regarding the proposed regulations, no substantive changes have been made to the proposed regulations.

The effectiveness of these regulations after issuance will be evaluated on the basis of comments received from offices within Treasury and the Internal Revenue Service, other governmental agencies, and the public.

DRAFTING INFORMATION

The principal author of this regulation is Robert H. Waltuch of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Parts 48 and 138 are amended as follows:

§ 48.4041-14 Fuels containing alcohol.

(a) *In general.* Under section 4041 (k) the tax imposed under section 4041 does not apply to the sale or use of any liquid fuel at least 10 percent of which consists of alcohol. Except where a different rule has been expressly provided, purchasers and sellers of liquids under section 4041(k) are subject to the same requirements and limitations as are imposed on purchasers and sellers of gasoline under section 4081(c). See § 48.4081-2.

(b) *Refunds relating to diesel, special motor, and noncommercial aviation fuels.* If a producer (as defined in paragraph (b) of § 48.4081-2) buys diesel, special motor, or noncommercial aviation fuels tax paid and uses the fuel in producing exempt gasohol, then the refund provision in section 6427 and the regulations under that section apply.

(c) *Effective date.* Section 4041(k) (relating to fuels other than gasoline) applies to sales or use after December 31, 1978, and before October 1, 1984. If the special fuels have been blended into gasohol and have been put into the tank of a vehicle prior to January 1, 1979, the fuels are considered used prior to that date.

§ 48.4081-2. Gasoline mixed with alcohol.

(*a*) *In general.* Under § 4081(c) the tax imposed by section 4081 on the sale of gasoline does not apply to the sale of qualifying gasohol or to the sale of gasoline for the purpose of producing qualifying gasohol if the requirements of this section are met. Qualifying gasohol is referred to in this section as gasohol. Gasohol is a blend of gasoline and alcohol (whether domestic or imported alcohol) in a mixture at least 10 percent of which contains alcohol made from any product other than petroleum, natural gas, or coal. In determining whether the 10 percent alcohol requirement has been met, alcohol that is 95 or more percent pure (190 degrees or more of proof) will be considered pure if no part of the impurity is gasoline.

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[1] This publication of the Treasury Decision contains the complete text of amendments to the regulations. The individual instructions for modifying the notices of proposed rulemaking have been omitted.

To the extent that the alcohol is less than 95 percent pure or to the extent that any part of the impurity is gasoline, a corresponding increase in the amount of alcohol is required to meet the 10 percent requirement. For certain requirements imposed on producers of alcohol (ethanol) under chapter 51 of the Code relating to distilled spirits, see 27 CFR Part 201. For certain requirements imposed on purchasers of specially denatured alcohol (ethanol), see 27 CFR Part 211.

(b) *Sale of gasoline to produce gasohol.* Under section 4081(c) the sale of gasoline for the purpose of producing gasohol is not exempt unless the sale is in bulk quantities for delivery into a bulk storage tank of a producer who meets the requirements of this section. For purposes of section 4081 (c), the term "producer" means any person who in the ordinary course of its trade or business regularly buys gasoline and alcohol in bulk quantities for blending for use in its trade or business or for resale. Thus, the mere purchase of gasoline for blending into gasohol does not qualify a person as a producer. A person is not a producer for purposes of section 4082 merely because such a person is a producer of gasohol as defined in this section. Thus, the provisions of section 4083 (relating to certain exempt sales to producers) do not necessarily apply.

(c) *Requirement for gasohol producers purchasing tax free*—(1) *Certificate of Registry.* A person qualifying as a producer who wishes to purchase gasoline tax free for the purpose of producing gasohol must be registered with the district director for the district in which its principal place of business is located, unless exempt from registration requirements under section 4222(b). A person registers, if not previously registered, by completing and filing Form 637, *Registration for Tax-Free Transactions Under Chapter 32 of the Internal Revenue Code,* in duplicate, in accordance with its instructions. Copies of Form 637 may be obtained from any district director. Upon approval a registry number is assigned and a Certificate of Registry is issued. At the time of purchase, a registered producer must furnish to the seller in writing its registry number together with its signed statement of the exempt purpose of the purchase. Persons not required to be registered under section 4222(b) may purchase tax free by following the procedure that applies to them in the case of other tax-free sales. See § 48.4222 (b)-1.

(2) *Revocation or suspension of registration.* The district director is authorized to revoke or temporarily suspend, upon written notice, the registration of any person and the right of such a person to purchase gasoline tax free under section 4081(c) in any case in which the district director finds that—

(i) the registrant is not a bona fide producer of gasohol;

(ii) the registrant failed to comply with the requirements of paragraph (c)(1) of this section, relating to the evidence required to support a tax-free sale;

(iii) the registrant has used its registration to avoid the payment of any tax imposed by chapter 31 or 32 of the Code, or to postpone or interfere in any manner with the collection of such a tax;

(iv) the revocation or suspension is necessary to protect the revenue; or

(v) the registrant is for some other reason not eligible under this section to retain a Certificate of Registry.

The revocation or suspension of registration is in addition to any other penalty that may apply under the law for any act or failure to act.

(d) *Seller not relieved of liability in certain cases.* The seller of the gasoline remains liable for the tax imposed under section 4081 if at the time of the sale the seller of the gasoline has reason to believe that all the gasoline sold by it to the purchaser is not intended for blending into gasohol or that the purchaser has failed to register or that its registration has been revoked or suspended.

(e) *Special rules*—(1) *Limitation on tax-free sales.* The exemption from the excise tax under section 4081(c) applies to the sale of gasoline only for use in producing gasohol. Therefore, unless the sale is exempt under another provision of the Code, the seller of the gasoline may sell tax free only that portion of the gasoline that is intended for use in producing gasohol.

(2) *Credit sales to exempt users.* Under section 6416 of the Code, the producer of gasoline is entitled to a refund or credit if tax-paid gasoline is ultimately sold to tax-exempt users in a case to which section 6416(b)(2) (A), (B), (C), (D), or (H) applies. To determine the amount of overpayment, the producer of gasoline, among other things, must be able to establish the amount of tax-paid gasoline that was sold by the ultimate vendor to tax-exempt users. Therefore, if the ultimate vendor sells both tax-paid gasoline and gasohol on credit and the sales of the two kinds of fuels are not clearly distinguished, the producer of the gasoline will not be entitled to a credit or refund with respect to the tax-paid gasoline if it can not establish the amount of the tax-paid gasoline sold by the ultimate vendor to tax-exempt users.

(f) *Refunds and credits*—(1) *Gasoline.* Except as provided in paragraph (f)(2) of this section, there is no provision in the Code that allows a refund or credit with respect to tax-paid gasoline used in producing gasohol.

(2) *Mixture of gasoline and alcohol containing more than 40 percent alcohol.* If a purchaser buys gasoline tax paid for blending a mixture of gasoline and alcohol containing more than 40 percent alcohol, that mixture will be treated as a special fuel under section 4041 and the refund provisions in section 6416 and the regulations under that section apply.

(g) *Later separation and failure to blend*—(1) *Gasoline.* If any person fails to blend gasoline purchased tax free under section 4081(c) with alcohol to make gasohol, or later separates the tax-free gasoline from the alcohol, that person is treated as a producer of gasoline as defined in section 4082 and the provisions of section 4081 relating to the sale of gasoline by a producer apply. If gasoline has been purchased tax free for the purpose of producing gasohol in excess of the amount of gasoline that the purchaser is able to establish has actually been used to produce gasohol by the records required under paragraph (h)(3) of this section, the purchaser is treated as having failed to blend the excess gasoline, and the provisions of this paragraph apply. In such a case, any of the excess gasoline that is not in the purchaser's possession is treated as having been disposed of by sale or by a use that is treated as a sale under section 4082(c). See section 7201 for criminal penalties relating to a willful attempt to evade or defeat tax, and sections 6651 and 6653 for additions to tax for failure to file a return or pay tax and for negligence and fraud.

(2) *Diesel, special, and noncommercial aviation fuels.* If any person separates the diesel, special, or noncommercial aviation fuel purchased tax free under section 4041(k) from the alcohol, the separation is treated as a sale of the fuel for purposes of section 4041.

(h) *Information; records*—(1) *Information to be furnished to purchaser.* A producer of gasoline who sells gasoline tax free under section 4081(c) shall indicate to the purchaser that the purchaser is obtaining gasoline tax free for making gasohol. The producer may transmit this information by any convenient means, such as coding of sales invoices, provided that the information is presented with sufficient particularity so that the purchaser is informed that he has obtained the gasoline tax free and the purchaser can compute and remit the tax due if the gasoline is diverted to a taxable use.

(2) *Records of seller.* Every person who, but for this section, would be liable for the excise tax on the sale of the gasoline, shall maintain in its records—

(i) The identity of the purchaser,

(ii) The written statement required to be given to the seller under paragraph (c) of this section, and

(iii) The quantity of gasoline sold tax free to each purchaser.

(3) *Records of producer of gasohol.* Any person purchasing gasoline tax free for the purpose of producing gasohol must maintain sufficient records to establish that the gasoline purchased tax free for the purpose of producing gasohol has actually been used for that purpose. Such a person must maintain records sufficient to establish to the satisfaction of the district director that alcohol, of the requisite kind, has actually been obtained by it in a quantity sufficient to have enabled it to have produced the full amount of gasohol that could have been produced from the quantity of gasoline it has acquired tax free for the purpose of producing gasohol.

(i) *Effective dates.* Section 4081(c) (relating to gasoline mixed with alcohol) applies to sales after December 31, 1978, and before October 1, 1984. Gasoline sold prior to January 1, 1979, and which is blended into gasohol after that date is not exempt from the tax under section 4081(c)of the Code. The recordkeeping requirements under this section apply to sales or uses that occur after July 19, 1979.

This Treasury decision is issued under the authority contained in sections 4041(k), 4081(c) (92 Stat. 3185, 26 U.S.C. 4041 & 4081) and section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved November 21, 1979.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on December 4, 1979, 8:45 a.m., and published in the issue of the Federal Register for December 5, 1979, 44 F.R. 69924)

Section 4081.—Imposition of Tax [Gasoline]

26 CFR 48.4081-2: Gasoline mixed with alcohol.

Whether purchasers and sellers of gasohol are subject to the same requirements and limitations imposed on purchasers and sellers of gasoline. See T.D. 7658, page 13.

Section 4221.—Certain Tax-Free Sales [Exemptions, Registrations, Etc.]

26 CFR 48.4221-6: Tax-free sales of articles to nonprofit educational organizations.

Whether a nonprofit organization that operates a rehabilitation center and provides classroom and on-the-job training programs for handicapped persons employed in its workshops and stores qualifies as a school for exemption from the manufacturers excise taxes. See Rev. Rul. 80-20, page 10.

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26 CFR 48.4221-6: Tax-free sales of articles to nonprofit educational organizations.

Whether an organization conducting a camping activity to rehabilitate persons with behavioral problems qualifies as a "nonprofit educational organization" for exemption from the manufacturers excise taxes. See Rev. Rul. 80-21, page 12.

Section 4253.—Exemptions [Communications]

Whether a nonprofit organization that operates a rehabilitation center and provides classroom and on-the-job training programs for handicapped persons employed in its workshop and stores qualifies as a school for exemption from the communications excise tax. See Rev. Rul. 80-20, page 10.

Section 6041.—Information at Source

26 CFR 1.6041-1: Return of information as to payments of $600 or more.
(Also Sections 278, 477; 1.278-1.)

Information returns; hail crop insurance proceeds. A mutual casualty insurance company is not required to file an information return to report hail crop insurance proceeds paid to a farmer if the farmer is required to capitalize expenses pursuant to section 278 or 477 of the Code and has informed the company that the expenses have been capitalized; Rev. Rul. 78-110 clarified.

Rev. Rul. 80-22

ISSUE

Must a mutual casualty insurance company file a Form 1099-MISC, Statement for Recipient of Miscellaneous Income, to report the payment of hail crop insurance proceeds to a farmer required to capitalize expenses pursuant to either section 278 or 447 of the Internal Revenue Code if the farmer has informed the insurance company that the expenses have been capitalized?

LAW AND ANALYSIS

Section 6041(a) of the Code requires that all persons engaged in a trade or business and making payment in the course of such trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income, of $600 or more in any taxable year, shall render a true and accurate return in such form and manner and to such extent as may be prescribed by the regulations.

Section 278(a) of the Code requires the capitalization of certain expenses attributable to the planting, cultivation, maintenance, or development of any citrus or almond grove. Section 278(b) requires the capitalization of certain expenses of a farming syndicate engaged in planting, cultivating, maintaining, or developing a grove, orchard, or vineyard in which fruits or nuts are grown.

Section 447 of the Code requires the capitalization of preproductive period expenses of a corporation engaged in the business of farming and a partnership, one of whose partners is a corporation, engaged in the business of farming.

Section 1.6041-1(a)(2) of the Income Tax Regulations provides that the return required by section 6041(a) of the Code shall be made on Forms 1096 and 1099.

Section 1.6041-1(c) of the regulations defines "fixed or determinable income." Income is fixed when it is paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained.

Rev. Rul. 78-110, 1978-1 C.B. 390, holds that a mutual casualty insurance company is required to file information returns to report hail crop insurance proceeds paid to farmers who elect, under section 451(d) of the Code, to include such proceeds in income for the taxable year following the taxable year that the crop was destroyed. The election provided by section 451(d) does not affect the status of the insurance proceeds as fixed or determinable income.

The capitalization of expenses under either section 278 or 447 of the Code will establish the farmer's basis in the crops. The determination of whether any insurance proceeds received for the destroyed crops are in excess of the basis of the destroyed crops and, thus, constitute "gains, profits, or income," depends upon the farmer's basis in the crops. Because the insurance company cannot require a farmer to disclose the basis in the destroyed crops, the amount of "gains, profits, or income," if any, resulting from the payment of the hail crop insurance proceeds is not fixed or determinable by the company.

HOLDING

The company is not required to file a Form 1099-MISC if the farmer has informed the insurance company that expenses have been capitalized pursuant to either section 278 or 447 of the Code. However, if the farmer does not inform the insurance company that the expenses have been capitalized pursuant to either section 278 or 447, the company is required to file a Form 1099-MISC.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 78-110, 1978-1 C.B. 390, is clarified to the extent that if the farmers making the election under section 451(d) of the Code were also required to capitalize expenses pursuant to either section 278 or 447, the holding of this present revenue ruling would apply.

Part III. Administrative, Procedural, and Miscellaneous

Statement of Procedural Rules

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER H, PART 601.

Tax Counseling for the Elderly

AGENCY: Internal Revenue Service, Treasury Department.

ACTION: Final Rules.

SUMMARY: This document provides rules under which the Internal Revenue Service will enter into cooperative agreements with private or public non-profit agencies or organizations to establish a network of trained volunteers to provide free tax information and return preparation assistance to the elderly (individuals age 60 or over) under the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1].

DATE: These rules take effect on December 13, 1979.

FOR FURTHER INFORMATION CONTACT: Ms. Judy M. Smith of the Taxpayer Service Division (TX:T:I), Internal Revenue Service, Room 7213, 1111 Constitution Avenue, N.W., Washington, D.C. (202-566-4904).

SUPPLEMENTARY INFORMATION:

BACKGROUND

Section 163 of the Revenue Act of 1978, Pub. L. 95-600, November 6, 1978 (92 Stat. 2810), provides that the Internal Revenue Service may enter into agreements with private or public non-profit agencies or organizations to establish a network of trained volunteers to provide free tax information and return preparation assistance to elderly individuals. Elderly individuals are defined as individuals age 60 and over at the close of their taxable year.

COOPERATIVE AGREEMENTS

Programs will be administered by non-profit agencies and organizations under cooperative agreement with the Internal Revenue Service in compliance with the Federal Grant and Cooperative Agreement Act of 1977, Pub. L. 95-224, February 3, 1978 (92 Stat. 3, 41 U.S.C. 501-509). Cooperative agreements will provide: (1) for the implementation of the program(s) by geographical area, (2) the functions to be performed by the Service and program sponsor, (3) the maximum amount of money available for reimbursement of expenses, and (4) other information.

COMPETITION

Normally cooperative agreements will be entered into based upon competition among eligible agencies and organizations. Competition will not be used where time makes competition impracticable. Agencies and organizations will be eligible to enter into a cooperative agreement if they are nonprofit and have experience in coordinating volunteer programs. Eligible applicants will be selected to enter into cooperative agreements on the basis of information provided in their application and in accordance with criteria set forth in the application instructions supplied by the Service.

PROGRAM ADMINISTRATION

Under a cooperative agreement, the agency or organization sponsoring a Tax Counseling for the Elderly program will normally be responsible for administration of the program, including the recruitment of volunteers.

The Service will normally provide training and technical support. Program operations will be primarily carried on by the volunteers. Sponsoring agencies and organizations will normally receive reimbursements for administrative expenses of the program and volunteers will normally receive reimbursements for expenses incurred in training and in providing tax return assistance. Volunteers will be provided training and will be required to pass tests designed to measure their understanding of Federal tax subjects on which they will provide assistance.

DRAFTING INFORMATION: The principal authors of these final rules are Judy M. Smith of the Taxpayer Service Division, Internal Revenue Service, James W. Corbitt, Jr. of the General Legal Services Division, Office of Chief Counsel, Internal Revenue Service, and Charles C. Saverude of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service. However, other personnel in the Taxpayer Service Division, other divisions in the Internal Revenue Service and the Office of Chief Counsel participated in developing these final rules, both on matters of substance and style.

ADOPTION OF AMENDMENTS TO THE REGULATIONS: The following additions are made to the Statement of Procedural Rules (26 CFR Part 601):

Paragraph 1. The folowing new provision is added at the end of the table of contents at the head of Part 601:

Subpart H—Tax Counseling for the Elderly

601.801 Purpose and Statutory Authority.
601.802 Cooperative Agreements.
601.803 Program Operations and Requirements.
601.804 Reimbursements.
601.805 Miscellaneous Administrative Provisions.
601.806 Solicitation of Applications.

Par. 2. New subpart H is added to read as follows:

Subpart H—Tax Counseling for the Elderly

§ 601.801 *Purpose and Statutory Authority.*

(a) This Subpart H contains the rules for implementation of the Tax Counseling for the Elderly assistance program under Section 163 of the Revenue Act of 1978, Pub. L. 95-600 [1978-3 C.B. (Vol. 1) 1], November 6, 1978 (92 Stat. 2810). Section 163 authorizes the Secretary of the Treasury, through the Internal Revenue Service, to enter into agreements with private or public non-profit agencies or organizations for the purpose of providing training and technical assistance to prepare volunteers to provide tax counseling assistance for elderly individuals, age 60 and over, in the preparation of their Federal income tax returns.

(b) Section 163 provides that the Secretary may provide:

(1) Preferential access to Internal Revenue Service taxpayer service representatives for the purpose of making available technical information needed during the course of the volunteers' work;

(2) Publicity for making elderly persons aware of the availability of volunteer taxpayer return preparation assistance programs under this section; and

(3) Technical materials and publications to be used by such volunteers.

(c) In carrying out responsibilities under Section 163, the Secretary, through the Internal Revenue Service, is also authorized:

(1) To provide assistance to organizations which demonstrate, to the satisfaction of the Secretary, that their volunteers are adequately trained and competent to render effective tax counseling to the elderly in the preparation of Federal income tax returns;

(2) To provide for the training of such volunteers, and to assist in such training, to ensure that such volunteers are qualified to provide tax counseling assistance to elderly individuals in the preparation of Federal income tax returns;

(3) To provide reimbursement to volunteers through such organizations for transportation, meals, and other expenses incurred by them in training or providing tax counseling assistance in the preparation of Federal income tax returns under this section, and such other support and assistance determined to be appropriate in carrying out the provisions of the section;

(4) To provide for the use of services, personnel, and facilities of Federal executive agencies and State and local public agencies with their consent, with or without reimbursement; and

(5) To prescribe rules and regulations necessary to carry out the provisions of the section.

(d) With regard to the employment status of volunteers, section 163 also provides that service as a volunteer in any program carried out under this section shall not be considered service as an employee of the United States. Volunteers under such a program shall not be subject to the provisions of law relating to Federal employment, except that the provisions relating to the illegal disclosure of income or other information punishable under Section 1905 of Title 18, United States Code, shall apply to volunteers as if they were employees of the United States.

§ 601.802 *Cooperative Agreements.*

(a) *General.* Tax Counseling for the Elderly programs will be administered by sponsor organizations under cooperative agreements with the Internal Revenue Service. Use of cooperative agreements is in acordance with the Federal Grant and Cooperative Agreement Act of 1977, Pub. L. 95-224, February 3, 1978 (92 Stat. 3, 41 U.S.C. 501-509). Cooperative agreements will be legally binding agreements in document form.

(b) *Nature and Contents of Cooperative Agreements.* Each cooperative agreement will provide for implementation of the program in specified geographic areas. Cooperative agreements will set forth:

(1) The functions and duties to be performed by the Internal Revenue Service and the functions and duties to be performed by the program sponsor,

(2) The maximum amount of the award avaliable to the program sponsor,

(3) The services to be provided for each geographical area, and

(4) Other requirements specified in the applications.

(c) *Entry into Cooperative Agreements.* The Commissioner of Internal Revenue, the Director, Taxpayer Service Division, or any other individual designated by the Commissioner may enter into a cooperative agreement for the Internal Revenue Service.

(d) *Competitive Award of Cooperative Agreements.* Cooperative agreements will generally be entered into based upon competition among eligible applicants.

(1) To be eligible to enter into a cooperative agreement, an organization must be a private or public nonprofit agency or organization with experience in coordinating volunteer programs. Federal, state, and local governmental agencies and organizations will not be eligible to become program sponsors.

(2) Eligible applicants will be selected to enter into cooperative agreements based on an evaluation by the Internal Revenue Service of material provided in their applications. The Service will set forth the evaluative criteria in the application instructions.

(3) Determinations as to the eligibility and selection of agencies and organizations to enter into cooperative agreements will be made solely by the Internal Revenue Service and will not be subject to appeal.

(e) *Noncompetitive Award of Cooperative Agreements.* If appropriations to implement the Tax Counseling for the Elderly program are received at a time close to when tax return preparation assistance must be provided or when other factors exist which make the use of competition to select agencies and organizations to enter into cooperative agreements impracticable, cooperative agreements will be entered into without competition with eligible agencies and organizations selected by the Internal Revenue Service. Determination of when the use of the competition is impracticable will be made solely by the Internal Revenue Service and will not be subject to appeal.

(f) *Renegotiation, Suspension, Termination and Modification.*

(1) Cooperative agreements will be subject to renegotiation (including the maximum amount of the award available to a sponsor), suspension, or termination if performance reports required by the cooperative agreement and/or other evaluations by or audits by the Internal Revenue Service or others indicate that planned performance goals or other provisions of the cooperative agreement, the regulations, or Section 163 of the Revenue Act of 1978 are not being satisfactorily met. The necessity for renegotiation, suspension, or termination, will be determined solely by the Internal Revenue Service and will not be subject to appeal.

(2) Cooperative agreements may be modified in writing by mutual agreement between the Internal Revenue Service and the program sponsor at any time. Modifications will be based upon factors such as an inability to utilize all funds available under a cooperative agreement, the availability of additional funds and an ability to effectively utilize additional funds, and interference of some provisions with the efficient operation of the program.

(g) *Negotiation.* If the proposed program of an eligible applicant does not warrant award of an agreement, the Internal Revenue Service may negotiate with the applicant to bring the application up to a standard that will be adequate for award. If more than one inadequate application has been received for the geographic area involved, negotiation to bring all such applications up to standard will be conducted with all such applicants unless time does not permit negotiations with all.

§ 601.803 *Program Operations and Requirements.*

(a) *Objective.* The objective of the Tax Counseling for the Elderly program is to provide free assistance in the preparation of Federal income tax returns to elderly taxpayers age 60 and over, by providing training, technical and administrative support to volunteers under the direction of non-profit agencies and organizations that have cooperative agreements with the Internal Revenue Service.

(b) *Period of Program Operations.* Most tax return preparation assistance will be provided to elderly taxpayers during the period for filing Federal income tax returns, from January 1 to April 15 each year. However, the program activities required to ensure elderly taxpayers efficient and quality tax assistance will normally be conducted year round. Program operations will generally be divided into the following segments each year: October—recruit volunteers; November and December—set training and testing schedules for volunteers, identify assistance sites, complete publicity plans for sites; December and January—train and test volunteers, set volunteer asistance schedules; January through May—provide tax assistance, conduct publicity for sites; May and June—prepare final reports and evaluate program; July and August—prepare for next year's program.

(c) *Assistance Requirements.* All tax return preparation assistance provided under Tax Counseling for the Elderly programs must be provided free of charge to taxpayers and must be provided only to elderly individuals. An elderly individual is an individual age 60 or over at the close of the individual's taxable year with respect to which tax return preparation assistance is to be provided. Where a joint return is involved, assistance may be provided where only one spouse satisfies the 60 year age requirement.

(d) *Training and Testing of Volunteers.* Volunteers will normally be provided training and will normally be required to pass tests designed to measure their understanding of Federal tax subjects on which they will provide tax return assistance. Volunteers who do not receive a satisfactory score will not be eligible to participate in the program.

(e) *Confidentiality of Tax Information.* Program sponsors must obtain written assurance from all volunteers and all other individuals involved in the program, to respect the confidentiality of income and financial information known as a result of preparation of a return or of providing tax counseling assistance in the preparation of Federal income tax returns.

§ 601.804 *Reimbursements.*

(a) *General.* When provided for in cooperative agreements, the Internal Revenue Service will provide amounts to program sponsors for reimbursement to volunteers for transportation, meals, and other expenses incurred in training or providing tax return assistance and to program sponsors for reimbursement of overhead expenses. Cooperative agreements will establish the items for which reimbursements will be allowed and the method of reimbursement, e.g., stipend versus actual expenses for meals, as well as developing necessary procedures, forms, and accounting and financial control systems.

(b) *Direct, Reasonable, and Prudent Expenses.* Reimbursements will be allowed only for direct, reasonable, and prudent expenses incurred as a part of a volunteer's service or as a part of the program sponsor's overhead.

(c) *Limitation.* Total reimbursements provided to a program sponsor shall not exceed the total amount specified in the cooperative agreement. The Internal Revenue Service shall not be liable for additional amounts to program sponsors, volunteers, or anyone else.

(d) *Availability of Appropriated Funds.* Expense reimbursements and other assistance to be provided by the Internal Revenue Service under cooperative agreements are contingent upon the availability of appropriated funds for the Tax Counseling for the Elderly program.

§ 601.805 *Miscellaneous Administrative Provisions.*

(a) *Responsibilities and Relationship of Internal Revenue and Program Sponsor.* Substantial involvement is anticipated between the Internal Revenue Service and the program sponsors in conducting this program. Specific responsibilities and obligations of the Internal Revenue Service and the program sponsors will be set forth in each cooperative agreement.

(b) *Administrative Requirements Set Forth in OMB and Treasury Circulars.*

(1) The basic administrative requirements applicable to individual cooperative agreements are contained in Office of Management and Budget Circular No. A-110, Grants and Agreements with Institutions of Higher Education, Hospitals and Other Nonprofit Organizations (41 F.R. 32016). Requirements for advances to program sponsor(s) for financing operations under cooperative agreements are contained in Treasury Department Circular No. 1075, as revised, Regulations Governing Withdrawal of Cash from Treasury for Advances under Federal Grant and Other Programs. All applicable provisions of these two circulars and any existing and further supplements and revisions are incorporated into these regulations and into

all cooperative agreements entered into between the Internal Revenue Service and program sponsors.

(2) Additional operating procedures and instructions may be developed by the Internal Revenue Service to direct recipient organizations in carrying out the provisions of this subpart, such as instructions for using letters of credit. Any such operating procedures or instructions will be incorporated into each cooperative agreement.

(c) *Joint Funding.* Tax Counseling for the Elderly programs will not be eligible for joint funding. Accordingly, the Joint Funding Simplification Act of 1974, Pub. L. 93-510, December 5, 1974 (88 Stat. 1604, 42 U.S.C. 4251-4261) and Office of Management and Budget Circular No. A-111, Jointly Funded Assistance to State and Local Governments and Nonprofit Organizations (41 F.R. 32039), will not apply.

(d) *Discrimination.* No program sponsor shall discriminate against any person providing tax return assistance on the basis of age, sex, race, religion or national origin in conducting program operations. No program sponsor shall discriminate against any person in providing such assistance on the basis of sex, race, religion or national origin.

§ 601.806 *Solicitation of Applications.*

(a) *Solicitation.* The Commissioner of Internal Revenue or the Commissioner's delegate may, at any time, solicit eligible agencies and organizations to submit applications. Generally, applications will be solicited and accepted in June and July of each year. Deadlines for submitting applications and the schedule for selecting program sponsors will be provided with application documents.

(1) Before preparing and submitting an unsolicited application, organizations are strongly encouraged to contact the Internal Revenue Service at the address provided in (b)(2) of this section.

(2) A solicitation of an application is not an assurance or commitment that the Internal Revenue Service will enter into a cooperative agreement. The Internal Revenue Service will not pay any expenses or other costs incurred by the applicant in considering, preparing or submitting an application.

(b) *Application.*

(1) In the application documents, the Commissioner or the Commissioner's delegate will specify program requirements which the applicant must meet.

(2) Eligible organizations interested in participating in the Internal Revenue Service Tax Counseling for the Elderly program should request an application from the:

Program Manager
Tax Counseling for the Elderly
Taxpayer Service Division TX:T:I
Internal Revenue Service
1111 Constitution Ave., N.W.
Washington, D.C. 20224
(202) 566-4904

These regulations involve matters relating to benefits. Accordingly, under Section 553(a)(2) of Title 5 of the United States Code, the notice and public procedure prescribed by Section 553(b) of the title need not be followed and the effective date limitation of Section 553(d) of that title is not applicable.

These regulations are issued under the authority contained in Section 163(b)(5) of the Revenue Act of 1978, Pub. L. 95-600 [1978-3 C.B. (Vol. 1) 1], November 6, 1978 (92 Stat. 2811) and Pub. L. 89-554, September 6, 1966 (80 Stat. 379, 5 U.S.C. 301).

JEROME KURTZ,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on December 12, 1979, 8:45 a.m., and published in the issue of the Federal Register for December 13, 1979, 44 F.R. 72113)

Part IV. Items of General Interest

Cash or Deferred Arrangements in Qualified Profit-Sharing and Stock Bonus Plans

Announcement 80-6 [1]

Employers and employees are advised as to the tax treatment of contributions to cash or deferred profit-sharing and stock bonus plans qualified under section 401(a) of the Internal Revenue Code of 1954, that provide a covered employee with an election to have the employer make certain payments as contributions to a trust under the plan on behalf of the employee, or directly to the employee in cash.

Until the first plan year beginning after December 31, 1979, the tax treatment of amounts contributed by an employer at the election of an employee to a cash or deferred qualified profit-sharing or stock bonus plan depends upon when the plan was established.

During this period, cash or deferred arrangements that were in existence on June 27, 1974, shall be treated in a manner consistent with Rev. Rul. 56-497, 1956-2 C.B. 284; Rev. Rul. 63-180, 1963-2 C.B. 189; and Rev. Rul. 68-89, 1968-1 C.B. 402. Under these Revenue Rulings, contributions made to a cash and trusteed plan which were subject to the election of the employee generally are not considered to be employee contributions, and the employee is not taxed currently on them.

Contributions made during this period under plans or arrangements which were not in existence on June 27, 1974, shall be treated as employee contributions and the employee will be currently taxed.

The Revenue Act of 1978 created a new type of plan arrangement known as a "Qualified Cash or Deferred Arrangement." Its requirements are found in section 401(k) of the Code and apply to contributions made for plan years beginning after December 31, 1979, pursuant to an employee's election not to receive the employee's share of such contributions in cash. The requirements apply no matter when the plan came into existence.

Under section 401(k) of the Code, contributions to a qualified profit sharing or stock bonus plan containing a Qualified Cash or Deferred Arrangement will not be treated as employee contributions or as distributions to the employee merely because of the election. However, contributions to a plan containing a cash or deferred arrangement which does not meet the requirements of section 401(k) will be treated as employee contributions because they will be considered to have been distributed or made available to the electing employee and, therefore, will be taxable currently under section 402(a)(1) of the Code.

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[1] Also released as News Release, IR-80-3, dated January 7, 1980.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants and Enrolled Agents from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following persons have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Richard O. Bertoli	Sparkhill, NY	Certified Public Accountant	Indefinite effective November 2, 1979
Slathern E. Gassiott	Port Arthur, TX	Certified Public Accountant	Thirty months effective November 19, 1979
Leonard M. Bernes	Atlanta, GA	Certified Public Accountant	Indefinite effective December 5, 1979

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.461-3, 1.6151-1—1.6302-2 and intermediate sections, 31.6071(a)-1—31.6302(c)-3 and intermediate sections, 36.3121(1)(10)-4, 46.6071(a)-1, 46.6151-1, 46.6302(c)-1, 48.6071(a)-1, 48.6151-1, 48.6302(c)-1, 49.6151-1, 49.6302(c)-1, 154.2-1, 301.6302-1, 301.6402-4, 301.7502-1, 601.401 amended; 301.7502 deleted; 301.7502-2 added.	Timeliness of tax returns, payments and deposits.	Dec. 11, 1979	Feb. 11, 1980
26 CFR 1.1033(a)-1, 1.1033(a)-2, 7.0, amended; 1.1033(g)-1 redesignated as 1.1033(h)-1 and amended; 1.1033(f)-1 redesignated as 1.1033(g)-1 and amended.	Election to treat outdoor advertising displays as real property.	Dec. 11, 1979	Feb. 11, 1980
26 CFR 1.85-1, 1.6050B-1, added.	Taxation of unemployment compensation.	Dec. 19, 1979	Feb. 18, 1980
26 CFR 25.2514-1, amended; 25.6075, 25.6075-1, deleted; 25.6075-1, 301.7517-1, added.	Time for filing gift tax returns and for requesting a statement explaining valuation for estate, gift, or generation-skipping transfer tax purposes. In addition, a change to an example that relates to the definition of a general power of appointment.	Dec. 19, 1979	Feb. 18, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1, dated January 7, 1980.

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* Denotes entry since last publication

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1 I.R.B., dated January 7, 1980.

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______	*1931–2*	*3.25*
______	*1932–1*	*2.80*
______	1932–2	8.65
______	*1933–1*	*3.35*
______	*1933–2*	*3.45*
______	*1934–1*	*3.70*
______	*1934–2*	*4.10*
______	1935–1	6.90
______	*1935–2*	*4.00*
______	*1936–1*	*3.55*
______	*1936–2*	*3.90*
______	*1937–1*	*3.75*
______	1937–2	7.70
______	*1938–1*	*4.05*
______	*1938–2*	*3.50*
______	1939–1–1	8.25
______	1939–1–2	10.90
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______	1940–1	5.55
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______	*1941–2*	*3.55*
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______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
______	*1944*(*)	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*2.65*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$10.10
______	1957–2	13.00
______	1958–1	9.60
______	1958–2	13.00
______	1958–3	15.00
______	1959–1	15.00
______	1959–2	9.60
______	1960–1	9.00
______	1960–2	11.50
______	1961–1	14.00
______	1961–2	10.00
______	1962–1	6.20
______	1962–2	7.15
______	1962–3	15.00
______	1963–1	9.00
______	1963–2	10.75
______	1964–1–1	10.00
______	1964–1–2	11.00
______	1964–2	9.80
______	1965–1	10.70
______	1965–2	12.25
______	1966–1	9.25
______	1966–2	14.05
______	1967–1	10.00
______	1967–2	10.00
______	1968–1	14.00
______	1968–2	11.75
______	1969–1	7.50
______	1969–2	6.50
______	1969–3	$12.50
______	1970–1	11.00
______	1970–2	14.00
______	1971–1	10.55
______	1971–2	8.50
______	1972–1	13.50
______	1972–2	13.70
______	1973–1	13.20
______	1973–2	8.30
______	1974–1	11.00
______	1974–2	9.95
______	*1974–3*	*8.20*
______	1974–3 Supp.	10.00
______	1975–1	13.25
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January 28, 1980
Bulletin No. 1980-4

Internal Revenue bulletin

contin 9258

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENTS

Announcement 80-7, page 41.

Announcement 80-9, page 42.

The date for submitting comments on proposed regulations under the Vinson-Trammell Act, relating to excess profits on contracts for naval vessels or military aircraft, is extended to February 26, 1980. A public hearing on these proposed regulations will be held on March 12, 1980.

Announcement 80-8, page 41.

Public hearings will be held on February 7, 1980, concerning regulations relating to reasonable funding methods and amortization of experience gains by pension plans funded by group deferred annuity contracts.

INCOME TAX

Rev. Rul. 80-23, page 5.

Unemployment benefits; Redwood National Park Expansion Act. Benefits received as "terminal pay" under the Redwood National Park Expansion Act are not includible in gross income under section 85 of the Code.

Rev. Rul. 80-24, page 5.

Bad debt; dishonored note; cause of action against seller. A taxpayer purchased an unsecured bearer promissory note. On the due date, the note was presented for payment, but was dishonored. Legal action to enforce payment on the note would not, in all probability, result in satisfaction of execution on a judgment. The taxpayer has a cause of action against the seller that may require the seller to return the purchase price of the note. The taxpayer was entitled under section 166 of the Code to a bad debt deduction in the year the note was dishonored. If amounts are recovered by the taxpayer from the seller, they will be ordinary income under section 61.

Rev. Rul. 80-25, page 6.

Capital expenditures; citrus groves; trees and irrigation system. A taxpayer, who was developing a citrus grove, planted citrus trees and installed and placed in service an irrigation system. The taxpayer may take a depreciation deduction for the cost of the trees beginning in the year the trees first reach an income producing stage and for the cost of the irrigation system beginning in the year the system is placed in service.

Rev. Rul. 80-26, page 7.

Redemption of stock; constructive ownership; family hostility. A corporation, all of the stock of which was owned by three individuals and five trusts, redeemed the stock held by four trusts that were for the benefit of an individual shareholder's children. Before the redemption, each trust owned, actually and constructively, 31 percent of the corporation's stock, and afterwards, each owned 33 percent solely by attribution under section 318 of the Code. Although family hostility prevented the trusts from exercising actual control over such stock, section 318 applies, and the redemption is not a distribution in exchange for stock under section 302(a). The Service will not follow the *Robin Haft Trust* decision.

(Continued on page 4)

Finding Lists begin on page 48.
Announcement of Voluntary Suspensions on page 44.
Announcement of Notice of Proposed Rulemaking begins on page 45.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part includes rulings and decisions based on Subpart A, Tax Conventions and related Treasury Decisions and Revenue Rulings; Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of Revenue Rulings, Revenue Procedures, and other published items, and (3) topical Indexes of Public Laws, Treasury Decisions, and Tax Conventions.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—(Cont'd)

Rev. Rul. 80-28, page 14.

Return preparers; negligence penalty; failure to report minimum tax liability. Factual situations illustrate application of the penalty imposed by section 6694(a) of the Code to an income tax return preparer's failure to report a taxpayer's minimum tax liability.

EMPLOYEE PLANS

Rev. Rul. 80-27, page 8.

Qualification; court ordered distribution of benefits. A plan will not lose its qualification under section 401(a) of the Code solely because the plan trustee complies with a court order requiring the distribution of the benefits of a participant in pay status to the participant's spouse or children in order to meet the participant's alimony or support obligations; Rev. Rul. 56-432 obsoleted.

Announcement 80-20, page 42.

Taxpayers may rely on section 1.415-5 of the proposed regulations to adopt provisions for defined benefit plans that provide for annual automatic cost-of-living adjustments of the $75,000 limitation provided by section 415(b)(1)(A) of the Code. Also, the Service will issue opinion, notification, and determination letters based on the proposed regulations.

EMPLOYMENT TAXES

T.D. 7660, page 9.

Amendments to the regulations under sections 3121 and 3306 of the Code relate to employment taxes with respect to employees of related corporations.

TAX CONVENTIONS

United Kingdom, page 16.

The convention between the United States and the United Kingdom of Great Britain and Northern Ireland with respect to taxes on estates of deceased persons and on gifts is reproduced.

Announcement 80-15, page 42.

The Treasury Department has announced discussions on an income tax treaty between United States and Tunisia and invites comments on the negotiations.

ADMINISTRATIVE

Del. Order No. 42 (Rev. 13), page 40.

Consents fixing period of limitations. The authority to sign consents fixing the period of limitations on assessment or collection is revised to include Revenue Representative Supervisors; Del. Order No. 42 (Rev. 12) superseded.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-1: Gross income.

What the proper year is for the deduction of a bad debt incurred when an unsecured note of a bankrupt is dishonored if the holder has a cause of action against the seller of the note that may require the seller to return the purchase price of the note to the holder. See Rev. Rul. 80-24, this page.

Section 85.—Unemployment Compensation

Unemployment benefits; Redwood National Park Expansion Act. Benefits received as "terminal pay" under the Redwood National Park Expansion Act are not includible in gross income under section 85 of the Code.

Rev. Rul. 80-23

ISSUE

Are certain benefits and payments made under Pub. L. No. 95-250, 92 Stat. 163 (1978) (the Redwood National Park Expansion Act), subject to the provisions of section 85 of the Internal Revenue Code?

FACTS

The Redwood National Park Expansion Act (the "Redwood Act") was enacted by Congress on March 27, 1978, and provides for terminal pay benefits to employees of private employers affected by the expansion of the Redwood National Park. Among the benefits are the following:

(1) Weekly layoff and vacation replacement benefits under section 207 of the Act.

(2) Severance payments under sections 208 and 209 of the Act.

LAW AND ANALYSIS

Section 85 of the Code provides that recipients of unemployment benefits must include a portion of such benefits in gross income if the recipient's adjusted gross income (determined without regard to this section and without regard to the disability income exclusion provided in section 105(d)) and the unemployment compensation benefits exceed a specified "base amount" for the taxable year. The amount includible in gross income is the lesser of (1) one-half of the excess of the unemployment compensation benefits and adjusted gross income (as previously determined) over the base amount, or (2) the amount of the unemployment compensation benefits. The term "unemployment compensation" is defined in section 85(c) as meaning any amount received under a law of the United States or of a state, which is in the nature of unemployment compensation.

Section 201(18) of the Redwood Act defines the payments provided for in sections 207, 208, and 209 as "terminal pay" and provides that regardless of the designations used to distinguish among them, the payments are intended and shall be deemed to be severance pay and, as such, shall be treated for federal income tax purposes in the same manner as is provided by California State law. Section 17148 of the California Revenue and Taxation Code (1979 Supp.) provides that gross income does not include payments for severance pay or terminal pay to an individual who is terminated from his or her employment as a direct result of the expansion of a federal redwood park in Northern California by reason of legislation enacted by Congress in 1977 or 1978. In addition, section 201(19) of the Redwood Act provides that the amount of terminal pay for an employee shall be reduced by the amount of the federal and state income taxes that would be required to be withheld by an employer from wages equal to such terminal pay, if paid to an employee with the same number of income tax exemptions as the recipient. Section 201(19) also provides for the withholding and payment of social security contributions on terminal pay.

Although the benefits provided under sections 207, 208, and 209 of the Redwood Act meet the definition of unemployment compensation for purposes of section 85 of the Code, subjecting such amounts to tax under section 85 would interfere with the specific taxing provisions of the Redwood Act and result in a situation analogous to one of double taxation.

HOLDING

The benefits and payments made under sections 207, 208, and 209 of Pub. L. No. 95-250, 92 Stat. 163 (1978), (the Redwood National Park Expansion Act), are not includible in gross income under the provisions of section 85 of the Code.

Section 166.—Bad Debts

26 CFR 1.166-2: Evidence of worthlessness.
(Also Section 61; 1.61-1.)

Bad debt; dishonored note; cause of action against seller. A taxpayer purchased an unsecured bearer promissory note. On the due date, the note was presented for payment, but was dishonored. Legal action to enforce payment on the note would not, in all probability, result in satisfaction of execution on a judgment. The taxpayer has a cause of action against the seller that may require the seller to return the purchase price of the note. The taxpayer was entitled under section 166 of the Code to a bad debt deduction in the year the note was dishonored. If amounts are recovered by the taxpayer from the seller, they will be ordinary income under section 61.

Rev. Rul. 80-24

ISSUE

What is the proper year of deductibility pursuant to section 166 of the Internal Revenue Code of a bad debt incurred when an unsecured note of a bankrupt is dishonored if the holder has a cause of action against the seller of the note that may require the seller to return the purchase price of the note to the holder?

FACTS

On July 1, 1974, *X* purchased from *Z*, a brokerage firm, an unsecured bearer promissory note issued by *Y* and payable June 30, 1975. *X*, *Y*, and *Z* are unrelated domestic corporations. The note was not issued with interest coupons and was not in registered form and therefore it is not a security within the meaning of section 165 of the Code.

X presented the note to *Y* for payment on June 30, 1975, but it was dishonored. On September 1, 1975, *Y* petitioned a United States District Court for bankruptcy under section 77 of the Bankruptcy Act (11 U.S.C. section 205). Legal action by *X* against *Y* or its successors to enforce payment on the note would, in all probability, as of September 1, 1975 or thereafter not result in satisfaction of execution on a judgment against the defendants. Due to alleged misconduct by the seller, *Z*, when the note was sold to *X*, *X* has a cause of action against *Z*, one of the remedies of which is to rescind the contract of sale and to recover the amount it paid to *Z* for the note. *X*'s right to sue *Z* is based on the Securities Act of 1933, 15 U.S.C. section 77 (1970) and the Securities Exchange Act of 1934, 15 U.S.C. section 78 (1970), as well as state law provisions and it has a reasonable likelihood of succeeding. *X* files its federal income tax returns on a calendar year basis.

The specific question is whether *X* is entitled to a bad debt deduction in 1975, the year when the note was dishonored by *Y*.

LAW AND ANALYSIS

Section 166(a)(1) of the Code provides that a deduction is allowed for any debt that becomes worthless within the taxable year.

Section 1.166-1(c) of the Income Tax Regulations provides that only a debt that arises from a debtor-creditor relationship based on a valid and enforceable obligation to pay a fixed or determinable sum of money qualifies under section 166 of the Code.

Section 1.166-2(b) of the regulations provides that whenever surrounding circumstances indicate that a debt is worthless and uncollectible and that legal action to enforce payment would, in all probability, not result in the satisfaction of execution on a judgment, a showing of these facts will be sufficient evidence of worthlessness of the debt for the purposes of the deduction under section 166 of the Code.

In *Zeeman v. United States*, 275 F. Supp. 235 (S.D. N.Y. 1967), remanded for further proceedings on other issues, 395 F.2d 861 (2nd Cir. 1968), a brokerage firm was owed money by a debtor that was adjudicated a bankrupt in 1963. The brokerage firm took a bad debt deduction in that year. Numerous suits were brought in 1963 on behalf of the brokerage firm seeking damages for fraudulent transactions that caused the debt to become worthless. The court held that recovery on these suits for damages would not be recovery on the debt, and, therefore, the pendency of the suits did not affect the deductibility of the bad debt loss in 1963 by the brokerage firm. The court relied on the fact that none of the suits dealt with the debt owed by the debtor to the creditor or with collateral, guarantees or indemnity contracts directly related to the debt as such, although the damages claimed could be measured by the debt loss.

In the present situation, *X*'s cause of action against *Z* is based on the sale of the note by *Z* to *X*, and not on the debtor-creditor relationship between *X* and *Y*. Any recovery would relate to the sale of the note by *Z* to *X* and would have no bearing on the actual worth or collectibility of the debt evidenced by the note.

HOLDING

X is entitled pursuant to section 166 of the Code to a bad debt deduction in 1975. Further, if any amounts are recovered by *X* from *Z* they will be ordinary income to *X* under section 61(a).

Section 167.—Depreciation

26 CFR 1.167(a)-1: Depreciation in general.

Whether a taxpayer who is developing a citrus grove may take a depreciation deduction for the cost of citrus trees and an irrigation system before the close of the fourth taxable year beginning with the taxable year in which the trees were planted. See Rev. Rul. 80-25, this page.

Section 263.—Capital Expenditures

26 CFR 1.263(a)-2: Examples of capital expenditures.

Whether a taxpayer who is developing a citrus grove must capitalize the cost of the citrus trees and irrigation system. See Rev. Rul. 80-25, below.

Section 278.—Capital Expenditures Incurred in Planting and Developing Citrus and Almond Groves; Certain Capital Expenditures of Farming Syndicates

26 CFR 1.278-1: Capital expenditures incurred in planting and developing citrus and almond groves.
(Also Sections 167, 263; 1.167(a)-1, 1.263(a)-2.)

Capital expenditures; citrus groves; trees and irrigation system. A taxpayer, who was developing a citrus grove, planted citrus trees and installed and placed in service an irrigation system. The taxpayer may take a depreciation deduction for the cost of the trees beginning in the year the trees first reach an income producing stage and for the cost of the irrigation system beginning in the year the system is placed in service.

Rev. Rul. 80-25

ISSUE

Under section 278 of the Internal Revenue Code, may a taxpayer who is developing a citrus grove take a depreciation deduction for the cost of citrus trees and an irrigation system before the close of the fourth taxable year beginning with the taxable year in which the trees were planted?

FACTS

In 1974, a taxpayer who was developing a citrus grove planted citrus trees and installed and placed in service an irrigation system with a useful life of 20 years. In 1977, the citrus trees first produced fruit. The taxpayer took deductions for depreciation of the cost of the irrigation system beginning in 1974 when the system was placed in service. The taxpayer also took deductions for depreciation of the cost of the citrus trees beginning in 1977, the year the trees first began to bear fruit.

LAW AND ANALYSIS

Section 263(a) of the Code provides in pertinent part that no deduction is allowed for any amount paid out for new buildings or for permanent improvements made to increase the value of any property or estate. Instead, these nondeductible capital expenditures must be charged to capital account.

Section 167(a) of the Code allows as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear (including a reasonable allowance for obsolescence) of property used in a trade or business, or held for the production of income.

Section 278(a) of the Code, however, provides that any amount otherwise allowable as a deduction that is attributable to the planting, cultivation, maintenance, or development of any citrus or almond grove and is incurred before the close of the fourth taxable year beginning with the taxable year in which the trees were planted, shall be charged to capital account.

Section 1.278-1(a)(2)(iii) of the Income Tax Regulations states that the provisions of section 278(a) of the Code apply only to expenditures allowable as deductions without regard to section 278(a) and have no application to expenditures otherwise chargeable to capital account, such as the cost of the land and preparatory expenditures incurred in connection with a citrus or almond grove.

Section 278(a) of the Code requires a taxpayer to capitalize for four years the daily out-of-pocket expenses that would otherwise be deductible under section 162 of the Code as ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business. Section 278(a) does not apply, however, to expenditures otherwise chargeable to capital account. Accordingly, section 278(a) does not prevent a taxpayer from taking depreciation deductions that may be allowable under section 167 with respect to capital assets held, and nondeductible capital expenditures made, in connection with a citrus grove.

The cost of the citrus trees that must be capitalized includes the cost of land preparation and planting expenses. This cost is recovered through depreciation when the trees first reach an income producing stage. See Rev. Rul. 69-249, 1969-1 C.B. 31.

HOLDING

The taxpayer may take a depreciation deduction for the cost of the citrus trees beginning in the year the trees first reach an income producing stage and may take a depreciation deduction for the cost of the irrigation system beginning in the year the system is placed in service.

Section 301.—Distributions of Property

26 CFR 1.301-1: Rules applicable with respect to distributions of money and other property.

Whether the Internal Revenue Service will follow the decision in *Robin Haft Trust, et al. v. Commissioner*, 510 F. 2d 43 (1st Cir. 1975), when applying the rules of attribution under section 318 of the Code to a redemption of stock for purposes of determining if the distribution is one to which section 302(a) or section 301 applies. See Rev. Rul. 80-26, below.

Section 302.—Distributions in Redemption of Stock

26 CFR 1.302-1: General.
(Also Sections 301, 318, 7805; 1.301-1, 1.318-1, 301.7805-1.)

Redemption of stock; constructive ownership; family hostility. A corporation, all of the stock of which was owned by three individuals and five trusts, redeemed the stock held by four trusts that were for the benefit of an individual shareholder's children. Before the redemption, each trust owned, actually and constructively, 31 percent of the corporation's stock, and afterwards, each owned 33 percent solely by attribution under section 318 of the Code. Although family hostility prevented the trusts from exercising actual control over such stock, section 318 applies, and the redemption is not a distribution in exchange for stock under section 302(a). The Service will not follow the *Robin Haft Trust* decision.

Rev. Rul. 80-26

ISSUE

Are the rules of attribution under section 318 of the Internal Revenue Code applicable under the facts described below in determining whether a distribution in redemption of stock qualifies under section 302(a) of the Code?

FACTS

X corporation had outstanding one class of voting common stock. The stock was owned by 8 shareholders: *A; B* (*A*'s brother); *C* (*A*'s brother-in-law); *TA*, a trust for the benefit of *A, B,* and *D* (*A*'s sister); *T1, T2, T3,* and *T4*, 4 separate trusts for the benefit of *A*'s children created by a parent of *A*'s spouse. *A*'s interest in the shares of *TA* was one-third. *B, C,* and *D* are individuals unrelated to the other shareholders within the meaning of section 318 of the Code. As a result of a bitter divorce and acrimonious property settlement between *A* and *A*'s spouse, all the stock owned by *T1, T2, T3,* and *T4* was redeemed by *X*. Due to the family hostility these 4 trusts were prevented from exercising actual control over the *X* stock attributed to them. Before the redemption *T1, T2, T3,* and *T4* each owned, actually and constructively, 31 percent of the *X* stock and after the redemption each owned, solely by attribution under sections 318(a)(1)(A)(ii) and 318(a)(3)(B)(i), 33 percent of the *X* stock.

LAW AND ANALYSIS

Pursuant to section 302(c) of the Code section 318(a) applies in determining the ownership of stock for purposes of determining whether a redemption qualifies under section 302(a).

In *United States* v. *Davis*, 397 U.S. 301 (1970), *rehearing denied*, 397 U.S. 1071 (1970), Ct. D. 1937, 1970-1 C.B. 62, the Supreme Court of the United States, in considering whether a distribution was a redemption under section 302(b)(1) of the Code, held that the attribution rules were "specifically applicable to the entire section, and * * * that Congress intended that they be taken into account * * *."

Furthermore, the legislative history of section 318 of the Code indicates that before the enactment of the 1954 Code there was "no specific statutory guidance * * * for stock ownership in the area of corporate distributions * * *." In order to remove the uncertainties Congress provided, through section 318, "precise standards whereby under specific circumstances, a shareholder may be considered as owning stock held by members of his family (* * * or trusts which he controls)." H.R. Rep. No. 1337, 83rd Cong., 2d Sess. A96 and 36 (1954).

In *Robin Haft Trust, et al.* v. *Commissioner*, 510 F. 2d 43 (1st Cir. 1975), *rev'g and remanding*, 61 T.C. 309 (1973), *supplemented*, 62 T.C. 145 (1974), on facts similar to those set forth above, the court viewed the attribution rules as a presumption of continuing influence over corporate affairs and, therefore, because of the family hostility disregarded the attribution rules in testing the redemption of the taxpayers' stock for dividend equivalency. Such an interpretation is, however, inconsistent with both the legislative history of section 318 of the Code and the language and the rationale of *Davis*. The purpose of the attribution rules under section 318 was to replace the confusion of prior law with clear and objective standards for attribution of stock ownership among related shareholders. The facts and circumstances of a particular case cannot contradict the mechanical determination under section 318 of how much stock a shareholder owns.

Consequently, the Internal Revenue Service will not follow the decision of the United States Court of Appeals for the First Circuit in *Haft*. Also, the acquiescence in the decision in *Estate of Squier* v. *Commissioner*, 35 T.C. 950 (1961), *acq.*, 1961-2 C.B. 5, upon which the decision in *Haft* relies, has been withdrawn and nonacquiescence substituted therefor. See 1978-2 C.B. 4.

HOLDING

The rules of attribution under section 318 of the Code are applicable in determining whether a distribution in redemption of stock qualifies under section 302(a). Therefore, in the instant case, pursuant to section 318, *T1, T2, T3,* and *T4* each was the owner of 33 percent of the *X* stock after the redemption and, consequently, the redemption of the stock owned by *T1, T2, T3,* and *T4* is not (i) a complete termination of interest in *X* within the meaning of section 302(b)(3); (ii) a substantially disproportionate redemption of stock within the meaning of section 302(b)(2); or (iii) a redemption not essentially equivalent to a dividend within the meaning of section 302(b)(1). Accordingly, the redemption is not a distribution in part or full payment in exchange for the *X* stock under section 302(a). Thus, under section 302(d), the redemption by *X* of the stock held by *T1, T2, T3,* and *T4* is a distribution of property to which section 301 applies.

PROSPECTIVE APPLICATION

Pursuant to the authority contained in section 7805(b) of the Code, this revenue ruling will not be applied adversely to taxpayers who relied upon the acquiescence in *Squier* and who either (1) before the decision in *Davis*, March 23, 1970, consummated transactions under section 302 in which, pursuant to section 302(c)(1), section 318(a) applied, or (2) consummated such transactions after that date pursuant to the terms of a binding written contract entered into before that date if such terms were in effect on the date of the *Davis* decision.

Section 318.—Constructive Ownership of Stock

26 CFR 1.318-1: Constructive ownership of stock; introduction.

Whether the Internal Revenue Service will follow the decision in *Robin Haft Trust, et al. v. Commissioner*, 510 F. 2d 43 (1st Cir. 1975), when applying the rules of attribution under section 318 of the Code to a redemption of stock for purposes of determining if the distribution is one to which section 302(a) or section 301 applies. See Rev. Rul. 80-26, page 7.

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401(a)-13: Assignment or alienation of benefits.

Qualification; court ordered distribution of benefits. A plan will not lose its qualification under section 401(a) of the Code solely because the plan trustee complies with a court order requiring the distribution of the benefits of a participant in pay status to the participant's spouse or children in order to meet the participant's alimony or support obligations; Rev. Rul. 56-432 obsoleted.

Rev. Rul. 80-27

Advice has been requested whether a plan will lose its qualification under section 401 of the Internal Revenue Code if the plan trustee complies with a court order requiring the distribution of benefits of a participant in pay status to the spouse or children of the participant in order to meet the alimony or support obligations of the participant.

X corporation established a qualified pension plan for its employees. *A* was a married employee of *X* with children. *A* retired and began to receive monthly payments of $500 under the terms of the plan. *A*'s spouse sued *A* for divorce. The final divorce decree provided that *A* should pay $100.00 per month to the spouse as alimony and child support payments. When *A* subsequently defaulted on these payments, *A*'s former spouse obtained a court order requiring the trustee of the *X* corporation plan to deduct $100 per month from the retirement payments due to *A* and to pay the amounts deducted to the former spouse.

Prior to the enactment of the Employee Retirement Income Security Act of 1974 (ERISA) [Pub. L. 93-406, 1974-3 C.B. 1], attachments of a participant's interest in a qualified plan because of the claims of the employer were permitted. See Rev. Rul. 56-432, 1956-2 C.B. 284.

Section 401(a)(13) of the Code, as added by ERISA, provides that a trust shall not constitute a qualified trust unless the plan of which the trust is a part provides that benefits under the plan may not be assigned or alienated.

Section 1.401(a)-13(b)(1) of the Income Tax Regulations provides that, for the purposes of section 401(a)(13) of the Code, a trust will not be qualified unless the plan of which the trust is a part provides that benefits provided under the plan may not be anticipated, assigned (either at law or in equity), alienated or subject to attachment, garnishment, levy, execution, or other legal or equitable process.

The rule against assignment or alienation of plan benefits was intended to assure that the accrued benefits of a plan participant are actually available for retirement purposes. (See H.R. Rep. 93-807, 93d Cong., 2d Sess. (1974), p. 68.) [1974-3 C.B. (Supplement) 236]. Therefore, the participant's benefits are not subject to attachment by general creditors. However, the rule was not intended to defeat the enforcement of the obligation of a plan participant to support the spouse or children of the participant through alimony or support payments. (See, e.g., *Cartledge v. Miller*, 457 F. Supp. 1146 (S.D.N.Y. 1978); *Cogollos v. Cogollos*, 402 N.Y.S.2d 929 (Sup. Ct. 1978); and *Wanamaker v. Wanamaker*, 401 N.Y.S.2d 702 (Sup. Ct. 1978).)

Accordingly, a plan will not lose its qualification under section 401(a) of the Code merely because the trustee complies with a court order requiring deductions from the benefits of a participant in pay status for alimony or support payments. However, accrued benefits that are not currently payable to the participant under the terms of the plan may not be attached since the participant has no present right to such benefits.

Rev. Rul. 56-432, 1956-2 C.B. 284, is obsoleted.

Section 3121.—Definitions [Federal Insurance Contributions Act]

26 CFR 31.3121(s)-1: Concurrent employment by related corporations with common paymaster.
(Also Section 3306; 31.3306(p)-1.)

T.D. 7660 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 31.—EMPLOYMENT TAXES; APPLICABLE ON OR AFTER JANUARY 1, 1955

Employment taxes with respect to employees of related corporations

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to employment taxes with respect to employees of related corporations. Provisions for treating certain related corporations as one employer for purposes of the social security and Federal unemployment taxes were added by the Social Security Amendments of 1977 [Pub. L. 95-216, 1978-1 C.B. 462]. The final regulations provide related corporations and their employees with the guidance needed to comply with the new law. The regulations affect related corporations and individuals who are employed by two or more related corporations one of which is the common paymaster of the corporations.

DATE: The amendments apply to wages paid after December 31, 1978.

FOR FURTHER INFORMATION CONTACT: Eileen Murphy of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T, 202-566-3297).

SUPPLEMENTARY INFORMATION

BACKGROUND

On December 13, 1978, the Federal Register published proposed amendments to the Employment Tax Regulations (26 CFR Part 31) under section 3121(s) and 3306(p) of the Internal Revenue Code of 1954. The amendments were proposed to conform the regulations to section 314 of the Social Security Amendments of 1977 (19 Stat. 1536). A public hearing was held on April 5, 1979. After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision.

The effectiveness of these regulations will be evaluated on the basis of comments and information received from the public, other Government agencies, and offices within the Treasury Department and Internal Revenue Service.

EXPLANATION OF PROVISIONS

Section 314 of the Social Security Amendments of 1977 added sections 3121(s) and 3306(p) to the Internal Revenue Code of 1954 to provide, in effect, for the treatment of certain related corporations as one employer for the purposes of the social security tax and the Federal unemployment tax. These new provisions state that when two or more related corporations concurrently employ the same individual, and compensate that individual through a common paymaster which is one of the related corporations for which the individual performs services, each of the corporations is considered to have paid only the remuneration it actually disburses to that individual. The regulations define the terms related corporations, common paymaster, and concurrent employment. The regulations also provide rules for the allocation of employment taxes, and for liability for those taxes.

COMMENTS

The proposed regulations were revised in several ways to reflect comments received from the public. Several comments requested that guidance be provided regarding treatment of reporting and filing requirements under the new sections. Accordingly, the regulations were expanded to include such guidance.

Under the regulations, no additional reporting or filing requirements have been imposed. One comment stated that the regulations are unclear as to the intended consequences when two corporations are related (under the tests provided in the regulations) to the common paymaster but not related to each other. An example has been added to clarify this situation. Several comments stated that one of the proposed tests for the definition of related corporations, dealing with nonstock corporations, should be revised to encompass some mutual insurance companies which, due to the way they were organized, could not meet the test. Since the test was designed to include mutual insurance companies (among other nonstock corporations), the test was accordingly revised. Several comments asked for clarification whether the tests for the definition of related corporations, requiring a certain percentage of common officers or employees, required the applicable percentage of officers or employees to exist in one corporation or in both corporations. An example has been revised to clarify this point. One comment suggested that a common paymaster should include a corporation which pays common employees with checks drawn on separate bank accounts of each employing corporation. The final regulations include this suggestion, with the limitation that the common paymaster must be the drawer of the checks.

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[1] This publication of the Treasury Decision contains the complete text of amendments to the regulations. The instructions for modifying the notice of the proposed rulemaking have been omitted.

Section 3121(s) applies only to concurrently employed individuals who are remunerated by a common paymaster that is one of the employing corporations. Several comments were received regarding the definition of concurrent employment. The comments requested that this definition be changed so that the performance of services for the employing corporation, and, in particular, the common paymaster corporation, was not a requirement. The definition of concurrent employment has not been changed in the final regulations, however, because the statute clearly indicates the individual must be employed by the common paymaster, and there is no indication that Congress intended the word "employment" to mean other than the normal definition of the term, which includes the concept of performance of services in exchange for wages. In addition, the suggested definition could cause administrative difficulties in determining who was concurrently employed. Recognizing that additional guidance was needed in this area, the final regulations have been revised and expanded to clarify the definition of concurrent employment, and the examples have been revised to illustrate common fact patterns.

The provisions of the proposed regulations dealing with allocation of employment taxes is unchanged in the Treasury decision. One comment was received suggesting that, in the case of insurance companies, an allocation method based on intercompany reinsurance agreements would be desirable. One method of allocation included in the proposed regulations for allocation in an appropriate manner varying according to the circumstances encompasses this suggestion.

DRAFTING INFORMATION

The principal author of this regulation is Eileen Murphy of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to 26 CFR Part 31 are hereby adopted:

Paragraph 1. Section 31.3121(a)(1) and the historical note are deleted.

Par. 2. Section 31.3121(a)(1)-1 is amended by adding at the end of the portion of paragraph (a)(3) that precedes example (1) a sentence which reads as follows:

§ 31.3121(a)(1)-1 Annual wage limitation.

(a) *In general.* * * *

(3) * * * In connection with the annual wage limitation in the case of remuneration paid after December 31, 1978, from two or more related corporations that compensate an employee through a common paymaster, see § 31.3121(s)-1.

* * * * *

Par. 3. There is added immediately after § 31.3121(r)-1 the following new section:

§ 31.3121(s)-1 Concurrent employment by related corporations with common paymaster.

(a) *In general.* For purposes of sections 3102, 3111, and 3121(a)(1), except as otherwise provided in paragraph (c) of this section, when two or more related corporations concurrently employ the same individual and compensate that individual through a common paymaster which is one of the related corporations that employs the individual, each of the corporations is considered to have paid only the remuneration it actually disburses to that individual. This rule applies whether the remuneration was paid with respect to the employment relationship of the individual with the disbursing corporation or was paid on behalf of another related corporation. Accordingly, if all of the remuneration to the individual from the related corporations is disbursed through the common paymaster, the total amount of taxes imposed with respect to the remuneration under sections 3102 and 3111 is determined as though the individual has only one employer (the common paymaster). The common paymaster is responsible for filing information and tax returns and issuing Forms W-2 with respect to wages it is considered to have paid under this section. Section 3121(s) and this section apply only to remuneration disbursed in the form of money, check, or similar instrument by one of the related corporations or its agent.

(b) *Definitions.* The definitions contained in this paragraph are applicable only for purposes of this section and § 31.3306(p)-1.

(1) *Related corporations.* Corporations shall be considered related corporations for an entire calendar quarter (as defined in § 31.0-2(a)(9)) if they satisfy any one of the following four tests at any time during that calendar quarter:

(i) The corporations are members of a "controlled group of corporations", as defined in section 1563 of the Code, or would be members if section 1563(a)(4) and (b) did not apply and if the phrase "more than 50 percent" were substituted for the phrase "at least 80 percent" wherever it appears in section 1563(a).

(ii) In the case of a corporation that does not issue stock, either fifty percent or more of the members of one corporation's board of directors (or other governing body) are members of the other corporation's board of directors (or other governing body), or the holders of fifty percent or more of the voting power to select such members are concurrently the holders of fifty percent or more of that power with respect to the other corporation.

(iii) Fifty percent or more of one corporation's officers are concurrently officers of the other corporation.

(iv) Thirty percent or more of one corporation's employees are concurrently employees of the other corporation.

The following examples illustrate the application of this paragraph:

Example (*1*). (a) X Corporation employs individuals A, B, D, E, F, G, and H. Y Corporation employs individuals A, B, and C. Z Corporation employs individuals A, C, I, J, K, L, and M. X Corporation is the paymaster for all thirteen individuals. The corporations have no officers or stockholders in common.

(b) X and Y are related corporations because at least 30 percent of Y's employees are also employees of X. Y and Z are related corporations because at least 30 percent of Y's employees are also employees of Z. X and Z are not related corporations because neither corporation has 30 percent of its employees concurrently employed by the other corporation.

(c) For purposes of determining the amount of the tax liability under sections 3102 and 3111, individual B is treated as having one employer. Individual C has two employers for these purposes, although Y and Z are related corporations, because C is not employed by X Corporation, the common paymaster. Individual A also is treated as having two employers for the purposes of these sections because X and Y Corporations are treated as one employer, and Z Corporation is treated as a second employer (since it is not related to the paymaster, X Corporation). Of course, individuals D, E, F, G, H, I, J, K, L, and M are not concurrently employed by two or more corporations and, accordingly, section 3121(s) is inapplicable to them.

Example (*2*). M and N Corporations are both related to Corporation O but are not related to each other. Individual A is concurrently employed by all three corporations and paid by O, their common paymaster. Although M and N are not related, O is treated as the employer for A's employment with M, N, and O.

Example (*3*). Corporations X, Y, and Z meet the definition of related corporations for the first time on April 12, 1979, and cease to meet it on July 5, 1979. A is concurrently employed by X, Y, and Z throughout 1979. In each of the four calendar quarters of 1979, A's remuneration from X, Y, and Z is $2,000, $10,000, and $30,000, respectively. All of the remuneration to A from X, Y, and Z for the year is disbursed by X, the common paymaster. Under these circumstances, the amount of wages subject to sections 3102 and 3111 is as follows:

For the first calendar quarter

X	Y	Z
$2,000	$10,000	$22,900

For the second calendar quarter

X	Y	Z
$20,900 ($22,900 – $2,000)	0	0

For the third calendar quarter

X	Y	Z
0	0	0

For the fourth calendar quarter

X	Y	Z
0	$10,000	0

Of course, if the corporations had been related throughout all of 1979, only $22,900 of X's first quarter disbursement would have constituted wages subject to sections 3102 and 3111.

(2) *Common Paymaster*—(i) *In general*. A common paymaster of a group of related corporations is any member thereof that disburses remuneration to employees of two or more of those corporations on their behalf and that is responsible for keeping books and records for the payroll with respect to those employees. The common paymaster is not required to disburse remuneration to all the employees of those two or more related corporations, but the provisions of this section do not apply to any remuneration to an employee that is not disbursed through a common paymaster. The common paymaster may pay concurrently employed individuals under this section by one combined paycheck, drawn on a single bank account, or by separate paychecks, drawn by the common paymaster on the accounts of one or more employing corporations.

(ii) *Multiple common paymasters*. A group of related corporations may have more than one common paymaster. Some of the related corporations may use one common paymaster and others of the related corporations use another common paymaster with respect to a certain class of employees. A corporation that uses a common paymaster to disburse remuneration to certain of its employees may use a different common paymaster to disburse remuneration to other employees.

(iii) *Examples*. The rules of this subparagraph are illustrated by the following examples:

Example (*1*). S, T, U, and V are related corporations with 2,000 employees collectively. Forty of these employees are concurrently employed by two or more of the corporations during a calendar quarter. The four corporations arrange for S to disburse remuneration to thirty of these forty employees for their services. Under these facts, S is the common paymaster of S, T, U, and V with respect to the thirty employees. S is not a common paymaster with respect to the remaining employees.

Example (*2*). (a) W, X, Y, and Z are related corporations. The corporations collectively have 20,000 employees. Two hundred of the employees are top-level executives and managers, sixty of whom are concurrently employed by two or more of the corporations during a calendar quarter. Six thousand of the employees are skilled artisans, all of whom are concurrently employed by two or more of the corporations during the calendar year. The four corporations arrange for Z to disburse remuneration to the sixty executives who are concurrently employed by two or more of the corporations. W and X arrange for X to disburse remuneration to the artisans who are concurrently employed by W and X.

(b) A is an executive who is concurrently employed only by W, Y, and Z during the calendar year. Under these facts, Z is a common paymaster for W, Y, and Z with respect to A. Assuming that the other requirements of this section are met, the amount of the tax liability under sections 3102 and 3111 is determined as if Z were A's only employer for the calendar quarter.

(c) B is a skilled artisan who is concurrently employed only by W and X during the calendar year. Under these facts, X is a common paymaster for S and X with respect to B. Assuming that the other requirements of this section are met, the amount of the tax liability under sections 3102 and 3111 is determined as if X were B's only employer for the calendar quarter.

(3) *Concurrent employment*. For purposes of this section, the term "concurrent employment" means the contemporaneous existence of an employment relationship (within the meaning of section 3121(b)) between an individual and two or more corporations. Such a relationship contemplates the performance of services by the employee for the benefit of the employing corporation (not merely for the benefit of the group of corporations), in exchange for remuneration which, if deductible for the purposes of Federal income tax, would be deductible by the employing corporation. The contemporaneous existence of an employment relationship with each corporation is the decisive factor; if it exists, the fact that a particular employee is on leave or otherwise temporarily inactive is immaterial. However, employment is not concurrent with respect to one of the related corporations if the employee's employment relationship with that corporation is completely nonexistent during periods when the employee is not performing services for that corporation. An employment relationship is completely nonexistent if all rights and obligations of the employer and employee with respect to employment have terminated,

other than those that customarily exist after employment relationships terminate. Examples of rights and obligations that customarily exist after employment relationships terminate include those with respect to remuneration not yet paid, employer's property used by the employee not yet returned to the employer, severance pay, and lump-sum termination payments from a deferred compensation plan. Circumstances that suggest that an employment relationship has become completely nonexistent include unconditional termination of participation in deferred compensation plans of the employer, forfeiture of seniority claims, and forfeiture of unused fringe benefits such as vacation or sick pay. Of course, the continued existence of an employment relationship between an individual and a corporation is not necessarily established by the individual's continued participation in a deferred compensation plan, retention of seniority rights, etc., since continuation of those benefits may be attributable to employment with a second corporation related to the first corporation if the corporations have common benefits plans or if the benefits are continued as a matter of corporate reciprocity. An individual who does not perform substantial services in exchange for remuneration from a corporation is presumed not employed by that corporation. Concurrent employment need not exist for any particular length of time to meet the requirements of this section, but this section only applies to remuneration disbursed by a common paymaster to an individual who is concurrently employed by the common paymaster and at least one other related corporation at the time the individual performs the services for which the remuneration is paid. If the employment relationship is nonexistent during a quarter, that employee may not be counted towards the 30-percent test set forth in paragraph (b)(1)(iv) of this section; however, even if the employment relationship is nonexistent, section 3121(s) of the Code applies to remuneration paid to the former employee for services rendered while the employee was a common employee. The principles of this subparagraph are illustrated by the following examples:

Example (*1*). M, N, and O are related corporations which use N as a common paymaster with respect to officers. Their respective headquarters are located in three separate cities several hundred miles apart. A is an officer of M, N, and O who performs substantial services for each corporation. A does not work a set length of time at each corporate headquarters, and when A leaves one corporate headquarters, it is not known when A will return, although it is expected that A will return. Under these facts, A is concurrently employed by the three corporations.

Example (*2*). P, Q, and R are related corporations whose geographical zones of business activity do not overlap. P, Q, and R have a common pension plan and arrange for Q to be a common paymaster for managers and executives. All three corporations maintain cafeterias for the use of their employees. B is a cafeteria manager who has worked at P's headquarters for 3 years. On June 1, 1980, B is transferred from P to the position of cafeteria manager of R. There are no plans for B's return to P. B's accrued pension benefits, vacation and sick pay, do not change as a result of the transfer. The decision to transfer B was made by Q, the parent corporation. Under these facts, B is not concurrently employed by P and R, because B's employment relationship with P was completely nonexistent during B's employment with R. Furthermore, section 3121(s) is inapplicable since B also was not employed by Q, the common paymaster, because B never contracted to perform services for remuneration from Q, and Q did not have the right to control the day-to-day duties of B's work.

Example (*3*). C is employed by two related corporations, S and T. C was concurrently employed by these corporations between April 1, 1979, and June 30, 1979. The corporations used T as the common paymaster with respect to C's wages between May 1, 1979, and September 30, 1979. T pays C on May 15 for services performed between April 1 and April 30, on July 15 for services performed between June 1 and June 30, and on August 15 for services performed between July 1 and July 31. Section 3121(s) applies to the first two payments but does not apply to the third payment (there was no concurrent employment). However, if the third payment was made by T for services performed for T, T counts the amounts previously disbursed to C in 1979 while C was concurrently employed by S and T towards the wage base (see section 3121(a)(1)).

(c) *Allocation of employment taxes*—(1) *Responsibility to pay tax.* If the requirements of this section are met, the common paymaster has the primary responsibility for remitting taxes pursuant to sections 3102 and 3111 with respect to the remuneration it disburses as the common paymaster. The common paymaster computes these taxes as though it were the sole employer of the concurrently employed individuals. If the common paymaster fails to remit these taxes (in whole or in part), it remains liable for the full amount of the unpaid portion of these taxes. In addition, each of the other related corporations using the common paymaster is jointly and severally liable for its appropriate share of these taxes. That share is an amount equal to the lesser of:

(i) The amount of the liability of the common paymaster under section 3121(s), after taking account of any tax payments made, or

(ii) The amount of the liability under sections 3102 and 3111 which, but for section 3121(s), would have existed with respect to the remuneration from such other related corporation, reduced by an allocable portion of any taxes previously paid by the common paymaster with respect to that remuneration.

The portion of taxes previously paid by the common paymaster that is allocable to each related corporation is determined by multiplying the amount of taxes paid by a fraction, the numerator of which is the portion of the amount of employment tax liability of the common paymaster under section 3121(s) that is allocable to such related corporation under paragraph (c)(2) of this section, and the denominator of which is the total amount of the common paymaster's liability under section 3121(s), both determined without regard to any prior tax payments. These rules apply whether or not the tax on employees was withheld from the employees' wages.

(2) *Allocation of tax*—(i) *In general.* If the related corporations maintain a record of the remuneration disbursed to the employee for services performed for each corporation, the remuneration-based allocation rules of paragraph (c)(2)(ii) of this section apply. If the related corporations do not maintain this record of remuneration, the group-wide allocation rules of paragraph (c)(2)(iii) of this section apply. In all cases, allocations must be made with respect to each payment of wages. The allocation of employment tax liabilities pursuant to this subparagraph also determines which related corporation may be entitled to income tax deductions with respect to the payments of those taxes.

(ii) *Remuneration-based allocation rules.* Under the remuneration-based method of allocation, each related corporation that remunerates an employee through a common paymaster has allocated to it for each pay period an amount of tax determined according to the following formula:

$$\frac{\text{Portion of wage payment constituting remuneration to the employee for services performed for the corporation}}{\text{Total wage payment constituting remuneration to the employee for all services performed for the related corporations using the common paymaster}} \times \text{Tax on employees under section 3102 and tax on employers under section 3111 that the common paymaster is required to remit with respect to the wage payment.}$$

If the remuneration disbursed to an employee for services performed for a corporation is inappropriate, the district director may adjust the remuneration records of the related corporations to reflect appropriate remuneration. The district director may use the principles of § 1.482-2(b) in making the adjustments.

Example. (i) X and Y are related corporations which use Y as common paymaster for their executives. A is a concurrently employed executive who performs services during the first quarter of 1979 for X and Y. Y remunerates $4,000 gross pay every week to A, calculated as follows:

Wage payments	Remuneration X	Remuneration Y	Total	Tax on employers under section 3111	Tax on employees withheld under section 3102	Total
1	$ 3,000	$ 1,000	$ 4,000	$ 245.20	$ 245.20	$ 490.40
2-3	—	8,000	8,000	490.40	490.40	980.80
4	1,000	3,000	4,000	245.20	245.20	490.40
5	4,000	—	4,000	245.20	245.20	490.40
6	2,000	2,000	4,000	177.77	177.77	355.54
7-13	10,000	18,000	28,000	-0-	-0-	-0-
	$20,000	$32,000	$52,000	$1,403.77	$1,403.77	$2,807.54

The amounts of remuneration to A are determined by the district director to be appropriate. Under these facts, the tax is allocated to X and Y in the following amounts:

Wage payments	X	Y
1	$\frac{\$3,000}{\$4,000} \times \$490.40 = \$367.80$	$\frac{\$1,000}{\$4,000} \times \$490.40 = \$122.60$
2-3	—	$\frac{\$8,000}{\$8,000} \times \$980.80 = \$980.80$
4	$\frac{\$1,000}{\$4,000} \times \$490.40 = \$122.60$	$\frac{\$3,000}{\$4,000} \times \$490.40 = \$367.80$
5	$\frac{\$4,000}{\$4,000} \times \$490.40 = \$490.40$	—
6	$\frac{\$2,000}{\$4,000} \times \$355.54 = \$177.77$	$\frac{\$2,000}{\$4,000} \times \$355.54 = \$177.77$
7-13	$\frac{\$10,000}{\$28,000} \times$ -0- = -0-	$\frac{\$18,000}{\$28,000} \times$ -0- = -0-
	$1,158.57	$1,648.97

(ii) If Y remits none of the taxes to the Internal Revenue Service, X is liable for $2,452.00 (the entire amount due pursuant to sections 3102 and 3111 with respect to the remuneration to A from X) (12.26% × $20,000). Any amount remitted by X to the Internal Revenue Service under these circumstances is also credited against the liability of the common paymaster, Y. However, only the portion of the employment taxes allocated to X under (i) above may be deducted by X as employment taxes paid by it in respect of wages paid by it to its employees.

(iii) If Y remits $1,000.00 of the total $2,807.54 due, Y as common paymaster remains liable for $1,807.54 ($2,807.54 minus $1,000). X's liability is the lesser of $1,807.54 (the liability of the common paymaster), or X's total liability in the absence of section 3121(s), on wages paid through the common paymaster ($2,452.00) minus a credit for an allocable part of the amount remitted by Y. The part is $412.66

$$\frac{\$1,158.57\ \text{(X's allocable share of tax)}}{\$2,807.54\ \text{(total tax)}} \times \$1,000$$

(tax remitted). Since $1,807.54 is less than $2,039.34 ($2,452.00 minus $412.66), X and Y are jointly and severally liable for $1,807.54.

(iii) *Group-wide allocation rules.* Under the group-wide method of allocation, the district director may allocate the taxes imposed by sections 3102 and 3111 in an appropriate manner to a related corporation that remunerates an employee through a common paymaster if the common paymaster fails to remit the taxes to the Internal Revenue Service. Allocation in an appropriate manner varies according to the circumstances. It may be based on sales, property, corporate payroll, or any other basis that reflects the distribution of the services performed by the employee, or a combination of the foregoing bases. To the extent practicable, the district director may use the principles of § 1.482-2(b) in making the allocation.

(d) *Effective date.* This section is effective with respect to wages paid after December 31, 1978.

Par. 4. Section 31.3306(b)(1) and the historical note are deleted.

Par. 5. Section 31.3306(b)(1)-1 is amended by adding at the end of the portion of paragraph (a)(3) that precedes example (1) a sentence which reads as follows:

§ 31.3306(b)(1)-1 $3,000 limitation.

(a) *In general.* * * *

(3) * * * In connection with the annual wage limitation in the case of remuneration after December 31, 1978 from two or more related corporations that compensate an employee through a common paymaster, see § 31.3306(p)-1.

* * * * *

Par. 6. There is added immediately after § 31.3306(o)-1 the following new section:

§ 31.3306(p)-1 Employees of related corporations.

(a) *In general.* For purposes of sections 3301, 3302, and 3306(b)(1), when two or more related corporations concurrently employ the same individual and compensate that individual through a common paymaster which is one of the related corporations for which the individual performs services, each of the corporations is considered to have paid only the remuneration it actually disburses to that individual (unless the disbursing corporation fails to remit the taxes due). Paragraphs (b) and (c) of § 31.3121(s)-1 contain rules defining related corporations, common paymasters, and concurrent employment, and rules for determining the liability of the other related corporations for employment taxes if the common paymaster fails to remit the taxes pursuant to sections 3102 and 3111, and for allocating these taxes among the related corporations. Those rules also apply to the tax under section 3301. For purposes of applying those rules to this section, references in those rules to sections 3111 are considered references to sections 3301 and 3302, and references to section 3121 are considered references to section 3306.

(b) *Allocation of credit for contributions to State unemployment funds.* A special rule for applying the rules of § 31.3121(s)-1 to this section applies if it is necessary to determine the ultimate liability of each related corporation for which services are performed in the event the common paymaster fails to remit the tax to the Internal Revenue Service. In determining the ultimate liability of a corporation, the credit for contributions to State unemployment funds that the corporation may claim under section 3302 is calculated as if each corporation were a separate employer.

(c) *Effective date.* This section is effective with respect to wages paid after December 31, 1978.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved December 10, 1979.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on December 18, 1979, 8:45 a.m., and published in the issue of the Federal Register for December 19, 1979, 44 F.R. 75137)

Section 3306.—Definitions [Federal Unemployment Tax Act]

26 CFR 31.3306(p)-1: Employees of related corporations.

Provisions for treating certain related corporations as one employer for purposes of the federal unemployment tax. See T.D. 7660, page 9.

Section 6694.—Understatement of Taxpayer's Liability by Income Tax Return Preparer

26 CFR 1.6694-1: Understatement of taxpayer's liability by income tax return preparer.

Return preparers; negligence penalty; failure to report minimum tax liability. Factual situations illustrate application of the penalty imposed by section 6694(a) of the Code to an income tax return preparer's failure to report a taxpayer's minimum tax liability.

Rev. Rul. 80-28

ISSUE

Does the penalty for negligent or intentional disregard of rules and regulations under section 6694(a) of the Internal Revenue Code apply where income tax return preparers failed to report the taxpayers' minimum tax on tax preference items in the situations described below?

Situation 1. An income tax return preparer failed to report on an individual taxpayer's income tax return for 1978, a minimum tax liability of $300 resulting from a net capital gain deduction shown on the taxpayer's return. The failure to report the minimum tax is an understatement of tax liability defined in section 6694(e).

The explanation given by the preparer for the failure to report the minimum tax was that the preparer believed the taxpayer would have some basis in the asset sold which would offset any minimum tax due. The preparer was unable to confirm a basis in the asset before filing the return.

Situation 2. The facts are the same as in situation 1, but the explanation given by the preparer for failure to report the minimum tax was that the failure was due to an oversight. The preparer contended that the oversight was not a deliberate understatement of the liability, and should not be considered as negligent or intentional disregard of rules and regulations.

Situation 3. The facts are the same in situation 1, but the explanation given by the preparer for failure to report the minimum tax was that the preparer was not aware of the minimum tax provisions. For this reason the preparer contended that the penalty for negligent or intentional disregard of rules and regulations should not apply.

LAW AND ANALYSIS

Section 56(a) of the Code provides for the imposition of an income tax on certain items of tax preference. Section 57(a)(9)(A) treats as a tax preference item an amount equal to the net capital gain deduction for the taxable year determined under section 1202, and for taxable years ending prior to January 1, 1979, such item was taxed under section 56(a). For years beginning after December 31, 1978, such item is taxed under section 55 (relating to the alternative minimum tax).

Section 6694(a) of the Code provides that if any part of any understatement of liability with respect to any return is due to the negligent or intentional disregard of rules and regulations by any person who is an income tax return preparer with respect to such return, such person shall pay a penalty of $100 with respect to such return.

Under section 1.6694-1(a)(1) of the Income Tax Regulations, a preparer is not considered to have negligently or intentionally disregarded a rule or regulation if the preparer exercises due diligence in an effort to apply the rules and regulations to the information given to the preparer to determine the taxpayer's correct liability for tax.

Section 1.6694-1(a)(5) of the regulations places the burden of proof on the preparer when there is a question as to whether the preparer has negligently or intentionally disregarded a rule or regulation.

The penalty in section 6694(a) of the Code shall be applied in a manner similar to the penalty under section 6653. The section of the Conference Report on the Revenue Act of 1978 relating to Technical Corrections to the Tax Reform Act of 1976 states that the Internal Revenue Service shall reasonably interpret section 6694 (a) according to the standards of section 6653(a) and in the light of all the facts and circumstances of each case, taking into account any and all mitigating factors. H.R. Rep. No. 95-1800, 95th Cong., 2d Sess. 284 (1978), 1978-3 C.B. (Vol. 1) 521, 618.

Under section 6653(a), negligence has been defined as the lack of due care in failing to do what a reasonable and ordinarily prudent person would do under the circumstances. *Marcello v. Commissioner*, 380 F. 2d 499, 506 (5th Cir. 1967).

In *Situation 1,* the preparer was aware of the minimum tax provisions but nevertheless failed to report the minimum tax based on an unsupported belief that the taxpayer's basis for the capital asset would offset the minimum tax due. This was not supported by the facts and circumstances because the preparer did not use a basis in the computation of the capital gain. Therefore, the preparer's belief that the taxpayer's basis for the capital asset would offset the minimum tax due is not sufficient to establish that the failure to report the minimum tax was not negligence.

In *Situation 2,* the preparer was aware of the minimum tax provisions and correctly claimed a capital gain deduction under section 1202 of the Code. Therefore, the preparer's explanation of oversight is not sufficient to establish that the omission was not negligence. Whether the preparer deliberately understated the taxpayer's liability, is not a factor in considering the application of the penalty under section 6694(a).

In *Situation 3,* the preparer did not do what a reasonably diligent preparer would have done under the circumstances. The minimum tax computation is not an unusual item. It is encountered frequently by return preparers. The instructions for an individual income tax return indicated the existence of the minimum tax provisions including the fact that capital gains were an item of tax preference. Therefore, it is clear that an adequate investigation into the tax consequences of the sale would have disclosed the minimum tax liability. An omission was clearly made by the preparer, and defense of error or ignorance of the law is not sufficient to establish that the omission was not negligence.

HOLDING

In all three situations, the preparers failed to exercise due diligence in applying the minimum tax provisions to the information provided. Therefore, the penalty for negligent or intentional disregard of rules and regulations under section 6694(a) of the Code applies in these situations.

Section 7805.—Rules and Regulations

26 CFR 301.7805-1: Rules and regulations.

Nonretroactive application of revenue ruling to certain taxpayers who relied upon the decision in *Estate of Squier v. Commissioner*, 35 T.C. 950 (1960), *acq.*, withdrawn and *nonacq.* substituted therefor, 1978-2 C.B. 4. See Rev. Rul. 80-26, page 7.

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions

United States-United Kingdom Estate and Gift Tax Convention [1]

Convention signed at London October 19, 1978;

Ratification advised by the Senate of the United States of America July 9, 1979;

Ratified by the President of the United States of America August 24, 1979;

Ratified by the United Kingdom of Great Britain and Northern Ireland June 14, 1979;

Ratifications exchanged at Washington October 11, 1979;

Proclaimed by the President of the United States of America December 6, 1979;

Entered into force November 11, 1979.

BY THE PRESIDENT OF THE UNITED STATES OF AMERICA

A PROCLAMATION

CONSIDERING THAT:

The Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Estates of Deceased Persons and on Gifts was signed at London on October 19, 1978, the text of which is hereto annexed;

The Senate of the United States of America by its resolution of July 9, 1979, two-thirds of the Senators present concurring therein, gave its advice and consent to ratification of the Convention;

The Convention was ratified by the President of the United States of America on August 24, 1979, in pursuance of the advice and consent of the Senate, and was ratified on the part of the United Kingdom of Great Britain and Northern Ireland on June 14, 1979;

It is provided in Article 14 of the Convention that the Convention shall enter into force immediately after the expiration of thirty days following the date on which the instruments of ratification are exchanged;

The instruments of ratification of the Convention were exchanged at Washington on October 11, 1979, and accordingly the Convention entered into force on November 11, 1979;

NOW, THEREFORE, I, Jimmy Carter, President of the United States of America, proclaim and make public the Convention to the end that it be observed and fulfilled with good faith on and after November 11, 1979, by the United States of America and by the citizens of the United States of America and all other persons subject to the jurisdiction thereof.

IN TESTIMONY WHEREOF, I have signed this proclamation and caused the Seal of the United States of America to be affixed.

DONE at the city of Washington this sixth day of December in the year of our Lord one thousand nine hundred seventy-nine and of the Independence of the United States of America the two hundred fourth.

By the President:

JIMMY CARTER

CYRUS VANCE,
Secretary of State

CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON ESTATES OF DECEASED PERSONS AND ON GIFTS

The Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland;

Desiring to conclude a new Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on estates of deceased persons and on gifts;

Have agreed as follows:

ARTICLE 1

SCOPE

This Convention shall apply to any person who is within the scope of a tax which is the subject of this Convention.

ARTICLE 2

TAXES COVERED

(1) The existing taxes to which this Convention shall apply are:

(*a*) in the United States: the Federal gift tax and the Federal estate tax, including the tax on generation-skipping transfers; and

(*b*) in the United Kingdom: the capital transfer tax.

(2) This Convention shall also apply to any identical or substantially similar taxes which are imposed by a Contracting State after the date of signature of the Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any changes which have been made in their respective taxation laws.

ARTICLE 3

GENERAL DEFINITIONS

(1) In this Convention:

(*a*) the term "United States" means the United States of America, but does not include Puerto Rico, the Virgin Islands, Guam or any other United States possession or territory;

(*b*) the term "United Kingdom" means Great Britain and Northern Ireland;

(*c*) the term "enterprise" means an industrial or commercial undertaking;

(*d*) the term "competent authority" means:

(i) in the United States: the Secretary of the Treasury or his delegate, and

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[1] Treaties and Other International Act Series (TIAS 9580). Pertinent excerpts from Senate Report No. 96-6, page 21; Treasury Department Technical Explanation, page 31; Senate Executive R is not published.

(ii) in the United Kingdom: the Commissioners of Inland Revenue or their authorised representative;

(*e*) the term "nationals" means:

(i) in relation to the United States, United States citizens, and

(ii) in relation to the United Kingdom, any citizen of the United Kingdom and Colonies, or any British subject not possessing that citizenship or the citizenship of any other Commonwealth country or territory, provided in either case he had the right of abode in the United Kingdom at the time of the death or a transfer;

(*f*) the term "tax" means:

(i) the Federal gift tax or the Federal estate tax, including the tax on generation-skipping transfers, imposed in the United States, or

(ii) the capital transfer tax imposed in the United Kingdom, or

(iii) any other tax imposed by a Contracting State to which this Convention applies by virtue of the provisions of paragraph (2) of Article 2,

as the context requires; and

(*g*) the term "Contracting State" means the United States or the United Kingdom as the context requires.

(2) As regards the application of the Convention by a Contracting State, any term not otherwise defined shall, unless the context otherwise requires and subject to the provisions of Article 11 (Mutual Agreement Procedure), have the meaning which it has under the laws of that Contracting State relating to the taxes which are the subject of the Convention.

ARTICLE 4

FISCAL DOMICILE

(1) For the purposes of this Convention an individual was domiciled:

(*a*) in the United States: if he was a resident (domiciliary) thereof or if he was a national thereof and had been a resident (domiciliary) thereof at any time during the preceding three years; and

(*b*) in the United Kingdom: if he was domiciled in the United Kingdom in accordance with the law of the United Kingdom or is treated as so domiciled for the purpose of a tax which is the subject of this Convention.

(2) Where by reason of the provisions of paragraph (1) an individual was at any time domiciled in both Contracting States, and

(*a*) was a national of the United Kingdom but not of the United States, and

(*b*) had not been resident in the United States for Federal income tax purposes in seven or more of the ten taxable years ending with the year in which that time falls,

he shall be deemed to be domiciled in the United Kingdom at that time.

(3) Where by reason of the provisions of paragraph (1) an individual was at any time domiciled in both Contracting States, and

(*a*) was a national of the United States but not of the United Kingdom, and

(*b*) had not been resident in the United Kingdom in seven or more of the ten income tax years of assessment ending with the year in which that time falls,

he shall be deemed to be domiciled in the United States at that time. For the purposes of this paragraph, the question of whether a person was so resident shall be determined as for income tax purposes but without regard to any dwelling-house available to him in the United Kingdom for his use.

(4) Where by reason of the provisions of paragraph (1) an individual was domiciled in both Contracting States, then, subject to the provisions of paragraphs (2) and (3), his status shall be determined as follows:

(*a*) the individual shall be deemed to be domiciled in the Contracting State in which he had a permanent home available to him. If he had a permanent home available to him in both Contracting States, or in neither Contracting State, he shall be deemed to be domiciled in the Contracting State with which his personal and economic relations were closest (centre of vital interests);

(*b*) if the Contracting State in which the individual's centre of vital interests was located cannot be determined, he shall be deemed to be domiciled in the Contracting State in which he had an habitual abode;

(*c*) if the individual had an habitual abode in both Contracting States or in neither of them, he shall be deemed to be domiciled in the Contracting State of which he was a national; and

(*d*) if the individual was a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

(5) An individual who was a resident (domiciliary) of a possession of the United States and who became a citizen of the United States solely by reason of his

(*a*) being a citizen of such possession, or

(*b*) birth or residence within such possession,

shall be considered as neither domiciled in nor a national of the United States for the purposes of this Convention.

ARTICLE 5

TAXING RIGHTS

(1) (*a*) Subject to the provisions of Articles 6 (Immovable Property (Real Property)) and 7 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services) and the following paragraphs of this Article, if the decedent or transferor was domiciled in one of the Contracting States at the time of the death or transfer, property shall not be taxable in the other State.

(*b*) Sub-paragraph (*a*) shall not apply if at the time of the death or transfer the decedent or transferor was a national of that other State.

(2) Subject to the provisions of the said Articles 6 and 7, if at the time of the death or transfer the decedent or transferor was domiciled in neither Contracting State and was a national of one Contracting State (but not of both), property which is taxable in the Contracting State of which he was a national shall not be taxable in the other Contracting State.

(3) Paragraphs (1) and (2) shall not apply in the United States to property held in a generation-skipping trust or trust equivalent on the occa-

sion of a generation-skipping transfer; but, subject to the provisions of the said Articles 6 and 7, tax shall not be imposed in the United States on such property if at the time when the transfer was made the deemed transferor was domiciled in the United Kingdom and was not a national of the United States.

(4) Paragraphs (1) and (2) shall not apply in the United Kingdom ~~to~~ property comprised in a settlement; but, subject to the provisions of the said Articles 6 and 7, tax shall not be imposed in the United Kingdom on such property if at the time when the settlement was made the settlor was domiciled in the United States and was not a national of the United Kingdom.

(5) If by reason of the preceding paragraphs of this Article any property would be taxable only in one Contracting State and tax, though chargeable, is not paid (otherwise than as a result of a specific exemption, deduction, exclusion, credit or allowance) in that State, tax may be imposed by reference to that property in the other Contracting State notwithstanding those paragraphs.

(6) If at the time of the death or transfer the decedent or transferor was domiciled in neither Contracting State and each State would regard any property as situated in its territory and in consequence tax would be imposed in both States, the competent authorities of the Contracting States shall determine the situs of the property by mutual agreement.

Article 6

IMMOVABLE PROPERTY (REAL PROPERTY)

(1) Immovable property (real property) may be taxed in the Contracting State in which such property is situated.

(2) The term "immovable property" shall be defined in accordance with the law of the Contracting State in which the property in question is situated, provided always that debts secured by mortgage or otherwise shall not be regarded as immovable property. The term shall in any case include property accessory to immovable property, livestock and equipment used in agriculture and forestry, rights to which the provisions of general law respecting landed property apply, usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats, and aircraft shall not be regarded as immovable property.

(3) The provisions of paragraphs (1) and (2) shall also apply to immovable property of an enterprise and to immovable property used for the performance of independent personal services.

Article 7

BUSINESS PROPERTY OF A PERMANENT ESTABLISHMENT AND ASSETS PERTAINING TO A FIXED BASE USED FOR THE PERFORMANCE OF INDEPENDENT PERSONAL SERVICES

(1) Except for assets referred to in Article 6 (Immovable Property (Real Property)) assets forming part of the business property of a permanent establishment of an enterprise may be taxed in the Contracting State in which the permanent establishment is situated.

(2)(*a*) For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

(*b*) The term "permanent establishment" includes especially:

(i) a branch;

(ii) an office;

(iii) a factory;

(iv) a workshop; and

(v) a mine, an oil or gas well, a quarry, or any other place of extraction of natural resources.

(*c*) A building site or construction or installation project constitutes a permanent establishment only if it lasts for more than twelve months.

(*d*) Notwithstanding the preceding provisions of this paragraph, the term "permanent establishment" shall be deemed not to include:

(i) the use of facilities solely for the purpose of storage, display or delivery of goods or merchandise belonging to the enterprise;

(ii) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display or delivery;

(iii) the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise;

(iv) the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise;

(v) the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any other activity of a preparatory or auxiliary character; or

(vi) the maintenance of a fixed place of business solely for any combination of activities mentioned in paragraphs (i)—(v) of this sub-paragraph.

(*e*) Notwithstanding the provisions of sub-paragraphs (*a*) and (*b*) where a person—other than an agent of an independent status to whom sub-paragraph (*f*) applies—is acting on behalf of an enterprise and has, and habitually exercises, in a Contracting State an authority to conclude contracts in the name of the enterprise, that enterprise shall be deemed to have a permanent establishment in that State in respect of any activities which that person undertakes for the enterprise, unless the activities of such person are limited to those mentioned in sub-paragraph (*d*) which, if exercised through a fixed place of business, would not make this fixed place of business a permanent establishment under the provisions of that sub-paragraph.

(*f*) An enterprise shall not be deemed to have a permanent establishment in a Contracting State merely because it carries on business in that State through a broker, general commission agent or any other agent of an independent status, provided that such persons are acting in the ordinary course of their business.

(*g*) The fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State or which carries on business in that other State (whether through a permanent establishment or otherwise) shall not of itself constitute either company a permanent establishment of the other.

(3) Except for assets described in Article 6 (Immovable Property (Real Property)), assets pertaining to a fixed base used for the performance of independent personal services may be taxed in the Contracting State in which the fixed base is situated.

Article 8

DEDUCTIONS, EXEMPTIONS, ETC.

(1) In determining the amount on which tax is to be computed, permitted deductions shall be allowed in accordance with the law in force in the Contracting State in which tax is imposed.

(2) Property which passes to the spouse from a decedent or transferor who was domiciled in or a national of the United Kingdom and which may be taxed in the United States shall qualify for a marital deduction there to the extent that a marital deduction would have been allowable if the decedent or transferor had been domiciled in the United States and if the gross estate of the decedent had been limited to property which may be taxed in the United States or the transfers of the transferor had been limited to transfers of property which may be so taxed.

(3) Property which passes to the spouse from a decedent or transferor who was domiciled in or a national of the United States and which may be taxed in the United Kingdom shall, where

(*a*) the transferor's spouse was not domiciled in the United Kingdom but the transfer would have been wholly exempt had the spouse been so domiciled, and

(*b*) a greater exemption for transfers between spouses would not have been given under the law of the United Kingdom apart from this Convention,

be exempt from tax in the United Kingdom to the extent of 50 per cent of the value transferred, calculated as a value on which no tax is payable and after taking account of all exemptions except those for transfers between spouses.

(4) (*a*) Property which on the death of a decedent domiciled in the United Kingdom became comprised in a settlement shall, if the personal representatives and the trustees of every settlement in which the decedent had an interest in possession immediately before death so elect and subject to sub-paragraph (*b*), be exempt from tax in the United Kingdom to the extent of 50 per cent of the value transferred (calculated as in paragraph (3)) on the death of the decedent if:

(i) under the settlement, the spouse of the decedent was entitled to an immediate interest in possession,

(ii) the spouse was domiciled in or a national of the United States,

(iii) the transfer would have been wholly exempt had the spouse been domiciled in the United Kingdom, and

(iv) a greater exemption for transfers between spouses would not have been given under the law of the United Kingdom apart from this Convention.

(*b*) Where the spouse of the decedent becomes absolutely and indefeasibly entitled to any of the settled property at any time after the decedent's death, the election shall, as regards that property, be deemed never to have been made and tax shall be payable as if on the death such property had been given to the spouse absolutely and indefeasibly.

(5) Where property may be taxed in the United States on the death of a United Kingdom national who was neither domiciled in nor a national of the United States and a claim is made under this paragraph, the tax imposed in the United States shall be limited to the amount of tax which would have been imposed had the decedent become domiciled in the United States immediately before his death, on the property which would in that event have been taxable.

Article 9

CREDITS

(1) Where under this Convention the United States may impose tax with respect to any property other than property which the United States is entitled to tax in accordance with Article 6 (Immovable Property (Real Property)) or 7 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services) (that is, where the decedent or transferor was domiciled in or a national of the United States), then, except in cases to which paragraph (3) applies, double taxation shall be avoided in the following manner:

(*a*) Where the United Kingdom imposes tax with respect to property in accordance with the said Article 6 or 7, the United States shall credit against the tax calculated according to its law with respect to that property an amount equal to the tax paid in the United Kingdom with respect to that property.

(*b*) Where the United Kingdom imposes tax with respect to property not referred to in sub-paragraph (*a*) and the decedent or transferor was a national of the United States and was domiciled in the United Kingdom at the time of the death or transfer, the United States shall credit against the tax calculated according to its law with respect to that property an amount equal to the tax paid in the United Kingdom with respect to that property.

(2) Where under this Convention the United Kingdom may impose tax with respect to any property other than property which the United Kingdom is entitled to tax in accordance with the said Article 6 or 7 (that is, where the decedent or transferor was domiciled in or a national of the United Kingdom), then, except in the cases to which paragraph (3) applies, double taxation shall be avoided in the following manner:

(*a*) Where the United States imposes tax with respect to property in accordance with the said Article 6 or 7, the United Kingdom shall credit against the tax calculated according to its law with respect to that property an amount equal to the tax paid in the United States with respect to that property.

(*b*) Where the United States imposes tax with respect to property not referred to in sub-paragraph (*a*) and the decedent or transferor was a national of the United Kingdom and was domiciled in the United States at the time of the death or transfer, the United Kingdom shall credit against the tax calculated according to its law with respect to that property an amount equal to the tax paid in the United States with respect to that property.

(3) Where both Contracting States impose tax on the same event with respect to property which under the law of the United States would be regarded as property held in a trust or trust equivalent and under the law of the United Kingdom would be regarded as property comprised in a settlement, double taxation shall be avoided in the following manner:

(*a*) Where a Contracting State imposes tax with respect to property in accordance with the said Article 6 or 7, the other Contracting State shall credit against the tax calculated according to its law with respect to that property an amount equal to the tax paid in the first-mentioned Contracting State with respect to that property.

(*b*) Where the United States imposes tax with respect to property which is not taxable in accordance with the said Article 6 or 7 then

(i) where the event giving rise to a liability to tax was a generation-skipping transfer and the deemed transferor was domiciled in the United States at the time of that event,

(ii) where the event giving rise to a liability to tax was the exercise or lapse of a power of appointment and the holder of the power was domiciled in the United States at the time of that event, or

(iii) where (i) or (ii) does not apply and the settlor or grantor was domiciled in the United States at the time when the tax is imposed,

the United Kingdom shall credit against the tax calculated according to its law with respect to that property an amount equal to the tax paid in the United States with respect to that property.

(*c*) Where the United States imposes tax with respect to property which is not taxable in accordance with the said Article 6 or 7 and sub-paragraph (*b*) does not apply, the United States shall credit against the tax calculated according to its law with respect to that property an amount equal to the tax paid in the United Kingdom with respect to that property.

(4) The credits allowed by a Contracting State according to the provisions of paragraphs (1), (2) and (3) shall not take into account amounts of such taxes not levied by reason of a credit otherwise allowed by the other Contracting State. No credit shall be finally allowed under those paragraphs until the tax (reduced by any credit allowable with respect thereto) for which the credit is allowable has been paid. Any credit allowed under those paragraphs shall not, however, exceed the part of the tax paid in a Contracting State (as computed before the credit is given but reduced by any credit for other tax) which is attributable to the property with respect to which the credit is given.

(5) Any claim for a credit or for a refund of tax founded on the provisions of the present Convention shall be made within six years from the date of the event giving rise to a liability to tax or, where later, within one year from the last date on which tax for which credit is given is due. The competent authority may, in appropriate circumstances, extend this time where the final determination of the taxes which are the subject of the claim for credit is delayed.

ARTICLE 10

NON-DISCRIMINATION

(1)(*a*) Subject to the provisions of sub-paragraph (*b*), nationals of a Contracting State shall not be subjected in the other State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected.

(*b*) Sub-paragraph (*a*) shall not prevent the United States from taxing a national of the United Kingdom, who is not domiciled in the United States, as a non-resident alien under its law, subject to the provisions of paragraph (5) of Article 8 (Deductions, Exemptions, Etc).

(2) The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities.

(3) Nothing contained in this Article shall be construed as obliging either Contracting State to grant to individuals not domiciled in that Contracting State any personal allowances, reliefs and reductions for taxation purposes which are granted to individuals so domiciled.

(4) Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

(5) The provisions of this Article shall apply to taxes which are the subject of this Convention.

ARTICLE 11

MUTUAL AGREEMENT PROCEDURE

(1) Where a person considers that the actions of one or both of the Contracting States result or will result in taxation not in accordance with the provisions of this Convention, he may, irrespective of the remedies provided by the domestic laws of those States, present his case to the competent authority of either Contracting State.

(2) The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at an appropriate solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation not in accordance with the Convention. Where an agreement has been reached, a refund as appropriate shall

be made to give effect to the agreement.

(3) The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. In particular the competent authorities of the Contracting States may reach agreement on the meaning of the terms not otherwise defined in this Convention.

(4) The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement as contemplated by this Convention.

Article 12

EXCHANGE OF INFORMATION

The competent authorities of the Contracting States shall exchange such information (being information available under the respective taxation laws of the Contracting States) as is necessary for the carrying out of the provisions of this Convention or for the prevention of fraud or the administration of statutory provisions against legal avoidance in relation to the taxes which are the subject of this Convention. Any information so exchanged shall be treated as secret and shall not be disclosed to any persons other than persons (including a court or administrative body) concerned with the assessment, enforcement, collection, or prosecution in respect of the taxes which are the subject of the Convention. No information shall be exchanged which would disclose any trade, business, industrial or professional secret or any trade process.

Article 13

EFFECT ON DIPLOMATIC AND CONSULAR OFFICIALS AND DOMESTIC LAW

(1) Nothing in this Convention shall affect the fiscal privileges of diplomatic or consular officials under the general rules of international law or under the provisions of special agreements.

(2) This Convention shall not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded by the laws of either Contracting State.

Article 14

ENTRY INTO FORCE

(1) This Convention shall be subject to ratification in accordance with the applicable procedures of each Contracting State and instruments of ratification shall be exchanged at Washington as soon as possible.

(2) This Convention shall enter into force immediately after the expiration of thirty days following the date on which the instruments of ratification are exchanged, and shall thereupon have effect:

(*a*) in the United States in respect of estates of individuals dying and transfers taking effect after that date; and

(*b*) in the United Kingdom in respect of property by reference to which there is a charge to tax which arises after that date.

(3) Subject to the provisions of paragraph (4) of this Article, the Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on the Estates of Deceased Persons signed at Washington on 16 April 1945 (hereinafter referred to as "the 1945 Convention") [T.D. 5565, 1947-1 C.B. 125] shall cease to have effect in respect of property to which this Convention in accordance with the provisions of paragraph (2) of this Article applies.

(4) Where on a death before 27 March 1981 any provision of the 1945 Convention would have afforded any greater relief from tax than this Convention in respect of

(*a*) any gift inter vivos made by the decedent before 27 March 1974, or

(*b*) any settled property in which the decedent had a beneficial interest in possession before 27 March 1974 but not at any time thereafter,

that provision shall continue to have effect in the United Kingdom in relation to that gift or settled property.

(5) The 1945 Convention shall terminate on the last date on which it has effect in accordance with the foregoing provisions of this Article.

Article 15

TERMINATION

(1) This Convention shall remain in force until terminated by one of the Contracting States. Either Contracting State may terminate this Convention, at any time after five years from the date on which the Convention enters into force provided that at least six months' prior notice has been given through the diplomatic channel. In such event the Convention shall cease to have effect at the end of the period specified in the notice, but shall continue to apply in respect of the estate of any individual dying before the end of that period and in respect of any event (other than death) occurring before the end of that period and giving rise to liability to tax under the laws of either Contracting State.

(2) The termination of the present Convention shall not have the effect of reviving any treaty or arrangement abrogated by the present Convention or by treaties previously concluded between the Contracting States.

In witness whereof the undersigned, duly authorised thereto by their respective Governments, have signed this Convention.

Done in duplicate at London this 19th day of October 1978. For the Government of the United States of America:

Edward J. Streator.

For the Government of the United Kingdom of Great Britain and Northern Ireland:

Frank A. Judd.

Senate Executive Report No. 96-6

[Bracketed numerals indicate official report page numbers]

ESTATE AND GIFT TAX TREATY WITH THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND

June 15, 1979

Mr. Church, from the Committee on Foreign Relations, submitted the following report to accompany Ex. R, 96th Cong., 1st sess.

The Committee on Foreign Relations, to which was referred the Estate and Gift Tax Treaty with the United Kingdom of Great Britain and Northern Ireland [1] for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on estates of deceased persons and on gifts ("the proposed treaty"), having considered the same, reports favorably thereon without reservation and recommends that the Senate give its advice and consent to ratification thereof.

I. PURPOSE

The purpose of the proposed estate and gift tax treaty between the United States and the United Kingdom is to alleviate double taxation on the estates and gifts of citizens and domiciliaries of both countries by modifying the jurisdictional rules of estate and gift taxation with respect to these individuals.

II. BACKGROUND

The proposed treaty was signed by the United States and the United Kingdom on October 19, 1978 and has been submitted to the Senate for advice and consent to its ratification. The treaty was transmitted to the Senate on May 2, 1979.

The portion of the proposed treaty dealing with estate taxation will replace the existing estate tax treaty between the United States and the United Kingdom [T.D. 5565, 1947-1 C.B. 125], which has been in force since July 25, 1946. There is no existing gift tax treaty between the two countries.

[2] III. SUMMARY OF TREATY

The proposed treaty will alleviate double taxation on gifts and estates of U.S. citizens and domiciliaries and U.K. domiciliaries by permitting each asset held by an estate or each gift to be subject to primary tax jurisdiction in only one of the two countries. This is accomplished in the treaty by allowing both countries to impose their tax but requiring one of the countries to allow a credit against its tax for the taxes paid to the other country. In most situations, the treaty allows the country of domicile to assert primary tax jurisdiction. However, the situs country is given a priority of taxation in the case of real property and business property (i.e., assets of a permanent establishment or a fixed base) which are located in that country.

The treaty provides that the domicile of an individual will be determined separately under the laws of each country. If only one of the two countries treats the individual as a domiciliary under its domestic laws, then that is the country of domicile for purposes of the treaty. However, if both countries treat the individual as a domiciliary under their domestic laws, then the treaty sets forth an extensive set of rules to select one of the countries as the individual's domicile for purposes of establishing primary tax jurisdiction under the treaty. The approach used in this set of rules is to recognize that where an individual domiciled in both countries is a national of one of the two countries and has been resident for only a limited period of time in the other country, his ties with the country of residence are not sufficient to justify the assertion of primary tax jurisdiction by that country. However, where an individual has been domiciled in both countries for a substantial period of time, the country with which he has his closest ties (such as the place of his permanent home) has the greater claim to domicile and, thus, primary tax jurisdiction will generally be allowed to that country.

[3] IV. DATE OF ENTRY INTO FORCE AND TERMINATION

Entry into force

The proposed treaty will enter into force on the 31st day following the date on which the instruments of ratification are exchanged. With certain limited exceptions, the existing treaty will terminate on the date this treaty enters into force. Where an individual dies before March 27, 1981, and the existing treaty would afford a greater relief from taxes than the proposed treaty for certain gifts or transfers in trust made before March 27, 1974, the provisions of the existing treaty will apply in the United Kingdom.

Termination

The proposed treaty will continue in force indefinitely but either country may terminate it as of the close of any calendar year which ends at least 5 years after the convention enters into force. The treaty will terminate on the date specified in the notice but not earlier than 6 months after the notice was given. However, the treaty will continue to apply to any estates or gifts which come under the jurisdiction of this treaty before it was terminated.

[4] V. COMMITTEE ACTION

The Committee on Foreign Relations held a public hearing on the proposed U.K. estate and gift tax treaty and on other proposed tax treaties on June 6, 1979. The Committee considered the proposed treaty on June 12, 1979, and ordered it favorably reported by a vote of 13 yeas, no nays, with the recommendations that the Senate give its advice and consent to ratification of the treaty.

VI. BUDGET IMPACT

The Committee estimates that the effect of the proposed treaty on budget receipts will be negligible.

In accordance with the objectives of section 403 of the Budget Act the Committee advises that the Director of the Congressional Budget Office has examined the Committee's budget estimate and agrees that the effect on budget receipts will be negligible. In keeping with the spirit of section 308 (a) of the Budget Act, and after consultation with the Director of the Congressional Budget Office, the Committee states that the treaty does not provide any new budget authority or any new or increased tax expenditures.

[5] VII. EXPLANATION OF TREATY PROVISIONS

A comprehensive article-by-article explanation of the proposed U.S.-U.K. estate and gift tax treaty is set forth below.

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[1] Page 16; Technical Explanation, page 31; Senate Executive R is not published.

Article 1. Estates and gifts covered

The proposed treaty will apply to any person who is subject to the U.S. gift or estate tax, including the tax on generation-skipping transfers, or the U.K. capital transfer tax. Thus, the proposed treaty will apply, in general, to estates of decedents who were domiciled in the United Kingdom at the time of their death and to estates that are subject to tax in the United States because the decedent was a citizen or domiciliary of the United States at the time of his death. The treaty will also apply to estates of decedents who had property situated in the United States or the United Kingdom at the time of their death.

With respect to gifts, the treaty applies to gifts made while the donor was a domiciliary of the United Kingdom and to gifts which are subject to tax in the United States because the donor was a citizen or domiciliary of the United States when the gift was made. The treaty also applies to gifts of property where the property was situated in the United States or the United Kingdom at the time of the gift.

Article 2. Taxes covered

The proposed treaty applies to the U.S. estate tax, gift tax, and the tax on generation-skipping transfers.

The United States imposes its estate tax on the worldwide assets of estates of persons who were citizens or domiciliaries of the United States at the time of their death, and on property belonging to nondomiciliaries of the United States which is located in the United States at the time of their death. The U.S. gift tax is imposed on all gifts made by U.S. citizens and domiciliaries, and on gifts of property made by nondomiciliaries where the property is located in the United States at the time of the gift.

The U.S. tax on generation-skipping transfers was enacted in 1976 to prevent the transfer of the use of property among generations of the transferor's descendants without the payment of gift or estate taxes. In general, the tax on generation-skipping transfers is imposed when property passes through a trust from persons of one generation to persons of another generation and the transfer is not otherwise subject to estate or gift tax.

The proposed treaty applies to the U.K. capital transfer tax. The capital transfer tax is imposed on the worldwide assets of persons domiciled in the United Kingdom at the time of their death, and on property of nondomiciliaries of the United Kingdom where the property is located in the United Kingdom at the time of such person's death. The capital transfer tax applies to all gifts made by per-[6]sons domiciled in the United Kingdom, and to property of nondomiciliaries that is located in the United Kingdom at the time of the gift.

As is generally true in the case of other U.S. estate tax treaties, the proposed treaty does not apply to death or gift taxes imposed by state or local governments. In addition, the proposed treaty does not apply to death or gift taxes imposed by state or local governments. In addition, the proposed treaty provides that it will apply to any substantially similar taxes on estates, inheritances and gifts that either country may subsequently impose. The competent authorities of both countries are required to notify each other in the case of any substantial changes in their estate, inheritance or gift tax laws.

Article 3. General definitions

The standard definitions generally found in most existing U.S. estate tax treaties are contained in the proposed treaty.

The United States is defined to mean the United States of America and specifically excludes U.S. possessions or territories. The United Kingdom means Great Britain and Northern Ireland.

Several provisions of the treaty are discussed in terms of "nationals." U.S. nationals are defined to be U.S. citizens. A U.K. national is any citizen of the United Kingdom and Colonies, or any British subject not possessing that citizenship or the citizenship of any other Commonwealth country or territory, provided that in either case he had the right of abode in the United Kingdom at the time of death or the time of the gift.

The proposed treaty also contains the standard provision that undefined terms are to have the meaning which they have under the applicable tax laws of the country applying the treaty. In addition, it is further provided (*Article 11*) that where a term is defined in a different manner by the two countries, then the competent authorities of the two countries may establish a common meaning of the term in order to prevent double taxation or to further any other purposes of the proposed treaty.

Article 4. Fiscal domicile

The concept of domicile is important under the proposed treaty because the country of domicile has, under the treaty, primary tax jurisdiction on all property other than the property subject to situs taxation. The country of domicile is initially determined by the domestic laws of each country. However, in those situations where both countries would treat an individual as a domiciliary, the treaty sets forth rules for establishing the country of domicile for purposes of the taxes covered by this treaty.

The proposed treaty provides that a person will be a domiciliary of the United States if he is a "resident (domiciliary)" of the United States. Article 3(2) of the treaty states that terms not defined in the treaty generally are defined by the domestic law of the country to which the term applies. Since the term "resident," as it applies to U.S. persons, is not defined in the treaty, it will be defined under the U.S. estate and gift tax law. Under the estate and gift tax regulations (sections 20.0-1(b)(1) and 25.2501-1(b) respectively) a resident of the United States is defined as a person who had his domicile in the United States at the time of his death or at the time of the gift. The regulations go on to state that, "a person acquires a domicile in a [7] place by living there, for even a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accomplished by actual removal." Domicile for the U.S. estate and gift tax law is a matter of Federal law and it is not determined with reference to state law and it does not incorporate any presumption that the domicile of one spouse controls the domicile of the other spouse.

The treaty also states that a U.S. citizen who was domiciled in the United States at any time within the preceding three years will also be considered a U.S. domiciliary.

The treaty provides that a person will be treated as a domiciliary of the United Kingdom if he was a U.K. domiciliary under general U.K. law or if he was treated as a U.K. domiciliary for purposes of the capital transfer tax. Under the capital transfer tax, a person is treated as a U.K. domiciliary if:

1. He was domiciled in the United Kingdom within three years preceding the date of death or the date the gift was made;

2. He was resident in the United Kingdom in not less than seventeen of the twenty income tax years which end with the income tax year in which the person died or in which the gift was made; or

3. He became, and has remained, a domiciliary of the Channel Islands or the Isle of Man, and he was a United Kingdom domiciliary immediately prior to that.

To provide relief from double taxation where the individual is considered domiciled in both countries under the general rules described above, the proposed treaty provides a series of rules designed to establish a single country of domicile for the individual for purposes of the taxes covered by the treaty. The country so selected will then have the primary tax jurisdiction with respect to the worldwide estate of the decedent or with respect to his worldwide gifts, other than real property and assets of a permanent establishment or a fixed base situated in the other country. As described below, these rules are based on the concept that primary tax jurisdiction should be exercised either by the country of nationality, if the dual domicile individual has not been resident in the other country for a substantial period of time prior to his death or the making of the gift, or by the country in which he has his most significant contacts if that nationality test is not determinative.

Under the first of these rules, if the individual is a national of the United Kingdom and not the United States, and has been a resident of the United States for Federal income tax purposes in less than 7 years during the 10-year period ending with the year of death or the gift, he will be considered a United Kingdom domiciliary. Conversely, if the individual is a U.S. national only and has been resident in the United Kingdom for less than 7 of the 10 income tax years of assessment which end with the year of death or the gift, he will be considered a U.S. domiciliary.

It is contemplated that this rule will resolve the great majority of dual domicile situations. However, if a dual domicile problem still [8] remains after application of these rules, the proposed treaty provides four additional rules to determine domicile. The rules (applied in the order presented) provide that the individual will be considered domiciled in the country (1) in which he had a permanent home available to him, (2) in which his personal and economic relations were the closest (center of vital interests), (3) in which he had a habitual abode, or (4) in which he was a national. In cases where an individual's domicile cannot be determined by these tests, then the competent authorities of the countries are to settle the question by mutual agreement.

The proposed treaty does not treat certain residents of U.S. possessions as U.S. nationals or domiciliaries. These are individuals who acquired U.S. citizenship solely because they were citizens of a possession or because they were born in a possession or were residents of a possession. Under U.S. tax law (Code sec. 2209 and sec. 2501 (c)), these individuals are not taxed by the United States on their worldwide estates and gifts, so protection against double taxation is generally unnecessary. Accordingly, the proposed treaty will not apply to estates or gifts of these individuals, unless it is applicable by reason of their being domiciled in the United Kingdom.

Article 5. Taxing rights

This article sets forth the general treaty rule that the country of domicile, as determined under the treaty, has the primary tax jurisdiction over the estates or gifts of its domiciliaries, other than the property specifically reserved for situs taxation. The proposed treaty generally provides that property, other than real property and assets of a permanent establishment or a fixed base in the other country, may only be subject to tax in the country of domicile of the decedent or donor.

However, this rule does not apply if the domiciliary was a national of the other country. Since the United States imposes its tax on the basis of citizenship (the United Kingdom does not) as well as domicile, there is still the possibility of double taxation if an individual is a U.S. citizen and a U.K. domiciliary. The possibility of double taxation in this situation is alleviated under the tax credit structure discussed in Article 9.

The treaty provides a special rule for a person who is a national of only one of the countries but who is not a domiciliary of either country. Property, other than property subject to situs country taxation under the treaty, which belongs to such a person and which is subject to tax in the country of which he is a national will not be subject to tax in the other country. Thus, property situated in the United Kingdom of a U.S. citizen, who is not domiciled in the United States or in the United Kingdom, which is subject to tax in the United States will not be subject to tax in the United Kingdom unless it is real property or assets of a permanent establishment or fixed base located in the United Kingdom.

This article also provides special rules regarding trusts. The United States agrees not to impose a tax on generation-skipping transfers where the deemed transferor was a U.K. domiciliary and is not a U.S. national. Conversely, the United Kingdom will not impose a [9] tax on property placed in a trust if the settlor was a U.S. domiciliary and was not a U.K. national. These rules do not limit the rules of situs country taxation under this treaty.

If the above rules of this article result in only one country's having the right to impose a tax but that tax is not paid, the other country may impose its tax on property within that country. However, if the tax is not paid because of a specific exemption, deduction, exclusion, credit or allowance, this rule will not apply.

This article provides that the competent authorities will determine the situs of property by mutual agreement in the case of property belonging to a person who was not domiciled in either country where the property was regarded by both countries as situated within its boundaries and thus subject to its tax.

Article 6. Immovable property (real property)

Under the proposed treaty, immovable property (real property) is one of two types of property over which the situs country, rather than the country of domicile, has primary tax jurisdiction. The other type is assets of a permanent establishment or fixed base (*Article 7*).

The determination of whether an item of property is immovable property (real property) is to be made under the laws of the country in which the property is located. Although U.S. law does not define "immovable property (real property)," that term for U.S. purposes is considered to mean real property. It is further provided that immovable property (real property) does not include claims secured by real property (such as mortgages).

Immovable property (real property) is specifically defined to include:

1. Property accessory to immovable property;
2. Livestock and equipment used in agriculture and forestry;
3. Rights to which the provisions of general law respecting landed property apply;
4. Usufruct of immovable property; and
5. Rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources.

This article also applies to the immovable property held by an enterprise or used for the performance of independent personal services.

Article 7. Business property of a permanent establishment and assets pertaining to a fixed base used for the performance of independent personal services

Under the proposed treaty, the second type of property owned by a nondomiciliary over which the situs country has primary tax jurisdiction is the business assets of a permanent establishment which is located in the situs country and the assets of a fixed base which is situated in that country and is used for the performance of independent personal services. The real property of a permanent establishment or fixed base is to be taxed by the country in which the property is situated, as provided in Article 6.

The proposed treaty contains a definition of the term "permanent establishment" which is similar to the definition found in recent U.S. income tax treaties. Generally, any fixed place of business through which [10] a person engages in a trade or business is considered a permanent establishment. A fixed place of business generally includes an office, branch, factory, workshop, place of extraction of natural resources, and any building site or construction or installation project which exists for more than 12 months. This general rule is modified by providing that a fixed place of business which is used for certain activities specified in the treaty will not be considered a permanent establishment. These activities include, for example, the warehousing of goods for purposes of storage, display, or delivery. They also include the maintenance of a fixed place of business solely for the purpose of purchasing merchandise or collecting information.

The proposed treaty also provides that a person will generally be deemed to have a permanent establishment in a country if he had an agent in that country who had and habitually exercised a general contracting authority (other than for the purchase of goods or merchandise) in that country. This agency rule does not apply, however, if the agent is a broker, general commission agent, or any other agent of an independent status, provided the agent is acting in the ordinary course of his business.

A company will not be held to have a permanent establishment in one of the countries solely because it controls or is controlled by a company which is a resident of that country.

Article 8. Deductions, exemptions, etc.

This article provides that in computing the tax imposed by either country, deductions will be allowed in keeping with the law in force in that country at the time.

Under this article, if property is passed to a spouse by a donor or decedent who is a U.K. national or domiciliary and if such property is subject to tax in the United States, then the spouse will be entitled to a marital deduction in computing the U.S. tax. The marital deduction is limited to the amount that would have been allowed as a marital deduction if the decedent or donor had been domiciled in the United States and the U.S. gross estate was limited to the amount of property which is subject to tax in the United States.

Under the treaty, the United Kingdom allows a similar benefit to spouses of U.S. nationals or domiciliaries. In this case, the United Kingdom allows an exemption equal to 50 percent of the value of the property where a decedent or donor is a U.S. national or domiciliary and transfers property to his spouse, provided that his spouse is not domiciled in the United Kingdom and that the transfer would have been wholly exempt under U.K. domestic law if the spouse had been domiciled in the United Kingdom.

The United Kingdom also allows an exemption for transfers to a trust, upon the death of the decedent, in which the spouse who is a U.S. national or domiciliary has a life estate. If the decedent is a U.K. domiciliary and the spouse is entitled to an immediate interest in possession of property that would have been wholly exempt if such spouse had been a U.K.

domiciliary then 50 percent of the value transferred to the spouse will be exempt from taxation in the United Kingdom. Two further conditions to this exemption are that the trustees of all trusts in which the decedent had an interest must elect to be included in this provision and if the spouse subsequently becomes in-[11]defeasibly entitled to any of the trust property the exemptions will be revoked as to that property.

This article also provides that where property of a U.K. national, who was not a U.S. national or domiciliary, is subject to U.S. estate taxation, the U.S. tax on that property will not be greater than the U.S. tax which would have been imposed on the decedent's worldwide assets if he had been a U.S. domiciliary at his death.

Article 9. Credits

The proposed treaty provides a series of rules to determine the amount of tax credits which will be allowed by each country in cases where a person's property is subject to tax by both countries. These rules determine the priority of the countries' rights to tax property in the sense that the country which grants a credit for the other country's tax, in effect, is exercising a secondary, rather than a primary, taxing jurisdiction. These credit rules, in conjunction with the limitations imposed by the proposed treaty on situs country taxation and on the ability of a country to tax the worldwide estate of a decedent, constitute the approach employed in the proposed treaty to avoid double taxation.

In general, the proposed treaty provides for two credit rules to alleviate double taxation. The first credit rule provides that the country in which a person was domiciled, or of which he was a citizen, will allow a credit for the taxes imposed by the other country on that person's real property and business property of a permanent establishment or fixed base which is situated in that other country.

In cases where both countries tax the estate of an individual on a worldwide basis because he was a citizen of one country and a domiciliary of the other country, the second credit rule of the proposed treaty generally provides for the allowance of an additional tax credit by the country in which the decedent was not domiciled. Thus, the non-domiciliary country, which is the country of citizenship, yields primary taxing jurisdiction to the country of domicile. However, if the tax of the country of citizenship exceeds the tax of the country of domicile the excess will be collected by the country of citizenship.

In resolving double taxation on trusts, the two countries use a credit mechanism almost identical to the one used for nontrust transfers. Where both countries impose a tax on a trust's real property and assets of a permanent establishment or fixed base which is located in one of the countries, the non-situs country will allow a credit for taxes paid to the situs country on that property. On all other property, where the transferor was a U.S. domiciliary, the United States will have the right of primary tax jurisdiction over the property, and the United Kingdom will allow a credit against its tax for the U.S. taxes paid on such property. In situations where the transferor was a U.K. domiciliary, the United Kingdom will have the right of primary tax jurisdiction over such other property and the United States will allow a credit for the U.K. taxes paid on such property.

The total amount of credits which one country will allow under the treaty is limited to that portion of its tax which is attributable to the property for which a credit is allowable under the treaty. As is the case under existing U.S. estate tax treaties, the proposed treaty further provides that credits allowed by a country under its domestic law [12] against its tax are to be subtracted from the gross tax imposed by that country in order to determine the tax imposed by it which is creditable against the other country's tax or against which the other country's tax may be credited.

A credit will not be finally allowed under the proposed treaty until the tax for which the credit is claimed has been paid. The proposed treaty allows a taxpayer to file a claim for credit or refund within 6 years from the date of death or the date of the gift, or within one year from the last day a tax (for which a credit is given) was due, whichever comes later. The competent authorities of the two countries may extend this time limit where the final determination of taxes (for which a credit is claimed) has been delayed.

Article 10. Non-discrimination

This article provides that one country will not impose more burdensome taxation on certain specified persons and entities of the other country than it would impose on its own similarly situated persons and entities. The parties covered are nationals of the other country, permanent establishments of enterprises of the other country, and enterprises owned or controlled in whole or in part by residents of the other country.

This article generally does not restrict the right of the United States to tax a United Kingdom national who is not domiciled in the United States as a nonresident alien under its law. It also does not require either country to grant to nondomiciliaries personal allowances, reliefs, and reductions that such country grants to its domiciliaries.

Articles 11 and 12. Administrative provisions

The proposed treaty contains various administrative provisions which are generally found in other U.S. tax treaties. In general, the proposed treaty provides—

(1) For consultation and negotiation between the competent authorities of the two countries to resolve differences arising in the interpretation or application of the proposed treaty and also to resolve claims by taxpayers that they are being subjected to taxation contrary to the proposed treaty;

(2) For the exchange between the countries of legal information and information necessary to carry out the provisions of the proposed treaty or the tax laws of one of the countries, insofar as its taxation is in accordance with the proposed treaty, or to prevent fraud or fiscal evasion with respect to the taxes covered by the proposed treaty.

Any information which is exchanged shall be treated as secret and shall not be disclosed to anyone other than persons involved in assessment, enforcement, collection or prosecution in respect of the taxes which are the subject of this treaty. Also, no information will be exchanged which would disclose any trade, business, industrial or professional secret or any trade process.

Article 13. Effect on diplomatic and consular officials and domestic law

The proposed treaty provides that its provisions are not to affect the fiscal privileges which diplomatic and consular officials enjoy under the general rules of international law or the provisions of special agreements.

[13] The proposed treaty specifically provides that it will not restrict in any manner any exclusion, exemption, deduction, credit or other allowance which is, or will be, enacted under the laws of either country. Therefore, the treaty will not be imposed to the detriment of any taxpayer.

Article 14. Entry into force

The proposed treaty will enter into force on the 31st day following the date on which the instruments of ratification are exchanged. With certain limited exceptions, the existing treaty will terminate on the date this treaty enters into force. Where an individual dies before March 27, 1981, and the existing treaty would afford a greater relief from taxes than the proposed treaty for certain gifts or transfers in trust made before March 27, 1974, the provisions of the existing treaty will apply in the United Kingdom.

Article 15. Termination

The proposed treaty will continue in force indefinitely but either country may terminate it as of the close of any calendar year which ends at least 5 years after the convention enters into force. The treaty will terminate on the date specified in the notice but not earlier than 6 months after the notice was given. However, the treaty will continue to apply to any estates or gifts which come under the jurisdiction of this treaty before it was terminated.

[14] VIII. TEXT OF RESOLUTION OF RATIFICATION

* * * * *

Resolution of Ratification

Resolved (two-thirds of the Senators present concurring therein), That the Senate advise and consent to the ratification of the Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Estates of Deceased Persons and on Gifts, done at London on October 19, 1978 (Ex. R, Ninety-sixth Congress, first session).

* * * * *

[17] LETTER OF TRANSMITTAL

The White House,
May 2, 1979.

To the Senate of the United States:

I transmit herewith, for Senate advice and consent to ratification, the Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Estates of Deceased Persons and on Gifts, signed at London on October 19, 1978. For the information of the Senate, I also transmit the report of the Department of State with respect to the Convention.

The Convention would replace the estate tax convention with the United Kingdom which was signed at Washington on April 16, 1945 [T.D. 5565, 1947-1 C.B. 125], and has been in force since 1946. It would apply in the United States to the federal gift tax, the federal estate tax, and the federal tax on generation-skipping transfers. In the United Kingdom it would apply to the capital transfer tax. The Convention is similar in principle to the United States estate tax convention with the Netherlands [1976-1 C.B. 471], which was signed at Washington on July 15, 1969, and entered into force in 1971, and to the United States model estate and gift tax convention published by the Department of the Treasury in 1977.

The general principle underlying the Convention is to grant to the country of domicile the right to tax estates and transfers on a worldwide basis. The Convention also permits a credit for tax paid to the other country in which certain property was taxed on the basis of its location. The Convention would provide rules for resolving the issue of domicile.

The Convention would enter into force on the thirty-first day after instruments of ratification are exchanged and would have effect in the United States with respect to estates of individuals dying and transfers taking effect after that date.

I recommend that the Senate give early and favorable consideration to the Convention and give advice and consent to its ratification.

Jimmy Carter.

LETTER OF SUBMITTAL

Department of State,
Washington, April 25, 1979.

The President,
The White House.

The President: I have the honor to submit to you, with a view to its transmission to the Senate for advice and consent to ratification, the Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Estates of Deceased Persons and on Gifts, signed at London on October 19, 1978.

This Convention would replace the estate tax convention with the United Kingdom which was signed at Washington on April 16, 1945, and has been in force since 1946. It would apply, in the United States, to the federal gift tax and the federal estate tax, including the tax on generation-skipping transfers. In the United Kingdom, it would apply to the capital transfer tax.

The Convention is similar to the estate tax convention with the Netherlands, which was signed at Washington on July 15, 1969, and entered into force in 1971, and to the United States model estate and gift tax convention, published by the Department of the Treasury in 1977.

The general principle underlying the proposed convention is to grant to the country of domicile the right to tax the estate or transfers of a decedent or transferor on a worldwide basis with a credit for tax paid to the other country with respect to certain types of property located therein. Specifically, immovable property and certain business assets are taxable in the Contracting State where situated. The Convention also allows the country of citizenship the right to tax the estate or transfers of a decedent or transferor, with a credit for tax paid to the other State on either a domiciliary or situs basis.

A significant feature of the convention adopted from the estate convention with the Netherlands, provides that a citizen of one country who is domiciled in that country may live up to seven years in the other country without becoming taxed as a domiciliary under the Convention. This provision will be of help in cases where an American dies or makes gifts after living in the United Kingdom for less than seven years.

The Convention also provides reciprocal rules for determining which State has the right to tax on a worldwide basis in the case of a decedent or transferor who is domiciled in both Contracting States at the time of death or transfer.

The Convention would enter into force on the thirty-first day after the date of the exchange of instruments of ratification and would become effective, in the United States, with respect to individuals dying and transfers taking effect on or after that date. The Convention would remain in force unless terminated by one of the Contracting States by giving six months prior notice through diplomatic channels. It may not, however, be terminated for five years after it enters into force.

A technical memorandum explaining the provisions in detail has been prepared by the Department of the Treasury and is being submitted to the Senate Foreign Relations Committee.

The Department of the Treasury, with the cooperation of the Department of State, was primarily responsible for the negotiation of the Convention. It has the approval of both Departments.

Respectfully submitted,

CYRUS VANCE.

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[55] APPENDIX C

WRITTEN RESPONSES BY TREASURY TO QUESTIONS BY THE COMMITTEE STAFF

DEPARTMENT OF THE TREASURY,
Washington, D.C., June 8, 1979.

Hon. FRANK CHURCH,
Chairman,
Committee on Foreign Relations,
U.S. Senate, Washington, D.C.

Dear Mr. CHAIRMAN: To follow up my testimony at the June 6 hearings concerning the six tax conventions or protocols involving the United Kingdom, France, Hungary and Korea, I want to assure you that Article I of the Third Protocol of the proposed US-UK Income Tax Treaty gives full effect to the Senate's reservation on Article 9(4) of that treaty. Let me also assure you that there is no similar state tax issue in any of the other five treaties which were considered by the Committee yesterday.

Again let me emphasize our view that each of these treaties is important to the United States and that their prompt approval is desirable.

I am also enclosing answers to the written questions submitted to me by your staff at the hearings as well as copies of my answers to questions from Senator Helms and Senator Javits.

Sincerely,

DONALD C. LUBICK,
Assistant Secretary (Tax Policy).

Enclosures.

QUESTIONS FOR ASSISTANT SECRETARY FOR TAX POLICY DONALD C. LUBICK

GENERAL QUESTIONS*

Question 1. On page three of your testimony, you mentioned that the public was able to make presentations to the Treasury concerning particular private sector concerns in the area of international taxation, could you explain how the notice of such public meetings is made, what the participation level has been and any changes in tax treaties or negotiations that have been affected by this public participation?

Answer. The public meetings, referred to in the testimony, are announced by Treasury Press Releases and notices in the Federal Register. These announcements are reported in publications which are widely read in the international tax community. Public participation [56] in these meetings varies, depending on the degree of interest in the particular country being discussed. The meeting to discuss the Canadian treaty was attended by well in excess of 100 individuals; a recent meeting to discuss a proposed treaty with Norway was attended by about 20 people. All of the reports we have received from the public regarding these meetings have been favorable.

It is difficult to point to particular changes in treaties under negotiations as a result of these meetings. In most cases, there has not yet been a further round of negotiations following the meeting. The meetings have clearly served to sharpen the negotiators' awareness and understanding of some of the complex issues involved.

Questions 2 and 3. The group of six tax treaties or protocols the Committee is conducting hearings on today, will they result in a net loss or gain for the U.S. from tax revenues? If a loss, how much and why; if a gain, how much and why?

Answer. In general, these treaties and protocols tend to balance out revenue losses and gains, leaving the overall revenue effect roughly neutral. For example, where the treaty partner is required to reduce or eliminate its tax on U.S. taxpayers, this results in a reduction in the U.S. foreign tax credit and an increase in U.S. revenue. These increases are roughly offset by reductions in U.S. revenues resulting from reductions in U.S. tax on taxpayers resident in the other country.

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*The questions and answers relating specifically to the other protocols and treaties considered at the June 6, 1979 hearings are set forth in the committee reports relating to those treaties.

In most cases, data on international flows and transactions are not available in sufficient detail to permit precise estimation of the revenue effects of particular treaty provisions.

Question 4. Please describe the personnel from the Department of the Treasury and other agencies of the U.S. Government involved in negotiating tax treaties or protocols. Please detail the prospective relationships between the IRS, Department of the Treasury and the Department of State.

Answer. The Office of the Assistant Secretary for Tax Policy in the Treasury has the principal responsibility for the negotiation of tax treaties. The actual negotiations are normally conducted by members of the Office of International Tax Affairs, which combines the Office of International Tax Counsel (Attorneys) and the International Tax Staff of the Office of Tax Analysis (Economists). The delegations are headed either by the Assistant Secretary for Tax Policy or by a senior member of the Office of International Tax Affairs.

The Internal Revenue Service is often represented on delegations. The nature and extent of this representation depends on the specific issues that are likely to arise. For example, if there are problems regarding the exchange of information, representatives of the IRS Office of International Operations, which is responsible for these exchanges, will participate in the discussions. In many cases, when negotiations are held abroad, the Revenue Service Representative assigned to that country will participate.

The State Department is invited to participate in all discussions. Country desk officers will sometimes attend a part or all of the discussions held in Washington. When negotiations are held abroad, the economic or commercial officers in the U.S. Embassy frequently participate. The State Department generally handles correspondence between the U.S. and foreign negotiators and is often called upon to [57] follow up with representatives of the other country on issues which arise in the negotiations.

There is close coordination between Treasury, IRS and the State Department throughout the negotiating process. The State Department advises the Treasury on political issues and IRS advises on administrative matters. The State Department is responsible for the arrangement for signing treaties and their transmittal to the Senate.

Question 5. The U.S. Treasury, in 1977, finalized a "model convention" for international tax treaties, could you please explain the status of this model and in particular, any changes that have been made to it?

Answer. For many years, the Treasury had used an informal "model" as a basis for negotiations. This model evolved and changed as the negotiators gained experience with it. In 1976 a decision was made to publish the U.S. model. Following the 1977 publication of the revised OECD Model Convention, the Treasury revised its model to conform it to the OECD Model, where possible, and the revised model was published in May of 1977.

The model is sent to potential treaty partners prior to the commencement of negotiations, and it normally serves as the discussion draft during the first round of negotiations. Many changes are made in the model during negotiations to reflect particular problems which arise in attempting to mesh two tax systems. Changes may be made to reflect the needs of the other country. For example, where negotiations are with a developing country, many of the model provisions (designed for treaties between two developed countries) are inappropriate. The U.S. negotiators are generally quite flexible in modifying the model for treaties with developing countries. These changes occur most frequently in the provisions dealing with permanent establishments or the taxation of personal service income, in which cases a somewhat lesser degree of economic contact or penetration is required for the host country to be able to tax the income of a resident of the other country. Similarly, with the taxation of dividends, interest, and royalties, less of a reduction in withholding tax rates is generally required of developing countries. The U.S. interest in these cases is to avoid rates which are so high as to generate excess foreign tax credits for U.S. income recipients.

Questions 6 and 7. In the third protocol proposed to the U.S.-U.K. Income Tax Treaty, the definition of permanent establishment has been changed. Please explain the basis of this change. Were the affected U.S. drilling companies contacted concerning the proposed change? If they were contacted, please give the details of when, by whom, and what resulted from such contact. Why was the permanent establishment definition selected as the item to be changed in the tax area?

Answer. In our discussions with the British subsequent to the Senate reservation on Article 9(4) of the proposed treaty, the United Kingdom specifically requested the inclusion in the protocol of a provision clarifying their taxing rights with respect to exploration and exploitation connected activities. This requested clarification was not unusual in light of the original negotiations in 1975 over the permanent establishment definition. In those negotiations, the United States agreed to delete from the twelve month permanent establishment exclusion contained in subparagraph (2)(f) of the proposed treaty any reference to [58] "an installation or drilling rig or ship used for the exploration or development of natural resources" as a result of the British insistence that there be no limitation on their right to tax such activities. This deletion left the application of the permanent establishment definition to these activities somewhat uncertain, although as the United Kingdom authorities believe, a strong argument exists that these activities could be taxed even without the clarification of the new protocol.

We agreed to the inclusion of this provision in the Third Protocol because it was reasonable to expect the British to request some additional concession for the loss of the benefits of Article 9(4); because the terms of the provision were reasonable in light of our own statutory tax policy (we would generally tax these kinds of activities conducted in the United States, even if they were of a shorter duration than 30 days); and because it could be viewed as little more than a clarification of a reasonable interpretation taken by the British of their taxing rights under the proposed treaty without the protocol provision.

The drilling industry was clearly aware of the precise terms of the protocol at least one month prior to the signing of the Protocol on March 15, 1979. On February 16, 1979, Mr. Arnold W. Bramlett, Chairman of the Accounting and Taxation Committee of the International Association of Drilling Contractors (IADC), wrote to the International Tax Counsel, Mr. H. David Rosenbloom, expressing general concern over the provision. Subsequently, there were telephone conversations between Mr. Rosenbloom and Mr. Bramlett in which the Treasury sought specific information as to the nature of the activities and the harm which was alleged would occur. These requests were confirmed in a letter from Mr. Rosenbloom to Mr. Bramlett on March 5, 1979, still 10 days before the Protocol was signed. To date, the Treasury has not received from the IADC, or any of its members, specific information detailing any specific adverse effects of the protocol provision.

QUESTIONS ON THE UNITED KINGDOM ESTATE AND GIFT TAX TREATY

Question 1. Explain the origin and development of the model estate and gift tax convention published by the Department of Treasury in 1977.

Answer. The U.S. Treasury Department released its "model" estate and gift tax treaty on March 16, 1977. The model serves as a statement of the Treasury's basic treaty negotiating position. It was developed over several months by Office of Tax Policy staff members conversant with estate and gift tax treaty issues. The general principle underlying the model is to grant to the country of domicile the right to tax the worldwide estate or gifts of a decedent or donor, with a credit for tax paid to the other State with respect to real property and business assets located therein.

The emphasis on domiciliary-basis taxation also explains the origin of the model. All U.S. estate and gift tax treaties negotiated between 1946 and 1956 contain a comprehensive set of situs rules. Double taxation is eliminated by awarding the situs state the primary right to tax a given type of property. In 1966, however, the Organization for Economic Cooperation and Development (OECD) published a model es-[59]state tax convention (Draft Double Taxation Convention on Estates and Inheritances). The OECD model, which the United States helped develop, provides for domiciliary-basis taxation. This is also the approach of our only estate tax treaty which has come into force since 1956, the United States-Netherlands treaty of 1971. Thus, the U.S. model estate and gift tax treaty reflects both the internationally-accepted concepts in the OECD model and our current treaty position.

Question 2. Does the U.S.-U.K. Estate and Gift Tax Treaty differ from the U.S. model treaty, and if so, please explain the policy reasons for the difference.

Answer. The U.S.-U.K. Estate and Gift Tax Treaty is similar, but not identical, to the model. It is similar in that both follow the principle of domiciliary-basis taxation. That is, the country of domicile may tax the worldwide estate or gifts of a decedent or donor. Immovable property and certain business assets are taxable in the Contracting State where situated.

The U.S.-U.K. treaty is different from the model in that it includes the tax on generation-skipping transfers, imposed by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1]. This is purely a matter of timing. Although the model was not published until 1977, it was developed early in 1976. Consequently, it does not include the estate and gift tax modifications in the Tax Reform Act of 1976, which was signed in October of that year. Unlike the model, the U.S.-U.K. treaty does not provide for a reciprocal exemption of $30,000 for property that is taxable under the treaty on a situs basis. This part of the model refers to pre-Reform Act of 1976 law; the $30,000 exemption was converted to a $3,600 credit by the 1976 changes. This provision is not in the treaty because the U.K.'s capital transfer tax does not apply to the first £25,000 (roughly $50,000) of property transferred.

Question 3. How does the U.S.-U.K. treaty define domicile and how, or why, was this definition selected?

Answer. The determination of a single treaty domicile is very important, since the country of domicile has the primary right to tax the worldwide estate and gifts of a decedent or donor, with the exception of property taxable under the situs articles. Domicile is determined initially under the law of each Contracting State. Under the treaty, an individual is domiciled in the United States (a) if he was a U.S. resident or (b) if he was a U.S. national, and had been a resident in the United States at any time during the preceding three years. The Convention uses the term "resident (domiciliary)" because U.S. domestic law equates the term "resident" with the term "domiciliary." The three-year rule simply parallels a provision in the U.K. capital transfer tax that a U.K. domiciliary will be deemed to be domiciled in the United Kingdom for a period of three years after a change of domicile is actually made. An individual is domiciled in the United Kingdom if he is (a) a U.K. domiciliary under general principles of U.K. law, or (b) treated as a U.K. domiciliary for purposes of the capital transfer tax.

The Convention provides rules for determining a single treaty domicile when a decedent or transferor is domiciled, under the laws of the respective countries, in both States. Particularly important in this regard is the provision that a U.S. citizen, who is considered under the Convention to be domiciled in both the United Kingdom and the [60] United States, shall be deemed to be domiciled in the

United States if he had not been resident in the United Kingdom for at least 7 of the 10 years. This rule is based on the concept that a Contracting State should not tax the estate or other transfers of an individual on a domiciliary basis if the individual has not been present in that State for a significant period of time. If the 7 out of 10 year rule does not apply, the single treaty domicile is determined by a set of tie-breaking rules based on: permanent home, center of vital interests, habitual abode, state of nationality, or mutual agreement. These tie-breaking rules are similar to those in both the OECD and U.S. model treaties and in our existing estate tax treaty with the Netherlands [1976-1 C.B. 471].

Question 4. By using a worldwide basis to determine the domiciliary States' right to tax estates and transfers, will the United States increase or decrease its tax revenues from estate and gift taxes? By what amount? Please give policy reasons for any projected increase or decrease.

Answer. Generally, the United States taxes the estates and property transfers of its citizens and residents (domiciliaries) on a worldwide basis under its statutory law. Thus, use of a worldwide basis under the treaty does not represent a material departure from our normal estate and gift tax base.

This treaty, like others, is a balanced package of mutual concessions where there may be revenue gains from some provisions and revenue losses on others but, where the net revenue effect is nil.

Question 5. Why was the 7 out of 10 year rule used for the determination of domicile under the treaty?

Answer. A basic concept of United States tax policy in this field is that a Contracting State should not tax the estate of other transfers of an individual on a domiciliary basis if the individual has not been present in that State for a significant period of time. Conversely, where an individual has been present for a significant period of time we believe that it is reasonable to permit the State to tax the individual's accumulation of wealth. The 7 out of 10 year rule represents, in our judgment, a sufficiently long period of presence to justify taxation and has been our treaty policy for a long time. The rule is incorporated in the existing estate tax treaty with the Netherlands which entered into force in 1971.

It is also important to point out that a U.S. citizen will not automatically be deemed to be domiciled in the United Kingdom if he has been resident there for, say, 8 out of 10 years. In that case the determination of a single treaty domicile is settled by the tie-breaking rules. These are based on the concepts of permanent home, center of vital interests, habitual abode, nationality, and mutual agreement. Thus, it is possible that an individual could be resident in the United Kingdom for more than 7 years and still be treated as a U.S. domiciliary, if, for example, he maintained a permanent home in the United States.

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TECHNICAL EXPLANATION[1] OF THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON ESTATES OF DECEASED PERSONS AND ON GIFTS SIGNED AT LONDON ON OCTOBER 19, 1978[2]

Introduction

The proposed Estate and Gift Tax Convention with the United Kingdom is the first Convention negotiated since the United States modified its estate and gift tax law in the Tax Reform Act of 1976. The 1976 modifications include combining the separate estate and gift tax rates into a single cumulative rate schedule, substituting a unified credit for the previously separate estate and gift tax exemptions, and imposing a tax on generation-skipping transfers. The Convention will replace the existing estate tax convention between the two countries which has been in effect since July 25, 1946.

The Convention is similar in principle to the U.S. Estate Tax Convention with the Netherlands [1976-1 C.B. 471], which entered into force in 1971, and to the U.S. Model Estate and Gift Tax Convention, published by the Treasury Department on March 16, 1977. The Convention also is based, in part, on the provisions of the Model Estate Tax Convention (Draft Double Taxation Convention on Estates and Inheritances), published in 1966 by the Organization for Economic Cooperation and Development (OECD).

The general principle underlying the proposed Convention is that the country of domicile may tax an individual's estate or other transfers on a worldwide basis with a credit for tax paid to the other State with respect to certain types of property located therein. Specifically, immovable property and certain business assets are taxable in the Contracting State where situated. The Convention also allows the country of citizenship the right to tax an individual's worldwide estate or other transfers, with a credit for tax paid to the other State on either a domiciliary or a situs basis.

The Convention provides rules for determining which State has the right to tax on a domiciliary basis when a decedent or transferor is domiciled, under the laws of the respective countries, in both States at the time of death or transfer. It provides that a U.S. citizen, who at the time of death or transfer is considered under the Convention to be domiciled in both the United Kingdom and the United

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[1] It is the practice of the Treasury Department to prepare for the use of the Senate and other interested persons a Technical Explanation of the tax conventions that are submitted to the Senate for its advice and consent to ratification.

An Estate and Gift Tax Convention with the United Kingdom of Great Britain and Northern Ireland was signed October 19, 1978, and submitted by the President to the Senate on May 2, 1979. On June 6, 1979, the Senate Committee on Foreign Relations held hearings, and this Technical Explanation was presented. The Senate voted its advice and consent on July 19, 1979, and instruments of ratification were exchanged on October 11, 1979.

[2] Page 16; pertinent excerpts from Senate Executive Report No. 96-6, page 21; Senate Executive R is not published.

States, shall be deemed to be domiciled in the United States if he had not been resident in the United Kingdom in 7 or more of the 10 income tax years of assessment ending with the year in which the death or transfer occurs. The effect of this rule is that the United Kingdom may not subject the estate or other transfers of a U.S. citizen and domiciliary to tax on a worldwide basis if he has been resident in the United Kingdom for less than 7 out of the 10 years ending with the year in which the death or transfer occurs. The Convention also provides that a U.S. citizen shall be deemed to have a domicile in the United States if he had been domiciled in the United States at any time during the three years preceding the time of death or transfer. This rule enables the United States to consider a citizen and former resident as a domiciliary for treaty purposes for a three year period. Thus, except for property taxable on a situs basis under the treaty, the United States generally retains primary taxing jurisdiction for three years after a U.S. citizen abandons his U.S. domicile. These rules for determining domicile are reciprocal.

The Convention is subject to ratification by the two Governments. Once ratified, it will enter into force on the thirty-first day after instruments of ratification are exchanged and will have effect in the United States with respect to estates of individuals dying and transfers taking effect after that date.

The Convention shall remain in force until terminated by one of the Contracting States. It may not be terminated for five years after it enters into force.

Federal Estate, Gift, and Generation-Skipping Transfer Taxes

The Federal estate, gift, and generation-skipping transfer taxes are excise taxes imposed on the transfer of property by death, gift, and generation-skipping transfer, respectively. Citizens and residents of the United States are subject to taxation on the transfers of all their property, wherever located. For these purposes, a resident of the United States is a domiciliary thereof, i.e., an individual living in the United States who has the intention to remain in the United States indefinitely or an individual who has lived in the United States with such an intention and who subsequently left the United States without having the intention to remain indefinitely in the country of his new residence.

Nonresidents who are not citizens of the United States (referred to hereafter as nonresident aliens) are taxable only on transfers of property situated within the United States. Tangible personal property and real estate, for example, are situated within the United States if located in the United States. Corporate stock has a U.S. situs only if issued by a corporation organized in the United States. Nonresident aliens are, however, exempt from Federal gift tax on all transfers of intangible property, including corporate stock.

U.S. statutory taxation rules for transfers of citizens and residents allow: (a) a tax credit of $38,000 at present, but which is scheduled to increase to $47,000 by 1981; (b) a marital deduction for gift tax purposes equal to the first $100,000 of gifts and 50 percent of the value of gifts in excess of $200,000; (c) a marital deduction for estate tax purposes equal to the greater of $250,000 or one-half the value of the adjusted gross estate, but reduced by any post-1976 gift tax marital deduction in excess of 50 percent of the value of the lifetime gifts to the spouse after 1976; and (d) deductions for charitable contributions, debts, funerals, and administrative expenses, and claims against, and losses of, the estate. Taxable transfers are taxed at rates ranging from 18 to 70 percent. Credits are allowed for foreign death taxes paid with respect to property which is considered under U.S. situs rules to be situated in the taxing foreign country and which is included in the gross estate for Federal estate tax purposes.

Nonresident aliens are allowed a $3,600 credit against the estate tax liability plus deductions for a portion of the debts, funeral and administrative expenses, claims, and losses, based on the proportion of the decedent's worldwide estate which is located in the United States. Taxable estates are taxed at rates ranging from 6 to 30 percent. Gifts and generation-skipping transfers by nonresident aliens, however, are taxed at the normal citizen or resident rates of 18 to 70 percent.

United Kingdom Capital Transfer Tax

The U.K. capital transfer tax applies to transfers of property by gift and death, as well as to transfers of settled or trust property. Individuals domiciled in the United Kingdom are subject to taxation on transfers of all their property, wherever situated. Individuals not domiciled in the United Kingdom are taxable only on property having a U.K. situs. All inter-spousal transfers are exempt from taxation, except that only the first £25,000 is exempt if the transferor is domiciled in the United Kingdom but the recipient is not. The tax base is the amount of "loss" to the transferor, but deductions are allowed for debts, expenses, and liabilities chargeable against the property transferred.

The rate of tax depends on the cumulative total of chargeable transfers during life and at death. There are two rate schedules: one for transfers on death or within 3 years of death and another for lifetime transfers. Where the cumulative total is less than £110,000 the rate of tax on lifetime gifts is one-half that imposed on a transfer by death; the schedules then converge and above £310,000 the rates are the same. A married couple's transfers are taxed separately. Nondomiciliaries are taxed according to the same rate schedule as domiciliaries. To lessen international double taxation, a credit against the capital transfer tax may be taken for similar taxes paid to another country on the same property.

Article 1. SCOPE

This Article states that the Convention applies to any person who is subject to a tax covered by the Convention. As set forth in Article 2 (Taxes Covered), the Convention applies in the United States to the Federal gift tax and the Federal estate tax, including the tax on generation-skipping transfers and to the capital transfer tax in the United Kingdom.

Existing U.S. estate tax treaties, as well as the U.S. Model Estate and Gifts Tax Convention, apply to domiciliaries of one or both of the Contracting States. This Convention has a broader application; its scope is not limited to domiciliaries of the two Contracting States.

Article 2. TAXES COVERED

Paragraph (1) identifies the taxes covered by the Convention. The Convention does not apply to any state or local taxes imposed by either Contracting State.

Paragraph (2) provides that the Convention also applies to any substantially similar taxes which are subsequently enacted in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States are to notify each other of any changes which have been made in their respective laws relating to the taxation of estates, gifts, and other transfers.

Article 3. GENERAL DEFINITIONS

Paragraph (1) defines the terms "United States," "United Kingdom," "enterprise," "competent authority," "nationals," "tax," and "Contracting State."

The term "United States" does not include Puerto Rico, the Virgin Islands, Guam, or any other U.S. possession or territory. The term "nationals" means, in relation to the United States, U.S. citizens. According to paragraph 5 of Article 4 (Fiscal Domicile), however, an individual who was at the time of death or other transfer, a resident of a U.S. possession and who became a U.S. citizen solely by reason of (a) being a citizen of such a possession or (b) birth or residence within such possession, will not be considered a national of the U.S. under the Convention. This exclusion conforms with Sections 2209 and 2501(c) of the Internal Revenue Code. In relation to the United Kingdom, "nationals" refers to (a) any citizen of the United Kingdom and Colonies, or (b) any British subject not possessing such citizenship or the citizenship of any other Commonwealth country or territory, if the individual in either case had the right of abode in the United Kingdom at the time of death or transfer.

Paragraph (2) provides that any term which is not otherwise defined in the Convention is, unless the Convention otherwise requires and subject to the provisions of Article 11 (Mutual Agreement Procedure), to have the meaning which it has under the tax laws of the Contracting State whose tax is being determined.

Article 4. FISCAL DOMICILE

This Article sets forth rules for resolving cases of double domicile. The determination of a single treaty domicile is important, since the country of domicile has the primary right to tax the worldwide estate and other transfers, with the exception of property covered by Articles 6 (Immovable Property (Real Property) and 7 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services).

Under paragraph (1), domicile is determined initially under the law of each Contracting State. An individual is domiciled in the United States (a) if he was a U.S. resident or (b) if he was a U.S. national, and had been a resident in the United States at any time during the preceding 3 years. The Convention uses the term "resident (domiciliary)" because U.S. domestic law equates the term "resident" with the term "domiciliary." The 3 year rule parallels a provision in the U.K. capital transfer tax that a U.K. domiciliary will be deemed to be domiciled in the United Kingdom for a period of 3 years after a change of domicile is actually made.

Paragraph (1) also provides that an individual is domiciled in the United Kingdom if he is (a) a U.K. domiciliary under general principles of U.K. law, or (b) treated as a U.K. domiciliary for purposes of the capital transfer tax. An individual who is not considered domiciled in the United Kingdom under general law is nevertheless deemed to be domiciled there for purposes of the capital transfer tax if he:

(1) was domiciled in the United Kingdom on or after December 10, 1974 and within 3 years immediately preceding the taxable event; or

(2) was resident in the United Kingdom on or after December 10, 1974, in at least 17 of the 20 income tax years of assessment ending with the income tax year in which the taxable event occurs; or

(3) has, since December 10, 1974, become and remained domiciled in the Channel Islands or the Isle of Man and, immediately before becoming domiciled there, was domiciled in the United Kingdom.

For condition (2), "resident" is defined as for income tax purposes except that the availability of a dwelling-house in the United Kingdom is disregarded. An individual is a U.K. resident for income tax purposes for the entire year if he has been present in the United Kingdom for a single day in that year, provided he also has a dwelling-house in the United Kingdom. Thus, the dwelling-house limitation means that an individual whose principal home is not in the United Kingdom, but who comes to the United Kingdom on occasional visits and maintains a flat or house there, will not be subject to capital transfer tax under this deemed domicile provision. By virtue of these "deemed domicile" provisions, an individual who is a foreign domiciliary under general law may be treated as a U.K. domiciliary and subject to capital transfer tax on all his assets wherever situated.

Paragraphs (2), (3), and (4) of the Convention set forth rules for resolving cases where, under the definitions in paragraph (1), there is a double domicile. Paragraph (2) provides that a U.K. national domiciled in both Contracting States shall be deemed to be domiciled in the United Kingdom for purposes of the Convention if he had not been resident in the United States for Federal income tax purposes in 7 or more of the 10 taxable years ending with the year in which the death or transfer occurs. The effect of this rule is to restrict the right of the United States to tax the estate and other transfers of a U.K. national and domiciliary who has been resident in the United States for less than 7 out of 10 years to certain situs property. The rule is based upon the concept that a Contracting State should not tax the estate or other transfers of an individual on a domiciliary basis if the individual has not been present in that State for a significant period of time.

Paragraph (3) is the reciprocal of paragraph (2). It provides that a U.S. national domiciled in both Contracting States shall be deemed to be domiciled in the United States for purposes of the Convention if he had not been resident in the United Kingdom in 7 or more of the 10 income tax years of assessment ending with the year in which the death or transfer occurs. For these purposes, residence in the United Kingdom is determined under the income tax rules, but the fact that a person maintains a dwelling-house in the United Kingdom is disregarded. The dwelling-house limitation has the same effect as in the "deemed domicile" provisions of U.K. internal law; thus a casual visitor who maintains a dwelling-house in the United Kingdom will not be considered a U.K. resident.

Paragraph (4) is subordinate to paragraphs (2) and (3). It provides rules for resolving cases of dual domicile where the 7 of 10 year rules do not apply. Under paragraph (4), an individual's domicile is determined as follows: (a) he will be deemed to be domiciled in the Contracting State in which he maintained his permanent home; if he had a permanent home in both Contracting States or in neither, his domicile will be deemed to be in the Contracting State with which his personal and economic relations were closest (in other words, the State in which his center of vital interests was located); (b) if the Contracting State in which the individual's center of vital interests was located cannot be determined, his domicile will be deemed to be in the Contracting State in which he had an habitual abode; (c) if he had an habitual abode in both Contracting States or in neither, his domicile will be deemed to be in the Contracting State of which he was a national; and (d) if he was a national of both Contracting States or neither, the competent authorities of the Contracting States will settle the issue by mutual agreement. These rules are similar to the rules in the OECD Model Convention on Estates and Inheritances.

Paragraph (5), as previously described, provides that an individual who was a resident of a U.S. possession and, who became a U.S. citizen solely by reason of citizenship, birth, or residence in that possession shall not be considered domiciled in or a national of the United States for purposes of this Convention.

Article 5. TAXING RIGHTS

This Article establishes taxing rights for property taxable other than on a situs basis. Paragraph (1)(a) provides that property of a decedent or transferor domiciled in one of the Contracting States shall not be taxable in the other Contracting State unless it is property covered in Articles 6 (Immovable Property (Real Property)) or 7 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services). The effect of this provision is to give exclusive taxing rights to the country of domicile with respect to all property except that covered by Articles 6 and 7.

Paragraph (1)(b), however, provides that paragraph (1)(a) does not apply if the decedent or transferor was a national of the State in which he was not domiciled. In effect, this paragraph preserves residual taxation based on nationality.

Paragraph (2) provides that where the decedent or transferor was domiciled in neither Contracting State, but was a national of one, (but not both) of the Contracting States, property taxable in the Contracting State of nationality shall not be taxable in the other Contracting State. Thus, property owned by a third-country domiciliary that is taxable in the Contracting State of nationality is not taxable in the other Contracting State, even if it has a situs in that State, with the exception of property covered by Articles 6 (Immovable Property (Real Property)) and 7 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for Independent Personal Services).

The rules of paragraphs (1) and (2) do not apply to property which is subject to the U.S. tax on generation-skipping transfers or which is comprised in a U.K. settlement. Paragraph (3), however, provides that property held in a generation-skipping trust or trust equivalent shall not be taxable by the United States on the occasion of a generation-skipping transfer if, at the time of the transfer, the deemed transferor was domiciled in the United Kingdom and was not a national of the United States. Paragraph (4) similarly precludes the United Kingdom from taxing property comprised in a settlement if at the time of settlement the settlor was domiciled in the United States and was not a national of the United Kingdom. Settled property includes property held in trust for successive beneficiaries or for anyone contingent on the occurrence of some event. The rules in paragraphs (3) and (4) do not apply to property covered by Articles 6 (Immovable Property (Real Property)) or 7 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services), which is taxable in the country of situs.

Paragraph (5) provides that the preceding paragraphs of Article 5 (Taxing Rights) shall not prevent a Contracting State from imposing tax where property, under the rules of paragraphs (1) through (4), is taxable only in the other Contracting State but tax, though chargeable, is not paid. A tax, however, shall be deemed paid where tax liability is reduced or eliminated by means of a specific exemption, deduction, exclusion, credit, or allowance.

Paragraph (6) allows the competent authorities to determine by mutual agreement the situs of property if, at the time of death or transfer, the decedent or transferor was not domiciled in either Contracting State and each State would regard the property as situated in its territory and therefore taxable under its laws. An example would be bearer bonds issued by a

U.S. corporation held in a safe deposit box in a U.K. bank by a decedent domiciled in France. The United States would generally consider the bonds to be U.S. situs property because they are issued by a domestic corporation. The United Kingdom would consider the bonds to have a U.K. situs, since bearer bonds are situated where located.

Article 6. IMMOVABLE PROPERTY (REAL PROPERTY)

This Article, which is similar to the immovable property article in the OECD Model Convention on Estates and Inheritances, and the United States-Netherlands Estate Tax Convention, provides that immovable property may be taxed in the Contracting State in which the property is situated. The term "immovable property" is defined in accordance with the law of the Contracting State in which the property is situated. The term generally includes, for example, property accessory to immovable property, livestock and equipment used in agriculture and forestry, and rights to payment for the working of mineral deposits and other natural resources. Debts secured by mortgage or otherwise are not considered immovable property, nor are ships, boats, and aircraft.

Article 7. BUSINESS PROPERTY OF A PERMANENT ESTABLISHMENT AND ASSETS PERTAINING TO A FIXED BASE USED FOR THE PERFORMANCE OF INDEPENDENT PERSONAL SERVICES

Paragraph (1) establishes the general rule that, with the exception of assets referred to in Article 6 (Immovable Property (Real Property)), assets forming part of the business property of a permanent establishment of an enterprise may be taxed in the Contracting State in which the permament establishment is situated.

Paragraph (2) defines the term "permanent establishment" as a fixed place of business through which the business of an enterprise is wholly or partly carried on. Illustrations of a permanent establishment are set forth in paragraph (2)(b). Paragraph (2)(c) states that a building site or construction or installation project constitutes a permanent establishment only if it lasts for more than twelve months. This twelve month period begins when work physically commences in the other Contracting State. A series of contracts or projects which are interdependent both commercially and geographically is to be treated as a single project for the purpose of applying the twelve months test.

Paragraph (2)(d) provides that a permanent establishment does not include: the use of facilities solely for the purpose of storage, display, or delivery of goods or merchandise belonging to an enterprise; the maintenance of a stock of goods or merchandise belonging to an enterprise solely for the purpose of storage, display or delivery; the maintenance of a stock of goods or merchandise belonging to an enterprise solely for the purpose of processing by another enterprise; the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for an enterprise; or the maintenance of a fixed place of business solely for the purpose of carrying on, for an enterprise, any other activity of a preparatory or auxiliary character. A fixed place of business used solely for one or more of these purposes will not be considered a permanent establishment under the Convention.

Under paragraph (2)(e), a person (other than an agent of an independent status to whom paragraph (2)(f) applies) will be deemed to constitute a permanent establishment if such person is acting in a Contracting State on behalf of an enterprise and habitually exercises in that State an authority to conclude contracts in the name of the enterprise, unless that person's activities are limited to the activities described in paragraph (2)(d).

On the other hand, paragraph (2)(f) provides that an enterprise of one Contracting State will not be deemed to have a permanent establishment in the other Contracting State merely because such enterprise carries on business in the other Contracting State through a broker, general commission agent, or any other agent of an independent status, where the broker or agent is acting in the ordinary course of his business.

Under paragraph (2)(g), the fact that a company which is a resident of a Contracting State controls or is controlled by a company which is a resident of the other Contracting State or which carries on business in that other State shall not of itself constitute either company a permanent establishment of the other.

Paragraph (3) provides that, except for assets described in Article 6 (Immovable Property (Real Property)), assets pertaining to a fixed base used for the performance of independent personal services may be taxed by a Contracting State if the fixed base is situated in that State. The concept of a "fixed base" is analogous to that of a "permanent establishment."

Article 8. DEDUCTIONS, EXEMPTIONS, ETC.

Paragraph (1) states that deductions shall be allowed in accordance with the law in force in the Contracting State in which the tax is imposed. Section 2106(a)(1) of the Internal Revenue Code accords the estate of a nonresident alien a deduction for allowable expenses in the proportion which the value of the decedent's gross estate situated in the United States bears to the value of his entire gross estate, wherever situated. The Code does not provide for any deductions, other than charitable or marital, for gift tax purposes. Since gifts are valued at their market value, however, any debt of the donor assumed by the donee constitutes a diminution in the total value of the transfer subject to tax. Deductions for generation-skipping tax purposes follow the relevant estate or gift tax rule.

The U.K. capital transfer tax provides that a liability secured by a particular property is deducted from the value of that property. Moreover, a liability to a person resident outside the United Kingdom which is neither payable in the United Kingdom nor an encumbrance on U.K. property is deductible from property outside the United Kingdom. In either case, if the debt exceeds the value of the property against which it is deductible, it may be deducted from the rest of the decedent's or transferor's property.

Paragraph (2) provides the benefits of the U.S. marital deduction for property which may be taxed in the United States and which passes to a spouse from a decedent or transferor who was domiciled in or a national of the United Kingdom. The benefit is given to the same extent as if (a) the decedent or transferor had been domiciled in the United States and (b) the decedent's gross estate or the transferor's transfers were limited to property which may be taxed by the United States.

The estate of a nonresident alien, who was domiciled in or a national of the United Kingdom, would thus be entitled to the full marital deduction provided by Section 2056 of the Code to the extent that the estate has property subject to estate tax in the United States. Thus, the deduction is limited to the greater of $250,000 or 50 percent of the value of the adjusted gross estate taxable in the United States. The marital deduction for gifts would be aggregated under the Convention in the same manner provided in Section 2523 of the Code: the first $100,000 of inter-spousal gifts taxable in the United States would be exempt, the second $100,000 would be fully taxable, and 50 percent of the amount of subsequent inter-spousal gifts would be taxable. All gifts by a transferor are cumulative regardless of whether the deduction has been made available by the Code or the Convention. Thus, if a transferor uses the full $100,000 deductions under the Code while domiciled in the United States and then becomes domiciled in the United Kingdom, the next $100,000 of gifts would be fully taxable under the Convention.

Paragraphs (3) and (4) provide for special marital exemptions for purposes of the U.K. capital transfer tax. In the absence of the Convention, transfers between husband and wife are wholly exempt from such tax, whether they are lifetime gifts or transfers on death and whether the property is settled or not. But where the spouse making the transfer is domiciled in the United Kingdom for purposes of the tax and the other spouse is domiciled outside the United Kingdom, the exemption is limited to a cumulative total of £25,000.

Paragraph (3) provides for exemption to the extent of 50 percent of the value of property which passes to the spouse from a decedent or transferor who was domiciled in or a national of the United States and which may be taxed in the United Kingdom. The exemption is computed after taking into account all exemptions except those for transfers between spouses. The exemption is only available where the transfer would have been wholly exempt had the recipient spouse been domiciled in the United Kingdom and where no larger marital deduction is available under U.K. law, apart from the Convention. Property passing to a spouse domiciled in the United States from a decedent or transferor domiciled in the United States would be wholly exempt under the U.K. capital transfer tax. Thus, in this case, U.K. law provides greater relief than the treaty. On the other hand, the Convention would provide greater relief if the decedent or transferor was domiciled in the United Kingdom.

Paragraph (4)(a) provides for a marital deduction in the United Kingdom for qualifying transfers into a settlement or trust in which the recipient spouse has a life interest. The paragraph applies where property is comprised in a settlement on the death of a U.K. domiciliary and the surviving spouse was domiciled in or a national of the United States. The exemption is only available if: (i) the spouse is entitled to an immediate interest in possession under the settlement, (ii) the transfer would have been wholly exempt if the recipient spouse had been domiciled in the United Kingdom, and (iii) U.K. law apart from the Convention would not provide a larger marital exemption. The exemption consists of 50 percent of the value of the property transferred, calculated in the same manner as the exemption provided for in paragraph (3).

The exemption provided for in paragraph (4)(a) is only available if it is elected by the personal representatives and trustees of every settlement in which the deceased person had an interest in possession immediately before the decedent's death. The personal representatives and trustees may be subsequently liable for capital transfer tax if, for example, the nondomiciled spouse eventually acquires the property outright. Paragraph (4)(b) provides, for example, that the election will be nullified and the settled property taxable as though given outright to the spouse if the spouse becomes absolutely and indefeasibly entitled to such property at any time after the decedent's death. Accordingly, the purpose of the election is to protect the interests of the personal representatives and trustees.

Paragraph (5) provides that U.S. tax imposed on the estate of a national of the United Kingdom, who was neither domiciled in nor a national of the United States, will not be greater than the tax which would have been imposed if the decedent had been domiciled in the United States and taxed by the United States on his worldwide property. Paragraph (5) does not require a formal election; the appropriate information need only be included in an estate tax return, which is filed or amended within the applicable time period.

Article 9. CREDITS

This Article establishes rules for determining which Contracting State will credit the taxes of the other Contracting State where both States tax the same property.

Paragraph (1) applies where the United States imposes tax on the basis of the decedent's or transferor's domicile or nationality. Under paragraph (1)(a), the United States will credit tax paid to the United Kingdom with respect to property covered by Articles 6 (Immovable Property (Real Property)) and 7 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services). Paragraph (1)(b) requires the United States to credit taxes imposed in the United Kingdom on the basis of the decedent's or transferor's domicile against U.S. taxes imposed on the basis of nationality. This enables the United States to retain the residual right to tax the estate and other transfers of its citizens domiciled in the United Kingdom.

Paragraph (2) establishes reciprocal credit rules for the United Kingdom. Paragraphs (1) and (2) taken together thus grant the Contracting State where the decedent or transferor was domiciled the right to tax the estate or transfers on a worldwide basis, with a credit for tax paid to the other State with respect to property taxed in that State on the basis of situs. The Contracting State of nationality may tax the estate or transfers of its nationals, but must credit the tax paid to the other State on a domiciliary or situs basis. Unlike the United States, the United Kingdom does not tax the estates or transfers of its citizens on a worldwide basis. Under the Convention, however, it can apply its statutory source rules to its non-U.K. domiciled nationals. Thus, the United Kingdom could impose tax, with a credit for U.S. taxes, on registered shares in a U.K. corporation held by a U.K. national domiciled in the United States.

Paragraph (3) prescribes credit rules where the same event gives rise to tax on property held under the trust laws of the two countries. Paragraph (3)(a) requires a Contracting State to credit tax imposed in the other Contracting State on property covered under Articles 6 (Immovable Property (Real Property)) or 7 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Independent Personal Services). Paragraph (3)(b) provides that the United Kingdom will credit the U.S. tax on other property where:

(i) the taxable event was a generation-skipping transfer and the deemed transferor was domiciled in the United States at the time of the deemed transfer;

(ii) the taxable event was the exercise or lapse of a power of appointment and the holder of the power was domiciled in the United States at the time of the exercise or lapse; or

(iii) in situations not covered by (i) or (ii), the settlor or grantor was domiciled in the United States at the time when the tax is imposed.

Paragraph (3)(c) provides that in all situations not covered by paragraph (3)(b), or where the United States may not tax on the basis of situs, the United States will credit the U.K. tax. Although paragraph (3)(c) is worded broadly, paragraph 3(b) preserves primary U.S. taxing jurisdiction in those situations where U.S. domiciliaries, as determined under the treaty, are taxable under the Federal estate, gift, and generation-skipping transfer tax laws of the United States.

Paragraph (4) establishes several general rules for computing the credit allowed under the Article. The credits allowed by a Contracting State shall not include taxes not levied in the other Contracting State because of a credit allowed by that other State. A tax is not creditable unless and until it is paid. In addition, the credit allowed by a Contracting State with respect to any property cannot exceed the portion of the tax paid in that State which is attributable to that property. In making this calculation, the tax paid shall be determined before the credit is given, but shall be reduced by any credit given for another tax.

Consider the estate of a decedent who was a U.S. national domiciled in the United Kingdom, which consisted of assets in the United Kingdom with a fair market value of $100 and U.S. real property with a fair market value of $20. The entire $120 estate would be taxable both in the United States and the United Kingdom. The United States would retain primary taxing jurisdiction over the U.S. real property and the United Kingdom over the other assets. If the U.K. capital transfer tax on the $120 estate were $24 and the U.S. estate tax were $30 before the allowance for any credits, the credits would be computed as follows. The United Kingdom would credit $4 of U.S. tax. Although $5 represents the portion of the U.S. tax of $30 attributable to U.S. real property, ($20/$120) × ($30), the credit would be limited to $4, which is the portion the U.K. tax of $24 attributable to the U.S. real property. The United States would credit $20 of the U.K. tax, which represents the portion of the U.K. tax of $24 attributable to U.K. property, ($100/$120) × ($24). The net U.K. tax liability would be $20 ($24 less $4) and the U.S. tax liability would be $10 ($30—$20).

Paragraph (5) provides that a claim for credit or refund under the Convention generally must be made within six years from the date of the event giving rise to the tax, or, where later, within one year from the last date on which the tax which is to be credited is due. The competent authority may, in appropriate circumstances, extend this time limit where the final determination of the taxes which are the subject of the claim is delayed.

Article 10.
NON-DISCRIMINATION

Paragraph (1)(a) states that nationals of a Contracting State shall not be subjected in the other State to taxation or any other requirement connected therewith which is other or more burdensome than the taxation or requirements connected therewith to which nationals of the other Contracting State in the same circumstances are or may be subjected. Paragraph (1)(b), however, recognizes that a nonresident alien is not in the same circumstances as a U.S. national, who is taxed by the United States on a worldwide basis regardless of his domicile. Paragraph (1)(b) provides that paragraph (1)(a) shall not prevent the United States from taxing a national of the United Kingdom who is not domiciled in the United States as a nonresident alien in accordance with U.S. internal law. Paragraph (3) further points out that this Article does not require either Contracting State to grant to individuals not domiciled in that Contracting State any personal allowances, reliefs, or tax reductions which are granted to its domiciliaries. Paragraphs (1) and (3), however, must be read in conjunction with paragraph (5) of Article 8 (Deductions, Exemptions, Etc.) which specifically limits the U.S. tax imposed on the property of a U.K. national not domiciled in the United States to the tax that would have been imposed had the decedent been domiciled in the United States at the time of death.

Paragraph (2) provides that a permanent establishment which an enterprise of one Contracting State has in the other Contracting State will not be subject in that other Contracting State to less favorable taxation than an enterprise of the other Contracting State carrying on the same activities. Paragraph (4) extends similar protection to an enterprise of a Contracting State, the capital of which is wholly or partly owned or controlled by one or more residents of the other Contracting State.

Paragraph (5) limits the application of this Article to the taxes which are the subject of the Convention, *i.e.*, the Federal gift tax and the Federal estate tax, including the tax on generation-skipping transfers in the United States and the capital transfer tax in the United Kingdom.

Article 11. MUTUAL AGREEMENT PROCEDURE

Under paragraph (1), if a person believes that the actions of one or both of the Contracting States result or will result in taxation which is not in accordance with the Convention, he may present his case to the competent authority of either Contracting State. Although a person need not exhaust any other administrative or judicial remedies prior to resorting to the mutual agreement procedure, it is anticipated that a person usually will do so.

Paragraph (2) provides that, if the competent authority considers the objection justified and cannot by itself arrive at an appropriate solution, it shall attempt to resolve the case by agreement with the competent authority of the other Contracting State. In cases in which the competent authorities reach an agreement, taxes will be imposed and refunds of taxes will be allowed, as appropriate, by the Contracting States. In the case of the United States, where an agreement is reached between the competent authorities which requires the United States to make a refund of tax or to extend any similar credit, the refund or credit will be made, assuming presentation of the case to the competent authority within a reasonable time, notwithstanding any procedural barriers existing under U.S. law, including any statute of limitations. In cases where an agreement cannot be reached between the competent authorities, the United States will not be required to provide any relief from double taxation on a unilateral basis.

Paragraph (3) permits the competent authorities of the Contracting States to endeavor to resolve any difficulties or doubts arising as to the application of the Convention, such as the meaning of terms not otherwise defined in the Convention.

Under paragraph (4), the competent authorities may communicate with each other directly and, when advisable, meet together for an oral exchange of opinions, for the purpose of reaching an agreement.

Article 12. EXCHANGE OF INFORMATION

This Article provides for a system of administrative cooperation between the competent authorities of the two Contracting States. It requires the exchange of available information necessary for carrying out the Convention and the domestic laws of the Contracting States concerning the taxes covered by the Convention. The competent authorities may exchange information in connection with tax compliance generally, not merely illegal acts or crimes.

The information exchanged must be treated as secret. However, the information may be disclosed to persons or authorities (including a court or administrative body) concerned with the assessment, collection, or enforcement of, or prosecution with respect to, the taxes which are the subject of the Convention. No information may be exchanged which would disclose any trade, business, industrial or professional secret or any trade process.

Article 13. EFFECT ON DIPLOMATIC AND CONSULAR OFFICIALS AND DOMESTIC LAW

Paragraph (1) provides that nothing in the Convention shall affect the fiscal privileges of diplomatic and consular officials under the general rules of international law or under the provisions of special agreements.

Paragraph (2) provides that the Convention will not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance' now or hereafter accorded by the laws of either Contracting State. This rule reflects the principle that a double taxation Convention should not increase the tax burden imposed by a Contracting State.

Article 14. ENTRY INTO FORCE

Paragraph (1) provides that the Convention shall be ratified and that instruments of ratification shall be exchanged at Washington, D.C. as soon as possible after both States have ratified the Convention.

Paragraph (2) provides that the Convention will become effective on the thirty-first day following the date of exchange of instruments of ratification. The Convention shall apply in the United States with respect to the estates of individuals dying and transfers taking effect after the effective date. The Convention shall apply in the United Kingdom with respect to property by reference to which a tax liability arises after the effective date.

Paragraphs (3), (4), and (5) set forth transition rules for determining when the 1945 Estate Tax Convention will cease to have effect. These rules are important because of the transition rules contained in the U.K. capital transfer tax. Paragraph (3) states the general rule that the 1945 Convention shall cease to have effect for property to which the new Convention will apply under paragraph (2). Paragraph (4), however, provides that any provision of the 1945 Convention which would afford greater relief than the new Convention will continue to apply in the United Kingdom with respect to:

(a) any *inter vivos* gift made by a decedent before March 27, 1974, or

(b) any settled property in which the decedent had a beneficial interest in possession before March 27, 1974 but not at any time thereafter.

These exceptions relate to transition rules in the U.K. capital transfer tax which will cease to have effect with respect to deaths occurring on or after March 27, 1981. Paragraph (5) provides that the 1945 Convention will terminate on the last date on which, under the foregoing rules, it has effect.

Article 15. TERMINATION

Paragraph (1) provides that the Convention shall remain in force until it is terminated by one of the Contracting States. A Contracting State may not terminate the Convention until after it has been in force at least 5 years. After the initial 5 year period, a Contracting State may terminate the Convention by providing the other State at least 6 months' prior notice through diplomaitc channels. If the Convention is terminated in accordance with these procedures, it will continue to apply to taxable events occurring between the time notice is given and the termination date specified in the notice.

Paragraph (2) provides that the termination of the Convention will not have the effect of reviving the 1945 Convention or other treaties previously abrogated.

Part III. Administrative, Procedural, and Miscellaneous

Delegation Order No. 42 (Rev. 13) (Effective December 4, 1979)

Authority to Execute Consents Fixing the Period of Limitations on Assessment or Collection Under Provisions of the 1939 and 1954 Internal Revenue Codes

1. Pursuant to authority vested in the Commissioner of Internal Revenue by Treasury Department Order No. 120, dated July 31, 1950; Order No. 150-2, dated May 15, 1952; 26 CFR 301.6501(c)-1; 26 CFR 301.6502-1; 26 CFR 301.6901-1(d); and 26 CFR 301.7701-9; the authority to sign all consents fixing the period of limitations on assessment or collection is delegated to the following officials:

a. Regional Directors of Appeals;

b. Service Center Directors;

c. District Directors;

d. Director of International Operations.

2. This authority may be redelegated but not below the following levels for each activity:

a. Service Centers—Chief, Accounting Branch; Chief, Correspondence and Processing Section; Revenue Officers; and Chief, Quality Review Staff;

b. Collection — Chiefs, Office Branches and Office Groups; Revenue Officers; Chiefs, Technical and Office Compliance Branches and Groups; Revenue Representative Supervisors;

c. Examination—Reviewers, Grade GS-11; Group Managers; Case Managers; and Returns Program Managers;

d. Criminal Investigation—Chiefs, Criminal Investigation Divisions, except this authority in streamlined districts is limited to the District Director;

e. Appeals—Appeals Officers;

f. Office of International Operations —Representatives at foreign posts; Revenue Agents, Tax Auditors, and Special Agents on foreign assignments; and levels b, c, and d, above; and

g. District Employee Plans and Exempt Organizations — Reviewers, Grade GS-11; Group Managers.

3. This Order supersedes Delegation Order No. 42 (Rev. 12) [1979-30 I.R.B. 13], issued May 24, 1979.

JEROME KURTZ,
Commissioner.

(Filed by the Office of the Federal Register on December 10, 1979, 8:45 a.m., and published in the issue of the Federal Register for December 11, 1979, 44 F.R. 71495)

Part IV. Items of General Interest

Vinson-Trammell Act; Excess Profits on Contracts for Naval Vessels or Military Aircraft—Extension of Comment Period

Announcement 80-7 [1]

AGENCY: Internal Revenue Service, Treasury

ACTION: Extension of Time for Comments and Requests for a Public Hearing.

SUMMARY: This document provides notice of an extension of time for submitting comments and request for a public hearing concerning the notice of proposed rulemaking with respect to the Vinson Trammell Act; Excess Profits on Contracts for Naval Vessels or Military Aircraft. The extended deadline for submission of comments and requests for a public hearing is February 26, 1980.

DATES: Written comments and requests for a public hearing must be delivered or mailed by February 26, 1980.

ADDRESS: Send comments and requests for a public hearing to Commissioner of Internal Revenue, Attn: CC:LR:T (LR-71-78), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: H. Benjamin Hartley of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, CC:LR:T, 202-566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION: By a notice of proposed rulemaking published in the Federal Register for Friday, October 26, 1979 (44 FR 61611), comments and requests for a public hearing with respect to the proposed rules were to be delivered or mailed to the Commissioner of Internal Revenue, Attention: CC:LR:T (LR-71-78), Washington, D.C. 20224, by December 26, 1979. The date by which comments or requests must be delivered or mailed is hereby extended to February 26, 1980.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive appearing in the Federal Register for Wednesday, November 8, 1978.

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[1] Filed by the Office of the Federal Register on December 20, 1979, 8:45 a.m., and published in the issue of the Federal Register for December 21, 1979, 44 F.R. 75670.

Reasonable Funding Methods; Amortization of Experience Gains by Pension Plans Funded by Group Deferred Annuity Contracts—Public Hearings

Announcement 80-8 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearings on proposed regulations.

SUMMARY: This document provides notice of public hearings on proposed regulations relating to reasonable funding methods and proposed regulations relating to amortization of experience gains by pension plans funded by group deferred annuity contracts.

DATES: The public hearings will be held on February 21, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by February 7, 1980.

ADDRESS: The public hearings will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines for oral comments on the proposed regulations relating to reasonable funding methods, should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (EE-150-78), Washington, D.C. 20224. The outlines for oral comments on the proposed regulations relating to the determination of actuarial cost under the minimum funding standards should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (EE-101-78), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: George Bradley or Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subjects of the public hearings are:

1. Proposed regulations relating to reasonable funding methods under section 412(c)(3) of the Internal Revenue Code of 1954, and section 3(31) of the Employee Retirement Income Security Act of 1974. These proposed regulations appeared in the Federal Register for Friday, October 5, 1979 (44 FR 57423).

2. Proposed regulations relating to the determination of actuarial cost under the minimum funding standards under section 412(b)(3) of the Internal Revenue Code of 1954. These proposed regulations appeared in the Federal Register for Friday, December 29, 1978 (43 FR 60964).

The rules of §601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearings. Persons who have submitted written comments within the time prescribed in the respective notices of proposed rulemaking and who desire to present oral comments at the respective hearing on such proposed regulations should submit an outline of the comments to be presented at the hearing and the time they wish to devote to each subject by February 7, 1980. Each speaker will be limited to 10 minutes for an oral presentation on each of the above listed proposed regulations for which timely comments have been submitted, exclusive of time consumed by questions from the panel for the Government and answers to these questions.

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[1] Filed by the Office of the Federal Register on December 20, 1979, 8:45 a.m., and published in the issue of the Federal Register for December 21, 1979, 44 F.R. 75670.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive appearing in the Federal Register for Wednesday, November 8, 1978.

Vinson-Trammell Act; Excess Profit on Contracts for Naval Vessels or Military Aircraft—Public Hearing

Announcement 80-9 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearings on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to the Vinson-Trammell Act; Excess profits on contracts for naval vessels or military aircraft.

DATES: The public hearing will be held on March 12, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by February 26, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-71-78), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: George Bradley or Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations that appeared in the Federal Register for Friday, October 26, 1979, at page 61611 (44 FR 61611). A notice of extension of time for submission of comments and requests for a public hearing appeared in the Federal Register for Friday, December 21, 1979, at page 75670 (44 FR 75670), extending the deadline for submitting the same from December 26, 1979, to February 26, 1980.

The rules of §601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and the notice of extension and who also desire to present oral comments at the hearing on the proposed regulations should submit an outline of the comments to be presented at the hearing and the time they wish to devote to each subject by February 26, 1980. Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive appearing in the Federal Register for Wednesday, November 8, 1978.

United States and Tunisia Discuss Income Tax Treaty

Announcement 80-15 [1]

Representatives of the United States and the Republic of Tunisia will meet in Tunis during the week of February 4, 1980, to undertake negotiations of a treaty to avoid double taxation of income.

There is no income tax treaty now in effect between the United States and Tunisia. Prior negotiations took place in September 1975, and there was a preliminary review of the issues to be covered at that time. After preliminary discussion in May, 1979, the Government of Tunisia recently invited the United States to send a delegation to Tunisia to resume the negotiations.

The negotiations are expected to be based on the draft texts exchanged in 1975, the model text published by the United States and by the Organization for Economic Cooperation & Development (OECD) in 1977, and the income tax treaty between the United States and Morocco, which was signed in August 1977 and has been submitted to the Senate for approval. The issues to be discussed will include the taxation by each country of income derived there by residents of the other country, whether from business activity, personal services or investment, as well as assurances of nondiscrimination in tax matters and provisions for administrative cooperation between the tax authorities of the two countries.

Interested persons are invited to send written comments and suggestions concerning the forthcoming negotiations to H. David Rosenbloom, International Tax Counsel, U.S. Treasury, Room 3064, Washington, D. C. 20220.

Automatic Cost-of-Living Adjustment of the Dollar Limitation on Benefits for Defined Benefit Plans

Announcement 80-20

The Service has reconsidered its position on the application of automatic cost-of-living adjustments to the maximum dollar limitation of defined benefit plans in light of the proposed amendments to the Income Tax Regulations under section 415 of the Internal Revenue Code, published in the Federal Register on January 24, 1980.

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[1] Filed by the Office of the Federal Register on December 27, 1979, 8:45 a.m., and published in the issue of the Federal Register for December 28, 1979, 44 F.R. 76824.

[1] Based on a Treasury Department announcement dated January 7, 1980, and published in the issue of the Federal Register for January 10, 1980, 45 F.R. 2142.

Section 415(b)(1)(A) of the Code provides a $75,000 limit on the annual benefit payable to a participant under a defined benefit plan. Section 415(d)(1)(A) annually adjusts the $75,000 for increases in the cost of living. Each year the Service publishes the limit for such year as adjusted for increases in the cost of living.

Although a defined benefit plan may annually revise the $75,000 limit to reflect the published cost-of-living increases, section 5.02 of Rev. Rul. 75-481, 1975-2 C.B. 188, prohibits a plan from incorporating language automatically reflecting these increases.

IRS News Release IR-1681, dated October 21, 1976, permitted defined contribution plans to incorporate by reference the changes in the limitations on contributions annually published by the Service. However, the position for defined benefit plans was not changed.

Section 1.415-5 of the proposed regulations under section 415 of the Code provides that a defined benefit plan may include a provision which provides for an annual automatic cost-of-living adjustment of the $75,000 limitation. However, under the proposed regulations, such a provision may only provide for scheduled annual increases in the plan's maximum dollar limitation which take effect no sooner than the effective date of the applicable adjusted dollar limitation published by the Service. The effect of this limitation will preclude the making of deductible contributions based on anticipated increases of the dollar limitation.

Taxpayers, pending the issuance of final regulations, may now rely on section 1.415-5 of the proposed regulations to adopt provisions for defined benefit plans which provide for annual automatic cost-of-living adjustments of the $75,000 limitation. Further, the Service will now issue opinion, notification, and determination letters, both for new and existing defined benefit plans, on the basis of section 1.415-5 of the proposed regulations. Taxpayers are cautioned, however, that once the final regulations are issued under section 415(d)(1) of the Code, plans may be required to be amended to conform to the final regulations.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants and Enrolled Agents from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following persons have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Richard O. Bertoli	Sparkhill, NY	Certified Public Accountant	Indefinite effective November 2, 1979
Slathern E. Gassiott	Port Arthur, TX	Certified Public Accountant	Thirty months effective November 19, 1979
Leonard M. Bernes	Atlanta, GA	Certified Public Accountant	Indefinite effective December 5, 1979
Frank J. Marcone	Media, PA	Attorney	Twenty-four months effective December 11, 1979
William P. Renner	Hagerstown, MD	Certified Public Accountant	Twenty-four months effective December 11, 1979

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.461-3, 1.6151-1—1.6302-2 and intermediate sections, 31.6071(a)-1—31.6302(c)-3 and intermediate sections, 36.3121(1)(10)-4, 46.6071(a)-1, 46.6151-1, 46.6302(c)-1, 48.6071(a)-1, 48.6151-1, 48.6302(c)-1, 49.6151-1, 49.6302(c)-1, 154.2-1, 301.6302-1, 301.6402-4, 301.7502-1, 601.401 amended; 301.7502 deleted; 301.7502-2 added.	Timeliness of tax returns, payments and deposits.	Dec. 11, 1979	Feb. 11, 1980
26 CFR 1.1033(a)-1, 1.1033(a)-2, 7.0, amended; 1.1033(g)-1 redesignated as 1.1033(h)-1 and amended; 1.1033(f)-1 redesignated as 1.1033(g)-1 and amended.	Election to treat outdoor advertising displays as real property.	Dec. 11, 1979	Feb. 11, 1980
26 CFR 1.85-1, 1.6050B-1, added.	Taxation of unemployment compensation.	Dec. 19, 1979	Feb. 18, 1980
26 CFR 25.2514-1, amended; 25.6075, 25.6075-1, deleted; 25.6075-1, 301.7517-1, added.	Time for filing gift tax returns and for requesting a statement explaining valuation for estate, gift, or generation-skipping transfer tax purposes. In addition, a change to an example that relates to the definition of a general power of appointment.	Dec. 19, 1979	Feb. 18, 1980

Proposed Regulations—Continued

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR (1939) 16.1 through 17.19 deleted; 26 CFR Subchapter D retitled; Part 160 added.	Profit limitations of the Vinson-Trammell Act on certain contracts and subcontracts for naval vessels and military aircraft.	Oct. 26, 1979	Feb. 26, 1980
26 CFR 1.44B-1, 1.51-1, 1.53-1, 1.53-2, 1.381(c)(26)-1, added; 1.51, 1.51-1, 5.44B-1, 5.51, deleted; 1.52-1, 1.52-2, 1.280C-1, amended; 1.52-3 revised; 1.53-1, redesignated as 1.53-3 and amended.	Targeted Jobs Tax Credit.	Dec. 28, 1979	Feb. 25, 1980
26 CFR 1.1001-2 added; 1.61-12, 1.671-1, 1.741-1, 1.1011-2 amended; 1.1001 deleted.	Discharge of liabilities on sale or other disposition of property.	Dec. 28, 1979	Feb. 25, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified,* above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1, dated January 7, 1980.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1 I.R.B., dated January 7, 1980.

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______	*1931–2*	*3.25*
______	*1932–1*	*2.80*
______	1932–2	8.65
______	*1933–1*	*3.35*
______	*1933–2*	*3.45*
______	*1934–1*	*3.70*
______	*1934–2*	*4.10*
______	1935–1	6.90
______	*1935–2*	*4.00*
______	*1936–1*	*3.55*
______	*1936–2*	*3.90*
______	*1937–1*	*3.75*
______	1937–2	7.70
______	*1938–1*	*4.05*
______	*1938–2*	*3.50*
______	1939–1–1	8.25
______	1939–1–2	10.90
______	1939–2	9.40
______	1940–1	5.55
______	1940–2	14.00
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______	*1941–2*	*3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
______	*1944*(*)	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*2.65*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$10.10
______	1957–2	13.00
______	1958–1	9.60
______	1958–2	13.00
______	1958–3	15.00
______	1959–1	15.00
______	1959–2	9.60
______	1960–1	9.00
______	1960–2	11.50
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______	1962–2	7.15
______	1962–3	15.00
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______	1963–2	10.75
______	1964–1–1	10.00
______	1964–1–2	11.00
______	1964–2	9.80
______	1965–1	10.70
______	1965–2	12.25
______	1966–1	9.25
______	1966–2	14.05
______	1967–1	10.00
______	1967–2	10.00
______	1968–1	14.00
______	1968–2	11.75
______	1969–1	7.50
______	1969–2	6.50
______	1969–3	$12.50
______	1970–1	11.00
______	1970–2	14.00
______	1971–1	10.55
______	1971–2	8.50
______	1972–1	13.50
______	1972–2	13.70
______	1973–1	13.20
______	1973–2	8.30
______	1974–1	11.00
______	1974–2	9.95
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______	1974–3 Supp.	10.00
______	1975–1	13.25
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______	1976–3–1	9.50
______	1976–3–2	16.00
______	1976–3–3	10.00
______	1977–1	10.75
______	1977–2	11.75
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February 4, 1980
Bulletin No. 1980-5

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENT

Announcement 80-23, page 27.
A public hearing will be held on February 26, 1980, concerning regulations relating to the withholding of tax on certain payments of gambling winnings.

INCOME TAX

Rev. Rul. 80-29, page 5.
Employee stock options and stock purchase plans; stockholders' approval. A corporation's qualified stock option plan and employee stock purchase plan may be approved, for purposes of sections 422(b)(1) and 423(b)(2) of the Code, without a stockholders' meeting if, in accordance with state law, unanimous written consent of the stockholders is obtained. However, a stockholders' meeting is required if there is less than unanimous consent.

Rev. Rul. 80-32, page 8.
Information return; power company; payment for use of roads. A power company that paid an individual $3,000 for the unrestricted use of certain roads on the individual's farm for a 10-year period is required to file a Form 1099-MISC reporting the payment.

Rev. Proc. 80-1, page 22.
Arbitrage bonds; ruling requests; nonissuing parties. Procedures are set forth for submission of requests for rulings to which section 103(c) of the Code and sections 1.103-13, 1.103-14, and 1.103-15 of the regulations apply by parties other than the issuer of the prospective obligations; Rev. Proc. 79-12 amplified.

Pub. L. 96-167, page 12.
Certain income tax provisions that are about to expire are extended, and certain provisions are repealed. A provision is added requiring that interest be paid on wrongful levies.

Announcement 80-11, page 26.
Various areas of the State of Washington have been declared disaster areas in which losses qualify for the special tax treatment under section 165(h) of the Code.

Announcement 80-13, page 26.
An error in the 1979 Package X version of Schedule J (Form 1041) and the related instructions is corrected.

GIFT TAX

Pub. L. 96-167, page 12.
The due dates for filing certain gift tax returns are extended, and procedures concerning an extension of time for filing are simplified.

EMPLOYMENT TAXES

Pub. L. 96-167, page 12.
Certain employment tax provisions that are about to expire are extended.

(Continued on page 4)

Announcement of Voluntary Suspensions on page 28.
Announcement of Notice of Proposed Rulemaking begins on page 29.
Monthly Index for January begins on page 32.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part includes rulings and decisions based on Subpart A, Tax Conventions and related Treasury Decisions and Revenue Rulings; Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

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Highlights of this Issue—Continued

(Continued from page 1)

EMPLOYMENT TAXES—(Con't)

T.D. 7661, page 6.
Amendments to the regulations under section 3402 of the Code relate to the amount of income tax to be withheld under the percentage method of withholding.

Announcement 80-14, page 26.
Pennsylvania has been added to the list of states and state unemployment compensation laws that have been certified by the Secretary of Labor to the Secretary of the Treasury pursuant to sections 3303(b)(1) and 3304(c) of the Code.

EXCISE TAXES

Rev. Rul. 80-30, page 7.
Exemption; communication services; nonprofit hospital and doctors. The exemption from communications taxes provided by section 4253(h) of the Code does not apply to amounts paid by a nonprofit hospital for communication services and facilities that are used exclusively by nonstaff doctors on the hospital premises or that are shared jointly by the doctors and the hospital. The exemption does apply to separate amounts paid by the hospital for communication services and facilities that are furnished for the executive use of the hospital in conducting its business. Rev. Rul. 68-382 distinguished.

Rev. Rul. 80-31, page 8.
Transportation; airline agency service charge. The service charge added by an airline or airline agency to the price of a ticket for taxable transportation to cover administrative costs involving use of the ticket by a different person in a different city is not subject to the tax imposed by section 4261(a) of the Code; Rev. Rul. 77-392 revoked.

T.D. 7662, page 9.
Temporary regulations under sections 6420 and 6427 of the Code relate to entitlement of aerial applicators to refunds of certain excise taxes when fuels are used for farming purposes.

ADMINISTRATIVE

Treas. Dept. Cir. 1-80, page 22.
Treas. Dept. Cir. 2-80, page 23.
Interest on the U.S. Savings Bonds of Series EE and HH is subject to all taxes imposed under the Code. Series E and EE bonds may be exchanged tax-free for Series HH bonds.

Announcement 80-12, page 26.
Form 1099-OID, Statement for Recipients of Original Issue Discount, has been revised and is available at Service offices.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 103.—Interest on Certain Governmental Obligations

26 CFR 1.103-13: Arbitrage bonds.

Procedures for submitting ruling requests under section 103(c) of the Code by persons other than the issuers of municipal obligations. See Rev. Proc. 80-1, page 22.

Section 422.—Qualified Stock Options

26 CFR 1.422-2: Qualified stock options defined.
(Also Section 423; 1.423-2.)

Employee stock options and stock purchase plans; stockholders' approval. A corporation's qualified stock option plan and employee stock purchase plan may be approved, for purposes of sections 422(b)(1) and 423(b)(2) of the Code, without a stockholders' meeting if, in accordance with state law, unanimous written consent of the stockholders is obtained. However, a stockholders' meeting is required if there is less than unanimous written consent.

Rev. Rul. 80-29

ISSUE

Is a stockholders' meeting required by section 422(b)(1) or 423(b)(2) of the Internal Revenue Code when, in accordance with state law, a corporation's qualified stock option plan or employee stock benefit plan is approved by either the unanimous written consent or, where allowable, by the majority written consent of the stockholders of the corporation?

FACTS

Corporation *A* obtained approval of a qualified stock option plan and an employee stock purchase plan by obtaining the unanimous written consent of all its stockholders within 12 months after the date the plans were adopted. The law of *A*'s state of incorporation allows such unanimous written consent in lieu of a meeting of the stockholders.

Corporation *B* obtained approval of a qualified stock option plan and an employee stock purchase plan by obtaining the written consent of a majority of its stockholders within 12 months after the date the plans were adopted. The law of *B*'s state of incorporation allows majority written consent in lieu of a meeting of the stockholders.

LAW AND ANALYSIS

Section 422(b)(1) of the Code provides that a stock option plan must be approved by the stockholders of the granting corporation within 12 months before or after the date the plan is adopted in order for options granted under the plan to be qualified stock options.

Section 1.422-2(b)(1) of the Income Tax Regulations requires that stockholder approval of a qualified stock option plan must comply with all applicable provisions of the corporate charter and bylaws and the law of the state of incorporation, and must represent the express consent of stockholders holding at least a majority of the voting stock of the corporation voting in person or by proxy at a duly held stockholders' meeting.

Section 423(b)(2) of the Code provides that employee stock purchase plans must be approved by the stockholders of the granting corporation within 12 months before or after the date such plan is adopted.

Section 1.423-2(c)(1) of the regulations requires that the approval of the stockholders must comply with all applicable provisions of the corporate charter and bylaws and the law of the state of incorporation, and must represent the express consent of stockholders holding at least a majority of the voting stock of the corporation voting in person or by proxy at a duly held stockholders' meeting.

The above regulations set forth procedures for obtaining stockholder approval to give stockholders as a group control over the issuance of stock options and thereby enable them to protect their equity interests. Sections 1.422-2(b)(1) and 1.423-2(c)(1) of the regulations require that the procedures for obtaining the approval of stockholders afford them a measure of control over the issuance of stock options that is at least equivalent to the control that exists when the holders of a majority of the outstanding voting stock of a corporation consent at a duly held stockholders' meeting. This is done by providing that stockholder approval must represent the consent of stockholders holding at least a majority of voting stock of the corporation voting in person or by proxy at a duly held stockholders' meeting. When, in accordance with state law, the approval of stockholders is obtained by written consent in lieu of a stockholders' meeting, and when that consent is unanimous, the stockholders are afforded the same protection and control over the issuance of stock options that exists when they are given notice of, and have the opportunity to attend, a stockholders' meeting. See also Rev. Rul. 75-256, 1975-2 C.B. 194, which concludes that section 1.422-2(b)(1) requires the express consent of stockholders who hold at least a majority of the outstanding voting stock of a corporation *and* vote in person or by proxy at a duly held stockholders' meeting.

Various jurisdictions permit less than unanimous written consent in lieu of a meeting of stockholders. A stockholders' meeting provides dissenting stockholders an oportunity to present their views to the other stockholders. Unanimous written consent is a satisfactory alternative to a stockholders' meeting since there are no dissenting stockholders who need to present their views. However, where a corporation allows written consent by a majority of the stockholders, dissenting stockholders are denied the opportunity to convince the other stockholders of their dissenting views at a stockholders' meeting. Thus, the stockholders are not provided the measure of protection required by sections 1.422-2(b)(1) and 1.423-2(c) of the regulations.

HOLDING

A stockholders' meeting is not required by section 422(b)(1) or 423(b)(2) of the Code when, in accordance with state law, a corporation's qualified stock option plan or employee stock benefit plan is approved by unanimous written consent of the stockholders of the corporation. However, a stockholders' meeting is required if there is less than unanimous written consent by the stockholders.

Section 423.—Employee Stock Purchase Plans

26 CFR 1.423-2: Employee stock purchase plan defined.

Whether obtaining the unanimous written consent of all the stockholders satisfies the requirement for a duly held stockholders' meeting. See Rev. Rul. 80-29, page 5.

Section 3402.—Income Tax Collected at Source

26 CFR 31.3402(a)-2: Amount of tax to be withheld under percentage method of withholding.

T.D. 7661

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 31.—EMPLOYMENT TAXES; APPLICABLE ON OR AFTER JANUARY 1, 1955

Extensions of temporary reduction of withholding of income tax at source

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the extensions of temporary reduction of withholding of income tax at source. Changes to the applicable tax law were made by the Revenue Adjustment Act of 1975 [Pub. L. 94-164, 1976-1 C.B. 486], the Act of June 30, 1976 [Pub. L. 94-331, 1976-2 C.B. 528], the Act of September 3, 1976 [Pub. L. 94-396, 1976-2 C.B. 531], the Act of September 17, 1976 [Pub. L. 94-414, 1976-2 C.B. 535], the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 (Vol. 1) C.B. 1], the Tax Simplification and Reduction Act of 1977 [Pub. L. 95-30, 1977-1 C.B. 451], and the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1]. The regulations provide employers required to withhold income tax from employees' wages with the guidance needed to comply with the changes.

DATE: The regulations are effective for wages paid after December 31, 1975.

FOR FURTHER INFORMATION CONTACT: Susan K. Thompson of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC: LR:T) (202-566-3740).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On June 5, 1979, the Federal Register published proposed amendments to the Employment Tax Regulations (26 CFR Part 31) under section 3402 of the Internal Revenue Code of 1954 (44 FR 32251). These amendments were proposed to conform the regulations to section 5(a) of the Revenue Adjustment Act of 1975 (89 Stat. 975), section 3(a) of the Act of June 30, 1976 (90 Stat. 782), section 2(a)(1) and (b) of the Act of September 3, 1976 (90 Stat. 1201), section 3(a) of the Act of September 17, 1976 (90 Stat. 1273), sections 401 (d)(1) and (e) of the Tax Reform Act of 1976 (90 Stat. 1557), section 105(a) of the Tax Reduction and Simplification Act of 1977 (91 Stat. 140), and section 101(e)(1) of the Revenue Act of 1978 (92 Stat. 2770). No comments were received with respect to the proposed amendments, and no public hearing was requested or held. The proposed amendments are adopted by this Treasury decision without change.

WITHHOLDING REQUIREMENTS

Existing regulations provide that the tables contained in Circular E (Employer's Tax Guide) shall govern the amount of tax to be deducted and withheld under the percentage method of withholding on wages paid after April 30, 1975, and before January 1, 1976. The regulations adopted by this Treasury decision require reference to Circular E with respect to wages paid on or after January 1, 1976.

The final regulations adopted by this Treasury decision impose no new reporting or recordkeeping requirements. The principal effect of the final regulations is to conform existing regulations to various statutory changes to the income tax withholding requirements. Evaluation of the effectiveness of these regulations after issuance will be based upon comments received from offices within Treasury and the Internal Revenue Service, other governmental agencies, and the public.

DRAFTING INFORMATION

The principal author of these proposed regulations is Susan K. Thompson of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Accordingly, 26 CFR Part 1 is amended as follows:

Paragraph 1. Section 31.3402(a) is deleted.

Par. 2. Section 31.3402(a)-2 is amended to read as follows:

§ 31.3402(a)-2 Amount of tax to be withheld under percentage method of withholding.

(a) *Wages paid after April 30, 1975.* With respect to wages paid after April 30, 1975, the amount of tax to be deducted and withheld under the percentage method of withholding shall be determined under the applicable percentage method withholding table contained in Circular E (Employer's Tax Guide).

(b) *Wages paid after December 31, 1969, and on or before April 30, 1975.* With respect to wages paid after December 31, 1969, and on or before April 30, 1975, the amount of tax to be deducted and withheld under the percentage method of withholding shall be determined in accordance with the tables set forth in section 3402(a), as in effect when such wages are paid.

Par. 3. Sections 31.3402(b), 31.3402(c), 31.3402(d), 31.3402(e), 31.3402(f)(1), 31.3402(f)(2), 31.3402(f)(3), 31.3402(f)(4), 31.3402(f)(5), 31.3402(f)(6), 31.3402(g), 31.3402(h)(1), 31.3402(h)(2), 31.3402(h)(3), 31.3402(h)(4), 31.3402(i), 31.3402(j), 31.3402(k), 31.3402(l), 31.3402(m), 31.3402(n), 31.3402(o), and 31.3402(p) are deleted.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved December 11, 1979.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on December 26, 1979, 8:45 a.m., and published in the issue of the Federal Register for December 27, 1979, 44 F.R. 76483)

Section 4251.—Imposition of Tax [Communications]

26 CFR 49.4251-1: Imposition of tax.

Whether the exemption from the communication taxes provided by section 4253(h) of the Code applies to communication services and facilities furnished jointly to a nonprofit hospital and an associated medical activity. See Rev. Rul. 80-30, below.

Section 4253.—Exemptions [Communications]

(Also Section 4251; 26 CFR 49.4251-1.)

Exemption; communication services; nonprofit hospital and doctors. The exemption from communications taxes provided by section 4253(h) of the Code does not apply to amounts paid by a nonprofit hospital for communication services and facilities that are used exclusively by nonstaff doctors on the hospital premises or that are shared jointly by the doctors and the hospital. The exemption does apply to separate amounts paid by the hospital for communication services and facilities that are furnished for the exclusive use of the hospital in conducting its business. Rev. Rul. 68-382 distinguished.

Rev. Rul. 80-30

ISSUE

Under the circumstances described below, does the exemption from the federal communication taxes provided by section 4253(h) of the Internal Revenue Code apply to communication services furnished jointly to a nonprofit hospital and an associated medical activity?

FACTS

A hospital, incorporated as a separate entity, qualifies as a "nonprofit hospital" for purposes of the exemption under section 4253(h) of the Code. The hospital operates under a contract with a health plan that also provides general medical services through separate contracts with private doctors in the community. The doctors rent and maintain offices that are located in the hospital. Although many of the hospital's patients are under the care of these doctors, none of the doctors are on the hospital staff and their function under the health plan is to administer to any persons in the community enrolled in the plan, whether or not such persons are patients of the hospital.

Various taxable communication services and facilities are furnished for the exclusive use of the hospital. Some services and facilities, such as individual telephone instruments (stations), are furnished for use exclusively by the doctors in their offices. Other communications services and facilities are shared jointly by the hospital and the doctors. The hospital is billed by the telephone company for all services and facilities furnished. The doctors reimburse the hospital for a proportionate share of the charges for communication services and facilities.

The method of billing by the telephone company distinguishes the telephone stations used exclusively by the hospital through means of a coding system. The system is based on a physical identification of the actual telephone lines and equipment furnished exclusively for use by the hospital.

LAW AND ANALYSIS

Section 4251 of the Code imp
a tax on amounts paid for certain c
munication services, including l
telephone service, toll telephone s
ice, and teletypewriter exchange s
ice. Under section 4253(h), no
is imposed under section 4251 on
amount paid by a nonprofit hosp
for services furnished to such organ
tion. For purposes of section 4253(
the term "nonprofit hospital" mean
hospital referred to in section 170(
(1)(A)(iii) which is exempt from
come tax under section 501(a).

In Rev. Rul. 66-382, 1966-2 C
474, a nonprofit hospital is furnis
telephone service that includes te
phones for use by patients in th
rooms. The charge for the entire se
ice is paid by the hospital to the lo
telephone company. The revenue r
ing holds that the exemption from t
under section 4253(h) of the C
applies to the hospital's payment
charges for the communication se
ices, notwithstanding the fact that t
hospital charges its patients for
use of its telephone facilities either
a per-day basis or on a per-call bas

The circumstances in this case a
distinguishable from those in Re
Rul. 66-382. In that revenue rulin
the telephones in the rooms of t
patients are provided as part of t
overall telephone service furnished t
hospital for use in conducting i
business and the telephones are ava
able and charged for by the telepho
company whether or not the roo
are occupied. Thus, they are regard
as being for the sole use of the ho
pital in caring for and meeting t
needs of its patients and are analogo
to other operating costs for which
hospital charges patients.

In this case, the medical offices o
erated by the doctors on the hospital
premises are not part of the hospit
business and thus the communicati
services and facilities that are use
exclusively by the doctors are not fu
nished for the use of the hospital an
would not have otherwise been pr
vided, but for the needs of the doctor
Further, the communication servic
and facilities shared jointly by th
hospital and the doctors are great

than would normally be necessary to meet the needs of the hospital and, therefore, are not for the sole benefit of the hospital in conducting its business.

HOLDING

The exemption provided by section 4253(h) of the Code does not apply to amounts paid for the taxable communication services and facilities furnished that are used exclusively by the doctors or that are shared jointly by the hospital and the doctors. However, separate amounts paid by the hospital for the communication services and facilities that are furnished for the exclusive use of the hospital in conducting its business come within the exemption.

See Rev. Rul. 78-109, 1978-1 C.B. 360, which holds that the exemption from the communications tax for nonprofit hospitals applies to communication services furnished exclusively to a nonprofit hospital for which there is a separate charge, but does not apply to services that are used jointly by the hospital and a for-profit clinic or to services used solely by the clinic.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 66-382 is distinguished.

Section 4261.—Imposition of Tax [Transportation by Air]

26 CFR 49.4261-7: Examples of payments subject to tax.

Transportation; airline agency service charge. The service charge added by an airline or airline agency to the price of a ticket for taxable transportation to cover administrative costs involving use of the ticket by a different person in a different city is not subject to the tax imposed by section 4261(a) of the Code; Rev. Rul. 77-392 revoked.

Rev. Rul. 80-31

ISSUE

Does the tax on transportation of persons by air apply to amounts paid for a service charge added to the price of a ticket for taxable transportation by an airline or an airline agency to cover certain administrative costs involving the purchase of a ticket for use by another person in a different city?

FACTS

The Internal Revenue Service has given further consideration to Rev. Rul. 77-392, 1977-2 C.B. 380, which holds that a service charge added by an airline agency to the price of a ticket for transportation for use by another person in a different city is a payment for taxable transportation and is subject to the tax on transportation of persons by air. The charge covers the administrative cost of processing the paper work and the reservations connected with the transportation.

LAW AND ANALYSIS

The applicable section of the Code and the Facilities and Services Excise Tax Regulations are 4261(a), which imposes a tax upon the amount paid for taxable transportation of any person by air; 49.4261-7(c), which provides that amounts paid as additional charges for changing the class of accommodations, destination, or route, extending the time limit of a ticket, as "extra fare," or for exclusive occupancy of a section, etc; are taxable; and 49.4261-7(f), which provides that the tax applies to prepaid orders, exchange orders or similar orders for transportation, and to additional amounts paid in procuring transportation in connection with the use of such orders.

Rev. Rul. 55-762, 1955-2 C.B. 660, holds that a time payment differential that is paid in excess of the established cash fare is not part of the amount paid for transportation because it is confined to or representative of the expense incurred by the carrier in selling tickets on the time payment plan, and is not taxable.

In light of the foregoing and upon further consideration of Rev. Rul. 77-392, it has been concluded that the tax imposed by section 4261 of the Code should not apply to a separate charge made by an air carrier or an airline agent for a service not reasonably necessary to the air transportation itself, provided the service is optional and the charge bears a reasonable relation to the cost of providing the service.

Thus, in Rev. Rul. 77-392 the service charge is for an extra service that is not reasonably necessary to the basic air transportation because the ticket could be purchased without the charge in the other city. Therefore, the amount paid for such a charge made by an airline or an airline agency is not a payment for transportation within the scope of section 49.4261-7 of the regulations.

HOLDING

The amount paid for the service charge made by an airline or an airline agency for the costs of issuing the ticket to another person in a different city is not subject to the tax imposed by section 4261(a) of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 77-392 is revoked.

Section 6041.—Information at Source

26 CFR 1.6041-1: Return of information as to payments of $600 or more.

Information return; power company; payment for use of roads. A power company that paid an individual $3,000 for the unrestricted use of certain roads on the individual's farm for a 10-year period is required to file a Form 1099-MISC reporting the payment.

Rev. Rul. 80-32

ISSUE

Must a company that pays, in the course of its business, $3,000 to an individual for the unrestricted use of certain roads for a ten-year period file a Form 1099-MISC, Statement for Recipients of Miscellaneous Income, reporting the payment?

FACTS

A power company paid $3,000 to an individual for the unrestricted use of certain roads on the individual's farm for a ten-year period. The agreement entered into by the company and the individual giving the company unrestricted use of certain roads was entitled "Lease Agreement" and characterized the $3,000 payment as rent.

LAW AND ANALYSIS

Section 6041(a) of the Internal Revenue Code requires the filing of information returns by all persons engaged in a trade or business and making payment in the course of such trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income of $600 or more in a taxable year.

Section 1.6041-1(a)(2) of the Income Tax Regulations provides that the return required by section 6041(a) of the Code shall be made on Forms 1096 and 1099.

A payment by a person engaged in a trade or business in the course of such trade or business of rent of $600 or more in any taxable year is one of the types of payments specifically mentioned in section 6041(a) of the Code.

HOLDING

The company is required to file a Form 1099-MISC.

Section 6420.—Gasoline Used on Farms

26 CFR 140.6420-1: Payment under section 6420 to be made to aerial applicators in certain cases.
(Also Section 6427; 140.6427-1.)

T.D. 7662

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 140.—TEMPORARY EXCISE TAX REGULATIONS UNDER SECTION 3 OF THE ACT OF OCTOBER 14, 1978 (PUBLIC LAW 95-458)

Payments to be made to aerial applicators in certain cases

AGENCY: Internal Revenue Service, Treasury

ACTION: Temporary Regulations

SUMMARY: This document provides temporary regulations governing claims by aerial applicators for payment of an amount equal to the tax imposed on gasoline and special fuels used on farms for farming purposes. Changes to the applicable tax law were made by section 3 of the Act of October 14, 1978 (Pub. L. 95-458) [1978-2 C.B. 367]. These regulations affect all aerial applicators and all owners, tenants, and operators of farms who employ the services of aerial applicators. The regulations provide the guidance needed to comply with the law.

EFFECTIVE DATE: The regulations apply to payments for gasoline and special fuels used after March 31, 1979, on farms for farming purposes by aerial applicators.

FOR FURTHER INFORMATION CONTACT: H. B. Hartley of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224, Attention: CC:LR:T, 202-566-6624, not a toll-free call.

BACKGROUND

This document contains temporary regulations governing claims by aerial applicators for payment of an amount equal to the taxes imposed under sections 4081 and 4041 of the Internal Revenue Code of 1954 on gasoline and special fuels used on farms for farming purposes. Sections 6420 and 6427 of the Code authorize the payments to the user and ultimate purchaser of these fuels. The law was amended by section 3 of the Act of October 14, 1978 (Pub. L. 95-458, 92 Stat. 1257) to permit aerial applicators to receive payments as users and ultimate purchasers of fuels they use on farms for farming purposes. A new Part 140, Temporary Excise Tax Regulations under Section 3 of the Act of October 14, 1978 (Pub. L. 95-458) is added by this document to Title 26 of the Code of Federal Regulations. The temporary regulations provided by this document will remain in effect until superseded by final regulations.

STATUTORY PROVISIONS

Sections 6420 and 6427 provide, respectively, for payment to the user and ultimate purchaser of an amount equal to the tax imposed under section 4081 on gasoline and under section 4041 on special fuels, if the gasoline or special fuel is used on a farm for farming purposes. For fuel used before April 1, 1979, only the owner, tenant, or operator of a farm is entitled to claim a payment as user and ultimate purchaser. Section 3 of the Act of October 14, 1978, amended sections 6420 and 6427 to entitle aerial applicators to receive these payments for fuels used by them after March 31, 1979. Before an aerial applicator may receive a payment, however, the owner, tenant, or operator of the farm served by the aerial applicator must waive his or her right to receive the payment in a written statement retained by the aerial applicator. The statement waiving the right of the owner, tenant, or operator to be treated as the user and ultimate purchaser of the gasoline or special fuel may be in any form that substantially meets the requirements of the regulations.

WAIVER OF PROCEDURAL REQUIREMENT OF TREASURY DIRECTIVE

There is need for expeditious adoption of the regulations contained in this document because of the need for immediate guidance to owners, tenants, and operators of farms and to aerial applicators using taxpaid gasoline and special fuels on farms for farming purposes. These regulations are necessary to determine whether the owner, tenant, or operator, or the aerial applicator will receive the payments provided in sections 6420 and 6427. For this reason, Jerome Kurtz, Commissioner of Internal Revenue, has determined that the provisions of paragraphs 8 through 14 of the Treasury Directive implementing Executive Order 12044 must be waived.

DRAFTING INFORMATION

The principal author of these regulations is H. B. Hartley of the Legislation and Regulations Division of the

Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and the Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of the amendments to the regulations

Accordingly, a new part 140, Temporary Excise Tax Regulations under Section 3 of the Act of October 14, 1978 (Pub. L. 95-458), is added to Title 26 of the Code of Federal Regulations, and the following temporary regulations are adopted:

PART 140—TEMPORARY EXCISE TAX REGULATIONS UNDER SECTION 3 OF THE ACT OF OCTOBER 14, 1978 (PUB. L. 95-458)

Sec. 140.6420-1 Payment under section 6420 to be made to aerial applicators in certain cases. 140.6427-1 Payment under section 6427 to be made to aerial applicators in certain cases.

Authority: Sec. 7805, Internal Revenue Code of 1954 (68A Stat. 917 (26 U.S.C. 7805)), and sec. 3, Act of October 14, 1978 (92 Stat. 1257 (26 U.S.C. 6420, 6427)).

§ 140.6420-1 Payment under section 6420 to be made to aerial applicators in certain cases.

(a) *Effective date.* This regulation is effective for payment for gasoline used after March 31, 1979, by aerial applicators on farms for farming purposes.

(b) *General rule.* Section 6420 provides a payment to the user and ultimate purchaser of gasoline used on a farm for farming purposes of an amount equal to the tax imposed on gasoline under section 4081. The general rule of section 6420(c)(3)(A) is that only the owner, tenant, or operator of a farm is entitled to be treated as a user and ultimate purchaser. Section 6420(c)(4) provides that under section 6420(c)(3)(A), an aerial applicator is entitled to be treated as the user and ultimate purchaser of gasoline used by it on a farm for farming purposes, but only if the owner, tenant, or operator who is otherwise entitled to treatment as the user and ultimate purchaser waives his or her right to the payment.

(c) *Form and manner of waiver.* To waive the right to be treated as user and ultimate purchaser of gasoline which is used on a farm by an aerial applicator, the owner, tenant, or operator of a farm who is otherwise entitled to treatment as user and ultimate purchaser must execute an irrevocable written agreement no later than the date on which the aerial applicator claiming the credit files its return for the taxable year in which the gasoline is used. The agreement must identify the period during which the owner, tenant, or operator waives his or her right to payment. The effective period of the waiver cannot extend beyond the last day of the taxable year of the owner, tenant, or operator of the farm on which the gasoline was used. If the owner, tenant, or operator's taxable year extends beyond the taxable year of the applicator, the applicator can only claim payment for periods included in the applicator's taxable year. Periods after the last day of the applicator's taxable year which are included under the agreement must be claimed on the applicator's return for the next succeeding taxable year. The waiver may be in the form shown under paragraph (g) of this section or in any other form that meets the requirements of these regulations, but must clearly say that the owner, tenant, or operator of the farm knowingly gives up the right to receive a payment.

(d) *Agreement included on aerial applicator's invoice.* The agreement waiving a right to receive a payment under section 6420 may be a separate document or may appear on the face or the reverse side of an invoice for aerial application services or other unrelated document from the aerial applicator to the owner, tenant, or operator of the farm. If the waiver agreement apears on an invoice or other unrelated document, however, it must be printed in a section of the invoice or other document clearly set off from all other material contained in the invoice or other document, and it must be printed in type sufficiently large to put the owner, tenant, or operator of the farm on notice that he or she has waived his or her right to receive a payment under section 6420. Additionally, if the waiver agreement appears as part of any invoice or other unrelated document, it must be executed separately from any other item included in the invoice or other document which requires the owner, tenant, or operator's signature.

(e) *Copies of agreement waiving right to payment.* No copies of any agreement waiving a right to payments under section 6420 are to be submitted to the Internal Revenue Service unless a request is made by the Service to the taxpayer for the waivers. Aerial applicators must, however, retain copies of all waivers, and a copy of each waiver must be supplied by the aerial applicator to the owner, tenant, or operator of the farm who waives his or her right to receive a payment. See regulations § 48.6420(f)-1 for general requirements for records to be kept.

(f) *Waiver on behalf of owner, tenant, or operator of farm.* If any owner, tenant, or operator of a farm desires that an agent (e.g., a cooperative) act for him or her or cannot legally bind himself or herself due to infancy or other incompetency, an agent expressly authorized under local law to bind the owner, tenant, or operator in a waiver of his or her rights to a payment under section 6420 may sign the waiver on his or her behalf.

(g) *Sample form of agreement.* While no specific form is required for an effective waiver, an acceptable form waiving the right to receive a payment under section 6420 follows:

I hereby waive my right as owner/tenant/operator of a farm located at ______

______________ to receive payment
(address)
or credit from the United States for gasoline used by ______________ on the
(aerial applicator)
farm in connection with cultivating the soil, or the raising or harvesting of any agricultural or horticultural commodity. This waiver applies to gasoline used during the period ______________, both dates inclusive.

I understand that by signing this waiver, I give up my right to claim any credit or payment for gasoline used by the aerial ap-

plicator during the period indicated, and I acknowledge that I have not previously claimed any credit or payment for that gasoline.

(Signature of Owner/Tenant/Operator)

Taxpayer Identification No. ____________

§ 140.6427-1. Payment under section 6427 to be made to aerial applicators in certain cases.

(a) *Effective date.* This regulation is effective for payments for special fuels used after March 31, 1979, by aerial applicators on farms for farming purposes.

(b) *In general.* Section 6427 provides for payment to the user and ultimate purchaser of certain fuels used on a farm for farming purposes of an amount equal to the amount of tax imposed on these fuels under section 4041. The general rule is that only an owner, tenant, or operator of a farm is entitled to be treated as a user and ultimate purchaser. Section 6427(c) provides that an aerial applicator is entitled to be treated as the user and ultimate purchaser of fuels which it uses on a farm for farming purposes, but only if the owner, tenant, or operator of the farm who is otherwise entitled to be treated as the ultimate purchaser, waives his or her right to receive the payment.

(c) ***Rules governing waivers by owners, tenants, and operators of farms.*** The rules contained in section 6420 and the regulations under that section regarding waivers by owners, tenants, and operators of farms of their rights to payments under section 6420 for gasoline which is used by aerial applicators on a farm for farming purposes apply to waivers under this section.

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

(Sec. 7805, Internal Revenue Code of 1954 (68A Stat. 917 (26 U.S.C. 7805)); sec. 3 of the Act of October 14, 1978 (Pub. L. 95-458, 92 Stat. 1257)).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved December 16, 1979.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on December 26, 1979, 8:45 a.m., and published in the issue of the Federal Register for December 27, 1979, 44 F.R. 76484)

Section 6427.—Fuels Not Used for Taxable Purposes

26 CFR 140.6427-1: Payment under section 6427 to be made to aerial applicators in certain cases.

Entitlement of aerial applicators to refund of gasoline and/or special fuels taxes when fuels are used for farming purposes. See T.D. 7662, page 9.

Part II. Treaties and Tax Legislation

Subpart B.—Legislation and Related Committee Reports

Public Law 96-167
96th Congress, H.R. 5224 [1]
December 29, 1979

An Act to continue through May 31, 1981, the existing prohibition on the issuance of fringe benefit regulations, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. PROHIBITION OF ISSUANCE OF FRINGE BENEFIT REGULATIONS.

Section 1 of the Act entitled "An Act to prohibit the issuance of regulations on the taxation of fringe benefits, and for other purposes", approved October 7, 1978 (Public Law 95-427) [1978-2 C.B. 363] is amended by striking out "December 31, 1979" each place it appears and inserting in lieu thereof "May 31, 1981".

SEC. 2. COMMUTING EXPENSES.

Section 2 of the Act entitled "An Act to prohibit the issuance of regulations of the taxation of fringe benefits, and for other purposes", approved October 7, 1978 (Public Law 95-427), is amended by striking out "December 31, 1979" and inserting in lieu thereof "May 31, 1981".

SEC. 3. STATE LEGISLATORS' TRAVEL EXPENSES AWAY FROM HOME.

(a) GENERAL RULE. — Subsection (a) of section 604 of the Tax Reform Act of 1976 (relating to State legislators' travel expenses away from home) is amended—

(1) by striking out "who elects the application" and inserting in lieu thereof "who, for the taxable year, elects the application", and

(2) by striking out "January 1, 1978" and inserting in lieu thereof "January 1, 1981".

(b) TECHNICAL AMENDMENT.—Effective for taxable years beginning after December 31, 1977, subsection (d) of section 604 of the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1] is amended by striking out the last sentence.

SEC. 4. PAYMENT OF INTEREST WHERE LEVY HAS BEEN WRONGFULLY MADE AND MONEY RECEIVED BY UNITED STATES.

(a) IN GENERAL.—Section 6343 of the Internal Revenue Code of 1954 (relating to release of levy and return of property) is amended by adding at the end thereof the following new subsection:

"(c) INTEREST.—Interest shall be allowed and paid at an annual rate established under section 6621—

"(1) in a case described in subsection (b)(2), from the date the Secretary receives the money to a date (to be determined by the Secretary) preceding the date of return by not more than 30 days, or

"(2) in a case described in subsection (b)(3), from the date of the sale of the property to a date (to be determined by the Secretary) preceding the date of return by not more than 30 days."

(b) TECHNICAL AMENDMENT. — Subsection (a) of section 6621 of such Code is amended to read as follows:

"(a) IN GENERAL.—The annual rate established under this section shall be such adjusted rate as is established by the Secretary under subsection (b)."

(c) EFFECTIVE DATES.—

(1) The amendment made by subsection (a) shall apply to levies made after the date of the enactment of this Act.

(2) The amendment made by subsection (b) shall take effect on the date of the enactment of this Act.

SEC. 5. REPEAL OF REQUIREMENT THAT TRANSFERORS OF CERTAIN PROPERTY TO EXEMPT ORGANIZATIONS MUST FILE RETURNS.

(a) GENERAL RULE.—Section 6050 of the Internal Revenue Code of 1954 (relating to returns relating to certain transfers to exempt organizations) is hereby repealed.

(b) CLERICAL AMENDMENT.—The table of sections for subpart B of part III of subchapter A of chapter 61 of such Code is amended by striking out the item relating to section 6050.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to transfers after the date of the enactment of this Act.

SEC. 6. REPEAL OF ADDITION TO TAX IN CASE OF JEOPARDY.

(a) GENERAL RULE.—Section 6658 of the Internal Revenue Code of 1954 (relating to addition to tax in case of jeopardy) is hereby repealed.

(b) CLERICAL AMENDMENT.—The table of sections for subchapter A of chapter 68 of such Code is amended by striking out the item relating to section 6658.

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to violations (or attempted violations) occurring after the date of the enactment of this Act.

SEC. 7. REPEAL OF REQUIREMENTS THAT INFORMATION BE FURNISHED TO THE SERVICE IN CONNECTION WITH CERTAIN OPTIONS.

(a) GENERAL RULE.—Section 6039 of the Internal Revenue Code of 1954 (relating to information required in connection with certain options) is amended to read as follows:

"SEC. 6039. INFORMATION REQUIRED IN CONNECTION WITH CERTAIN OPTIONS.

"(a) FURNISHING OF INFORMATION.—Every corporation—

"(1) which in any calendar year transfers a share of stock to any person pursuant to such person's exercise of a qualified stock option or a restricted stock option, or

"(2) which in any calendar year records (or has by its agent recorded) a transfer of the legal title of a share of stock—

"(A) acquired by the transferee pursuant to his exercise of an option described in section 423(c) (relating to special rule where option price is between 85 percent and 100 percent of value of stock), or

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[1] Senate Report No. 96-433, page 14. House Report No. 96-448, page 20.

"(B) acquired by the transferor pursuant to his exercise of a restricted stock option described in section 424 (c)(1) (relating to options under which option price is between 85 percent and 95 percent of value of stock),

shall (on or before January 31 of the following calendar year) furnish to such person a written statement in such manner and setting forth such information as the Secretary may by regulations prescribe.

"(b) Special Rules.—For purposes of this section—

"(1) Treatment by employer to be determinative. — Any option which the corporation treats as a qualified stock option, a restricted stock option, or an option granted under an employee stock purchase plan shall be deemed to be such an option.

"(2) Subsection (a)(2) applies only to first transfer described therein.—A statement is required by reason of a transfer described in subsection (a)(2) of a share only with respect to the first transfer of such share by the person who exercised the option.

"(3) Identification of stock.—Any corporation which transfers any share of stock pursuant to the exercise of any option described in subsection (a)(2) shall identify such stock in a manner adequate to carry out the purposes of this section.

"(c) Cross References.—

"For definition of—

"(1) The term 'qualified stock option', see section 422(b).

"(2) The term 'employee stock purchase plan', see section 423(b).

"(3) The term 'restricted stock option', see section 424(b)."

(b) Technical Amendments.—

(1) Subsection (a) of section 6652 of such Code is amended—

(A) by inserting "or" at the end of paragraph (1),

(B) by striking out paragraph (2) and redesignating paragraph (3) as paragraph (2), and

(C) by striking out "return referred to in paragraph (2) or (3)" and inserting in lieu thereof "return referred to in paragraph (2)".

(2) Section 6678 of such Code (relating to penalty for failure to furnish certain statements) is amended to read as follows:

"SEC. 6678. FAILURE TO FURNISH CERTAIN STATEMENTS.

"In the case of each failure—

"(1) to furnish a statement under section 6042(c), 6044(e), 6049(c), or 6052(b), on the date prescribed therefor to a person with respect to whom a return has been made under section 6042(a)(1), 6044(a)(1), 6049(a)(1), or 6052(a), respectively, or

"(2) to furnish a statement under section 6039(a) on the date prescribed therefor to a person with respect to whom such a statement is required,

unless it is shown that such failure is due to reasonable cause and not to willful neglect, there shall be paid (upon notice and demand by the Secretary and in the same manner as tax) by the person failing to so furnish the statement $10 for each such statement not so furnished, but the total amount imposed on the delinquent person for all such failures during any calendar year shall not exceed $25,000."

(c) Effective Date.—The amendments made by this section shall apply with respect to calendar years beginning after 1979.

SEC. 8. EXTENSION OF TIME FOR FILING GIFT TAX RETURNS FOR FOURTH CALENDAR QUARTER.

(a) General Rule. — Paragraph (1) of section 6075(b) of the Internal Revenue Code of 1954 (relating to due date for gift tax returns) is amended to read as follows:

"(1) General rule.—Except as provided in paragraph (2), returns made under section 6019 (relating to gift taxes) shall be filed on or before—

"(A) in the case of a return for the first, second, or third calendar year, the 15th day of the second month following the close of the calendar quarter, or

"(B) in the case of a return for the fourth calendar quarter of any calendar year, the 15th day of the fourth month following the close of the calendar quarter."

(b) Extension of Date for Filing Income Tax Return Treated as Extension of Date for Filing Gift Tax Return.—Subsection (b) of section 6075 of such Code is amended by redesignating paragraph (3) as paragraph (4) and by inserting after paragraph (2) the following new paragraph:

"(3) Extension where taxpayer granted extension for filing income tax return.—Any extension of time granted the taxpayer for filing the return of income taxes imposed by subtitle A for any taxable year which is a calendar year shall be deemed to be also an extension of time granted the taxpayer for filing the return under section 6019 for the fourth calendar quarter of such taxable year."

(c) Technical Amendments. — Paragraph (2) of section 6075(b) of such Code is amended—

(1) by striking out "the 15th day of the second month after" and inserting in lieu thereof "the date prescribed by paragraph (1) for filing the return for", and

(2) by striking out "the close of" in subparagraphs (A) and (B).

(d) Effective Date.—The amendments made by this section shall apply to returns for gifts made in calendar years ending after the date of the enactment of this Act.

SEC. 9. EXTENSION OF CERTAIN TEMPORARY TAX PROVISIONS.

(a) Government Health Professions Scholarship Programs.—Subsection (c) of section 4 of Public Law 93-483 [1974-2 C.B. 447], as amended, is amended—

(1) by striking out "1980" and inserting in lieu thereof "1981", and

(2) by striking out "1984" and inserting in lieu thereof "1985".

(b) National Research Service Awards.—Paragraph (2) of section 161(b) of the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1] (relating to national research service awards) is amended by striking out "1979" and inserting in lieu thereof "1980".

(c) DEDUCTION FOR ELIMINATING ARCHITECTURAL AND TRANSPORTATION BARRIERS TO THE HANDICAPPED.—Subsection (c) of section 2122 of the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1] (relating to effective date for allowance of deduction for eliminating architectural and transportation barriers to the handicapped) is amended by striking out "January 1, 1980" and inserting in lieu thereof "January 1, 1983".

(d) CONTROVERSIES INVOLVING WHETHER INDIVIDUALS ARE EMPLOYEES FOR PURPOSES OF THE EMPLOYMENT TAXES.—

(1) IN GENERAL.—Subsection (a) of section 530 of the Revenue Act of 1978 (relating to termination of certain employment tax liability for periods before 1980) is amended—

(A) by striking out "January 1, 1980" in paragraphs (1)(A) and (3) and inserting in lieu thereof "January 1, 1981",

(B) by striking out "1980" in the subsection heading and inserting in lieu thereof "1981", and

(C) by striking out "1979" in the heading for paragraph (3) and inserting in lieu thereof "1979 and 1980".

(2) PROHIBITION AGAINST REGULATIONS AND RULINGS ON EMPLOYMENT STATUS.—Subsection (b) of section 530 of the Revenue Act of 1978 is amended by striking out "January 1, 1980" and inserting in lieu thereof "January 1, 1981".

(e) ADDITIONAL 2-YEAR DELAY IN APPLICATION OF THE NET OPERATING LOSS RULES ADDED BY THE TAX REFORM ACT OF 1976.—Paragraphs (2) and (3) of section 806(g) of the Tax Reform Act of 1976 (relating to effective dates for the amendments to sections 382 and 383 of the Internal Revenue Code of 1954) are amended by striking out "1980" each place it appears and inserting in lieu thereof "1982".

Approved December 29, 1979.

Senate Report No. 96-433
1st Session

[Bracketed numerals indicate official report page numbers]

FRINGE BENEFIT REGULATIONS

NOVEMBER 29, 1979

Mr. LONG, from the Committee on Finance, submitted the following report to accompany H.R. 5224.[1]

The Committee on Finance, to which was referred the bill (H.R. 5224) to continue the existing prohibition on the issuance of fringe benefit regulations, through May 31, 1981, and for other purposes, having considered the same, reports favorably thereon with an amendment and recommends that the bill as amended do pass.

The amendment is shown in the text of the bill in italic.

House bill.—H.R. 5224 as it passed the House extends the existing prohibition on the issuance of regulations relating to the taxation of employee fringe benefits until June 1, 1981, extends the existing prohibition on the issuance of rulings or regulations with respect to the deductibility of certain commuting or transportation expenses paid or incurred prior to June 1, 1981, and extends, for 3 additional years, provisions relating to the tax treatment of travel expenses incurred by State legislators while away from home.

Committee bill.—The committee amendment deletes the provision relating to the tax treatment of travel expenses incurred by State legislators and adds provisions relating to the simplification of certain tax procedure rules and the extension of other provisions which are about to expire. The provisions added by the committee are contained in H.R. 5505, which was passed by the House on November 1, 1979. The Subcommittee on Taxation and Debt Management Generally of the Committee on Finance held public hearings on June 22, 1979, on a bill, S. 1062, which contains the simplification amendments.

I. SUMMARY

In general, H.R. 5224 contains changes in the Federal tax laws to extend provisions which are about to expire and to simplify certain procedural provisions. The following is a section-by-section summary of the bill as reported by the committee.

[2] Section 1. Employee fringe benefits

This section prohibits the issuance of final regulations under Code section 61, relating to taxation of employees fringe benefits, before June 1, 1981, and the issuance of proposed or final regulations on that subject which would be effective before June 1, 1981.

Section 2. Commuting expenses

This section prohibits the issuance of Treasury (or Internal Revenue Service) rulings on final regulations with respect to the deductibility of certain commuting or transportation expenses paid or incurred before June 1, 1981.

Section 3. Payment of interest on wrongful levies

This section provides for the payment of interest when the Internal Revenue Service administratively determines that a wrongful levy of property has been made and money is returned to the owner of the property.

Section 4. Repeal of requirement that transferors of certain property to exempt organizations must file returns

This section repeals the requirement that a person, who transfers income-producing property valued at more than $50,000 to an exempt organization, must file an information return if the organization is known to be subject to tax on unrelated business income.

Section 5. Repeal of addition to tax in the case of certain jeopardy assessments

This section repeals the 25-percent penalty imposed when a taxpayer violates or attempts to violate the special termination of taxable year jeopardy assessment provisions under present law.

Section 6. Repeal of requirement that information be furnished to the IRS in connection with certain stock options

This section repeals the requirement that information relating to certain qualified and restricted stock options be furnished to the Internal Revenue Service.

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[1] Public Law 96-167, page 12.

Section 7. Time for filing certain gift tax returns

This section provides that the due date for filing a gift tax return for the fourth calendar quarter or the calendar year is April 15 of the following year. Thus, the gift tax return due date would be consistent with the income tax due date for calendar year taxpayers. This section also provides that an extension for filing an income tax return will automatically extend the time for filing the fourth quarter or annual gift tax return.

Section 8(a). Uniformed Services Health Professions Scholarships

This section extends for one year the exclusion from gross income for amounts received by participants in the Uniformed Services Health Professions Scholarship program. As extended, the exclusion will be available to students entering the program in 1980 and to amounts received by them through 1984.

[3] Section 8(b). National Research Service Awards

This section extends the scholarship exclusion for National Research Service Awards for one year to apply to awards first made in 1980.

Section 8(c). Expenditures to remove architectural and transportation barriers to the handicapped and elderly

This section extends for 3 years, through December 31, 1982, the election to deduct annually up to $25,000 in capital costs incurred during the taxable year for the removal of architectural and transportation barriers to the handicapped and elderly.

Section 8(d). Interim relief for independent contractor status controversies

This second extends for one year, through December 31, 1980, the interim relief provided by the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1] with respect to independent contractor status controversies.

Section 8(e). Postponement of effective date for special limitations on net operating loss carryovers

This section defers for 2 years the effective date for provisions under the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1] relating to special limitations on net operating loss carryovers. These provisions would be deferred until January 1, 1982, with respect to tax-free reorganizations and until June 30, 1982, with respect to taxable acquisitions.

II. EXPLANATION OF PROVISIONS

A. Employee Fringe Benefits (sec. 1 of the bill and sec. 61 of the Code)

Present law

Section 61 of the Internal Revenue Code defines gross income as including "all income from whatever source derived" and specifies that it includes "compensation for services". The regulations (§ 1.61-2(a)(1)) provide that income includes compensation for services paid for other than in money. Further, the Supreme Court has stated that section 61 "is broad enough to include in taxable income any economic or financial benefit conferred on the employee as compensation whatever the form or mode by which it is effected."[1] In actual practice, however, the "economic benefit" test has not been rigidly followed. Thus, where compensation is paid in some form other than cash, the issue as to taxability has been resolved by statutes, regulations, and administrative rulings which take account of several different factors.

Some fringe benefits, such as the provision of health insurance by an employer for its employees, are expressly excluded from gross income by the Internal Revenue Code; others are excluded by legislation outside the Code; and yet other exclusions are based on judicial authority or on administrative practice. For example, some fringe benefits have been excluded under administrative practice on the basis of a *de minimis* principle, i.e., accounting for the benefits of small value would be unreasonable or administratively impractical. Other items are excluded due to a combination of valuation difficulties and widely held perceptions that the items do not constitute income.

[4] In 1975, the Treasury Department issued a discussion draft of proposed regulations[2] which contained a number of rules for determining whether various fringe benefits constitute taxable compensation. Under the principles contained in the discussion draft, some employee fringe benefits which, as a matter of prior administrative practice, had not been considered to be taxable compensation would have been treated as subject to tax. Other benefits which might be viewed as taxable compensation would not have been taxed under the discussion draft's proposed rules. The discussion draft was withdrawn by the Treasury Department on December 28, 1976.[3] Thus, the question of whether, and what, employee fringe benefits result in taxable income to employees generally continues to depend on the facts and circumstances in each individual case.

In 1978, Public Law 95-427 [1978-2 C.B. 363] was enacted to prohibit the Treasury Department from issuing final regulations, under section 61 of the Code, relating to the income tax treatment of fringe benefits prior to 1980. The Act further provided that no regulations relating to the treatment of fringe benefits under section 61 were to be proposed which would be effective prior to 1980.

Reasons for change

Although the use of fringe benefits has increased in recent years, few comprehensive or generally applicable income tax rules have been developed. As a result, there has been an inevitable lack of uniformity of treatment of taxpayers who receive different types of benefits even though the benefits may have approximately the same economic value.

The appropriate income tax treatment of various fringe benefits has led to a number of problems aside from the issue of whether a benefit constitutes taxable compensation. Although there are differences between includible "compensation" for income tax purposes and "wages" for payroll tax purposes, the terms are used interchangeably. Thus, employers may be presented with the question of whether employment taxes should be withheld from an employee's wages because of non-cash benefits being provided to employees.[4] In addition, both taxpayers and the Internal Revenue Service must face difficult problems of valuing benefits provided in kind.

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[1] *Commissioner* v. *Smith,* 324 U.S. 177, 181 (1945) [Ct. D. 1633 modified, 1945 C.B. 52].

[2] 40 Fed. Reg. 4118 (Sept. 5, 1975).

[3] 41 Fed. Reg. 56334 (Dec. 28, 1976).

While the committee recognizes that the Internal Revenue Service constantly is reexamining the treatment of fringe benefits in accordance with its obligations to enforce the tax laws, the committee also recognizes that it is primarily the responsibility of the Congress to legislate tax policy. The committee believes that a proper review of these issues requires a longer period of time than is available under Public Law 95-427.

Explanation of provision

The bill provides that the Treasury Department (Internal Revenue Service) is precluded from issuing final regulations, under section 61, relating to the income tax treatment of fringe benefits prior to June 1, 1981. In addition, no regulations relating to the treatment of fringe [5] benefits under section 61 are to be proposed which would be effective prior to June 1, 1981. While the bill would prevent the IRS from deviating from the present administration of the income tax laws as they concern the taxation of fringe benefits as compensation, the bill would not prevent the IRS from continuing to study the question of the appropriate tax treatment of fringe benefits.

Although the provisions of this bill relate only to the issuance of regulations, it is still the intent of the committee that the Treasury Department will not alter, or deviate from, in any significant way, the historical treatment of fringe benefits through the issuance of revenue rulings or revenue procedures, etc.

Effective date

The provision is effective upon enactment.

Revenue effect

This provision would continue present administrative practice and thus would have no effect on budget receipts.

B. Commuting Expenses (sec. 2 of the bill, Rev. Rul. 76-453, and secs. 62, 162, and 262 of the Code)

Present law

In general, a taxpayer is allowed a deduction for ordinary and necessary expenses paid or incurred in carrying on a trade or business. This includes transportatiaon expenses incurred in the pursuit of a trade or business. However, no deduction is allowed for personal, living, or family expenses, including the cost of commuting to and from work. Problems have arisen in delineating between transportation expenses which are considered to be nondeductible personal commuting expenses and other transportation expenses which are deductible business expenses. Generally, transportation expenses are not deductible if the taxpayer is going to his principal place of work from his residence or is returning to his home from his principal place of work. On the other hand, transportation expenses to temporary worksites other than the taxpayer's principal place of work often are deductible as a business expense.

On November 22, 1976, the IRS published Revenue Ruling 76-453 (1976-2 C.B. 86) which states that a taxpayer's transportation expenses incurred in traveling between the taxpayer's residence and place of work, even though temporary, will be nondeductible commuting expenses, regardless of the nature of the work performed, the distance traveled, the mode of transport, or the degree of necessity. In addition, the ruling states that reimbursement for such expenses will be considered "wages" for purposes of FICA, FUTA, and income tax withholding. The ruling was originally effective for transportation costs paid or incurred after December 31, 1976. The Service postponed the effective date of this ruling, and on September 23, 1977, announced that the ruling was suspended indefinitely and that proposed regulations inviting public comment would be issued shortly. Proposed regulations have not as yet been issued.

Public Law 95-427 was enacted in 1978 to require that the application of the income tax, FICA, FUTA, and withholding provisions relating to the treatment of transportation expenses paid or incurred after 1976 and before January 1, 1980, in traveling between a tax-[6]payer's residence and place of work, shall be made fully in accordance with the rules in effect prior to the issuance of Revenue Ruling 76-453 on November 22, 1976. Thus, the IRS may not issue any ruling or final regulation prior to January 1, 1980, changing the tax treatment of these transportation exepnses paid or incurred prior to that date.

It was intended that the provision would allow Congress time to study this matter prior to the effective date of any changes made by new regulations or ruling issued by the IRS.

Reasons for change

The committee believes that the Congress should have an additional opportunity to study this area prior to the adoption of any rules or regulations by the IRS changing the treatment of expenses for transportation between a taxpayer's residence and place of work.

Explanation of provision

The bill extends the provisions of Public Law 95-427 to apply to expenses, paid or incurred prior to June 1, 1981, for transportation between a taxpayer's residence and place of work.

Effective date

The provision is effective with respect to expenses, paid or incurred after December 31, 1979, and before June 1, 1981, for transportation between a taxpayer's residence and place of work.

Revenue effect

This provision would continue present administrative practice and thus would have no effect on budget receipts.

C. Payment of Interest on Wrongful Levies (sec. 3 of the bill and sec. 6343(b) of the Code)

Present law

Under present law, two remedies are provided for third-party owners whose property is wrongfully seized by the Internal Revenue Service for the collection of a delinquent taxpayer's liability. In general, one remedy provides an administrative procedure for the return of the property wrongfully seized (sec. 6343(b)), and the other authorizes a civil action for an injunction, the return of the property wrongfully seized, or the proceeds from the sale of the property (sec. 7426).

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[4] For a recent discussion of differences between the terms "income" and "wages," see *Central Illinois Power Service Co.* v. *United States*, 435 U.S. 21, 98 S. Ct. 917 (1978).

Under the administrative procedure, the Internal Revenue Service is authorized to return property (or the proceeds from the sale of the property) to a person when it determines that the levy was wrongful (sec. 6343(b)). Where the Service returns the property or proceeds under the administrative procedure, a person whose property was wrongfully seized is not entitled to the payment of interest for the period the Government held the property or the proceeds therefrom.

On the other hand, the payment of interest is provided if the third party prevails under the judicial remedy, sec. 7426(g).[1]

Under this provision, interest accrues from the date the Service receives money wrongfully levied upon (or the date of the sale of prop-[7]erty wrongfully levied upon) until the date the judgment is paid. The interest is payable at the rate generally established to be paid on the overpayment of taxes (sec. 6621).[2]

Reasons for change

The committee believes that interest should be payable where it is administratively determined by the Internal Revenue Service that a wrongful levy of property has been made and money is returned to the owner of the property by the Service.

Explanation of provision

The bill provides for the payment of interest to a person under the administrative procedure for wrongful levies. Under rules similar to those in the interest provisions for the judicial remedy, interest is to be paid if money is wrongfully seized or if the proceeds from a sale of the property are returned to the owner of the property. The rate of interest is to be determined under the general provision for the payment of interest on overpayments of tax. In the case of a seizure of money, the period for the payment of interest begins with the date the money is seized and ends on a date (to be determined by the Secretary) not more than 30 days prior to the date when the money is returned. In the case of a payment of the proceeds from the sale of property wrongfully seized, the period for the payment of interest begins with the date of sale of the property and ends on a date (to be determined by the Secretary) not more than 30 days prior to the date when the payment to the owner is made.[3]

Effective date

This provision applies to levies made after the date of enactment of the bill.

Revenue effect

This provision will reduce budget receipts by a negligible amount.

D. Repeal of Requirement that Transferors of Certain Property to Exempt Organizations Must File Returns (sec. 4 of the bill and sec. 6050 of the Code)

Present law

Under present law, a person who transfers income-producing property valued at over $50,000 (without regard to any lien thereon) to an exempt organization must file a return (Form 4629) if the transferor knows the recipient is the type of organization subject to tax on its unrelated business income (sec. 6050). The regulations require that the return show a description of property transferred, the date of transfer, the fair market value of the property (without regard to any lien thereon) on that date, and the amount of any mortgage or similar lien on the property immediately after the transfer. This return requirement was added by the Tax Reform Act of 1969 [Pub. L. 91-172, 1969-3 C.B. 10].

[8] Under present law, the Internal Revenue Service can require an exempt organization to maintain records and furnish information with respect to transfers of income-producing property to it (secs. 6001 and 6033). Thus, the information now required to be furnished by the transferor may also be furnished by the transferee exempt organization.

Reasons for change

The committee believes that the reporting requirement for transfers of property to exempt organizations is unnecessary and should be repealed.

Explanation of provision

The bill repeals the requirement that transferors file an information return with respect to transfers to an exempt organization.

Effective date

The provision applies to transfers of property made after the date of enactment of the bill.

Revenue effect

This provision will have no direct effect on budget receipts.

E. Repeal of Addition to Tax in the Case of Certain Jeopardy Assessments (sec. 5 of the bill and sec. 6658 of the Code)

Present law

Under present law, if the Internal Revenue Service determines that the collection of tax is in jeopardy, an assessment and collection of that tax may be made without resorting to the normal time-consuming assessment and collection procedures. For this purpose, there are two basic types of special assessments—termination assessments (sec. 6851) and jeopardy assessments (secs. 6861 and 6862). The termination assessment is limited to the assessment of income tax when the collection of income tax is in jeopardy before the end of the taxpayer's normal tax year or before the due date of return. In other income tax cases and in all cases involving other taxes, the jeopardy assessment procedures are used.

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[1] The general provision for payment of interest on a judgment for the overpayment of taxes is sec. 2411 of title 28 of the United States Code. The rate of interest under this provision is determined by reference to section 6621 of the Internal Revenue Code of 1954.

[2] Currently, the rate of interest is 6 percent; however, under the present law provision, the IRS has determined that the rate will be 12 percent, effective on February 1, 1980 (Rev. Rul. 79-366 [1979-45 I.R.B. 16], based on October 12, 1979).

[3] The rule relating to the date after which interest is no longer payable is similar to the rule on interest on overpayment of tax (sec. 6611(b)(2)).

The Code (sec. 6658) provides an addition to tax equal to 25 percent of the amount of tax when a taxpayer violates or attempts to violate the termination assessment provision. No similar penalty applies to jeopardy assessments.

Reasons for change

The committee believes that the addition to tax for a violation, or attempted violation, of the termination assessment provision is unnecessary and should be repealed.

Explanation of provision

The bill repeals the 25-percent addition to tax penalty with respect to termination assessments.

Effective date

This provision applies to violations (or attempted violations) occurring after the date of enactment of this bill.

[9] *Revenue effect*

This provision will reduce budget receipts by a negligible amount.

F. Repeal of Requirement that Information be Furnished to the Internal Revenue Service in Connection with Certain Stock Options (sec. 6 of the bill and sec. 6039 of the Code)

Present law

Under present law, an annual information return (Form 3921) is required to be filed with the Internal Revenue Service by a corporation which transfers a share of stock to any person pursuant to his exercise of a qualified stock option (described in sec. 422) or restricted stock option (sec. 424).[1] In addition, a return (Form 3922) is required to be filed by every corporation that records (or has its agent record) a transfer of stock which was acquired either through the exercise of an option granted under an employee stock purchase plan (sec. 423) at an exercise price between 85 percent and 100 percent of the stock's value as of the time of the grant of the option, or through the exercise of a restricted stock option (sec. 424) at an exercise price between 85 percent and 95 percent of the value of the stock as of the time of the grant of the option. (Under each of these sections, a portion of the sales price for the stock is treated as ordinary income.)

A written statement concerning information relating to these transfers must also be furnished to the persons listed on the return prior to January 31 of the year following the calendar year covered by the return.

Reasons for change

The committee believes that the requirement that the information relating to certain stock options be furnished to the Service is unnecessary and should be repealed.

Explanation of provision

The bill repeals the requirement that information relating to certain qualified and restricted stock options be furnished to the Internal Revenue Service.

Effective date

This provision applies with respect to calendar years beginning after 1979.

Revenue effect

This provision will have no direct effect on budget receipts.

G. Time for Filing Certain Gift Tax Returns (sec. 7 of the bill and sec. 6075(b) of the Code)

Present law

Under present law, a gift tax return, if required, is due on or before the 15th day of the second month following the close of the calendar quarter. Quarterly returns are required when taxable gifts made [10] during a calendar year exceed $25,000. Where all transfers made in a calendar year which are subject to the gift tax filing requirements do not exceed $25,000 in taxable gifts, a return need be filed only by the filing date for gifts made during the fourth calendar quarter of the calendar year (i.e., February 15 of the following year).

On the other hand, an individual's income tax return is due on or before the 15th day of the fourth month following the close of the taxable year. For the calendar year taxpayer, a return is due on or before April 15. In addition, the Internal Revenue Service may grant an extension of time for filing a return. Presently, the Service grants an automatic 2-month extension for individuals upon timely application and payment of the estimated tax due.

Reasons for change

Because the filing date for the gift tax return is earlier than the due date of an individual's income tax return, a timely gift tax return cannot be filed for a taxable gift if the obligation to file a gift tax return is discovered during a review of the taxpayer's financial transactions in connection with the preparation of this income tax return. The committee believes that conformity of filing dates should be made in order to allow a taxpayer's advisors to review the taxpayer's annual transactions at one time to prepare both the gift and income tax returns.

Explanation of provision

The bill provides that the due date for the fourth calendar quarter or annual gift tax return is April 15. In addition, the bill provides that an extension for filing the income tax return of a calendar year taxpaper will automatically extend the time for filing the fourth quarter or annual gift tax return.

Effective date

The provision applies to gift tax returns for calendar years ending after the date of enactment of this bill.

Revenue effect

This provision will reduce budget receipts by a negligible amount.

H. Uniformed Services Health Professions Scholarships and National Research Service Awards (subsections (a) and (b) of sec. 8 of the bill)

Present law

Uniformed Services Health Professions Scholarships

The Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1] extended the exclusion provided under prior law for participants in the Uniformed Services Health Professions Scholarship programs (including the Armed Forces and Public Health Professions Scholarship programs) so that students entering the programs in 1979 could exclude amounts received under these programs through 1983. This one-year extension generally covered program participants entering medical school in 1979 for their four years of training.

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[1] Under a provision added by section 603 of the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1], options exercised after May 20, 1981, will no longer be treated as qualified or restricted stock options.

[11] *National Research Service Awards*

In addition, the 1978 Act provided tax-exempt scholarship treatment for National Research Service Awards made through 1979 for the duration of such awards.

Reasons for change

The committee believes that, pending the completion of a comprehensive review of the tax treatment of scholarships, the excludable treatment of amounts received under the Uniformed Services Health Professions Scholarships program and as a National Research Service Award should be continued.

Explanation of provision

The provision extends the tax exemption for participants in the Uniformed Services Health Professions Scholarship programs with respect to students entering programs in 1980, and applies to amounts received by them through 1984.

Also, the tax-exempt scholarship treatment for National Research Service Awards is extended to awards initially made during calendar year 1980.

Revenue effect

The one-year extension of tax exemption for Uniformed Services Health Professions Scholarship programs will reduce budget receipts by less than $5 million per year for fiscal years 1980-1984.

The one-year extension of tax exemption for 1980 National Research Service Awards will reduce budget receipts by $6 million in fiscal year 1981, $6 million in fiscal year 1982, and less than $5 million in fiscal year 1983.

I. Deduction for Expenditures to Remove Architectural and Transportation Barriers to the Handicapped and Elderly (sec. 8(c) of the bill and sec. 190 of the Code)

Present law

The Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1] provided taxpayers with an elective tax deduction for the removal of architectural and transportation barriers to the handicapped and elderly (Code sec. 190). A taxpayer may treat certain expenses for the removal of such barriers as deductible expenses in the year paid or incurred instead of capitalizing them. Deductible expenses are those paid or incurred in order to make more accessible to, and usable by, the handicapped and elderly any facility or public transportation vehicle owned or leased by the taxpayer for use in his trade or business. The maximum deduction for a taxpayer, including a controlled group of corporations filing a consolidated return for any taxable year, is $25,000.

In order to qualify for the deduction, the expenses must be for barrier removal in business facilities which the taxpayer establishes to the satisfaction of the Secretary meets standards set by the Secretary of the Treasury with the concurrence of the Architectural and Transportation Barriers Compliance Board as established by 1968 legislation.

[12] The deduction was limited to a three-year period ending before January 1, 1980, in order that the Congress could review its effectiveness.

Reasons for change

The committee believes that it is appropriate to extend this provision for an additional period of time so that the review of the effectiveness of the provision may be completed.

Explanation of provision

This provision extends the elective deduction for expenditures to remove architectural and transportation barriers to the handicapped and the elderly for three years, to taxable years beginning before January 1, 1983.

Revenue effect

This provision will result in a reduction in budget receipts of $4 million in fiscal 1980, $10 million per year in fiscal years 1981 and 1982, and $6 million in fiscal year 1983.

J. Extension of Interim Relief in Independent Contractor Status Controversies (sec. 8(d) of the bill and sec. 530 of the Revenue Act of 1978)

Present law

The Revenue Act of 1978 provided interim relief (until January 1, 1980) for certain taxpayers involved in controversies with the Internal Revenue Service over IRS-proposed reclassifications of workers, whom the taxpayers had considered independent contractors, as employees. In general, the Act terminated taxpayers' potential liabilities for Federal income tax withholding, social security and FUTA taxes in cases where taxpayers have a reasonable basis for treating workers other than as employees. In addition, the Act prohibited the issuance of Treasury regulations and Revenue Rulings on common law employment status before January 1, 1980, while the Congress considered legislative proposals for clarifying individuals' employment tax status.

Reasons for change

The committee believes that it is appropriate to extend the interim relief provision to permit the orderly consideration of pending legislation which will provide permanent rules in this area. Although the Subcommittee on Select Revenue Measures of the House Committee on Ways and Means has held hearings on this subject and has completed the markup of a bill (H.R. 5460) providing permanent rules, it may not be possible to complete Congressional action on proposed legislation for permanent rules before 1980 because of the press of other legislative business.

Explanation of provision

This provision extends the relief period, enacted in the Revenue Act of 1978, for one year until 1981, in order to allow the Congress to complete consideration of clarifying legislation.

Revenue effect

The revenue loss of this provision cannot be estimated because it generally affects individuals whose employment tax status under the present common law rules is the subject of dispute.

[13] K. Postponement of Effective Date for Special Limitations on Net Operating Loss Carryovers (sec. 8(e) of the bill and secs. 382 and 383 of the Code)

Present law

Prior to enactment of the Tax Reform Act of 1976, generally, if new owners purchased 50 percent or more of the stock of a loss corporation during a two-year period, the corporation's loss carryovers from prior years were allowed in full only if the corporation continued to conduct its prior trade or business or substantially the same kind of business. Generally, if the same business was not continued, however, loss carryovers were completely lost. This "purchase" rule applied where one or more of the 10 largest shareholders increased their stock ownership, within a two-year period, by 50 percentage points or more in a transaction in which the purchasers took a cost basis in their stock (except where the stock was acquired from "related" persons).

In the case of a tax-free reorganization, loss carryovers were allowed on a declining scale. If the former owners of the loss company received 20 percent or more of the fair market value of the stock of the acquiring company, the loss carryovers were allowed in full. For each percentage point less than 20 which the former owners received, the loss carryover was reduced by five percent. It was immaterial whether the business of the loss company was continued after the reorganization.

The 1976 Act extensively revised the Code provisions dealing with the carryover of net operating losses in cases of acquisitions of loss corporations. The limitations on loss carryover attributes were to apply to acquisitions made by purchase or through corporate reorganizations. The new provisions changed the basic concepts underlying the rules by deleting continuity of business requirements for purchases and establishing a new continuity of ownership test applicable to both purchases and reorganizations.

These new provisions were to apply to plans of reorganization adopted on or after January 1, 1978, and to sales or exchanges in taxable years beginning after June 30, 1978. However, the Revenue Act of 1978 extended these effective dates for two years, to January 1, 1980, and June 30, 1980.

Reasons for change

A number of technical problems concerning the 1976 revisions have been brought to the committee's attention. The committee believes that an additional period of time is necessary to complete a review of the provision.

Explanation of provision

This provision delays the effective date of the 1976 Act change for an additional two years, until January 1, 1982, with respect to plans of reorganization adopted on or after that date, or until June 30, 1982, with respect to sales or exchanges occurring in taxable years beginning after that date.

Revenue effect

The provision will reduce budget receipts by less than $5 million annually during the postponement period.

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House of Representatives
Report No. 96-448
1st Session

[Bracketed numerals indicate official report page numbers]

FRINGE BENEFIT REGULATIONS

SEPTEMBER 20, 1979

Mr. ULLMAN, from the Committee on Ways and Means, submitted the following Report to accompany H.R. 5224.[1]

The Committee on Ways and Means, to whom was referred the bill (H.R. 5224) to continue through December 31, 1980, the existing prohibition on the issuance of fringe benefit regulations, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

* * * * *

[2] I. SUMMARY

The bill, as amended, contains prohibitions on the issuance of final regulations under Code section 61, relating to the taxation of employee fringe benefits, before June 1, 1981, and the issuance of proposed or final regulations on that subject which would be effective before June 1, 1981.

The bill also contains a prohibition on the issuance of Treasury (or Internal Revenue Service) rulings or final regulations with respect to the deductibility of certain commuting or transportation expenses paid or incurred before June 1, 1981.

The bill also extends, for 3 additional years, provisions relating to the tax treatment of travel expenses incurred by State legislators while away from home. As extended, the provisions would apply to taxable years beginning before January 1, 1981.

These deferrals are to give Congress additional time to review these areas and to consider any proposed changes in Treasury regulations or rulings.

II. EXPLANATION OF PROVISIONS

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[5] C. State Legislators Business Expenses (sec. 3 of the bill and sec. 162 of the Code)

Present law

Under present law, an individual is allowed a deduction for traveling expenses (including amounts expended for meals and lodging) while away from home overnight in the pursuit of a trade or business (sec. 162(a)). These expenses are deductible only if they are reasonable and necessary in the taxpayer's business and directly attributable to it. "Lavish or extravagant" expenses are not allowable deductions. In addition, no deductions are allowed for personal, living, and family expenses except as expressly allowed under the Code (sec. 262).

Generally, under section 262, expenses and losses attributable to a [6] dwelling unit which is occupied by a taxpayer as his personal residence are not deductible. However, deductions for interest, certain taxes, and casualty losses attributable to a personal residence are expressly allowed under other provision of the tax laws (secs. 163, 164, and 165).

A taxpayer's "home" for purposes of the deduction of traveling expenses generally means his principal place of business or employment. Where a taxpayer has more than one trade or business, or a single trade or business which requires him to spend a substantial amount of time at two or more localities, his "home" is held to be at his principal place of business. A taxpayer's principal place of business is determined on an objective basis taking into account the facts and circumstances in each case. The more important factors to be considered in determining the taxpayer's principal place of business (or tax home) are: (1) the total time ordinarily spent by the taxpayer at each of his business posts, (2) the degree of business activity at each location, (3) the amount of income derived from each location, and (4) other significant contacts of the taxpayer at each location. No one factor is determinative.

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[1] Public Law 96-167, page 12.

In 1952 a provision was adopted with respect to the living expenses paid or incurred by a Member of Congress (including a Delegate or Resident Commissioner).[1] Under these rules, the place of residence of a Member of Congress within the congressional district which he represents in Congress is considered his tax home. However, amounts expended by the Member within each taxable year for away from home living expenses are not deductible in excess of $3,000.

Prior to the Tax Reform Act of 1976, no special rule applied to determine a State legislator's tax home. As a result, the tax home of a State legislator was determined in accordance with the general rule described above.

The Tax Reform Act of 1976 provided an election for the tax treatment of State legislators for taxable years beginning before January 1, 1976. This was extended for one year by the Tax Reduction and Simplification Act of 1977 to taxable years beginning before January 1, 1977, and was extended further by Public Law 96-258 to taxable years beginning before January 1, 1978.[2]

Under this election, a State legislator may, for any such taxable year, treat his place of residence within his legislative district as his tax home for purposes of computing the deduction for away from home living expenses. If this election is made, the legislator is treated as having expended for living expenses an amount equal to the sum of the daily amount of per diem generally allowed to employees of the U.S. [7] government for traveling away from home,[3] multiplied by the number of days during that year that the State legislature was in session, including any day in which the legislature was in recess for a period of four or fewer consecutive days. In addition, if the State legislature was in recess for more than four consecutive days, a State legislature may count each day in which his physical presence was formally recorded at a meeting of a committee of the State legislature. For this purpose, the rate of per diem to be used is to be the rate that was in effect during the period for which the deduction was claimed.

These limitations apply only with respect to the away from home living expenses incurred in connection with the trade or business of being a legislator. The 1976 Act did not impose a limitation on living expenses incurred by a legislator in connection with a trade or business other than that of being a legislator. As to any other trade or business, the ordinarily applicable test continues to apply.

In the absence of further congressional action, the tax home of a State legislator, for taxable years beginning after December 31, 1977, has to be determined in accordance with the general rules described previously.

Reasons for change

The provision which allows a State legislator to treat his place of residence within his legislative district as his tax home for purposes of computing the deduction for away from home living expenses only applies to taxable years beginning before January 1, 1978. The committee believes this provision should be extended for a 3-year period during which time the problem can be given further consideration and a permanent rule can be developed.

Explanation of provision

The provision extends, for 3 additional years, the effective date of the provision relating to the tax treatment of certain travel expenses incurred by State legislators while away from home to taxable years beginning before January 1, 1981.

Effective date

The provision applies to taxable years beginning after December 31, 1977, and before January 1, 1981.

Revenue effect

It is estimated that this provision would reduce budget receipts by $8 million in fiscal year 1980 and by $2 million in fiscal year 1981.

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[1] Prior to this time Members of Congress were not allowed a deduction for these expenses because Washington, D.C. was considered to be their tax home. *See George W. Lindsay,* 34 B.T.A. 840, 843 (1936).

[2] H.R. 3091, which would extend for one additional year the effective date for the tax treatment of travel expenses incurred by State legislators, was passed by the House on March 27, 1979, and by the Senate on March 28, 1979. The Senate amended the House-passed bill by adding certain social service amendments, and no conference action has been taken.

On March 28, 1979, the Subcommittee on Select Revenue Measures of the Committee on Ways and Means conducted hearings on three bills relating to the tax treatment of travel expenses incurred by State legislators and Members of Congress. No legislative recommendations have been referred by the Subcommittee to the Committee on Ways and Means.

[3] The maximum per diem allowance generally is $35.00. Greater maximum amounts apply, however, to designated high rate geographical areas, including the capitals of Alaska ($70), Connecticut ($39), Hawaii ($58), Massachusetts ($49), Minnesota ($41), New York ($39), Rhode Island ($40), and West Virginia ($39).

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.201: Rulings and determinations letters.
(Also Part I, Section 103; 1.103-13.)

Rev. Proc. 80-1

Section 1. Purpose

The purpose of this revenue procedure is to set forth procedures for submission of requests for ruling to the Internal Revenue Service to which section 103(c) of the Internal Revenue Code and sections 1.103-13, 1.103-14, and 1.103-15 of the Income Tax Regulations apply, in those instances in which the requester of the ruling is other than the issuer of the prospective obligations.

Sec. 2. Background

.01 Section 103(a) of the Code provides that gross income does not include interest on 1) the obligations of a state or political subdivision therof, and 2) qualified scholarship funding bonds. Section 103(c)(1) provides that, with certain exceptions, any arbitrage bond will not be treated as an obligation described in section 103(a)(1) or (2). An arbitrage bond is any obligation that is part of an issue all or a major portion (more than 15 percent) of the proceeds of which are reasonably expected to be used to acquire securities that will produce a yield over the term of the issue that is materially higher than the yield on such issue.

.02 Sections 1.103-13, 1.103-14, and 1.103-15 of the regulations provide rules relating to whether bonds are arbitrage bonds as defined in section 103(c)(2) of the Code. Certain provisions of those regulations describe conditions under which an issuer of prospective obligations must obtain a ruling that such obligations will not be arbitrage bonds if certain actions proposed by the issuer are taken. For example, section 1.103-13(c)(1)(ii), relating to computation of yield, provides that in the case of governmental obligations, the computation must be made separately for each issue of obligations issued by a governmental unit, except that a single computation may be made for two or more issues if, before the issuance of the last issue, the issuer establishes to the satisfaction of the Commissioner that the single computation will not distort yield or otherwise tend to defeat the purposes of section 103(c).

There are also other situations, in addition to the example described above, under which an issuer must request a ruling pursuant to provisions of sections 1.103-13, 1.103-14 and 1.103-15 or the regulations that prospective obligations are not arbitrage bonds as defined in section 103(c)(2) of the Code.

.03 Rev. Proc. 79-4, 1979-1 C.B. 483, sets forth procedures that preclude the issuance of a ruling to an issuer of prospective obligations unless the issuer has submitted a statement of facts, reasons, and legal authority, together with supporting documents that address all issues pertaining to whether the prospective obligations are described in section 103(a) of the Code. The reason for the requirements set forth in Rev. Proc. 79-4 is that, under section 7478, the issuer (and only the issuer) of the prospective obligations may ultimately petition the United States Tax Court to determine whether the prospective obligations are described in section 103(a).

.04 Rev. Proc. 79-12, 1979-1 C.B. 492, amplifies Rev. Proc. 79-4 and sets forth the procedures for submitting requests for ruling to which section 103 of the Code applies in those instances in which the requester is other than the issuer of the prospective obligations. Rev. Proc. 79-12 permits parties with a material financial interest in the prospective obligations to obtain rulings that address a specific issue pertaining to whether the prospective obligations are described in section 103(a). The Service also will issue rulings to such requesters that the prospective obligations are described in section 103(a).

Sec. 3. Application

.01 In the case of requests for rulings made by a person, other than the issuer, that has a material financial interest in the issuance of governmental obligations, the Service will issue rulings whether such obligations are arbitrage bonds as defined in section 103(c)(2) of the Code in situations referred to in section 2.02 of this revenue procedure. Thus, for example, a party that has a material financial interest in the issue may request a ruling that a single computation of yield may be made pursuant to section 1.103-13(c)(1)(ii) of the regulations. Such requests will be processed under Rev. Proc. 79-12 rather than Rev. Proc. 79-4.

.02 The requester must comply with the requirements of any other applicable revenue procedures, other than Rev. Proc. 79-4, that relate to submission to the Service of requests for ruling.

Sec. 4. Inquiries

Inquiries with respect to this revenue procedure should refer to its number and should be addressed to the Commissioner of Internal Revenue, Attention: T:I:I or T:C:E, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

Sec. 5. Effect on Other Documents

This revenue procedure amplifies Rev. Proc. 79-12.

Department of the Treasury Circular, Public Debt Series No. 1-80 [1]

Department of the Treasury

Bureau of the Public Debt

31 CFR Part 351

Offering of United States Savings Bonds, Series EE

AGENCY: Fiscal Service, Department of the Treasury.

ACTION: Final rule.

SUMMARY: This part, which contains the terms and conditions of the offering of United States Savings Bonds of Series EE, is being published in final form. These bonds will be offered for sale as of January 1, 1980. United States Savings Bonds of Series

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[1] Filed by the Office of the Federal Register on December 13, 1979, 8:45 a.m., and published in the issue of the Federal Register for December 14, 1979, 44 F.R. 72826.

E are being withdrawn from sale. Their over-the-counter sale will be terminated as of December 31, 1979, and issues under payroll savings plans will be terminated as of June 30, 1980.

EFFECTIVE DATE: January 1, 1980

FOR FURTHER INFORMATION CONTACT: Mr. Charles A. Guerin, Assistant Chief Counsel, Bureau of the Public Debt, 202-376-0243.

* * * * *

A new Part 351 is added to read as set forth below:

PART 351—OFFERING OF UNITED STATES SAVINGS BONDS, SERIES EE

Sec.
351.0 Offering of bonds.

* * * * *

351.8 Taxation.

* * * * *

Authority: Sec. 22, Second Liberty Bond Act, as amended, 49 Stat. 21, as amended (31 U.S.C. 757c); (5 U.S.C. 301.)

Source: Department of the Treasury Circular, Public Debt Series No. 1-80.

Part 351—OFFERINGS OF UNITED STATES SAVINGS BONDS, SERIES EE

§ 351.0 Offering of bonds.

The Secretary of the Treasury offers for sale to the people of the United States, United States Savings Bonds of Series EE, hereinafter referred to as "Series EE bonds" or "bonds." This offer, effective as of January 1, 1980, will continue until terminated by the Secretary of the Treasury.

* * * * *

§ 351.8 Taxation.

(a) *General.* The increment in value, represented by the difference between the price paid for a Series EE bond and the redemption value received for it, is interest. This interest is subject to all taxes imposed under the Internal Revenue Code of 1954, as amended. The bonds are subject to estate, inheritance, gift, or other excise taxes, whether Federal or State, but are exempt from all other taxation now or hereafter imposed on the principal or interest of any State, any possession of the United States or any local taxing authority.

(b) *Federal income tax on bonds.* The owner of a Series EE bond may use either of the following two methods for reporting the increase in the redemption value of the bond for Federal income tax purposes:

(1) *Cash basis.* Defer reporting the increase to the year of final maturity, redemption, or other disposition, whichever is earlier; or

(2) *Accrual basis.* Elect to report the increase each year as it accrues, in which case the election applies to all Series EE bonds then owned by the taxpayer and those subsequently acquired, as well as to any other obligations purchased on a discount basis, such as those of Series E.

If the method in paragraph (b)(1) of this section is used, the taxpayer may change to the method in paragraph (b)(2) of this section without obtaining permission from the Internal Revenue Service. However, once the election to use the method in paragraph (b)(2) of this section is made, the taxpayer may not change the method of reporting unless he or she obtains permission from the Internal Revenue Service. For further information, the District Director of the taxpayer's district, or the Internal Revenue Service, Washington, D.C. 20224, should be consulted.

(c) *Tax-deferred exchanges.* Department of the Treasury Circular, Public Debt Series No. 2-80 (31 CFR Part 352), authorizes the exchange of Series EE bonds for Series HH bonds with a continuation of the tax-deferral privilege. The rules governing tax-deferred exchanges are contained in that Circular.

(d) *Reissue.* A reissue that affects the rights of any of the persons named on a Series EE bond may have a tax consequence.

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Department of the Treasury Circular, Public Debt Series No. 2-80 [1]

Department of the Treasury Fiscal Service

31 CFR Part 352

Offering of U.S. Savings Bonds, Series HH

AGENCY: Fiscal Service, Department of the Treasury.

ACTION: Final rule.

SUMMARY: This Part, which contains the terms and conditions of the offering of United States Savings Bonds of Series HH, is being published in final form. These bonds will be offered for sale, as of January 1, 1980. United States Savings Bonds of Series H are being withdrawn from sale as of December 31, 1979.

EFFECTIVE DATE: January 1, 1980.

FOR FURTHER INFORMATION CONTACT: Mr. Charles A. Guerin, Assistant Chief Counsel, Bureau of the Public Debt, 202-376-0243

* * * * *

A new part 352 is added to read as follows:

PART 352—OFFERING OF UNITED STATES SAVINGS BONDS, SERIES HH

Sec.
352.0 Offering of bonds.

* * * * *

352.7 Issues on exchange.
352.8 Reinvestment of matured Series H bonds.

* * * * *

352.10 Taxation.

* * * * *

Authority: Sec. 22, Second Liberty Bond Act, as amended, 49 Stat. 21, as amended (31 U.S.C. 757c); sec. 18, 40 Stat. 1309, as amended; sec. 20, 48 Stat. 343, as amended (31 U.S.C. 753, 754b); (5 U.S.C.. 301).

Source: Department of the Treasury Circular, Public Debt Series No. 2-80.

PART 352—OFFERING OF UNITED STATES SAVINGS BONDS, SERIES HH

§ 352.0 Offering of bonds.

(a) *Cash offering.* The Secretary of the Treasury offers for sale to the people of the United States, United States Savings Bonds of Series HH, hereinafter referred to as "Series HH bonds" or "bonds." This offer will continue until terminated by the Secretary of the Treasury.

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[1] Filed by the Office of the Federal Register on December 13, 1979, 8:45 a.m., and published in the issue of the Federal Register for December 14, 1979, 44 F.R. 72832.

(b) *Exchange offering.* The Secretary of the Treasury also offers to the people of the United States, United States Savings Bonds of Series HH in exchange for outstanding United States Savings Bonds of Series E and EE and United States Savings Notes (Freedom Shares). This offer will continue until terminated by the Secretary of the Treasury.

(c) *Effective date.* These offers are effective as of January 1, 1980. They supersede previous offers of United States Savings Bonds of Series H, contained in Department of the Treasury Circular No. 905 (31 CFR Part 332) and Department of the Treasury Circular No. 1036 (31 CFR Part 339).

* * * * *

§ 352.7 Issues on exchange.

(a) *Securities eligible for exchange.* Owners may exchange United States Savings Bonds of Series E and EE and United States Savings Notes (Freedom Shares) at their current redemption values for Series HH bonds. Series E bonds are eligible for exchange until one year after their final maturity dates. Series EE bonds become eligible for exchange six months after their issue dates.

(b) *Basis for issue.* Series HH bonds will be issued on exchange by an authorized issuing agent upon receipt of a properly executed exchange subscription with eligible securities and additional cash, if any, and any supporting evidence that may be required under the regulations. If eligible securities are submitted directly to a Federal Reserve Bank or Branch or the Bureau of the Public Debt, each must bear a properly signed and certified request for payment. Checks in payment of any cash difference (see paragraph (d) of this section) must be drawn to the order of the Federal Reserve Bank or Branch or Bureau of the Public Debt.

(c) *Role of financial institutions.* Department of the Treasury Circular No. 750, current revision (31 CFR Part 321), authorizes financial institutions qualified as paying agents for savings bonds and notes to redeem eligible securities presented for exchange and to forward an exchange subscription and full payment to a Federal Reserve Bank or Branch for the issue of Series HH bonds. The securities redeemed on exchange by such an institution must be securities which it is authorized to redeem for cash.

(d) *Computation of issue price.* The total current redemption value of the eligible securities submitted in exchange in any one transaction must be $500 or more. If the current redemption value is an even multiple of $500, Series HH bonds must be requested in that exact amount. If the total current redemption value exceeds, but is not an even multiple of, $500, the owner has the option either of furnishing the cash necessary to obtain Series HH bonds at the next highest $500 multiple, or of receiving payment of the difference between the total current redemption value and the next lower $500 multiple. For example, if the eligible securities presented for exchange in one transaction have a total current redemption value of $4,253.33, the owner may elect to:

(1) Receive $4,000 in Series HH bonds and the amount of the difference, $253.33; or

(2) Pay the difference, $246.67, necessary to obtain $4,500 in Series HH bonds.

(e) *Registration.* A Series HH bond issued on exchange may be registered in any authorized form (see Subpart B of Circular No. 3-80), subject to the following restrictions:

(1) If the securities submitted in exchange are in single ownership form, the owner must be named as owner or first-named co-owner on the Series HH bonds. A co-owner or beneficiary may be named.

(2) If the securities submitted in exchange are in coownership form, and one coowner is the "principal coowner," the "principal coowner" must be named as owner or first-named coowner. A beneficiary or coowner may also be named. The "principal coowner" is a coowner who (i) purchased the securities submitted for exchange with his or her own funds, or (ii) received them as a gift, inheritance or legacy, or as a result of judicial proceedings, and had them reissued in coownership form, provided he or she has received no contribution in money or money's worth for designating the other coowner on the securities.

(3) If the securities submitted in exchange are in coownership form and both coowners shared in the purchase of the securities or received them jointly as a gift, inheritance or legacy, or as a result of judicial proceedings, both persons must be named as coowners on the Series HH bonds.

(4) If the securities submitted in exchange are in beneficiary form, the owner must be named on the Series HH bonds as owner or first-named coowner. If the owner is deceased, a surviving beneficiary must be named as owner or first-named coowner. In either case, a coowner or beneficiary may be named.

A reissue that affects the rights of any of the persons required to be named on the Series HH bond may have a tax consequence.

(f) *Dating.* Series HH bonds issued on exchange will be dated as of the first day of the month in which the eligible securities presented for exchange are redeemed by a Federal Reserve Bank, the Bureau of the Public Debt, or a qualified paying agent, as evidenced by the payment stamp on the bonds and subscription form.

(g) *Tax-deferred exchanges.*—(1) *Continuation of tax-deferral.* Pursuant to the provisions of Section 1037(a) of the Internal Revenue Code of 1954, as amended, an owner who has not been reporting the interest on his or her Series E or EE savings bonds and savings notes on an accrual basis, for Federal income tax purposes, and who exchanges those securities for Series HH bonds, may continue to defer reporting the interest on the securities exchanged until the taxable year in which the Series HH bonds received in the exchange reach final maturity, are redeemed, or are otherwise disposed of, whichever is earlier.

(2) *Tax-deferral legend.* Each bond issued on a tax-deferred exchange shall bear a legend showing how much of its issue price represents interest on the securities exchanged. This interest must be treated as income for Federal income tax purposes and reported in

accordance with paragraph (g)(1) of this section.

(3) *Reporting of interest for any difference paid on exchange.* The amount of any difference paid to the owner (see paragraph (d)(1) of this section) must be treated as income for Federal income tax reporting purposes for the year in which it is received, up to the amount of the total interest on the securities exchanged.

(h) *Exchanges without tax-deferral.* The rules prescribed for exchanges under paragraphs (a) through (f) of this section also apply to exchanges by owners who (1) report the interest on their bonds of Series E and EE and savings notes annually for Federal income tax purposes; (2) elect to report all such interest in the year of the exchange, regardless of whether or not it exceeds the amount of any cash difference received (see paragraph (d)(1) of this section); or (3) are tax-exempt under the provisions of the Internal Revenue Code of 1954, as amended. However, no amount will appear in the tax-deferral legend printed on the bond, and any part of the cash difference received (see paragraph (d)(1) of this section) which represents interest previously reported for Federal income tax purposes need not be treated as income.

§ 352.8 Reinvestment of matured Series H bonds.

(a) *General.* The face amount of Series H bonds purchased for cash that have reached final maturity may be reinvested in Series HH bonds. The Series H bonds, bearing properly signed and certified requests for payment, must be submitted to a Federal Reserve Bank or Branch or the Bureau of the Public Debt with a reinvestment application.

(b) *Rules.* The reinvestment transaction will be subject to the rules governing exchanges, as set forth in § 352.7, and the Series HH bonds issued on reinvestment will be identical in all respects with those issued on a non-tax-deferred exchange.

* * * * *

§ 352.10 Taxation.

The interest paid on Series HH bonds is subject to all taxes imposed under the Internal Revenue Code of 1954, as amended. The bonds are subject to estate, inheritance, gift, or other excise taxes, whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest by any State, any of the possessions of the United States, or any local taxing authority.

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Part IV. Items of General Interest

Disaster Areas

Announcement 80-11 [1]

The President of the United States has determined that the areas listed below were adversely affected by disasters of sufficient severity and magnitude to warrant Federal disaster assistance.

Taxpayers who suffered losses in these areas as a result of these disasters may elect the special tax treatment provided under section 165(h) of the Internal Revenue Code of 1954. Section 1.165-11 of the Income Tax Regulations sets forth the procedure for making this election. Losses not incurred with respect to a trade or business or any transaction entered into for profit will not qualify for treatment under section 165(h) unless such losses qualify as casualty losses.

State: Washington

Counties affected: Clallam, Grays Harbor, Jefferson, King, Kitsap, Mason, Skagit, Snohomish, Whatcom

Type of disaster: Severe storms, high tides, mudslides and flooding

Begun on or about: December 13-23, 1979

Original Issue Discount Reporting Changed

Announcement 80-12

Form 1099-OID, Statement for Recipients of Original Issue Discount, has been revised for 1980.

The 1979 version required payers to show all payments of original issue discount in Box 1. The ratable monthly portion was shown in Box 2.

The 1980 version requires issuers of certificates of deposit, time deposits, bonus savings plans, and other deposit arrangements having a term of more than one year to use Box 1 to report the amount earned as original issue discount. Issuers of corporate obligations with deferred payments of earnings will use Box 2 to report the original issue discount earned for the year.

A new Box 5 has been added for reporting the ratable monthly portion of the discount, previously shown in Box 2. Boxes 3 and 4 are unchanged for 1980.

Nominees who receive Form 1099-OID on behalf of the actual owner must show the same information on the 1087-OID that they issue to the owner. Both of these forms will be available on or about January 15, 1980, at Internal Revenue Service offices.

Error in the 1979 Package X Version of Schedule J (Form 1041), Information Return, Trust Allocation of an Accumulation Distribution (IRC Section 665), and Related Instructions

Announcement 80-13

As printed in the 1979 Package X, Informational Copies of Federal Tax Forms, Schedule J (Form 1041) and the related instructions each contain an error. The errors appear on pages 136 and 138 of Package X. With regard to the "throwback" year 1978, the last part of line 22 and the instructions for line 22 provide for the entry of the captial gains deduction. The correct entry for the 1978 throwback year column is the net long-term capital gain allocated to the trust less the capital gains deduction.

Line 22, Schedule J (Form 1041), reads, "Enter 50% of line 13(e), Schedule D (Form 1041) for 1969-1970, 50% of line 17(e), Schedule D (Form 1041) for 1971-1977, amount from line 23 Form 1041 for 1978." As corrected, line 22 should read, "Enter 50% of line 13(e), Schedule D (Form 1041) for 1969-1970, 50% of line 17(e), Schedule D (Form 1041) for 1971-1977, amount from line 23 Form 1041 subtracted from line 17(e) or line 31, Schedule D (Form 1041), whichever is applicable for 1978."

The information for line 22 in the Instructions for Schedule J (Form 1041) reads in part, "For throwback year 1978 enter the amount from Form 1041 line 23." As corrected, the instruction should read, "For throwback year 1978 enter the amount from Form 1041 line 23 subtracted from line 17(e) or line 31, Schedule D (Form 1041), whichever is applicable."

This error appears only in the Schedule J (Form 1041) and instructions that are printed in Package X for 1979. The first version of the 1979 separate Schedule J (Form 1041) and instructions were replaced with corrected versions (Revised December 1979). The revised versions are available from the Internal Revenue Service.

Certification of Unemployment Compensation Laws

Announcement 80-14

In a letter of December 26, 1979, Secretary of Labor Ray Marshall certified, to Secretary of the Treasury G. William Miller, the Commonwealth of Pennsylvania for the 12-month period ending October 31, 1979, in accordance with the provisions of section 3304(c) of the Internal Revenue Code, and the Commonwealth's unemployment compensation law for the 12-month period ending October 31, 1979, in accordance with the provisions of section 3303(b)(1) of the Code.

Announcement 79-175, 1979-53 I.R.B. 47, which does not include Pennsylvania in the list of certified states and does not include Pennsylvania's unemployment compensation law in the list of certified state laws, is modified.

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[1] This disaster will be listed in Rev. Rul. 79-426, 1979-53 I.R.B. 7, when it is printed in 1979-2 C.B.

Withholding of Tax on Certain Payments of Gambling Winnings — Public Hearing

Announcement 80-23 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to the withholding of tax on certain payments of gambling winnings.

DATES: The public hearing will be held on February 26, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by February 12, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-264-76), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: George Bradley or Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under section 3402 of the Internal Revenue Code of 1954. The proposed regulations appeared in the FEDERAL REGISTER for Thursday, November 15, 1979, at page 65777 (44 FR 65777).

The rules of §601.60(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of the comments to be presented at the hearing and the time they wish to devote to each subject by February 12, 1980. Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive appearing in the FEDERAL REGISTER for Wednesday, November 8, 1978.

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[1] Filed by the Office of the Federal Register on January 17, 1980, 9:25 a.m., and published in the issue of the Federal Register for January 22, 1980, 45 F.R. 4364.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants and Enrolled Agents from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following persons have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Frank J. Marcone	Media, PA	Attorney	Twenty-four months effective December 11, 1979
William P. Renner	Hagerstown, MD	Certified Public Accountant	Twenty-four months effective December 11, 1979

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.461-3, 1.6151-1—1.6302-2 and intermediate sections, 31.6071(a)-1—31.6302(c)-3 and intermediate sections, 36.3121(1)(10)-4, 46.6071(a)-1, 46.6151-1, 46.6302(c)-1, 48.6071(a)-1, 48.6151-1, 48.6302(c)-1, 49.6151-1, 49.6302(c)-1, 154.2-1, 301.6302-1, 301.6402-4, 301.7502-1, 601.401 amended; 301.7502 deleted; 301.7502-2 added.	Timeliness of tax returns, payments and deposits.	Dec. 11, 1979	Feb. 11, 1980
26 CFR 1.1033(a)-1, 1.1033(a)-2, 7.0, amended; 1.1033(g)-1 redesignated as 1.1033(h)-1 and amended; 1.1033(f)-1 redesignated as 1.1033(g)-1 and amended.	Election to treat outdoor advertising displays as real property.	Dec. 11, 1979	Feb. 11, 1980
26 CFR 1.85-1, 1.6050B-1, added.	Taxation of unemployment compensation.	Dec. 19, 1979	Feb. 18, 1980
26 CFR 25.2514-1, amended; 25.6075, 25.6075-1, deleted; 25.6075-1, 301.7517-1, added.	Time for filing gift tax returns and for requesting a statement explaining valuation for estate, gift, or generation-skipping transfer tax purposes. In addition, a change to an example that relates to the definition of a general power of appointment.	Dec. 19, 1979	Feb. 18, 1980

Proposed Regulations—Continued

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR (1939) 16.1 through 17.19 deleted; 26 CFR Subchapter D retitled; Part 160 added.	Profit limitations of the Vinson-Trammell Act on certain contracts and subcontracts for naval vessels and military aircraft.	Oct. 26, 1979	Feb. 26, 1980
26 CFR 1.44B-1, 1.51-1, 1.53-1, 1.53-2, 1.381(c)(26)-1, added; 1.51, 1.51-1, 5.44B-1, 5.51, deleted; 1.52-1, 1.52-2, 1.280C-1, amended; 1.52-3 revised; 1.53-1, redesignated as 1.53-3 and amended.	Targeted Jobs Tax Credit.	Dec. 28, 1979	Feb. 25, 1980
26 CFR 1.1001-2 added; 1.61-12, 1.671-1, 1.741-1, 1.1011-2 amended; 1.1001 deleted.	Discharge of liabilities on sale or other disposition of property.	Dec. 28, 1979	Feb. 25, 1980
26 CFR 48.6420(a), (b), (c), (d), (e), (f), (g), (h) deleted; 48.6420(a)-1, 48.6420(b)-1, 48.6420(c)-1 amended; 140.6420-1, 140.6427-1, published as temporary regulations in T.D. 7662, page , this Bulletin, redesignated as 48.6420(c)-2 and 48.6427-1 respectively with all references to Part 140 changed to Part 48.	Claims by aerial applicators when fuels are used for farming purposes.	Dec. 27, 1979	Feb. 25, 1980
26 CFR 1.368 deleted; 1.368-1 amended.	The continuity of business enterprise requirement for corporate reorganizations.	Dec. 28, 1979	Feb. 25, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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Key to Abbreviations:

RR	Revenue Ruling
RP	Revenue Procedure
TD	Treasury Decision
CD	Court Decision
PL	Public Law
EO	Executive Order
DO	Delegation Order
TDO	Treasury Department Order
TC	Tax Convention
SPR	Statement of Procedural Rules
PTE	Prohibited Transaction Exemption

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1928–1	6.95
1928–2	9.50
1929–1	*2.50*
1929–2	*3.15*
1930–1	7.30
1930–2	9.50
1931–1	*3.60*
1931–2	*3.25*
1932–1	*2.80*
1932–2	8.65
1933–1	*3.35*
1933–2	*3.45*
1934–1	*3.70*
1934–2	*4.10*
1935–1	6.90
1935–2	*4.00*
1936–1	*3.55*
1936–2	*3.90*
1937–1	*3.75*
1937–2	7.70
1938–1	*4.05*
1938–2	*3.50*
1939–1–1	8.25
1939–1–2	10.90
1939–2	9.40
1940–1	5.55
1940–2	14.00
1941–1	*$6.95*
1941–2	*3.55*
1942–1	7.25
1942–2	*5.55*
1943(*)	*9.55*
1944(*)	*7.85*
1945(*)	9.40
1946–1	*2.55*
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1947–1	*1.80*
1947–2	3.40
1948–1	*3.15*
1948–2	7.50
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1950–1	6.35
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1951–1	*2.65*
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1954–1	12.00
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1956–2	18.00
1957–1	$10.10
1957–2	13.00
1958–1	9.60
1958–2	13.00
1958–3	15.00
1959–1	15.00
1959–2	9.60
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1963–2	10.75
1964–1–1	10.00
1964–1–2	11.00
1964–2	9.80
1965–1	10.70
1965–2	12.25
1966–1	9.25
1966–2	14.05
1967–1	10.00
1967–2	10.00
1968–1	14.00
1968–2	11.75
1969–1	7.50
1969–2	6.50
1969–3	$12.50
1970–1	11.00
1970–2	14.00
1971–1	10.55
1971–2	8.50
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1974–1	11.00
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1974–3 Supp.	10.00
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T22.23:980/6

February 11, 1980
Bulletin No. 1980-6

9258

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-33, page 5.
Charitable contribution; section 306 stock. A corporation issued section 306 stock to its controlling shareholder in a reorganization to accomplish a valid business objective, although an issue of long term bonds would have accomplished the same objective. The shareholder has not shown that none of the principal purposes of the stock issue was the avoidance of federal income tax. The shareholder's charitable contribution of the stock will be reduced under section 170(e)(1)(A) of the Code.

T.D. 7663, page 6.
Amendments to the regulations under sections 451 and 1232 of the Code relate to the tax treatment of certain short-term corporate obligations and certificates of deposit, time deposits, bonus plans, or other deposit arrangements issued, or entered into, by banks or similar financial institutions.

Pub. L. 96-178, page 12.
Amendments to the Work Incentive Program credits under sections 50A and 50B of the Code, including special rules with respect to employment of day care workers, are set forth.

EXEMPT ORGANIZATIONS

Announcement 80-16, page 18.
A listing is given of organizations now classified as (1) private foundations, or (2) not private operating foundations.

EMPLOYMENT TAXES

Rev. Proc. 80-2, page 16.
Unemployment funds; credit reduction; Delaware and Pennsylvania. The credit against federal unemployment tax for amounts paid into the unemployment funds maintained by Delaware and Pennsylvania is reduced by 0.3 percent of the wages paid during 1979 for services performed in those States.

Rev. Proc. 80-3, page 16.
Certification of State Unemployment Compensation Laws; Alabama, Nevada, and New Hampshire. The States of Alabama, Nevada, and New Hampshire are not included in the list of certified States for 1979 under section 3304 of the Code. These States have filed petitions for review that temporarily stay the Secretary of Labor's action. Employers that have made contributions to the unemployment funds of these States may file the 1979 Forms 940 as if certifications were not being withheld. If certification is later withheld, any affected employer will be liable for any additional tax due, plus interest under section 6601.

Rev. Proc. 80-4, page 17.
State and local agencies; agents for welfare recipients. Procedures are set forth for state and local health and welfare agencies wishing to act

(Continued on page 4)

Finding List on page 22.
Announcement of Voluntary Suspension on page 20.
Announcement of Notice of Proposed Rulemaking on page 21.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part includes rulings and decisions based on Subpart A, Tax Conventions and related Treasury Decisions and Revenue Rulings; Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

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Highlights of this Issue—Continued

(Continued from page 1)

EMPLOYMENT TAXES—(Con't)

as agents for welfare recipients who employ individuals furnished by the agencies to provide inhome domestic services; Rev. Proc. 70-6 amplified.

EXCISE TAXES

Rev. Rul. 80-34, page 9.
Communications; exemption; travel agencies. The communications tax exemption for common carriers does not apply to amounts paid for wide area telephone service (WATS) by travel agencies that sell tours to the general public but charter the necessary aircraft and buses from airlines and bus companies; Rev. Rul. 75-296 distinguished.

TAX CONVENTIONS

Rev. Rul. 80-36, page 11.
Japanese citizen performing medical research in U.S. Examples are set forth in which amounts paid to a citizen of Japan for performing research at a heart research foundation in the U.S. are either compensation for services rendered or payments made under a "grant, allowance, or award" within the meaning of Article 20(1) of the U.S.-Japan Income Tax Convention; Rev. Rul. 76-567 superseded.

Announcement 80-17, page 19.
The Treasury Department has announced upcoming negotiations on amendments to the income tax treaty between the United States and Trinidad and Tobago and invites comments on the present treaty.

Announcement 80-24, page 19.
The Treasury Department has announced discussions with Austria with a view to beginning negotiations of an estate and gift tax treaty. Modernization of the existing income tax treaty will also be discussed. Comments concerning either convention are invited.

ADMINISTRATIVE

Rev. Rul. 80-35, page 10.
Penalties; return preparers; deposit of refund checks. A business manager prepares income tax returns for clients who maintain special checking accounts against which the business manager is authorized to sign certain checks on their behalf. The clients' federal income tax refunds are mailed to the business manager, who has the clients endorse the checks and deposits them in the special accounts. The business manager is not subject to the penalty imposed by section 6695(f) of the Code regarding the negotiation of checks by return preparers.

Announcement 80-18, page 19.
Certain "continuous use" forms that have been revised are listed.

Announcement 80-19, page 19.
Publication 438, Statistics of Income—1976, Business Income Tax Returns, may be purchased from the Superintendent of Documents, Washington, D.C.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 117.—Scholarships and Fellowship Grants

26 CFR 1.117-4: Items not considered as scholarships or fellowship grants.

Whether amounts paid to a citizen of Japan for performing research at a heart research foundation in the United States are compensation for service rendered or payments made under a "grant, allowance, or award" within the meaning of Article 20(1) of the United States-Japan Income Tax Convention, TIAS 7365, 1973-1 C.B. 630. See Rev. Rul. 80-36, page 11.

Section 170.—Charitable, Etc., Contributions and Gifts

26 CFR 1.170A-4: Reduction in amount of charitable contributions of certain appreciated property.

Whether the distribution of voting preferred stock, which is section 306 stock, was in pursuance of a plan having as one of its principal purposes the avoidance of federal income tax within the meaning of section 306(b)(4)(A) of the Code so that upon the contribution of the preferred stock to a charitable organization described in section 170(c), the amount of the charitable contribution will be reduced under section 170(e)(1)(A). See Rev. Rul. 80-33, below.

Section 306.—Dispositions of Certain Stock

26 CFR 1.306-2: Exception.
(Also Section 170; 1.170A-4.)

Charitable contribution; section 306 stock. A corporation issued section 306 stock to its controlling shareholder in a reorganization to accomplish a valid business objective, although an issue of long term bonds would have accomplished the same objective. The shareholder has not shown that none of the principal purposes of the stock issue was the avoidance of federal income tax. The shareholder's charitable contribution of the stock will be reduced under section 170(e)(1)(A) of the Code.

Rev. Rul. 80-33

ISSUE

Whether under the circumstances described below, the distribution of voting preferred stock, which is section 306 stock, was in pursuance of a plan having as one of its principal purposes the avoidance of federal income tax within the meaning of section 306(b)(4)(A) of the Internal Revenue Code so that upon the contribution of the preferred stock to a charitable organization described in section 170(c) of the Code, the amount of the charitable contribution will be reduced under section 170(e)(1)(A).

FACTS

X corporation has outstanding 28,000*x* shares of voting common stock and 2,000*x* shares of voting preferred stock. Individual *A* owns 8,500*x* shares of the common stock and all of the shares of the preferred stock. Individual *B* owns 10,000*x* shares of the common stock. The remaining 9,500*x* shares of the common stock are widely held and are traded in the over-the-counter market.

A is not related to any of the other *X* shareholders. *B* was formerly the sole shareholder of corporation *Z* which was acquired by *X* in 1969 in a stock-for-stock exchange. *A*, who is 80 years old, served as chief executive officer of *X* from 1933 until 1969, when *A* turned over the management and control of *X* to younger officers, including *B*. *B* is on the board of directors of *X*.

The laws of the state of incorporation of *X* require a two-thirds vote of the outstanding stock of corporations in order for mergers, consolidations, liquidations and sales of substantially all of the assets to be undertaken.

Prior to 1964, *X* had only 10,000*x* shares of voting common stock outstanding, all of which were owned by *A*. In 1965, *X* and *A* sold, respectively, 1,000*x* and 1,500*x* shares of common stock to the public, reducing *A*'s ownership of *X* to approximately 77 percent.

Shortly after the public offering, *A* received 2,000*x* shares of *X* voting preferred stock in exchange for all of the outstanding stock of corporation *Y* in a stock-for-stock exchange in accordance with section 369(a)(1)(B) of the Code. The preferred stock received by *A* was "section 306 stock." *A*'s ratable share of *X*'s earnings and profits exceeded the fair market value of the preferred stock issued by *X*. *A* caused *X* to acquire *Y* because *Y* was engaged in financing sales of some of the products manufactured by *X*, and *A* wanted to avoid any conflict of interest charges by the minority shareholders of *X*. Although *A* was willing to accept *X* common stock in exchange for the *Y* stock, the underwriters who had managed the public sale of *X* stock advised *X* to issue preferred stock to *A*. The issuance of additional common stock would dilute the earnings per share of *X* common stock, and the underwriters believed it would appear as if *A* was taking advantage of the new public shareholders. The underwriters' advice was also motivated by *X*'s plans to make another public offering of common stock. They believed the dilution of earnings per share that would result from the issuance of common stock in the acquisition would make the planned offering more difficult.

In 1969, *X* issued 10,000*x* shares of common stock to *B* in the acquisition of *Z* corporation. In 1973, *X* made an additional public offering of 7,000*x* shares of common stock. As a result of the issuance of these additional shares of common stock, *A*'s voting power in *X* was reduced to 35 percent.

A now wishes to give the 2,000*x* shares of the voting preferred stock to several charitable organizations described in section 170(c) of the Code. The fair market value of the preferred stock exceeds its adjusted basis to *A*. There is no plan for the contributed stock to be redeemed by *X*.

LAW AND ANALYSIS

Section 170(a) of the Code provides for the deduction of charitable contributions. Section 170(e)(1)(A) provides that the amount of any charitable contribution of property will be reduced by the amount of gain that would not have been long-term capital gain if the property contributed had been sold by the taxpayer at its fair market value. Section 1.170A-4 of the Income Tax Regulations provides that section 170(e)(1)(A) applies to section 306 stock to the extent that, after applying section 306, gain on the disposition of the stock would not have been long-term capital gain if the stock had been sold at its fair market value at the time of its contribution to the charities.

Section 306(a)(1) of the Code provides that if a shareholder sells section 306 stock, the amount realized will be treated as ordinary income to the extent the amount realized does not exceed the stock's ratable share of the amount that would have been a dividend at the time the stock was distributed if the corporation had distributed money, in lieu of section 306 stock, in an amount equal to the fair market value of the stock at the time of the distribution.

Section 306(b)(4)(A) provides an exception to the general rule of section 306(a), if it is established to the satisfaction of the Secretary or his delegate that the distribution, and the disposition or redemption, were not in pursuance of a plan having as one if its principal purposes the avoidance of federal income tax. The Congressional intent of this section is to provide an exception to the general rule in the case of distributions and isolated dispositions of section 306 stock by minority shareholders who do not in the aggregate have control of the distributing corporation because it was inappropriate to impute to noncontrolling shareholders an intention to bail-out earnings and profits at capital gains rates. S. Rep. No. 1622, 83rd Cong., 2d Sess. 243 (1954); see section 1.306-2(b)(3) of the regulations.

Consistent with the limited application of section 306(b)(4)(A), the Service has ruled that the receipt of section 306 stock by a shareholder in a merger with a widely-held corporation in which the shareholder was not a controlling shareholder and the disposition of that stock not in redemption or in anticipation of redemption, other than pursuant to the terms of a sinking fund, is not pursuant to a plan having as one of its principal purposes the avoidance of federal income tax. See Rev. Rul. 56-116, 1956-1 C.B. 164; Rev. Rul. 57-103, 1957-1 C.B. 113; Rev. Rul. 57-212, 1957-1 C.B. 114. See also Rev. Proc. 77-37, 1977-2 C.B. 568.

In *Fireoved v. United States,* 462 F.2d 1281 (3d Cir. 1972), the taxpayer received a preferred stock dividend as part of a business combination of his wholly-owned corporation and an unrelated two-person partnership. The preferred stock was section 306 stock. When the corporation later redeemed some of the preferred stock, the Government argued that the amount realized should be treated as a distribution of property under section 301 of the Code, as provided for by section 306(a)(2). The taxpayer claimed the exception of section 306(b)(4)(A), arguing that the sole purpose of the stock dividend, to leave needed capital in the business while equalizing the common stock interests of the shareholders of the surviving corporation, was motivated by business considerations and not by a desire to avoid tax.

The court reviewed the legislative history of section 306 of the Code and concluded that section 306 was enacted to prevent the "preferred stock bail-out" by which the controlling shareholders withdraw earnings from the corporation at the more favorable tax rates for capital gains while retaining their ownership interests in the corporation. In analyzing the issuance of the preferred stock, the court pointed out that the taxpayer could have accomplished his business objective by taking a cash dividend and loaning the proceeds to the corporation. The court concluded that if the reason for distributing a stock dividend instead of a cash dividend was to avoid the tax at ordinary income rates, then one of the principal purposes of the stock dividend would have been the avoidance of federal income tax. Finally, the court concluded that the taxpayer had not borne his burden of proving that none of the principal purposes of the plan was the avoidance of federal income tax.

In the present case, *A* was in control of *X* at the time *A* received the voting preferred stock. *A* has shown that one of the principal purposes for the issuance of the preferred stock was to prevent the adverse effect of the issuance of common stock on *X*'s ability to raise capital from the public in the future. However, *A* has not shown that *X* could not have accomplished the same business objective by issuing *A* long term bonds, instead of preferred stock. If one of the principal purposes for which *X* issued the preferred stock instead of long term bonds was to avoid the ordinary dividend to *A* that would have resulted upon the receipt of the bonds, then one of the principal purposes for the issuance of the preferred stock was the avoidance of federal income tax. Consequently, *A* has not borne the burden of showing that none of the principal purposes for the issuance of the preferred stock was the avoidance of federal income tax.

HOLDING

Section 306(b)(4)(A) of the Code would not be available to except a sale by *A* of the section 306 stock from the ordinary income characterization of section 306(a)(1). Therefore, *A*'s charitable contribution will be reduced under section 170(e)(1)(A).

Section 451.—General Rule for Taxable Year of Inclusion

26 CFR 1.451-2: Constructive receipt of income.
(Also Section 1232; 1.1232-3.)

T.D. 7663

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Tax treatment of certain short-term corporate obligations and certificates of deposit and similar deposit arrangements

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations concerning the tax treatement of certain short-term corporate obligations and certificates of deposit, time deposits, bonus plans, or other deposit arrangements issued or entered into by banks or similar financial institutions. The regulations reflect a change in the position of the Internal Revenue Service with respect to the tax treatment of these types of obligations and deposits and provide the public with needed guidance.

DATES: The amendment to § 1.451-2(a)(2) of the regulations is effective for corporate obligations and certificates of deposit, time deposits, bonus plans, and other deposit arrangements issued or entered into after December 31, 1978. In general, the amendment to § 1.1232-3(b)(1)(iii)(*a*) of the regulations is effective for taxable years beginning after December 31, 1978. However, the amendment to § 1.1232-3(b)(1)(iii)(*a*) does not apply for taxable years beginning before September 19, 1979, if for the issuer's last taxable year beginning before September 19, 1978, the issuer properly applied the rules of § 1.163-4 (relating to deduction for original issue discount on certain obligations issued after May 27, 1969).

FOR FURTHER INFORMATION CONTACT: John A. Tolleris of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. Attention: CC:LR:T, 202/566-3294.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On September 19, 1979, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 451(a) and 1232(b)(1) of the Internal Revenue Code of 1954 (44 FR 54315). The amendments were proposed to clarify the tax treatment of certain short-term corporate obligations and certificates of deposit, time deposits, bonus plans, and other deposit arrangements. After consideration of all comments received in response to the notice of proposed rulemaking and at the public hearing on the proposed amendments which was held on November 1, 1979, those amendments are adopted as revised by this Treasury decision.

EXPLANATION OF PROVISIONS

The proposed regulation contained an example to be added to § 1.451-2(a)(2) of the regulations to provide that if three months' interest must be forfeited upon withdrawal or redemption before maturity of a one year certificate of deposit or similar deposit arrangement, then the earnings payable on premature withdrawal or redemption of the deposit would be substantially less when compared with the earnings available at maturity. Thus, under § 1.451-2(a)(2) such an interest forfeiture penalty would be a substantial limitation or restriction on the taxpayer's control and no interest earned on the certificate of deposit or similar deposit arrangement would be constructively received by the taxpayer before maturity. In response to a comment on the notice, paragraph 1 of this Treasury decision amends the facts of this example so that the term of the deposit is one year or less to make it clear that the rule illustrated by the example applies to certificates of deposit or similar deposit arrangements with terms of not only one year, but also with a term of less than one year.

Paragraph 2 of this Treasury decision makes several changes to the amendments that were proposed by the notice to § 1.1232-3(b)(1)(iii) of the regulations. A number of persons submitting comments urged that the effective date of the final regulations be postponed because they felt that in this case it was not appropriate to issue regulations late in 1979 affecting the tax treatment to the issuer in 1979. In response to these concerns it was decided to provide in this Treasury decision that the amendment to § 1.1232-3(b)(1)(iii)(*a*) does not apply for taxable years beginning before September 19, 1979, if for the issuer's last taxable year beginning before September 19, 1978, the issuer properly applied the rules of § 1.163-4 (relating to deduction for original issued discount on certain obligations issued after May 27, 1969). Thus, for example, if a calendar year bank or similar financial institution properly deducted original issue discount as interest and prorated or amortized the amount over the term of a certificate of deposit before January 1, 1979, it can continue to do so during 1979. In connection with these amendments normal rules for a change in method of accounting apply.

The amendments proposed by the notice to § 1.1232-3(b)(1)(iii) provided that the term of the obligation included renewal periods. The Supplementary Information in the notice indicated that the proposed amendment would thus not apply to a one year certificate of deposit or similar deposit arrangement that was renewable for a specified number of years and indicated that the tax treatment of this type of instrument would continue to be governed by § 1.1232-3A(e)(4) of the regulations. A number of comments on the notice expressed confusion about the circumstances under which renewal periods would be included in determining the term of the obligation. In response to these concerns, the proposed amendment is modified by this Treasury decision to provide that the term of the obligation includes all renewal periods with respect to which, under the terms of the obligation, the holder may either take action or refrain from taking action which would prevent the actual or constructive receipt of any interest on the obligation until the expiration of the renewal period. This rule thus parallels the rule of § 1.1232-3A(e)(4)(iii) concerning renewal periods in the case of obligations having a term of one year or less. It is illustrated by the example in § 1.1232-3A(e)(4)(iv) of the regulations.

Under sections 871 and 881 of the Code, original issue discount on certain bonds or other evidences of indebtedness with a term of six months or less are exempt from the 30% tax imposed by those sections on income not effectively connected with a United States business of nonresident alien individuals and foreign corporations. See S. Rep. No. 92-437, 92d Cong., 1st Sess. 76 (1971) [1972-1 C.B. 599]. Under the proposed amendment to § 1.1232-3(b)(1)(iii)(*a*), corporate obligations with a term of one year or less on which an amount based on a fixed rate of simple or compound interest is payable at maturity would not have original issue discount.

Thus, because there would be no original issue discount, amounts earned on such obligations would be subjected to the 30% tax under sections 871 and 881. In order to avoid the imposition of this tax on corporate obligations with a term of six months or less and to implement Congressional intent to exempt amounts earned on such obligations from the 30% tax, the amendment proposed by the notice to § 1.1232-3(b)(1)(iii)(*a*) has been limited so that it will not apply for purposes of applying sections 871 and 881. Thus, such obligations will be treated as having original issue discount only for purposes of exempting them from the 30% tax. For all other purposes under the Code, the obligations will not have original issue discount.

Evaluation of the effectiveness of these regulations will be based on comments received from offices within Treasury and the Internal Revenue Service, other governmental agencies, State and local governments, and the public. These regulations will impose no new reporting or recordkeeping requirements.

REVENUE RULING 79-72

The regulations adopted by this Treasury decision apply to the time deposit certificates to which Revenue Ruling 79-72, 1979-1 C.B. 278, relating to Federal income tax treatment of interest on short-term nonnegotiable time deposit certificates issued by financial institutions where the term of the certificate overlaps the end of the holder's taxable year, applied. Therefore, this Treasury decision supersedes Revenue Ruling 79-72.

DRAFTING INFORMATION

The principal author of these regulations is John A. Tolleris of the Legislation and Regulations Division of the Office of Chief Council, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly 26 CFR Part 1 is amended as follows:

Paragraph 1. Paragraph (a)(2) of § 1.451-2 is amended to read as follows:

§ 1.451-2 Constructive receipt of income.

(a) *General rule.* * * *

(2) The fact that the taxpayer would, by withdrawing the earnings during the taxable year, receive earnings that are not substantially less in comparison with the earnings for the corresponding period to which the taxpayer would be entitled had he left the account on deposit until a later date (for example, if an amount equal to three months' interest must be forfeited upon withdrawal or redemption before maturity of a one year or less certificate of deposit, time deposit, bonus plan, or other deposit arrangement then the earnings payable on premature withdrawal or redemption would be substantially less when compared with the earnings available at maturity);

* * * * *

Par. 2. Paragraph (b)(1)(iii) of § 1.1232-3 is amended by deleting the second and third sentences of subdivision (*a*) and inserting in lieu thereof three new sentences and by adding a new subdivision (*e*) at the end thereof. The new provisions read as follows:

§ 1.1232-3 Gain upon sale or exchange of obligations issued at a discount after December 31, 1954.

* * * * *

(b) *Definitions*—(1) *Original issue discount.* * * *

(iii) *Stated redemption price at maturity*—(a) *Definition* * * * If any amount based on a fixed rate of simple or compound interest is actually payable or will be treated as constructively received under section 451 and the regulations thereunder either—

(*1*) At fixed periodic intervals of one year or less during the entire term of an obligation, or

(*2*) Except as provided in subdivision (*e*) of this paragraph (b)(1)(iii), at maturity in the case of an obligation with a term of one year or less,

any such amount payable at maturity shall not be included in determining the stated redemption price at maturity. For purposes of subdivision (*a*)(*2*) of this paragraph (b)(*1*)(iii), the term of an obligation shall include any renewal period with respect to which, under the terms of the obligation, the holder may either take action or refrain from taking action which would prevent the actual or constructive receipt of any interest on such obligation until the expiration of any such renewal period. To illustrate this paragraph (b)(1)(iii), assume that a note which promises to pay $1,000 at the end of three years provides for additional amounts labeled as interest to be paid at the rate of $50 at the end of the first year, $50 at the end of the second year, and $120 at the end of the third year. * * *

(*e*) *Application of definition.* Subdivision (*a*)(*2*) of this paragraph (b)(1)(iii) shall not apply—

(*1*) For taxable years beginning before September 19, 1979, if for the issuer's last taxable year beginning before September 19, 1978, the rules of § 1.163-4 were properly applied by the issuer, or

(*2*) In the case of an obligation with a term of six months or less held by a nonresident alien individual or foreign corporation, but only for purposes of the application of sections 871 and 881.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of Internal Revenue.

Approved December 21, 1979,

DONALD C. LUBICK,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on December 21, 1979, 4:25 p.m., and published in the issue of the Federal Register for December 28, 1979, 44 F.R. 76781)

Section 894.—Income Affected by Treaty

26 CFR 1.894-1: Income affected by treaty.

Whether amounts paid to a citizen of Japan for performing research at a heart research foundation in the United States are compensation for service rendered or payments made under a "grant, allowance, or award" within the meaning of Article 20(1) of the United States-Japan Income Tax Convention, TIAS 7365, 1973-1 C.B. 630. See Rev. Rul. 80-36, page 11.

Section 1232.—Bonds and Other Evidences of Indebtedness

26 CFR 1.1232-3: Gain upon sale or exchange of obligations issued after December 31, 1934.

Tax treatment of certain short-term corporate obligations and certificates of deposit and similar deposit arrangements. See T.D. 7663, page 6.

Section 3302.—Credits Against Tax [Federal Unemployment Tax Act]

26 CFR 31.3302(a)-1: Credit against tax for contributions paid.

Whether employers in Alabama, Nevada, and New Hampshire are entitled to the credit for 1979. See Rev. Proc. 80-3, page 16.

26 CFR 31.3302(c)-1: Limit on total credits.

Reductions in credit applicable to employers from whom services are performed in Delaware and Pennsylvania. See Rev. Proc. 80-2, page 16.

Section 3303.—Conditions of Additional Credit Allowance [Federal Unemployment Tax Act]

Whether the Secretary of Labor will certify the Alabama, Nevada, and New Hampshire laws for 1979. See Rev. Proc. 80-3, page 16.

Section 3304.—Approval of State Laws [Federal Unemployment Tax Act]

Whether the Secretary of Labor will certify the Alabama, Nevada, and New Hampshire laws for 1979. See Rev. Proc. 80-3, page 16.

Section 3310.—Judicial Review [Federal Unemployment Tax Act]

Whether employers in Alabama, Nevada, and New Hampshire are entitled to a credit in 1979 while judicial review is a possibility. See Rev. Proc. 80-3, page 16.

Section 3504.—Acts to be Performed by Agents

26 CFR 31.3504-1: Acts to be performed by agents.

State and local health and welfare agencies applying to act as agents for welfare recipient/employers of individuals furnished by the agencies to provide in-home domestic type services. See Rev. Proc. 80-4, page 17.

Section 4251.—Imposition of Tax

26 CFR 49.4251-1: Imposition of tax.

Whether the communication tax exemption for common carriers applies to amounts paid for wide area telephone service (WATS) furnished to certain travel agencies. See Rev. Rul. 80-34, below.

Section 4252.—Definitions

Whether the communication tax exemption for common carriers applies to amounts paid for wide area telephone service (WATS) furnished to certain travel agencies. See Rev. Rul. 80-34, below.

Section 4253.—Exemptions [Communications]

(*Also Sections 4251, 4252; 26 CFR 49.4251-1.*)

Communications; exemption; travel agencies. The communications tax exemption for common carriers does not apply to amounts paid for wide area telephone service (WATS) by travel agencies that sell tours to the general public but charter the necessary aircraft and buses from airlines and bus companies; Rev. Rul. 75-296 distinguished.

Rev. Rul. 80-34

ISSUE

Does the communication tax exemption for common carriers apply to amounts paid for wide area telephone service (WATS) furnished to certain travel agencies?

FACTS

X, a travel agency, is primarily engaged in selling air tours to the general public through its tour division as a principal, and charters necessary aircraft from domestic airlines. It collects, reports, and pays air transportation taxes to the government. Further, as agent for hotels, motels, and airlines, *X* sells tickets and accommodations.

Y travel agency operates similar to *X* except that *Y* sells bus tours through its tour division.

Both *X* and *Y* subscribe to the wide area telephone service (WATS) that is used exclusively in their charter tour divisions.

LAW AND ANALYSIS

Section 4251 of the Internal Revenue Code imposes a tax on amounts paid for local and toll telephone service. Section 4252(b)(2) defines WATS, a specific type of toll telephone service. Section 4253(f) provides common carriers with an exemption from the WATS tax for toll telephone service used in the conduct of their business as common carriers.

Rev. Rul. 76-405, 1976-2 C.B. 352, concludes that for the purpose of section 4253(f) of the Code a common carrier is one holding itself out to the public as engaged in the business of transportation of persons or property from place to place for compensation, offering its services to the public generally. The distinctive characteristic of a common carrier is that it undertakes to carry for all people indifferently.

X and *Y* hold themselves out to the public as travel agencies. In the operation of their businesses in connection with their chartered tours that include air transportation, hotel reservations, meals, tour guide, and tips, they charter aircraft or buses from commercial airlines or bus companies. The airplanes or buses leased from the airlines or bus companies are operated and controlled by the lessor; therefore, the airlines or bus companies are the carriers and, hence the ones furnishing the transportation. Accordingly, *X* and *Y* are not common carriers for purposes of the exemption provided by section 4253(f) of the Code.

Rev. Rul. 75-296, 1975-2 C.B. 440, is distinguishable from the present situation. Rev. Rul. 75-296 considers whether an independent travel agency that arranges and sells tours that include chartered air transportation is required under section 4291 of the

Code to collect the air transportation tax imposed by section 4261 of the Code. Section 4291 provides that every person receiving any payment for facilities or services on which tax is imposed must collect the tax from the person making the payment. Rev. Rul. 75-296 concludes that where the travel agency is selling the taxable air transportation as a principal rather than as an agent, it is required to collect the tax. This does not mean that the travel agency was acting as an air carrier. Rather, it was purchasing transportation from an air carrier under charter and reselling the transportation to others.

HOLDING

X and *Y* do not qualify for the exemption provided by section 4253(f) of the Code with respect to the tax imposed by section 4251 on amounts paid for WATS, as described in section 4252(b).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 75-296 is distinguished.

Section 6601.—Interest on Underpayment, Nonpayment, or Extensions of Time for Payment of Tax

26 CFR 301.6601-1: Interest on underpayments.

Employers in Alabama, Nevada, and New Hampshire who take advantage of a conditional credit that may be rescinded. See Rev. Proc. 80-3, page 16.

Section 6695.—Other Assessable Penalties with Respect to the Preparer of Income Tax Returns for Other Persons

26 CFR 1.6695-1: Other assessable penalties with respect to the preparation of income tax returns for other persons.

Penalties; return preparers; deposit of refund checks. A business manager prepares income tax returns for clients who maintain special checking accounts against which the business manager is authorized to sign certain checks on their behalf. The clients' federal income tax refunds are mailed to the business manager, who has the clients endorse the checks and deposits them in the special accounts. The business manager is not subject to the penalty imposed by section 6695(f) of the Code regarding the negotiation of checks by return preparers.

Rev. Rul. 80-35

ISSUE

Is an income tax return preparer subject to the penalty imposed by section 6695(f) of the Internal Revenue Code if the preparer, acting as the business manager of the taxpayer, deposits a Federal income tax refund check in the client's special checking account after the client has endorsed the check?

FACTS

X, a business manager, prepares income tax returns for clients and is an income tax return prepared as defined in section 7701(a)(36) of the Code.

X requires each client to have a checking account, against which under a power of attorney on file with the bank, *X* is authorized to sign checks on behalf of the client. *X* may sign checks only upon the specific authorization of the client.

Pursuant to a power of attorney on file with the Internal Revenue Service, the client's Federal income tax refund is mailed to *X*. *X* has the client endorse the check and then, pursuant to the client's specific instructions, *X* deposits the check in the client's checking account.

LAW AND ANALYSIS

Section 6695(f) of the Code provides that any person who is an income tax return preparer who endorses or otherwise negotiates (directly or through an agent) any check made in respect to the taxes imposed by subtitle A which is issued to a taxpayer (other than the income tax return preparer) shall pay a penalty of $500 with respect to each such check.

Section 1.6695-1(f) of the Income Tax Regulations provides that no person who is an income tax return preparer may endorse or otherwise negotiate, directly or through an agent, a check for the refund of tax under subtitle A of the Code which is issued to a taxpayer other than the preparer if the person was a preparer of the return which gave rise to the refund check.

Section 3-202(1) of the Uniform Commercial Code provides that negotiation is the transfer of an instrument in such form that the transferee becomes a holder. If the instrument is payable to order it is negotiated by delivery with any necessary indorsement; if payable to bearer it is negotiated by delivery.

In this situation, the client has not transferred any rights in the check to the business manager (income tax return preparer), who is an agent for the client. The business manager delivers the check to the bank pursuant to the client's specific instructions. It is the client, and not the business manager that is transferring the check to the bank and, therefore, it is the client that is negotiating the check. This is true whether the client endorses the refund check "for deposit only," "Pay to the order of" (name of the depository bank), or with only his or her own name. The delivery of the check by the business manager is done on behalf of the client and is performed solely in the business manager's capacity as an agent.

HOLDING

X is not subject to the penalty imposed by section 6695(f) of the Code for depositing a Federal income tax refund check in a client's special account after the client has endorsed the check.

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions

United States-Japan Income Tax Convention
1973-1 C.B. 630

(Also Part I, Sections 117, 894; 1.117-4, 1.894-1.)

Japanese citizen performing medical research in U.S. Examples are set forth in which amounts paid to a citizen of Japan for performing research at a heart research foundation in the U.S. are either compensation for services rendered or payments made under a "grant, allowance, or award" within the meaning of Article 20(1) of the U.S.-Japan Income Tax Convention; Rev. Rul. 76-567 superseded.

Rev. Rul. 80-36

ISSUE

Are amounts paid to a citizen of Japan for performing research at a heart research foundation in the United States compensation for services rendered or payments made under a "grant, allowance, or award" within the meaning of Article 20(1) of the United States-Japan Income Tax Convention (Convention), TIAS 7365, 1973-1 C.B. 630?

FACTS

Situation 1.—A is a citizen of Japan who is a specialist in cardiology from a Japanese university. *A* was a resident of Japan when *A* arrived in the United States on June 1, 1977 to begin research work at *X*, a tax-exempt foundation. *X*'s primary function is heart research and its staff, including *A*, is primarily engaged in heart research. The foundation is funded by public contributions and a grant from a charitable organization, *Y*. The grant was provided to finance a specific research project, including payments to skilled specialists such as *A*. It is expected that the project will continue after *A*'s return to Japan.

A, who replaced another specialist in cardiology, will remain in the United States for 2 years and then return to Japan. *A*, in turn, will then be replaced by another specialist in cardiology who will continue to work on the project. *X* will publish the results of the research upon its completion.

The research project is directed by a physician employed by *X*, who supervises *A*'s work. While doing research at *X*, *A* is paid $15,000 per year by *X*.

Situation 2.—B is also a citizen of Japan who is a research specialist in cardiology from a Japanese university. *B* was a resident of Japan when *B* arrived in the United States on June 1, 1977 to do research at *X*. However, *B* had applied for a research grant from *Y* several months before coming to the United States. *B* was awarded the grant to do research on a project that *B* had chosen. The research was to be done at *X* because of *X*'s facilities. Neither *X* nor *Y* have any right to the product of *B*'s research.

B carries out the research project in accordance with a plan submitted with the grant application, but *B* is not supervised by any employee of *X* or *Y*, and *B* directs the project. The grant is for a period of 2 years and *B* receives $15,000 per year from *Y*, plus a smaller sum for equipment, as well as the use of *X*'s facilities. At the end of the 2 years, *B* is entitled, but not required, to publish the results of the research. *B* will also return to Japan at that time.

LAW AND ANALYSIS

Section 1.117-4(c)(2) of the Income Tax Regulations provides that amounts paid to an individual to enable that person to pursue studies or research primarily for the benefit of the grantor are not scholarship or fellowship grants.

Section 894(a) of the Internal Revenue Code provides that income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under this subtitle.

Article 20(1)(a)(iii) of the Convention provides that an individual who is a resident of Japan at the beginning of a visit to the United States and who is temporarily present in the United States for the primary purpose of studying or doing research as a recipient of a grant, allowance, or an award from a governmental, religious, charitable, scientific, literary, or educational organization shall be exempt from Federal income tax with respect to the amounts described in Article 20(1)(b) for a period not exceeding 5 taxable years from the date of the individual's arrival in the United States.

Article 20(1)(b) of the Convention provides that pursuant to Article 20(1)(a) the following amounts shall be exempt from Federal income tax: (i) gifts from abroad for the purpose of maintenance, education, study, research, or training; (ii) the grant, allowance, or award; and (iii) income for personal services performed in the United States in an aggregate amount not in excess of 2,000 United States dollars for any taxable year.

In Rev. Rul. 76-567, 1976-2 C.B. 491, the taxpayer, a citizen and resident of Japan, received funds from a charitable organization paid in connection with the taxpayer's research work at an institute located in the United States. The ruling concludes that the amount paid to the taxpayer for the research work is a grant, allowance, or award from a charitable organization within the meaning of Article 20(1)(a)(iii) of the Convention and, thus, is exempt from Federal income tax. However, the ruling does not distinguish between an amount paid under a grant for research and an amount paid as compensation for services rendered in performing research. Although Rev. Rul. 76-567 does not specifically so state, the amounts paid were not for services rendered to the institute.

The term "grant" is not defined in the Convention, but the phrase "fellowship grant" is defined in regulations under section 117 of the Code. Under Article II(3) of the Convention, any term not defined in the Convention shall have the meaning it has under applicable United States law. Section 117(a) provides in part that in the case of an individual gross income does not include any amount received as a fellowship grant. Section 1.117-3(c) of the regulations provides in part that a "fellowship grant" generally means an amount paid or allowed to an individual to aid that person in the pursuit of study or research. Section 1.117-4(c) provides that payments shall not be considered a fellowship grant if they represent compensation for services, if they represent payment for services that are subject to the direction or supervision of the grantor, or are paid to the individual to enable that person to pursue research primarily for the benefit of the grantor.

The phrase "studying or doing research" in Article 20(1)(a)(iii) of the Convention indicates that the intent of the provision, with respect to persons doing research, does not extend to professional researchers receiving compensation for performing research services. This is further indicated by the fact the exemption is limited to persons receiving a "grant, allowance or an award." The use of such terms suggests that ordinary compensation for services rendered is not within the intent of the exemption. In fact, Article 20(1)(b) grants a separate but limited exemption for income for personal services. Thus, the term "grant" has a meaning similar to that of "fellowship grant" as used in section 117 of the Code and defined in section 1.117-4(c) of the regulations.

In *Situation 1*, *A* is performing valuable research services under the supervision of the grantor that are primarily for the benefit of the grantor of the payments, *X*. The knowledge *A* is getting is merely an incidental benefit from what is essentially an employment relationship. Rev. Rul. 69-425, 1969-2 C.B. 16.

In *Situation 2*, *B* is being paid an amount to aid *B* in the pursuit of a specific research goal. *B*'s work is not subject to direction or supervision by any other person, and *B* is entitled, but not required to publish the results of the research. No other person has any right to the product of *B*'s research.

HOLDINGS

1. Amounts paid to *A* for performing research at *X* are compensation for services rendered and are not payments made under a "grant, allowance, or award" within the meaning of Article 20(1) of the Convention.

2. Amounts paid to *B* for performing research at *X* are payments made under a "grant, allowance, or award" within the meaning of Article 20(1) of the Convention.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 76-567 is superseded.

Subpart B.—Legislation and Related Committee Reports

Public Law 96-178 [1]
96th Congress, H.R. 3091
January 2, 1980

An Act to extend for one year the provisions of law relating to the business expenses of State legislators.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That subsections (a) and (d) of section 604 of the Tax Reform Act of 1976 (Public Law 94-455) [1976-3 C.B. (Vol. 1) 1, 51] are each amended by striking out "January 1, 1978" and inserting in lieu thereof "January 1, 1979".

* * * * *

WIN CREDIT

Sec. 3. (a)(1) Section 50B of the Internal Revenue Code of 1954 is amended by redesignating subsection (i) as subsection (j) and by adding after subsection (h) the following new subsection:

"(i) Special Rules With Respect to Employment of Day Care Workers.—

"(1) Eligible employee.—An individual who would be an 'eligible employee' (as that term is defined for purposes of this section) except for the fact that such individual's employment is not on a substantially full-time basis, shall be deemed to be an eligible employee as so defined, if such employee's employment consists of services performed in connection with a child day care program of the taxpayer, on either a full-time or part-time basis.

"(2) Alternative limitation with respect to child day care services eligible employees.—The amount of the credit allowed a taxpayer under the preceding provisions of this section with respect to work incentive program expenses paid or incurred by him with respect to an eligible employee whose services are performed in connection with a child day care services program conducted by the taxpayer shall, at the election of the taxpayer, be determined by including (in computing the amount of such expenses so paid or incurred by him) any amount with respect to such employee for which he was reimbursed from funds made available pursuant to section 3(c) of Public Law 94-401 or section 2007 of title XX of the Social Security Act, except that, if the total amount of such credit, as so computed, plus such amount reimbursed to him under such sections, exceeds the lesser of $6,000 or 100 percent of the total expenses paid or incurred by him with respect to such employee, the amount of such credit shall be reduced (but not below zero) so as to provide that such total does not exceed the lesser of $6,000 or 100 percent of the total expenses paid or incurred by him with respect to such employee.".

(2) The amendment made by paragraph (1) shall become effective on the date of the enactment of this Act, and shall apply with respect to taxable years beginning after December 31, 1978, and before January 1, 1980.

(3) Section 50B(a)(2)(B) of the Internal Revenue Code of 1954 as in effect prior to amendment by the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1] is amended, effective October 1, 1978, by striking out "October 1, 1978" and inserting in lieu thereof "January 1, 1979".

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AMENDMENTS RELATED TO SECTION 322 OF THE REVENUE ACT OF 1978

Sec. 6. (a) Paragraph (1) of section 322(e) of the Revenue Act of 1978 (relating to effective date) is amended by adding at the end thereof the following new sentence: "For purposes of applying section 50A(a)(2) of the Internal Revenue Code of 1954 with respect to a taxable year beginning before January 1, 1979, the rules of sections 50A(a)(4), 50(a)(5), and 50B(e)(3) of such Code (as in effect on the day before the date of the enactment of this Act) shall apply.".

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[1] This publication of the law is restricted to excerpts involving tax matters: House Report No. 96-63, page 13; Conference Report No. 96-718, page 14.

(b) Subparagraph (B) of section 322(e)(2) of the Revenue Act of 1978 (relating to eligible employees hired after September 26, 1978) is amended —

(1) by striking out "September 27, 1978," and inserting in lieu thereof "September 26, 1978, for purposes of applying the amendments made by this section,"; and

(2) by striking out "January 1, 1979." and inserting in lieu thereof "January 1, 1979, and any wages paid or incurred after December 31, 1978, with respect to such individual shall be considered to be attributable to services rendered after that date.".

(c)(1) Subparagraph (C) of section 50A(a)(4) of the Internal Revenue Code of 1954 (relating to limitation with respect to nonbusiness eligible employees) is amended by striking out " '$6,000' and" and inserting in lieu thereof " '$6,000' for".

(2) Subparagraph (B) of section 50B(g)(2) of such Code is amended by striking out "giving to such credit" and inserting in lieu thereof "giving rise to such credit".

(3) Clause (i) of section 50B(h)(1)(A) of such Code is amended by striking out "9-day" and inserting in lieu thereof "90-day".

(4) The second subsection designated as subsection (d) of section 322 of the Revenue Act of 1978 is amended by striking out "our" in paragraph (1)(A) thereof and inserting in lieu thereof "out".

(d) Any amendment made by this section to the Revenue Act of 1978 shall take effect as if it had been included in the provision of the Revenue Act of 1978 to which such amendment relates.

Approved January 2, 1980.

House Report No. 96-63
1st Session

[Bracketed numerals indicate official report page numbers]

STATE LEGISLATORS' BUSINESS EXPENSES

March 21, 1979

Mr. Ullman, from the Committee on Ways and Means, submitted the following report to accompany H.R. 3091.[1]

The Committee on Ways and Means to whom was referred the bill (H.R. 3091) to extend for one year the provisions of law relating to the business expenses of State legislators, having considered the same, report favorably thereon without amendment and recommend that the bill do pass.

I. Summary

H.R. 3091 extends, for 1 additional year, the effective date for the tax treatment of travel expenses incurred by State legislators while away from home to taxable years beginning before January 1, 1979.

II. General Statement

Present law

Under present law, an individual is allowed a deduction for traveling expenses (including amounts expended for meals and lodging) while away from home overnight in the pursuit of a trade or business (sec. 162(a)). These expenses are deductible only if they are reasonable and necessary in the taxpayer's business and directly attributable to it. "Lavish or extravagant" expenses are not allowable deductions. In addition, no deductions are allowed for personal, living, and family expenses except as expressly allowed under the Code (sec. 262).

Generally, under section 262, expenses and losses attributable to a dwelling unit which is occupied by a taxpayer as his personal residence are not deductible. However, deductions for interest, certain taxes, and casualty losses attributable to a personal residence are expressly allowed under other provisions of the tax laws (secs. 163, 164, and 165).

A taxpayer's "home" for purposes of the deduction of traveling expenses generally means his principal place of business or employment. When a taxpayer has more than one trade or business, or a single trade or business which requires him to spend a substantial amount of time [2] at two or more localities, his "home" is held to be at his principal place of business. A taxpayer's principal place of business is determined on an objective basis taking into account the facts and circumstances in each case. The more important factors to be considered in determining the taxpayer's principal place of business (or tax home) are: (1) the total time ordinarily spent by the taxpayer at each of his business posts, (2) the degree of business activity at each location, (3) the amount of income derived from each location, and (4) other significant contacts of the taxpayer at each location. No one factor is determinative.

In 1952 a provision was adopted with respect to the living expenses paid or incurred by a Member of Congress (including a Delegate or Resident Commissioner).[2] Under these rules, the place of residence of a Member of Congress within the congressional district which he represents in Congress is considered his tax home. However, amounts expended by the Member within each taxable year for living expenses are not deductible in excess of $3,000. Prior to the Tax Reform Act of 1976 [Pub L. 94-455, 1976-3 C.B. (Vol. 1) 1], * * * [these special rules for a member of Congress were not] applied in the case of a State legislator. As a result, the tax home of a State legislator was determined in accordance with the general rule described above.

The Tax Reform Act of 1976 provided an election for the tax treatment of State legislators for taxable years beginning before January 1, 1967. This was extended for one year by the Tax

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[1] Public Law 96-178, page 12.

[2] Prior to this time Members of Congress were not allowed a deduction for these expenses because Washington, D.C. was considered to be their tax home. *See George W. Lindsay*, 34 B.T.A. 840, 843 (1936).

Reduction and Simplification Act of 1977 [Pub. L. 95-30, 1977-1 C.B. 451] to taxable years beginning before January 1, 1977, and was extended further by Public Law 95-258 to taxable years beginning before January 1, 1978.

Under this election, a State legislator may, for any such taxable year, treat his place of residence within his legislative district as his tax home for purposes of computing the deduction for living expenses. If this election is made, the legislator is treated as having expended for living expenses an amount equal to the sum of the daily amount of per diem generally allowed to employees of the U.S. government for traveling away from home,[2] multiplied by the number of days during that year that the State legislature was in session, including any day in which the legislature was in recess for a period of four or less consecutive days. In addition, if the State legislature was in recess for more than four consecutive days, a State legislator may count each day in which his physical presence was formally recorded at a meeting of a committee of the State legislature. For this purpose, the rate of per diem to be used is to be the rate that was in effect during the period for which the deduction was claimed.

These limitations apply only with respect to living expenses incurred in connection with the trade or business of being a legislator. The 1976 Act did not impose a limitation on living expenses incurred by a legislator in connection with a trade or business other than that of being a legislator. As to any other trade or business, the ordinary and necessary test of prior law will continue to apply.

[3] In the absence of further congressional action, the tax home of a State legislator, for taxable years beginning after December 31, 1977, has to be determined in accordance with the general rules described previously.

Reasons for change

The provision which allows a State legislator to treat his place of residence within his legislative district as his tax home for purposes of computing the deduction for living expenses only applies to taxable years beginning before January 1, 1978. The committee believes this provision should be extended for a 1-year period during which time the problem can be given further consideration and a permanent rule can be developed.

Explanation of the bill

The bill extends, for 1 additional year, the effective date of the provision relating to the tax treatment of certain travel expenses incurred by State legislators while away from home to taxable years beginning before January 1, 1979.

Effective date

The bill applies to taxable years beginning before January 1, 1979.

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Conference Report No. 96-718
1st Session

[Bracketed numerals indicate official report page numbers]

BUSINESS EXPENSES OF STATE LEGISLATORS; SOCIAL SERVICES AND RELATED AMENDMENTS

DECEMBER 19, 1979

Mr. ULLMAN, from the committee of conference, submitted the following conference report to accompany H.R. 3091.[1]

* * * * *

[7] JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 3091) to extend for one year the provisions of law relating to the business expenses of State legislators, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report:

1. BUSINESS EXPENSES OF STATE LEGISLATORS

Both the House and Senate versions contain a provision extending for one year the provisions of law relating to the business expenses of State legislators.

* * * * *

[8] 3. PROVISIONS RELATING TO AUTHORITY TO HIRE WELFARE RECIPIENTS AS CHILD CARE WORKERS

House bill.—No provision.

Senate amendment.—The amendment would restore the authority of the States to use social services funds under title XX to pay the costs of employing welfare recipients in child care jobs. This authority was available in fiscal years 1977 and 1978. The amendment would make this authority permanent, retroactive to October 1, 1978. It would also make certain changes to conform and better coordinate it with the provisions under which employers obtain a tax credit for hiring welfare recipients. Specifically, the amendment would—

1. extend the authority to use title XX funds to reimburse the costs of hiring welfare recipients in child care jobs;

2. incorporate this authority as a permanent part of the basic title XX statute;

3. increase the maximum per recipient annual combined tax credit and title XX reimbursement from $5,000 to $6,000—the same level of wages that is eligible for the new welfare recipient tax credit;

4. make the payment and credit available for part-time as well as full-time employment in child care jobs;

5. permit the credit to be computed on the basis of the full wages including the part reimbursed under title XX—subject to a maximum combined tax credit and title XX payment not to exceed 100 percent of the first $6,000 of wages; and

6. make the tax credit coverage ap-

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[2] The maximum per diem allowance generally is $35.00. Greater maximum amounts apply, however, to designated high rate geographical areas, including the capitals of Alaska ($70), Connecticut ($39), Hawaii ($58), Massachusetts ($49), Minnesota ($41), New York ($39), Rhode Island ($40), and West Virginia ($39).

[1] Public Law 96-178, page 12.

plicable to the period between the date it previously expired (October 1, 1978) and the effective date of the new credit enacted last year (January 1, 1979).

Conference Agreement.—The Conference agreement follows the Senate amendment, except the authority to use title XX funds to make grants to qualified child day care providers would be effective only for the period October 1, 1978 through March 31, 1980, and the tax credit for hiring welfare recipients would apply only with respect to taxable years beginning after December 31, 1978 and before January 1, 1980.

* * * * *

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.602: Forms and instructions.
(Also Part I, Section 3302; 31.3302(c)-1.)

Rev. Proc. 80-2

SECTION 1. PURPOSE

The purpose of this revenue procedure is to bring up to date the procedure to be followed in computing reductions in the credit against the tax reportable on Form 940, Employer's Annual Federal Unemployment Tax Return, for 1979.

SEC. 2. BACKGROUND

Section 3301 of the Internal Revenue Code imposes an excise tax on employers on wages paid to employees. Section 3306(a) defines the term "employer" for purposes of the tax imposed by section 3301.

Section 3302 of the Code provides for credits against the tax imposed by section 3301. Reductions in the amount of credit otherwise allowable are provided for in section 3302(c). Section 3302(c)(2) provides that the reductions shall occur if an employer pays wages for services performed in a state that has not restored amounts that were advanced under title XII of the Social Security Act, 42 U.S.C. sections 1321-1324 (1976). Section 3302(d)(3) provides that credit reductions for any year may be forestalled if a state restores to the United States Treasury, before November 10 of that year, the full amount of the advances.

SEC. 3. CREDIT REDUCTIONS FOR 1979

For the years 1975 through 1979 the credit reduction is not applicable if, upon the application of any state, the Secretary of Labor finds that such state has studied and taken appropriate action with respect to the financing of its unemployment programs so as substantially to accomplish the purpose of restoring the fiscal soundness of the state's unemployment account in the Unemployment Trust Fund and permitting the repayment within a reasonable time of any advances made to such account under title XII of the Social Security Act. Emergency Compensation and Special Unemployment Assistance Extension Act of 1975, section 110, 1975-2 C.B. 513, 515, as amended by the Emergency Unemployment Compensation Extension Act of 1977, section 201, 1977-1 C.B. 437, 440.

As of November 10, 1970, the States of Delaware and Pennsylvania had not repaid the advances made to them in 1975. For the years 1977 and 1978, the first two years in which the States would have had to repay the advances to avoid the credit reductions under section 3302(c) of the Code, the Secretary of Labor determined that both States met the criteria of section 110 of the Emergency Compensation and Special Unemployment Extension Act of 1975, as amended, for deferral of a federal unemployment tax credit reduction. However, in 1979, the Secretary of Labor determined that the States of Delaware and Pennsylvania did not qualify for deferrals of the credit reductions under section 110. Therefore, the credit reductions will take effect as provided for in section 3302(c)(2) of the Code in the amount of 0.3 percent of the wages (as defined in section 3306(b)) paid during 1979 for services performed in Delaware and Pennsylvania.

SEC. 4. PROCEDURE

If a credit reduction applies, it is computed on Part II, Line 2, or Part III, Line 4, of the Form 940 for 1979, whichever is applicable to the employer.

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26 CFR 601.401: Employment taxes.
(Also Part I, Sections 3302, 3303, 3304, 3310, 6601; 31.3302(a)-1, 301.6601-1.)

Rev. Proc. 80-3

SECTION 1. PURPOSE

This revenue procedure sets forth the procedure to be folowed on the 1979 Form 940, Employer's Annual Federal Unemployment Tax Return, by employers who claim certain credits based on their contributions to the unemployment funds of the States of Alabama, Nevada, and New Hampshire.

SEC. 2. BACKGROUND

Section 3302(a) of the Internal Revenue Code provides for a credit against the Federal Unemployment Tax Act (FUTA) tax imposed on employers by section 3301. The amount of the credit depends upon the amount of contributions paid by an employer into an unemployment fund maintained during the taxable year under the unemployment compensation law of a state that is certified as provided in section 3304.

Section 3302(b) of the Code provides an additional credit to employers who are permitted by a state to pay less than the highest rate in a taxable year under the provisions of an unemployment compensation law of the state if the law is certified as provided in section 3303. Section 3303 sets forth the standards by which a state unemployment compensation law may allow certain employers reduced rates under their experience rating provisions.

The certification of state unemployment compensation laws for sections 3303 and 3304 are to be made by the Secretary of Labor. As a precondition to certification under section 3303, the unemployment compensation law of a state must first be certified under section 3304.

SEC. 3. STATUS OF ALABAMA, NEVADA, AND NEW HAMPSHIRE

The Secretary of Labor has informed the Secretary of the Treasury that the States of Alabama, Nevada, and New Hampshire are not included in the list of certified states for 1979 under section 3304. 44 Fed. Reg. 64368, 64383 (1979). Notifications of the finding that certification may be withheld have been sent to the Governors of those States.

Pursuant to section 3310 of the Code the States of Alabama, Nevada, and New Hampshire have filed with the United States Courts of Appeals for the appropriate circuits, petitions for review of the Secretary of Labor's action. Section 3310(d)(2) provides that the commencement of judicial proceedings shall stay the Secretary of Labor's action for a period of 30 days, and the court may thereafter grant interim relief, if warranted, including a further stay of the Secretary of Labor's action and including such other relief as may be necessary to preserve status or rights.

SEC. 4. EFFECT ON ALABAMA, NEVADA, AND NEW HAMPSHIRE EMPYOYERS

Since the Secretary of Labor has been precluded from finally withholding the certifications until the appropriate court has finally determined whether the proposed action of the Secretary of Labor is appropriate, or until the court determines that preliminary equitable relief is no longer justified, employers that have made contributions to the unemployment funds of the States of Alabama, Nevada, and New Hampshire will be permitted to file the 1979 Form 940 as if certifications have not been withheld for 1979. However, if certification for 1979 is later withheld by the Secretary of Labor, any affected employer will be liable for any additional tax due, plus interest under section 6601 of the Code. The Internal Revenue Service will announce the final determinations with respect to whether the unemployment compensation laws of the States of Alabama, Nevada, and New Hampshire are entitled to certification for 1979.

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26 CFR 601.401: Employment taxes.
(Also Part I, Section 3504; 31.3504-1.)

Rev. Proc. 80-4

SECTION 1. PURPOSE

The purpose of this revenue procedue is to set forth the procedures to be followed by state and local health and welfare agencies wishing to act as agents, under section 3504 of the Internal Revenue Code, for welfare recipients who become the employers of individuals furnished by the agencies to provide in-home domestic service for the welfare recipients.

SEC. 2. BACKGROUND

.01 Rev. Proc. 70-6, 1970-1 C.B. 420 sets forth the procedures to be followed in requesting authorization to act as an agent under section 3504 of the Code. Pursuant to section 31.3504-1 of the Employment Tax Regulations, the authorization is applicable to the taxes required to be paid under sections 3101, 3111, and 3403 of the Code.

.02 Titles XIX and XX of the Social Security Act, as amended, 42 U.S.C. sections 1396 and 1397, respectively, (1976), provide for federal grants to states under programs administered either by state or local governments through their health and welfare agencies.

.03 In some instances, workers who perform in-home domestic services paid for with funds supplied by such state or local agencies are the employees of the welfare recipients who receive those services. In cases in which the services are provided under a statewide, uniform program, the state may file one application under Rev. Proc. 70-6 to act as the agent for the recipient/employers; in cases in which the programs vary from local government to local government, each local government that desires to act as an agent should file an application.

.04 Section 3.01 of Rev. Proc. 70-6 provides that application for authorization as agent to perform acts required of an employer should be made in writing by the agent to the Director, Internal Revenue Service Center, with whom the agent will file returns upon approval of the application.

.05 Section 3.04 of Rev. Proc. 70-6 provides that an application (for authorization to act as an agent under section 3504 of the Code) covering more than one employer must be accompanied by a properly executed Form 2678, Employer Appointment of Agent under Section 3504 of the Internal Revenue Code, from each of the employers.

.06 Under sections 3306(a)(3) and 3306(c)(2) of the Code, persons who pay cash remuneration of $1,000 or more during any calendar quarter of the calendar year (or the preceding calendar year) to individuals performing domestic services in private homes are subject to the tax imposed by section 3301 with respect to remuneration paid after December 31, 1977, for services performed after that date.

SEC. 3. PROCEDURE

.01 The large number of welfare recipient/employers who receive in-home domestic services paid for with funds supplied by state and local governments makes it impractical to comply with the requirement that each employer submit a Form 2678. Accordingly, the Internal Revenue Service will not enforce the requirement that each employer must submit that form to the state or local government.

.02 In order for a state or local health or welfare agency to secure the authorization to act as an agent under section 3504 of the Code for welfare recipient/employers, it is sufficient for the agency to include with its application to the Service a reference to the document that the welfare recipient/employers have filed (or will file) with the agency appointing the agency to act as a collection agent. The state or local agency may include such appointment to act as an agent in the application form required to be signed and filed by welfare recipient/employers in order to receive in-home domestic service. The execution of the application by a welfare recipient/employer constitutes an authorization by the employer and becomes (by reference) a part of the agency's application to the Service.

.03 Details with respect to the application for authorization to act as agent should be worked out between the state or local agency and the Director of the Internal Revenue Service Center with whom the employment tax returns are filed. The Director will indicate the length of time that the state or local agency must retain the document filed by the welfare recipient/employer appointing the agent.

.04 In those instances in which a welfare recipient/employer is liable for the tax under section 3301 of the Code, the Service will interpose no objection if the state or local agency acting as an agent under section 3504 for taxes required to be paid under sections 3101, 3111, and 3403 also acts as an agent for the reporting and paying of the taxes imposed by section 3301.

.05 This revenue procedure does not apply to state and local welfare agencies that contract with outside organizations to provide the services or that use their own employees, as in Rev. Rul. 73-268, 1973-1 C.B. 415.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 70-6 is amplified.

Part IV. Items of General Interest

Foundation Status of Certain Organizations

Announcement 80-16

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3) of the Code, eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Allen Memorial Institute for Intracellular Research, Mary B., Richmond, VA

American Cancer Association, McLean, VA

Architectural Education Corporation for Community Development, Fayetteville, AK

Assistance to the Elderly and Handicapped, Inc., Bartlesville, OK

Band Booster Club of Lithia Springs High School, Inc., Lithia Springs, GA

Banneker-Douglas Museum Foundation, Inc., Annapolis, MD

Bessemer City Rescue Squad, Inc., Bessemer City, NC

Big Brothers and Big Sisters of Frederick County Maryland, Inc., Frederick, MD

Board of Regents, Haskell Indian Junior College, Inc., Lawrence, KS

Camelot Production Co., Pittsburgh, PA

Centers for the Handicapped Development Corp., Silver Spring, MD

Children's Aid International, Inc., Washington, DC

Children's Service and Training Center, Meadville, PA

Community Action Movement, Philadelphia, PA

Community Arts Council, New Castle, PA

Development Strategies Corp., Washington, DC

Faithram, Inc., Hutchison, KS

Federally Employed Womens Legal and Education Fund, Inc., Washington, DC

Foundation for Arab-Israeli Reconciliation, Washington, DC

Golden Triangle Community Services, Denton, TX

Gynecological Society for the Study of Breast Diseases, The, Gaithersburg, MD

Help Unite Human Relations, Inc., Topeka, KS

Hibbs Memorial Scholarship Fund, George Edgar, Perryopolis, PA

Higher Education Management Institute, Inc., Washington, DC

Life in Christ, Fort Worth, TX

Livingston Babe Ruth Baseball League, Inc., The, Livingston, NJ

Local Government Data Processing Corp., Columbia, TN

Manhattan Chamber Orchestra, Manhattan, KS

Maryland Home for Retarded, Inc., The, Baltimore, MD

Mental Health Services of Northeast Oklahoma, Inc., Miami, OK

Metropolitan Hockey Club, Alexandria, VA

Mid-America College Art Association, Iowa City, IA

Mid American Crafts Exhibits, Inc., Lawrence, KS

Midwestern Bible Institute, Inc., Winona Lake, IN

Nexus House, Inc., Wichita Falls, TX

Oral Histories of Fort Worth, Inc., Fort Worth, TX

Palisades Theatre Company of Maryland, Inc., Bethesda, MD

Pittsburgh Dance Alloy, Pittsburgh, PA

Platte Valley Chapter of the American Institute of Banking, Aurora, NE

Progressive Development Project, Inc., Petersburg, VA

"Sadhana" Divine Life for Children, Washington, DC

7th Step Foundation of Atlanta, Inc., The, Atlanta, GA

Southern Center for Military and Veterans Rights, Atlanta, GA

Tappahannock Essex Volunteer Fire Department, Inc., Tappahannock, VA

Theatrical Outfit, Inc., The, Atlanta, GA

Total Resources United for a Safer Tomorrow, Inc., Toms River, NJ

Town Hall—Levy Opera House Foundation, Inc., Charlottesville, VA

Trenton Ecumenical Area Ministry, Trenton, NJ

United States Committee for East-West Common Existence, The, Washington, DC

United States of America Bangladesh Cultural Forum, Washington, DC

United Way of Lake Prairie Township, Nicollet County, Minnesota, Inc., St. Peter, MN

Upper Rockaway River Watershed Association, Danville, NJ

Youth Development Foundation of America, Inc., Decatur, GA

Youth Services Housing Corp., Durant, OK

The following organizations, which have been treated as private operating foundations, described in section 4942(j)(3) of the Code, have now been classified as organizations that are not private operating foundations. Grantors and contributors may no longer rely upon rulings or determinations that these organizations are private operating foundations. These organizations are:

Liberty Athletic Club, Inc., Boston, MA

New England Evaluative and Diagnostic Systems, Inc., Sanford, ME

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

United States and Trinidad and Tobago Discuss Income Tax Treaty

Announcement 80-17 [1]

Representatives of the United States and Trinidad and Tobago have recently concluded exploratory talks in Washington with a view to beginning negotiations on amendments to the present income tax treaty between the two countries.

Trinidad and Tobago initiated the exploratory meeting to discuss some of the problems in the scope and administration of the present income tax treaty which was ratified in 1970 and remains in force. It is expected that negotiations will resume in Trinidad and Tobago early in 1980.

The Treasury invites persons wishing to submit comments concerning problems under the present treaty or to suggest changes to write to H. David Rosenbloom, International Tax Counsel, U.S. Treasury, Room 3064, Washington, D.C. 20220.

Certain "Continuous Use" Forms Have Been Revised

Announcement 80-18

Certain "continuous use" forms have been revised because of legislation and are expected to be available in most Internal Revenue Service district offices by mid-January, 1980. Taxpayers should use the new version of the forms. Following is a list of the revised forms:

Form	Title	Revision Date
637	Registration for Tax-Free Transactions Under Chapter 32 of the Internal Revenue Code	April 1979
927	Proof of Worthlessness of Mineral Rights or Geothermal Deposits	September 1979
1040X	Amended U.S. Individual Income Tax Return	October 1979
1040X	Instructions for Form 1040X	October 1979
1045	Application for Tentative Refund	December 1979
1139	Corporation Application for Tentative Refund	November 1979
4347	Information Return by Person Receiving Program Payments From the U.S. Department of Agriculture	October 1979
4782	Employee Moving Expense Information	April 1979
5074	Allocation of Individual Income Tax to Guam or Northern Mariana Islands	December 1979
7004	Application for Automatic Extension of Time to File Corporation Income Tax Return	October 1979

Statistics from 1976 Business Income Tax Returns

Announcement 80-19 [1]

Publication 438, Statistics of Income—1976, Business Income Tax Returns, is now available and may be purchased for $8.00 from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

United States and Austria to Discuss Income and Estate and Gift Tax Treaties

Announcement 80-24 [2]

The Treasury Department has announced that representatives of the United States and Austria will conduct exploratory talks in Austria during the week of February 18 with a view to beginning negotiations of an estate and gift tax treaty between the two countries. Discussions will be based upon the United States Model Estate and Gift Tax Treaty of 1979 and will consider the allocation of taxing jurisdiction between the two countries on the basis of citizenship, domicile, and location of property, in order to avoid double taxation. Rules for resolving the issue of domicile will also be discussed.

Representatives will also discuss modernization of the existing income tax treaty between the United States and Austria, which has been in effect since 1957, with a view to bringing it into line with the 1977 U.S. and OECD model treaties.

The Treasury invites persons wishing to submit comments concerning either the income tax convention or the proposed estate and gift tax convention to write to H. David Rosenbloom, International Tax Counsel, U.S. Department of the Treasury, Room 3064, Washington, D.C. 20220.

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[1] Based on a Treasury Department announcement dated January 4, 1980, and published in the issue of the Federal Register for January 10, 1980, 45 F.R. 2142.

[1] Based on News Release IR-2181, dated November 21, 1979.

[2] Based on an announcement dated January 21, 1980, and published in the issue of the Federal Register for January 24, 1980, 45 F.R. 5881.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants and Enrolled Agents from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following persons have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Richard O. Bertoli	Sparkill, NY	Certified Public Accountant	Indefinite effective November 2, 1979
Slathern E. Gassiott	Port Arthur, TX	Certified Public Accountant	Thirty months effective November 19, 1979
Leonard M. Bernes	Atlanta, GA	Certified Public Accountant	Indefinite effective December 5, 1979
Franke J. Marcone	Media, PA	Attorney	Twenty-four months effective December 11, 1979
William P. Renner	Hagerstown, MD	Certified Public Accountant	Twenty-four months effective December 11, 1979

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.85-1, 1.6050B-1, added.	Taxation of unemployment compensation.	Dec. 19, 1979	Feb. 18, 1980
26 CFR 25.2514-1, amended; 25.6075, 25.6075-1, deleted; 25.6075-1, 301.7517-1, added.	Time for filing gift tax returns and for requesting a statement explaining valuation for estate, gift, or generation-skipping transfer tax purposes. In addition, a change to an example that relates to the definition of a general power of appointment.	Dec. 19, 1979	Feb. 18, 1980
26 CFR (1939) 16.1 through 17.19 deleted; 26 CFR Subchapter D retitled; Part 160 added.	Profit limitations of the Vinson-Trammell Act on certain contracts and subcontracts for naval vessels and military aircraft.	Oct. 26, 1979	Feb. 26, 1980
26 CFR 1.44B-1, 1.51-1, 1.53-1, 1.53-2, 1.381(c)(26)-1, added; 1.51, 1.51-1, 5.44B-1, 5.51, deleted; 1.52-1, 1.52-2, 1.280C-1, amended; 1.52-3 revised; 1.53-1, redesignated as 1.53-3 and amended.	Targeted Jobs Tax Credit.	Dec. 28, 1979	Feb. 25, 1980
26 CFR 1.1001-2 added; 1.61-12, 1.671-1, 1.741-1, 1.1011-2 amended; 1.1001 deleted.	Discharge of liabilities on sale or other disposition of property.	Dec. 28, 1979	Feb. 25, 1980
26 CFR 48.6420(a), (b), (c), (d), (e), (f), (g), (h) deleted; 48.6420(a)-1, 48.6420(b)-1, 48.6420(c)-1 amended; 140.6420-1, 140.6427-1, published as temporary regulations in T.D. 7662, page , this Bulletin, redesignated as 48.6420(c)-2 and 48.6427-1 respectively with all references to Part 140 changed to Part 48.	Claims by aerial applicators when fuels are used for farming purposes.	Dec. 27, 1979	Feb. 25, 1980
26 CFR 1.368 deleted; 1.368-1 amended.	The continuity of business enterprise requirement for corporate reorganizations.	Dec. 28, 1979	Feb. 25, 1980

Finding List of Current Action on Previously Published Rulings[1]

Bulletin 1980-1 through 1980-5

* Denotes entry since last publication

Delegation Orders:

42 (Rev. 12)
Superseded by
42 (Rev. 13), 1980-4 I.R.B. **40**

Revenue Procedures:

79-12
Amplified by
Rev. Proc. 80-1, 1980-5 I.R.B. **22***

Revenue Rulings:

56-432
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80-27, 1980-4 I.R.B. **8**

56-497
Obsoleted by
80-16, 1980-3 I.R.B. **6**

62-197
Distinguished by
80-17, 1980-3 I.R.B. **5**

63-180
Obsoleted by
80-16, 1980-3 I.R.B. **6**

64-149
Distinguished by
80-17, 1980-3 I.R.B. **5**

64-264
Clarified & Superseded by
80-20, 1980-3 I.R.B. **10**

65-16
Amplified by
80-4, 1980 I.R.B. **14**

67-431
Amplified by
80-7, 1980-1 I.R.B. **17**

68-89
Obsoleted by
80-16, 1980-3 I.R.B. **6**

68-382
Distinguished by
80-30, 1980-5 I.R.B. **7***

75-368
Modified by
80-6, 1980-1 I.R.B. **16**

77-392
Revoked by
80-31, 1980-5 I.R.B. **8***

78-110
Clarified by
80-22, 1980-3 I.R.B. **15**

78-161
Distinguished by
80-9, 1980-2 I.R.B. **5**

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1 I.R.B., dated January 7, 1980.

INTERNAL REVENUE CUMULATIVE BULLETINS

1927–1	$6.90	1941–1	*$6.95*	1957–1	$10.10	1969–3	$12.50
1927–2	*2.95*	*1941–2*	*3.55*	1957–2	13.00	1970–1	11.00
1928–1	6.95	1942–1	7.25	1958–1	9.60	1970–2	14.00
1928–2	9.50	*1942–2*	*5.55*	1958–2	13.00	1971–1	10.55
1929–1	*2.50*	*1943*(*)	*9.55*	1958–3	15.00	1971–2	8.50
1929–2	*3.15*	*1944*(*)	*7.85*	1959–1	15.00	1972–1	13.50
1930–1	7.30	1945(*)	9.40	1959–2	9.60	1972–2	13.70
1930–2	9.50	*1946–1*	*2.55*	1960–1	9.00	1973–1	13.20
1931–1	*3.60*	1946–2	5.20	1960–2	11.50	1973–2	8.30
1931–2	*3.25*	*1947–1*	*1.80*	1961–1	14.00	1974–1	11.00
1932–1	*2.80*	1947–2	3.40	1961–2	10.00	1974–2	9.95
1932–2	8.65	*1948–1*	*3.15*	1962–1	6.20	*1974–3*	*8.20*
1933–1	*3.35*	1948–2	7.50	1962–2	7.15	1974–3 Supp.	10.00
1933–2	*3.45*	*1949–1*	*6.90*	1962–3	15.00	1975–1	13.25
1934–1	*3.70*	*1949–2*	*2.80*	1963–1	9.00	1975–2	13.00
1934–2	*4.10*	1950–1	6.35	1963–2	10.75	1976–1	11.00
1935–1	6.90	*1950–2*	*4.70*	1964–1–1	10.00	1976–2	10.25
1935–2	*4.00*	*1951–1*	*2.65*	1964–1–2	11.00	1976–3–1	9.50
1936–1	*3.55*	*1951–2*	*5.05*	1964–2	9.80	1976–3–2	16.00
1936–2	*3.90*	*1952–1*	*2.55*	1965–1	10.70	1976–3–3	10.00
1937–1	*3.75*	1952–2	7.05	1965–2	12.25	1977–1	10.75
1937–2	7.70	*1953–1*	*4.25*	1966–1	9.25	1977–2	11.75
1938–1	*4.05*	1953–2	12.00	1966–2	14.05	1978–1	11.75
1938–2	*3.50*	1954–1	12.00	1967–1	10.00	1978–2	13.00
1939–1–1	8.25	1954–2	12.00	1967–2	10.00	1978–3–1	12.25
1939–1–2	10.90	1955–1	10.25	1968–1	14.00	1978–3–2	9.00
1939–2	9.40	1955–2	13.00	1968–2	11.75	1979–1	14.00
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February 19, 1980
Bulletin No. 1980-7

Internal Revenue
bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENT

Announcement 80-21, page 20.
A public hearing will be held on March 18, 1980, concerning proposed regulations clarifying the continuity of business enterprise requirement for corporate reorganizations.

INCOME TAX

Rev. Rul. 80-37, page 6.
Sale of property held for sale or lease; CLADR system. A taxpayer that manufactures, leases, and sells electronic data processing equipment elected to depreciate the equipment, which is leased under lease-with-option-to-purchase arrangements, under the CLADR system. Gain on sales to the lessees is ordinary income for the year of sale. The unadjusted basis of the equipment sold is to be removed from the taxpayer's vintage account, the accrued depreciation is to be removed from the reserve for depreciation, and the equipment's salvage value is to be removed from the salvage value of the vintage account.

Rev. Rul. 80-38, page 7.
Charitable remainder trust; percentage limitation; remote contingency. A taxpayer created a charitable remainder trust with the remainder interest payable to a public university described in section 170(b)(1)(A)(ii) and (c)(2)(B) of the Code. The trust instrument provides that if the university is not an organization described in section 170(c) when the trust is to be distributed, the trustee will then select a beneficiary described in section 170(c). The possibility that the remainder will not go to an organization described in section 170(b)(1)(A) is so remote as to be negligible, and the 50 percent limitation is applicable with respect to the taxpayer's transfer to the trust.

Rev. Rul. 80-39, page 8.
Change in accounting method; condition; remaining adjustment. A domestic corporation carries out its business operations through several divisions. Each division is in a different trade or business, and each keeps a complete and separate set of books and records. The corporation seeks permission to change its method of accounting for the trade or business conducted by one of the divisions. In granting a change in method of accounting, the Service will impose a condition that requires any remaining balance of a section 481(a) adjustment applicable to the trade or business conducted by that division to be reported in the year in which the corporation ceases to engage in that trade or business.

Rev. Rul. 80-40, page 12.
U.S. corporation; Virgin Islands inhabitant. A situation is described in which a U.S. corporation that has its principal office in the Virgin Islands and qualifies for certain Virgin Islands tax incentives is treated as a Virgin Islands inhabitant so that it satisfies its U.S. income tax obligation by

(Continued on page 4)

Finding Lists begin on page 24.
Announcement Relating to Decisions of the Tax Court on page 5.
Announcement of Voluntary Suspensions on page 21.
Announcement of Notice of Proposed Rulemaking on page 22.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part includes rulings and decisions based on Subpart A, Tax Conventions and related Treasury Decisions and Revenue Rulings; Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of Revenue Rulings, Revenue Procedures, and other published items, and (3) topical Indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

paying tax on its income from all sources to the Virgin Islands. The same corporation is a domestic corporation for purposes of the dividends received deduction.

Rev. Rul. 80-42, page 14.
Basis; film rights; cost exceeding fair market value. A corporation purchased certain motion picture exhibition rights in an arm's length transaction and resold them to a limited partnership whose general partner was the corporation's majority shareholder for a cash downpayment greater than the corporation's original cost plus a nonrecourse note. The partnership is unable to demonstrate that the fair market value of the rights exceeds the corporation's original cost, and the partnership's basis in the rights is limited to their fair market value.

Rev. Rul. 80-43, page 9.
Depletion; proven oil or gas property; small business corporation election. The election to be treated as a small business corporation under section 1372(a) of the Code is not a transfer, within the meaning of section 613A(c)(9), of an interest in any proven oil or gas property.

T.D. 7664, page 10.
An amendment to the temporary regulations under section 911 of the Code, as amended by the Foreign Earned Income Act of 1978, relates to the definition of a "camp" for U.S. citizens employed abroad.

EMPLOYEE PLANS

Announcement 80-22, page 20.
For 1979, taxpayers and employees may rely on the proposed regulations defining "active participant" to determine if the payments to an individual retirement account are deductible and to determine what information must be furnished on Form W-2 about an employee's coverage by a pension plan.

EMPLOYMENT TAXES

Rev. Rul. 80-41, page 14.
Meals furnished to hotel and restaurant employees. The Service will not follow the *Hotel Conquistador* decision holding that the value of certain meals furnished without charge to hotel and restaurant employees was not wages under the FICA and FUTA.

ADMINISTRATIVE

Rev. Proc. 80-6, page 16.
Offers in compromise; acceptance; inspection. The jurisdictional changes pertaining to the consideration and disposition of offers in compromise and general guidelines relating to the acceptability of an offer in compromise are set forth; Rev. Procs. 64-44 and 66-53 superseded.

Announcement Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issues or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by Revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the Court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the Tax Court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decision:

Taxpayer	Docket No.	Report	
		Volume	Page
Horne, J. E., Est. of, Andrew Berry, executor, & Amelia S. Horne [1]	3904-74	64	1020

The Commissioner does NOT ACQUIESCE in the following decision:

Taxpayer	Docket No.	Report	
		Volume	Page
Chronicle Publishing Co.	8550-74	67	964

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[1] Acquiescence in result. Acquiescence "in result" means acceptance of the decision of the Court but disagreement with some or all the reasons assigned for the decision.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 167.—Depreciation

26 CFR 1.167(a)-11: Depreciation based on class lives and asset depreciation ranges for property placed in service after December 31, 1970.

Sale of property held for sale or lease; CLADR system. A taxpayer that manufactures, leases, and sells electronic data processing equipment elected to depreciate the equipment, which is leased under lease-with-option-to-purchase arrangements, under the CLADR system. Gain on sales to the lessees is ordinary income for the year of sale. The unadjusted basis of the equipment sold is to be removed from the taxpayer's vintage account, the accrued depreciation is to be removed from the reserve for depreciation, and the equipment's salvage value is to be removed from the salvage value of the vintage account.

Rev. Rul. 80-37

ISSUE

What is the proper treatment for sales of equipment to leasing customers by a taxpayer who is regularly engaged in the dual business of renting and selling such equipment and who has, during the rental period, elected to depreciate such equipment under the Class Life Asset Depreciation Range (CLADR) system?

FACTS

The taxpayer is a corporation engaged in manufacturing, leasing, and selling electronic data processing equipment.

The taxpayer elected the CLADR system as provided by section 1.167 (a)-11 of the Income Tax Regulations and the leased equipment was included in the appropriate guideline class. All of this equipment is subject to lease agreements to a minimum period of one year, and the rental is expressed as a monthly rate.

An addendum to the lease agreement gives the lessee the option to acquire the equipment at the established price in effect on the date of purchase. A portion of the rental payments may be applied against the purchase price.

LAW AND ANALYSIS

Section 167(a) of the Internal Revenue Code provides there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear of property used in a trade or business or for property used for the production of income.

Section 167(m) of the Code provides that in the case of a taxpayer who has made an election to use the CLADR system, the term "reasonable allowance" means only an allowance based on lives prescribed by the Secretary that reasonably reflect the anticipated useful life of that class of property to the industry.

Section 1.167(a)-11(a) of the regulations provides an asset depreciation range and class life system for designated classes of assets placed in service after December 31, 1970. The system is optional with the taxpayer, and the taxpayer must make an annual election. Generally, an election for a taxable year must apply to all additions of eligible property during the taxable year of election.

Section 1.167(a)-11(b)(2) of the regulations defines "eligible property" as tangible property that is subject to the allowance for depreciation provided by section 167(a) of the Code but only if—

(i) an asset guideline class and asset guideline period are in effect for such property for the taxable year of election,

(ii) the property is either section 1245 property as defined in section 1245(a)(3) or section 1250 property as defined in section 1250(c).

Section 1.167(a)-11(d)(3)(i) of the regulations provides for the treatment of retirements from vintage accounts. An asset in a vintage account is retired when such asset is permanently withdrawn from use in a trade or business or in the production of income by the taxpayer. A retirement may occur as a result of a sale or exchange, by another act of the taxpayer amounting to a permanent disposition, or by physical abandonment of an asset. A retirement may also occur by transfer of an asset to supplies of scrap.

Section 1.167(a)-11(d)(3)(ii) of the regulations defines ordinary and extraordinary retirements. The term "ordinary retirement" means any retirement of section 1245 property from a vintage account that is not treated as an "extraordinary retirement" under this subparagraph. The retirement of an asset from a vintage account in a taxable year is an "extraordinary retirement" if the asset is section 1250 property or the asset is section 1245 property retired as a direct result of a cessation, termination, curtailment, or disposition of a business.

Section 1.167(a)-11(d)(3)(iii) of the regulations provides for the nonrecognition of loss upon an ordinary retirement from a vintage account. All proceeds from ordinary retirements are to be added to the depreciation reserve of the vintage account from which the asset is retired.

Section 1.167(a)-11(d)(3)(ix) of the regulations provides that in the case of a vintage account for section 1245 property, gain is to be recognized for each taxable year to the extent of the excess of the depreciation reserve over the unadjusted basis of such account.

Such gain shall constitute section 1245 gain to the extent that it does not exceed the total amount of depreciation allowances in the related year-end depreciation reserve reduced by previously recognized section 1245 gain. Any excess over such total amount so reduced may constitute gain to which section 1231 of the Code applies.

At the time section 167(m) of the Code was enacted and the regulations were promulgated, a body of case law had been developed with respect to dual purpose property. The cases, including *Recordak Corporation v. United States*, 325 F.2d 460 (Ct. Cl. 1963), *Continental Can Company, Inc. v. United States*, 422 F.2d 405 (Ct. Cl. 1970), *cert. den.* 400 U.S. 819 (1971), and *International Shoe Machine Corporation v. United States*, 491 F.2d 157 (1st Cir 1974), *cert.*

den., 419 U.S. 834 (1974), interpreted the term "primarily" as invoking a contrast between sales made in the ordinary course of business and those made in the liquidation of inventory rather than between sale and lease. This interpretation is viewed by the courts as being consistent with the decision in ***Malat v. Riddell,*** 383 U.S. 569 (1966), Ct. D. 1906, 1966-1 C.B. 184, in which the Supreme Court of the United States held that "primarily" means "of first importance" or "principally." The sale-and-rent cases cited above hold that when a manufacturer is regularly engaged in the dual business of selling and renting the equipment it manufactures, then income resulting from either activity satisfies the "primarily" concept since both activities are part of the normal stream of the taxpayer's business. Hence, sales of such leased equipment are not sales of depreciable property at the time of sale and capital gains treatment is forbidden.

In the present case, because the leased asset does not cease to be depreciable property until the year of sale, it is treated, during the rental period, as are all assets in the vintage account for property used in the trade or business of the taxpayer. During this period CLADR provisions are applicable to the dual purpose asset. However, on the date of sale of the dual purpose asset, the asset becomes property held by the taxpayer for sale to customers in the ordinary course of business. The CLADR regulations cease to have any applicability, and the tax treatment of the asset is determined under the case law and statutory provisions dealing with gain from the sale of assets held for sale in the ordinary course of business. See section 1231(b)(1)(B) of the Code.

Under the CLADR regulations, sales of dual purpose property cannot, by definition, be considered to be extraordinary retirements. Similarly, sales of dual purpose property cannot be treated as ordinary retirements because the retirements discussed in sections 1.167(a)-11(d)(3)(iii) and (ix) of the regulations are necessarily retirements of property held for use in the taxpayer's trade or business, and as of the date of sale, dual purpose assets have ceased to be so held. Since, on the date of sale, the asset is held for sale to customers in the ordinary course of business it must, at that time, be removed from the depreciation vintage account. Further, in order not to distort the depreciation deduction on the balance of the vintage account as well as to compute properly the ordinary income on the sale of the equipment now held primarily for sale in the ordinary course of business, the depreciation attributable to such property must be removed from the depreciation reserve. Also, the salvage value of the account should be adjusted for salvage of the asset removed from the account.

HOLDINGS

The gain from the sale of this dual purpose property is part of the taxpayer's normal business operations and is ordinary income for the year of sale notwithstanding that the property had been held for the dual purpose of rent or sale and had, in fact, been depreciated in accordance with the taxpayer's election to apply the CLADR system of depreciation.

The unadjusted basis of the property sold is to be removed from the vintage account, the accrued depreciation is to be removed from the reserve for depreciation, and the salvage value of the vintage account is to be adjusted by removal of the salvage value of the property sold.

Section 170.—Charitable, Etc., Contributions and Gifts

26 CFR 1.170A-8: Limitations on charitable deductions by individuals.
(Also Section 664; 1.664-1.)

Charitable remainder trust; percentage limitation; remote contingency. A taxpayer created a charitable remainder trust with the remainder intrest payable to a public university described in section 170(b)(1)(A)(ii) and (c)(2)(B) of the Code. The trust instrument provides that if the university is not an organization described in section 170(c) when the trust is to be distributed, the trustee will then select a beneficiary described in section 170(c). The possibility that the remainder will not go to an organization described in section 170 (b)(1)(A) is so remote as to be negligible, and the 50 percent limitation is applicable with respect to the taxpayer's transfer to the trust.

Rev. Rul. 80-38

ISSUE

What percentage limitation is applicable to a charitable contributions deduction under section 170 of the Internal Revenue Code, in view of the trustee's power to designate an alternative remainder beneficiary, in the circumstances described below?

FACTS

The taxpayer made an inter vivos transfer of property to a valid charitable remainder trust described in section 664(d) of the Code. Under the terms of the trust, the remainder interest is payable to a public university that qualifies as an educational organization described in section 170(c)(2)(B) and in section 170(b)(1)(A)(ii).

The trust instrument also provides that if the designated charitable remainder beneficiary is not an organization described in section 170(c) of the Code when the trust remainder is to be distributed, the remainder shall be distributed to one or more organizations, to be selected in the sole discretion of the trustee, that are then described in section 170(c). The trust terms do not expressly require that, in exercising the power to select alternative remainder beneficiaries, the trustee must choose organizations that are described in section 170(b)(1)(A) as well as in section 170(c).

LAW AND ANALYSIS

Section 170 of the Code provides, subject to certain limitations, a deduction for charitable contributions (as defined in subsection (c)).

Section 170(f)(2) of the Code provides that in the case of property transferred in trust, no deduction shall be allowed under section 170 for the value of the contribution of a remainder interest unless the trust is one of the specified types described in section 664(d) or section 642(c)(5).

Under sections 664(d)(1)(C) and 664(d)(2)(C) of the Code, a charitable remainder trust must provide for payment of the remainder interest to an organization described in section 170(c).

Section 170(c) of the Code describes various types of charitable organizations to which transfers qualify as charitable contributions for the purposes of section 170. An organization that is described in section 170(c) may be an organization described in section 170(b)(1)(A) or it may be an organization to which a contribution described in section 170(b)(1)(B) is made.

Section 170(b)(1)(A) of the Code sets forth a list of various types of organizations and provides that contributions by an individual taxpayer to those organizations are allowable as deductions in a total amount of not more than 50 percent of the taxpayer's contribution base for the taxable year.

Under section 170(b)(1)(B) of the Code, if charitable contributions are made to organizations that are not described in section 170(b)(1)(A), the maximum amount allowable as a deduction for such contributions by an individual taxpayer is 20 percent of the taxpayer's contribution base for the taxable year.

Thus, if a contribution is made by an individual taxpayer to an organization described in section 170(c) of the Code, the amount deductible is subject to either the 50 percent limitation of section 170(b)(1)(A) or the 20 percent limitation of section 170(b)(1)(B), depending on whether the transferee organization is described in section 170(b)(1)(A).

Section 1.170A-1(e) of the Income Tax Regulations provides that if the interest in property transferred to charity may be defeated by the subsequent performance of some act or by the happening of some event, the deduction is nevertheless allowable if the possibility that the act or event will occur and defeat the charity's interest is so remote as to be negligible.

In Rev. Rul. 76-307, 1976-2 C.B. 56, a trustee was empowered to select one or more organizations described in section 170(c) of the Code if the designated remainder beneficiary was not described in section 170(c) when the trust terminated. The revenue ruling concludes that although the governing instrument limited the alternative remainder beneficiaries to organizations described in section 170(c), without reference to their also being described in section 2522(a), a charitable deduction is allowable for federal gift tax purposes under section 2522 because the possibility that the designated beneficiary would not continue to be an organization described in both sections 170(c) and 2055(a) was so remote as to be negligible.

Rev. Rul. 76-307 also concludes that in the situation described a deduction is allowable for federal income tax purposes under section 170(a) of the Code. The revenue ruling did not reach the question as to the proper percentage limitation under section 170(b).

Because the designated organization in the present case is a public university, there is small likelihood that it will cease to exist as an organization described in sections 170(c) and 170(b)(1)(A) of the Code. Therefore, the possibility that the remainder interest will not go to an organization described in section 170(b)(1)(A) is so remote as to be negligible.

HOLDING

The 50 percent limitation of section 170(b)(1)(A) of the Code is applicable with respect to the taxpayer's transfer to the charitable remainder trust.

Section 243.—Dividends Received by Corporations

26 CFR 1.243-1: Deduction for dividends received by corporations.

Whether a United States corporation, which is treated as a Virgin Islands inhabitant, is a "domestic corporation" for purposes of the dividends received deduction of section 243 of the Code. See Rev. Rul. 80-40, page 12.

Section 446.—General Rule for Methods of Accounting

26 CFR 1.446-1: General rule for methods of accounting.

Whether the Internal Revenue Service will impose a condition in a change of method of accounting, which requires the remaining balance of a section 481(a) adjustment applicable to a division of the taxpayer going out of business to be taken into account in the year in which the taxpayer ceases to engage in that (the division's) trade or business. See Rev. Rul. 80-39, below.

Section 481.—Adjustments Required by Changes in Methods of Accounting

26 CFR 1.481-1: Adjustments in general. (*Also Section 446; 1.446-1.*)

Change in accounting method; condition; remaining adjustment. A domestic corporation carries out its business operations through several divisions. Each division is in a different trade or business, and each keeps a complete and separate set of books and records. The corporation seeks permission to change its method of accounting for the trade or business conducted by one of the divisions. In granting a change in method of accounting, the Service will impose a condition that requires any remaining balance of a section 481(a) adjustment applicable to the trade or business conducted by that division to be reported in the year in which the corporation ceases to engage in that trade or business.

Rev. Rul. 80-39

ISSUE

In granting a change in method of accounting with respect to a trade or business, what condition will the Internal Revenue Service impose on the taxpayer regarding the remaining balance of the adjustment required by section 481(a) of the Internal Revenue Code in the event the taxpayer ceases to operate that trade or business?

FACTS

M, a domestic corporation, carries out its business operations through several divisions. Each division is in a different trade or business, and each keeps a complete and separate set of books and records. Division 1 has been in existence for 15 years and has accounted for income and expenses under its present method of accounting during that time.

M seeks permission to change its method of accounting for the trade or business conducted in division I from its present method to another method. In accordance with Rev. Proc. 70-27, 1970-2 C.B. 508, *M* filed an Application for Change in Method of Accounting (Form 3115) with respect to the trade or business conducted in division I with the Service, proposing that *M* take the necessary resulting section 481(a) adjustment into account ratable over 10 taxable years. One of the conditions prescribed by the Service is that if *M* ceases to engage in the trade or business for which the change in method of accounting is granted at any time prior to the expiration of the 10-year period, *M* will take into account, for federal income tax purposes for the year in which *M* ceases to engage in that trade or business, the balance of the section 481(a) adjustment not previously taken into account in computing taxable income.

LAW AND ANALYSIS

Section 1.446-1(e)(3)(i) of the Income Tax Regulations provides that permission to change a taxpayer's method of accounting will not be granted unless the taxpayer and the Service agree to the terms, conditions, and adjustments under which the change will be effected. Under this provision, the Service may prescribe the necessary terms and conditions under which a change in method of accounting will be effected in order to prevent amounts from being duplicated or omitted.

The section 481(a) adjustment applicable to the trade or business conducted in division I is totally unrelated to *M*'s other trades or businesses. Should *M* continue to spread the section 481(a) adjustment applicable to the trade or business conducted in division I over years subsequent to the time that *M* ceases to engage in that trade or business, such continued spread of the adjustment would distort the income of *M* during such period.

HOLDING

The Service will impose a condition that requires the remaining balance of a section 481(a) adjustment applicable to the business conducted in division I of the taxpayer to be taken into account in the year in which the taxpayer ceases to engage in that trade or business.

Section 613A.—Limitation on Percentage Depletion in Case of Oil and Gas Wells

(Also Section 1372; 26 CFR 1.1372-1.)

Depletion; proven oil or gas property; small business corporation election. The election to be treated as a small business corporation under section 1372(a) of the Code is not a transfer, within the meaning of section 613A(c)(9), of an interest in any proven oil or gas property.

Rev. Rul. 80-43

ISSUE

Is the filing of an election to be treated as a small business corporation under section 1372(a) of the Internal Revenue Code a transfer, within the meaning of section 613A(c)(9), of an interest in any proven oil or gas property?

FACTS

M is a corporation that owns and operates proven oil and gas properties. In 1978, *M* made a valid election to be treated as a "small business corporation" in accordance with the provisions of section 1372 of the Code.

LAW AND ANALYSIS

Section 613A(a) of the Code provides that, except as otherwise provided in that section, the allowance for depletion under section 611 with respect to any oil or gas well shall be computed without regard to section 613.

Section 613A(c)(9)(A) of the Code provides that, in the case of a transfer (including a sublease) after December 31, 1974, of an interest (including an interest in a partnership or trust) in any proven oil or gas property, the allowance for percentage depletion that is provided under section 613A(c)(1) does not apply to the transferee (or sublessee) with respect to production of crude oil or natural gas attributable to such interest, and such production shall not be taken into account for any computation by the transferee (or sublessee) under section 613A(c).

Section 1372(a) of the Code allows a small business corporation, as defined in section 1371, to elect not to be subject to the taxes imposed by Chapter 1 of the Code, but to have all its income taxed directly to its shareholders.

Section 1373(a) of the Code provides that the undistributed taxable income of an electing small business corporation for any taxable year shall be included in the gross income of the shareholders of such corporation in the manner and to the extent set forth in section 1373. Section 1373(b) provides that each person who is a shareholder of an electing small business corporation on the last day of a taxable year of such corporation shall include in gross income, for the taxable year in which or with which the taxable year of the corporation ends, the amount the shareholder would have received as a dividend, if on such last day there had been distributed pro rata to its shareholders by such corporation an amount equal to the corporation's undistributed taxable income. Section 1373(c) defines "undistributed taxable income" as taxable income determined without regard to certain deductions, not relevant here, reduced by the taxes imposed by sections 56 and 1378(a) and by the amount of money distributed as dividends during the taxable year to the extent that any such amount is a distribution out of earnings and profits of the taxable year as specified in section 316(a)(2).

A "transfer" of any proven oil or gas property means a change in legal or equitable ownership in the oil or gas property. Any change that increases a taxpayer's proportionate share of income from an oil or gas property is also a transfer.

The filing of an election under section 1372(a) of the Code does not cause a transfer of legal or equitable ownership of any property from or to *M*. *M* owns the same oil and gas properties before and after the election. The amount included in the gross income of a shareholder of an electing small business corporation under section 1373 is an "adjusted" taxable income from which the allowance for depletion has been deducted. Thus, the shareholder's proportionate share of income from an oil or gas property is not increased as a result of the election under section 1372(a).

HOLDING

The filing of an election under section 1372(a) of the Code is not a transfer within the meaning of section 613A(c)(9) of an interest in any proven oil or gas properties.

Section 664.—Charitable Remainder Trusts

26 CFR 1.664-1: Charitable remainder trusts.

Whether the 50 percent limitation on the charitable contributions deduction is applicable if the trustee of a charitable remainder trust may select an alternative remainderman. See Rev. Rul. 80-38, page 7.

Section 864.—Definitions

26 CFR 1.864-2: Trade or business within the United States.

Whether a United States corporation that has its principal office in the Virgin Islands and qualifies for certain Virgin Islands tax incentives is treated as a Virgin Islands inhabitant so that it satisfies its United States income tax obligations by paying tax on its income from all sources to the Virgin Islands. See Rev. Rul. 80-40, page 12.

Section 881.—Tax on Income of Foreign Corporations not Connected with United States Business

26 CFR 1.881-1: Manner of taxing foreign corporations.

Whether a United States corporation that has its principal office in the Virgin Islands and qualifies for certain Virgin Islands tax incentives is treated as a Virgin Islands inhabitant so that it satisfies its United States income tax obligations by paying tax on its income from all sources to the Virgin Islands. See Rev. Rul. 80-40, page 12.

Section 882.—Tax on Income of Foreign Corporations Connected with United States Business

26 CFR 1.882-1: Taxation of foreign corporations engaged in U.S. business or of foreign corporations treated as having effectively connected income.

Whether a United States corporation that has its principal office in the Virgin Islands and qualifies for certain Virgin Islands tax incentives is treated as a Virgin Islands inhabitant so that it satisfies its United States income tax obligations by paying tax on its income from all sources to the Virgin Islands. See Rev. Rul. 80-40, page 12.

Section 911.—Income Earned by Individuals in Certain Camps

26 CFR 5b.911-1: Individuals qualifying for the exclusion.

T.D. 7664

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 5B.—TEMPORARY INCOME TAX REGULATIONS UNDER THE FOREIGN EARNED INCOME ACT OF 1978

The foreign earned income exclusion

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides temporary regulations relating to the foreign earned income exclusion. Changes to the applicable tax law were made by the Foreign Earned Income Act of 1978 [Pub. L. 95-615, 1978-26.B. 415, 416]. These regulations affect individuals residing in camps located in hardship areas.

DATE: The regulations apply to taxable years beginning after December 31, 1977.

FOR FURTHER INFORMATION CONTACT: Mary E. Dean of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T; 202-566-3289 (not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains temporary regulations under section 911 of the Internal Revenue Code of 1954. The amendments are being proposed to conform the regulations under section 911 relating to the foreign earned income exclusion to section 202 of the Foreign Earned Income Act of 1978 (Pub. L. No. 95-615, 92 Stat. 3098). The temporary regulations provided by the document will remain in effect until superseded by final regulations on this subject.

EXPLANATION OF PROVISION

This Treasury decision contains only amendments to § 5b.911-1(c) relating to the definition of camp. The amended temporary regulations, § 5b.911-1(c), amplify the statutory definition of camp. Paragraph (c)(1) of § 5b.911-1 sets forth the general definition of camp. A rule has been added, providing that two or more common areas or enclaves which house employees who work on the same project are considered to be one common area or enclave in determining whether the lodging accommodates 10 or more employees performing services at the taxpayer's worksite.

Paragraph (c)(2) of § 5b.911-1 provides that lodging will be considered to be substandard if it is appreciably below the standard of housing typically occupied in the United States by individuals whose income equals the lesser of the median salary paid to American employees residing in the common area or the salary of an employee of the United States who is compensated at an annual rate paid for step 1 of grade GS-14. A list of facts and circumstances to be considered in determining whether lodging is substandard is provided. In addition a list of presumptions is provided.

Paragraph (c)(3) of § 5b.911-1 provides a new definition of remote area which focuses on the availability of satisfactory housing. A list of facts and circumstances to be considered in determining whether an area is remote is provided. In addition a list of presumptions is provided.

DRAFTING INFORMATION

The principal author of the regulation is Mary E. Dean of the Legislation and Regulations Division of the

Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

The amendments to 26 CFR Part 5b are as follows:

Paragraph 1. Section 5b.911-1(c) is revised to read as follows:

§ 5b.911-1 Individuals qualifying for the exclusion.

* * * * *

(c) *Camp*—(1) *In general.* A camp is lodging which is all of the following:

(i) Substandard;

(ii) Provided by or on behalf of the employer for the convenience of the employer because the place where the taxpayer renders services is in a remote area where satisfactory housing is not available to the taxpayer on the open market;

(iii) Located as near as practicable to, and in the vicinity of, the worksite of the taxpayer; and

(iv) Furnished in a common area or enclave which is not available to the general public for lodging or accommodations and which normally accommodates 10 or more persons who are either employees of the taxpayer's employer or other employees performing services at the taxpayer's worksite.

For purposes of paragraph (c)(1)(ii) of this section, the term "for the convenience of the employer" has the same meaning which it has for purposes of section 119. For purposes of paragraph (c)(1)(iv) of this section, a cluster of housing units is not a common area or enclave if it is adjacent to or surrounded by substantially similar housing available to the general public. For purposes of paragraph (c)(1)(iv) of this section, two or more common areas or enclaves which house employees who work on the same project (for example, a highway project) are considered to be one common area or enclave in determining whether they normally accommodate 10 or more employees performing services at the taxpayer's worksite.

(2) *Substandard lodging*—(i) *In general.* Lodging is considered to be substandard if, under all the relevant facts and circumstances, it is appreciably below the standard of housing typically occupied in the United States by individuals whose income equals the lesser of the median salary paid to American employees residing in the common area or the salary of an employee of the United States who is compensated at an annual rate paid for step 1 of Grade GS-14. Relevant facts and circumstances which may indicate that lodging is substandard include (but are not limited to) the following:

(A) Inadequate living space;

(B) Lack of privacy occasioned by communal dining halls or other shared facilities;

(C) Temporary nature of the lodging, such as that inherent in prefabricated housing set in position on cinder blocks or housing consisting of movable units such as mobile homes, trailers, or portable camp facilities;

(D) An immediate environment that exposes the occupants of the housing to unsanitary or unhealthy conditions (for example, open sewers immediately adjacent to the housing) or to unusual risk of personal harm or property loss due to terrorism or civil unrest;

(E) Lack of improvements typically found in residential areas in the United States, such as paved and lighted streets, recreational areas, sewage facilities, and landscaping; or

(F) The cost per square foot of the lodging if constructed in the United States would be substantially less than the median cost per square foot to construct housing in the United States.

The general environment in which lodging is located (*e.g.*, the climate, prevalence of insects, etc.) does not of itself make lodging substandard. The general environment is relevant, however, if lodging is inadequate to protect the occupants from environmental conditions. The individual employee's income level is under no circumstances relevant to whether lodging is substandard. Thus, lodging occupied by a particular employee which is substantially inferior to the housing previously occupied by that individual in the United States is not substandard unless it is also substantially inferior to housing typically occupied in the United States by individuals whose income equals the lesser of the median salary paid to American employees residing in the common area or the salary of a GS-14, step 1, U.S. Government employee.

(ii) *Presumptions.* Lodging will generally be considered to be substandard if it consists of any of the following:

(A) Portable, temporary, or movable housing occupied by employees who are not accompanied by spouse or dependents, in which the living space intended to be occupied by each employee is less than 250 square feet;

(B) Portable, temporary, or movable housing occupied by employees who are accompanied by spouse or dependents, in which the total interior living space intended to be occupied by a family unit is less than 800 square feet plus 200 square feet for each family member, other than the employee's spouse, who is expected to reside with the employee, and is no more than 1200 square feet;

(C) Housing which lacks adequate and reliable heating or air conditioning if appropriate for the climate, or adequate and reliable utilities such as electricity or sewage facilities; or

(D) Housing which lacks private sleeping quarters for unrelated individuals, private bath or toilet facilities for unrelated individuals, or fresh hot and cold piped water.

Notwithstanding the fact that lodging is described in paragraph (c)(2)(ii)(A), (B), or (C), lodging will not be considered substandard if it is clearly not inferior to housing typically occupied in the United States by individuals whose income equals the lesser of the median salary paid to American employees residing in the common area or the salary of a GS-14, step 1, U.S. Government employee. For purposes of paragraph (c)(2)(ii)(A) and (B), living space does not include shared areas, such as dining halls, lavatories, or storage facilities which are used by unrelated employees. For purposes of paragraph (c)(2)(ii)(A) and (B), housing is not portable, temporary or movable merely because it is prefabricated.

(iii) *Determination of median salary.* In determining the median salary of American employees residing in the common area, any reasonable method may be used. For example, the median salary may be determined by taking the average of the median salaries of American employees at the beginning and end of the calendar year.

(3) *Remote area.* Solely for purposes of section 911, a remote area is a place where satisfactory housing is unavailable to the taxpayer on the open market within a reasonable commuting distance of the place at which the taxpayer renders services.

(i) *Facts and circumstances.* Facts and circumstances to be considered in determining if satisfactory housing is unavailable within a reasonable commuting distance include (but are not limited to):

(A) The inaccessibility to available housing due to geographic factors or the quality of the roads;

(B) The number of housing units available on the open market within a reasonable commuting distance in relation to the number of housing units required for the employer's employees;

(C) The cost of housing available on the open market; or

(D) Terrorism or civil unrest present in the area where housing would be available which would subject U.S. citizens to unusual risk of personal harm or property loss.

(ii) *Presumptions.* Satisfactory housing will generally be considered to be unavailable to the employee on the open market if any of the following conditions is satisfied:

(A) The foreign government requires the employer to provide housing for its employees other than housing available on the open market;

(B) An unrelated person awarding work to an employer requires that the employer's employees occupy housing specified by such person; or

(C) The place at which the employee renders services is not within a reasonable commuting distance of a community with a population of 50,000 or more individuals.

The conditions of paragraph (c)(3)(ii)(A) and (B) are not fulfilled if the requirement described therein applies primarily to American employers or employers of American employees and there is a significant number of foreign employers or employees other than Americans.

* * * * *

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved December 19, 1979.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on December 26, 1979, 2:53 p.m., and published in the issue of the Federal Register for December 31, 1979, 44 F.R. 77155)

Section 934.—Limitation on Reduction in Income Tax Liability Incurred to the Virgin Islands

26 CFR 1.934-1: Limitation on reduction in income tax liability incurred to the Virgin Islands.
(Also Sections 243, 864, 881, 882, 7701; 1.243-1, 1.864-2, 1.881-1, 1.882-1, 301.7701-1.)

U.S. corporation; Virgin Islands inhabitant. A situation is described in which a U.S. corporation that has its principal office in the Virgin Islands and qualifies for certain Virgin Islands tax incentives is treated as a Virgin Islands inhabitant so that it satisfies its U.S. income tax obligation by paying tax on its income from all sources to the Virgin Islands. The same corporation is a domestic corporation for purposes of the dividends received deduction.

Rev. Rul. 80-40

ISSUES

(1) Is a United States corporation that has its principal office in the Virgin Islands and qualifies for certain Virgin Islands tax incentives treated as a Virgin Islands inhabitant so that it satisfies its United States income tax obligation by paying tax on its income from all sources to the Virgin Islands?

(2) Is such a United States corporation a "domestic corporation" for purposes of the dividends received deduction of section 243 of the Internal Revenue Code?

FACTS

P, a corporation organized in state *X*, is engaged in manufacturing in state *X*. In order to take advantage of certain income tax incentives offered by the Virgin Islands, *P* organized *S* to carry out part of *P*'s manufacturing operations in the Virgin Islands. *S* is incorporated in state *Y*.

S conducts all of its manufacturing operations in the Virgin Islands and derives 80 percent or more of each taxable year's gross income from Virgin Islands sources, and 50 percent or more of each taxable year's gross income from the active conduct of its business in the Virgin Islands. *S* maintains its principal office in the Virgin Islands. Management and control of *S* is in the Virgin Islands and all policy is made there. Board of directors and shareholders' meetings are held in the Virgin Islands, and all officers and some directors of *S* are Virgin Islands residents. *S*'s corporate receipts are received in the Virgin Islands and deposited in Virgin Islands bank accounts. All disbursements are made from the Virgin Islands and the corporate books and records are maintained and audited there.

LAW AND ANALYSIS—ISSUE (1)

Section 934(a) of the Code prevents the Virgin Islands from reducing by subsidy its income tax on United States source income of a United States corporation. However, section 934(b) provides that in the case of a domestic corporation, subsection (a) shall not apply to the extent such corporation derived its income from sources without the United States: (1) if 80 percent or more of the gross income of such corporation for the 3-year period immediately preceding the close of the taxable year (or for such part of such period immediately preceding the close of such taxable year as may be applicable) was derived from sources within the Virgin Islands: and (2) if 50 percent or more of the gross income of such corporation for such period or such part thereof was derived from the active conduct of a trade or business within the Virgin Islands.

Section 1.934-1(b)(3) of the Income Tax Regulations explains how to compute income tax liability incurred to the Virgin Islands and attributable to income derived from sources without the United States by a United States corporate inhabitant of the Virgin Islands. Section 1.934-1(b)(5) explains how to make a similar computation for a United States corporation which is not an inhabitant of the Virgin Islands. Section 934(d) of the Code provides that section 934(b) will only apply to corporations who supply the information required by section 1.934-1(d) and (e) of the regulations.

Section 1.901-1(g)(5) of the regulations states that a United States foreign tax credit is not allowable to persons who are inhabitants of the Virgin Islands.

Authority for income taxation in the Virgin Islands is derived from the Naval Appropriations Act, approved July 12, 1921 (U.S.C. 1937). This Act mirrors the income tax laws of the United States into the Virgin Islands as if the Virgin Islands legislature had adopted the Internal Revenue Code and applied it to United States persons in the same way the United States applies the Code to foreigners.

Under the mirror system the United States and the Virgin Islands are separate and distinct taxing jurisdictions even though their income tax laws arise from an identical statute applicable to each (the Code). *See* Rev. Rul. 73-315, 1973-2 C.B. 225. Thus, the effect of this mirror system of taxation is to require all persons including United States corporations incurring income tax obligations to both the United States and the Virgin Islands under Chapter 1 of the Code (as applicable in each jurisdiction) to file tax returns and pay income tax to both jurisdictions.

Section 28(a) of the Revised Organic Act of the Virgin Islands (R.O.A.), 48 U.S.C. section 1642 (Supp. 1979), makes substantial changes in this system as it affects "inhabitants of the Virgin Islands." Section 28(a) requires inhabitants to satisfy their United States and Virgin Islands income tax obligations arising under Chapter 1 of the Code (as applicable in each jurisdiction) by filing a single return with, and paying to, the Virgin Islands the Virgin Islands territorial income tax (the Code as mirrored into the Virgin Islands) on their income from all sources. *See* Rev. Rul. 60-291, 1960-2 C.B. 407.

Section 28(a) of the R.O.A. defines "inhabitants of the Virgin Islands" as all persons whose permanent residence is the Virgin Islands."

A United States corporation can qualify as an inhabitant of the Virgin Islands because (1) under section 7701(a)(1) of the Code, the term "person" includes a corporation, and (2) in adopting section 28(a), Congress rejected an attempt to limit the definition of "inhabitants of the Virgin Islands" to—"U.S. citizens" instead of "all persons." *See* Conf. Rept. No. 2105, 83rd Cong., 2d Sess. 22 (1954). Also, section 934 of the Code and section 1.934-1(b)(3) of the regulations operate on the assumption that a United States corporation can qualify as an inhabitant of the Virgin Islands. *See* S. Rept. No. 1767, 86th Cong., 2d Sess. 3 (1960).

In the present situation, all of the officers and some directors of *S* are Virgin Islands residents. All significant business operations, shareholder meetings, and Board of Directors meetings are conducted in the Virgin Islands, and *S* meets the percentage tests of section 934(b) of the Code. In addition, *S* is carrying on a trade or business in the Virgin Islands within the meaning of section 864(a). This is sufficient to constitute *S* a permanent resident, and therefore an inhabitant, of the Virgin Islands for purposes of section 28(a) of the R.O.A.

The United States does not tax a foreign corporation on its non-United States source income that is not effectively connected with the corporation's conduct of a trade or business within the United States. See sections 881(a) and 882. Therefore, under an exact mirror system, non-Virgin Islands source income that is not effectively connected with a United States corporate inhabitant's conduct of a Virgin Islands trade or business would escape territorial income tax since the inhabitant is considered a foreign corporation by the Virgin Islands. However, Congress, in section 28(a) of the R.O.A., made it clear that such income of inhabitants of the Virgin Islands would not escape taxation by using the words "paying their tax on *income derived from all sources both within and outside the Virgin Islands* into the Treasury of the Virgin Islands" (emphasis added). Thus, in effect, *S* is taxed as if it were a Virgin Islands corporation and satisfies both its United States and Virgin Islands income tax obligations by paying the Virgin Islands territorial income tax on its income from all sources. If *S* fails to file a return or pay tax on its income from all sources to the Virgin Islands, then *S* does not satisfy its U.S. tax obligations.

LAW AND ANALYSIS—ISSUE (2)

Under section 243 of the Code, a deduction is allowed for dividends received from a domestic corporation that is subject to taxation under Chapter 1 of the Code.

As a domestic corporation, *S* is still subject to taxation under Chapter 1 of the Code as applicable in the United States. Section 28(a) of the R.O.A. merely requires *S* to satisfy this obligation by paying income tax to the Virgin Islands on *S*'s income from all sources. Thus dividends paid by *S* are not excluded from qualifying for treatment under section 243 when received by *P*.

HOLDINGS

(1) *S* is treated as an inhabitant of the Virgin Islands and must satisfy its United States and Virgin Islands income tax obligations by paying tax on its income from all sources to the Virgin Islands.

(2) *S* is a domestic corporation for purposes of the dividends received deduction of section 243 of the Code.

Section 1011.—Adjusted Basis for Determining Gain or Loss

26 CFR 1.1011-1: Adjusted basis.

Basis; film rights; cost exceeding fair market value. A corporation purchased certain motion picture exhibition rights in an arm's length transaction and resold them to a limited partnership whose general partner was the corporation's majority shareholder for a cash downpayment greater than the corporation's original cost plus a nonrecourse note. The partnership is unable to demonstrate that the fair market value of the rights exceeds the corporation's original cost, and the partnership's basis in the rights is limited to their fair market value.

Rev. Rul. 80-42

ISSUE

What is the basis of the motion picture exhibition rights for federal income tax purposes under the circumstances described below, where the cash downpayment for the rights is in excess of their fair market value?

FACTS

On October 15, 1979, *X*, a limited partnership, acquired the rights from *M*, a corporation, to exhibit a completed motion picture in the United States. *A*, the general partner of *X*, is a majority shareholder of *M*, but there is no relationship between *M* and the limited partners of *X*. *X* uses the accrual method of accounting. The purchase agreement between *X* and *M* stated that the purchase price was 2,000*x* dollars. The stated purchase price was agreed upon in order to establish a higher basis for the property. Pursuant to the agreement, *X* paid 500*x* dollars on delivery of the film rights and gave a note to *M* in the face amount of 1,500*x* dollars. As collateral for the note, *X* gave *M* a security interest in the film rights and in one-half the net receipts earned from exploitation of the film. The note was non-negotiable, bearing interest at the annual rate of eight percent with principal and interest due and payable on October 14, 1983. Prepayment of principal and interest was required to the extent of 50 percent of the net receipts derived from distribution of the picture.

Neither *X* nor any of the partners of *X* was personally liable for payment of the note. The sole recourse of *M* in the event of default was to the collateral securing the note.

The motion picture had been produced in a foreign country. *M* had acquired the United States exhibition rights from the foreign producer in an arm's length transaction for 400*x* dollars a few months before transferring the rights to *X*. *X* is unable to demonstrate that the fair market value of the acquired rights exceeded 400*x* dollars.

LAW AND ANALYSIS

Section 1011(a) of the Internal Revenue Code provides that, in general, the adjusted basis for determining gain or loss from the sale or other disposition of property, whenever acquired, shall be the basis determined under section 1012, adjusted as provided in section 1016.

Section 1012 of the Code provides that, in general, the basis of property shall be its cost.

In Rev. Rul. 77-110, 1977-1 C.B. 58, the Service concludes that the liability on a nonrecourse interest-bearing note given as part of the purchase price of film distribution rights, whose value could not be shown to approximate the amount of the note, may not be included in the basis of the rights and no deduction is allowable for interest accrued on the note.

In this case, *X* is unable to establish that the fair market value of the film rights purchased from *M* exceeds 400*x* dollars. The burden is on *X* to prove that the payment to *M* for the film rights that is in excess of their fair market value is not for a purpose other than the acquisition of the film rights. See *Majestic Securities Corp. v. Commissioner,* 120 F.2d (8th Cir. 1941), *aff'g* 42 B.T.A. 698 (1940); and *New Hampshire Fire Insurance Co. v. Commissioner,* 2 T.C. 708 (1943).

HOLDING

The cash payment made by *X* to *M* that is in excess of the fair market value of the film exhibition rights may not be included in the basis of the film rights. The basis of the film rights purchased by *X* is limited to their fair market value.

Consistent with Rev. Rul. 77-110, the liability created by the nonrecourse note given by *X* to *M* may not be included in the basis of the film rights.

Section 1372.—Election by Small Busniess Corporation

26 CFR 1.1372-1: Election by small business corporation.

Whether the election by a small business corporation is a transfer of proven oil or gas property under section 613A(c) of the Code. See Rev. Rul. 80-43, page 9.

Section 3121.—Definitions [Federal Insurance Contributions Act]

26 CFR 31.3121(a)-1: Wages.
(Also Section 3306; 31.3306(b)-1.)

Meals furnished to hotel and restaurant employees. The Service will not follow the *Hotel Conquistador* decision holding that the value of certain meals furnished without charge to hotel and restaurant employees was not wages under the FICA and FUTA.

Rev. Rul. 80-41

ISSUE

In *Hotel Conquistador, Inc. v. United States,* 597 F.2d 1348 (Ct. Cl. 1979), *cert. denied* January 14, 1980, the Court of Claims held that the value of certain meals furnished without charge to hotel and restaurant employees was not "wages" under sections 3121(a) and 3306(b) of the Internal Revenue Code.

It is the long standing position of the Service that the value of meals furnished without charge, for example, to hotel or restaurant employees, or to seamen or other employees aboard vessels, is wages under sections 3121 (a) and 3306(b) of the Code. This position has been supported by the courts in *S. S. Kresge Co. v. United States,* 379 F.2d 309 (6th Cir. 1967), concerning free meals furnished to lunch stand employees, and *Pacific American Fisheries, Inc. v. United*

States, 138 F.2d 464 (9th Cir. 1943), concerning the value of board and lodging furnished to salmon packing plant employees.

For these reasons, the Service will not follow the decision of the United States Court of Claims in the *Hotel Conquistador* case, and employers must continue to treat the value of such free meals furnished to their employees as wages under sections 3121(a) and 3306(b) of the Code.

Section 3306.—Definitions [Federal Unemployment Tax Act]

26 CFR 31.3306(b)-1: Wages.

Whether the value of free meals furnished by employers to their employees is wages. See Rev. Rul. 80-41, page 14.

Section 7122.—Compromises

26 CFR 301.7122-1: Compromises.

Jurisdiction and procedure for the processing and disposition of certain offers in compromise. See Rev. Proc. 80-6, page 16.

Section 7701.—Definitions

26 CFR 301.7701-1: Classification of organizations for tax purposes.

Whether a United States corporation that has its principal office in the Virgin Islands and qualifies for certain Virgin Islands tax incentives is treated as a Virgin Islands inhabitant so that it satisfies its United States income tax obligations by paying tax on its income from all sources to the Virgin Islands. See Rev. Rul. 80-40, page 12.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.203: Offers in compromise.
(Also Part I, Section 7122; 301.7122-1.)

Rev. Proc. 80-6

SECTION 1. PURPOSE

The purpose of this revenue procedure is to set forth the jurisdictional changes pertaining to the consideration and disposition of offers in compromise under Delegation Order No. 11 (Rev. 11), 1979-43 I.R.B. 25; to outline general guidelines relating to the acceptability of an offer in compromise; and also to supersede and restate in a current document the practices and procedures set forth in prior revenue procedures applicable to comparable positions and organizational components.

SEC. 2. DECENTRALIZED AREAS OF RESPONSIBILITY

.01 Certain functions of the Commissioner of Internal Revenue with respect to the compromise of civil cases involving doubt as to liability or collectibility, incurred under the regulatory provisions of the Internal Revenue Code and related statutes have been delegated under Order No. 11 (Rev. 11) as follows:

1 Assistant Commissioner (Compliance), for cases originating in the Office of International Operations, and Regional Commissioners.—Delegated authority to accept, under section 7122 of the Code, compromises of civil cases involving tax liabilities of $100,000 or more (including any interest, penalty, additional amount or addition to tax) based solely upon doubt as to liability. This authority may not be redelegated.

2 Director, Collection Division and Regional Commissioners.—Delegated authority to accept, under section 7122, compromises of civil cases involving liabilities of $100,000 or more (including any interest, penalty, additional amount or addition to tax) based on doubt as to collectibility or doubt as to both collectibility and liability and offers submitted under section 3469 of the Revised Statutes, as amended (31 U.S.C. 194) insofar as claims arising in the administration of the Internal Revenue laws are concerned. This authority may not be redelegated.

3 District Directors, the Director of International Operations, Assistant District Directors and the Assistant Director of International Operations. —Delegated authority to accept, under section 7122, compromises of civil cases involving liabilities under $100,000 (including any interest, penalty, additional amount or addition to the tax), to accept offers involving specific penalties, and reject offers to compromise civil cases (subject to the appeal procedures prescribed by section 6 of this revenue procedure) regardless of the amount of the liability involved. This authority may not be redelegated except that the authority to reject offers may be redelegated, but not lower than to Division Chief. The District Director in a streamlined district may not redelegate this authority. In addition, those Service officials delegated rejection authority are authorized to close, regardless of the amount of the liability involved, by written notification to the offeror, all compromise cases where the offer has been withdrawn.

4 Regional Directors of Appeals, Chiefs and Associate Chiefs, Appeals Offices.—Delegated authority to accept, under section 7122, compromises of civil cases involving liabilities under $100,000 (including any interest, penalty, additional amount or addition to the tax), to accept offers involving specific penalties, and reject offers to compromise civil cases regardless of the amount of the liability involved. This authority may not be redelegated.

5 Service Center Directors and Assistant Service Center Directors.—Delegated authority to accept, under section 7122, compromises of civil cases under $100,000 involving penalty liabilities based solely on doubt as to liability, and reject offers in compromise, limited to penalties (subject to the appeal procedures prescribed by section 6 of this revenue procedure), regardless of the amount of the liability involved. This authority may be redelegated, but not lower than to Division Chief. In addition, those Service officials delegated rejection authority are authorized to close, regardless of the amount of the liability involved, by written notification to the offeror, all compromise cases where the offer has been withdrawn.

The above delegations are "limited" to the extent that the delegated authority must be exercised in accordance with the limitations prescribed by section 301.7122-1 of the Regulations on Procedure and Administration and with procedures established by the National Office. See section 3 with respect to offers excepted from this delegated authority.

.02 Appeals Offices.—The District Director, Director of International Operations or Service Center Director refers two types of offer in compromise cases for consideration by the appropriate Office of Regional Director of Appeals. The first type relates to offers in compromise based in whole or in part on doubt as to liability, which liability, irrespective of the amount involved, is pending before or was determined by an Appeals office. The second type involves consideration of a taxpayer's appeal from a rejection or proposed rejection by the District Director, Director of International Operations or Service Center Director. (The procedure governing appeals is applicable only to those offers with respect to which the Directors have processing jurisdiction and which relate to a tax over which the Appeals office has authority to function. See section 3.01.) In considering either type of case referred to above, the Appeals office may call upon the originating office to conduct any investigation considered necessary to reach a conclusion on the disposition of the offer. See section 6.02.

.03 Chief Counsel. — The Chief Counsel has delegated authority to review and dispose of offers in compromise to the Director, General Litigation Division, for cases that are accepted or rejected at the National Office of the Commissioner, and to the Regional Counsel or delegate. C.C. Order 1030.1B. The following legal functions are performed by these delegates:

1 The Director, General Litigation Division, reviews cases recommended for acceptance by the Director of International Operations involving liabilities of $100,000 or more (including any interest, penalty, additional amount or addition to the tax) and any other cases referred to the National Office of the Commissioner, signs the legal opinion required under section 7122(b), and forwards the case to the appropriate delegated Service official for signature on the Abstract and Statement and issuance of the acceptance letter.

2 The Regional Counsel, for cases involving liabilities of $100,000 or more, and the District Counsel reviews:

(a) Cases recommended for acceptance prepared by the District Director which involve liabilities (including any interest, penalty, additional amount or addition to the tax) of $500 or more, those relating to specific penalties, and those submitted under section 3469 of the Revised Statutes, as amended (31 U.S.C. 194), insofar as claims arising in the administration of the Internal Revenue laws are concerned; signs the legal opinion required under section 7122(b), and then forwards the case to the appropriate delegated Service official (depending upon the amount of the liability) for signature on the Abstract and Statement and issuance of the acceptance letter.

(b) Cases recommended for acceptance prepared by Service Center Directors which involve penalty liabilities of $500 or more, signs the legal opinion required under section 7122(b) of the Code, and then forwards the case to the appropriate delegated Service official (depending upon the amount of the liability) for signature on the Abstract and Statement and issuance of the acceptance letter; and

(c) Cases described as Chief Counsel cases which involve the compromise of tax liabilities in the following categories:

(1) Cases in which recommendations for prosecution are pending in the Office of the Chief Counsel, the Department of Justice, or Offices of United States Attorneys, including cases in which criminal proceedings have been instituted but not disposed of, and related cases in which offers in compromise have been submitted or are pending;

(2) Cases in which the taxpayer is in receivership or is involved in a proceeding under any provision of the Bankruptcy Act;

(3) Cases in which the taxpayer is deceased; in joint liability cases, where either taxpayer is deceased;

(4) Cases involving proposals to discharge property from the effect of tax liens or to subordinate the lien or liens;

(5) Cases involving insolvent banks;

(6) Cases involving assignments for the benefit of creditors;

(7) Cases involving liquidation proceedings; and

(8) Other cases in which court proceedings are pending, except cases pending before the Tax Court of the United States.

Where appropriate, Regional Counsel or District Counsel prepares the legal opinion required under section 7122(b), and forwards the case to the appropriate delegated Service official (depending upon the amount of the liability) for signature on Counsel's determination and issuance of the appropriate letter to the offeror.

3 The Regional Counsel, where appropriate, and the District Counsel furnishes legal advice in the form of an advisory opinion when the District Director or Service Center Director submits a specific request involving a question of law or regarding which, for any other reason in the judgment of the Director, Counsel's opinion should be obtained.

SEC. 3. LIMITATIONS ON DELEGATED AUTHORITY

.01 Regardless of the amount of the liability involved, the Assistant Commissioner (Compliance), the Director, Collection Division, Regional Commissioners, District Directors, the Director of International Operations, Assistant District Directors, the Assistant Director of International Operations, Service Center Directors, Assistant Service Center Directors, Regional Directors of Appeals, and Chiefs and Associate Chiefs, Appeals Offices have not been delegated authority to accept offers in compromise in the following classes:

1 Cases in which recommendations for prosecution are pending in the Department of Justice or United States Attorneys' offices, including cases in which criminal proceedings have been instituted but not disposed of.

2 Cases in which recommendations for prosecution or defense are pending in the Office of the Chief Counsel, and in related cases in which offers in compromise have been submitted.

3 Cases in which the acceptance of an offer by the Internal Revenue Service is dependent upon the acceptance of a related offer or a settlement under the jurisdiction of the Department of Justice.

4 Cases arising under laws relating to alcohol, tobacco and firearms taxes.

5 Cases involving liabilities "in suit," including those where the tax lien has been reduced to judgment.

SEC. 4. GENERAL GUIDELINES RELATING TO THE ACCEPTABILITY OF AN OFFER IN COMPROMISE

.01 The compromise of a tax liability rests upon but one or both of two grounds—(1) doubt as to liability or (2) doubt as to collectibility. The doubt as to liability must be supported by evidence and the amount acceptable will depend upon the degree of doubt found in the particular case. Where doubt as to collectibility is involved, an acceptable offer must reflect all that can be collected from a taxpayer's income, present or prospective, after giving effect to all priorities granted to the Government. In any case involving a large liability and a nominal offer, or involving a criminal violation under the Internal Revenue laws, additional consideration is usually required for the acceptance of offers based in whole or in part on inability to pay. The additional consideration required is dependent upon the facts in the particular case, but generally is provided for by the submission of collateral agreements. The agreements most commonly employed pertain to payments from future income and, where applicable, to the relinquishment of certain present or potential tax benefits.

.02 A Statement of Financial Condition and Other Information, Form 433, signed by the taxpayer, is required in all offer in compromise cases based on the taxpayer's inability to pay the total amount due, regardless of the type of tax or amount of liability involved.

SEC. 5. FUNCTIONAL ALIGNMENT AND COORDINATION AMONG SERVICE CENTERS, DISTRICT OFFICES, REGIONAL OFFICES AND NATIONAL OFFICE

.01 Service Centers.

1 The service center is responsible for the initial processing of offers in compromise. When these processes are completed, the offers are then referred to the appropriate office for further disposition.

2 The service center Collection function has jurisdiction over the consideration of penalty offers based solely on doubt as to liability (except 100-percent penalties and those arising under laws relating to alcohol, tobacco and firearms) prior to the Service Center Director or Assistant Service Center Director exercising delegated authority to accept or reject the offer.

.02 District Offices and Office of International Operations.—Prior to the Director or Assistant Director exercising delegated authority to accept or reject an offer in compromise recommended for acceptance by District officials:

1 District Collection functions will have jurisdiction over:

(a) Investigating and processing offers in compromise based on doubt as to collectibility, in the following type cases:

(1) Taxes of all classes, except alcohol, tobacco, and firearms, including penalties and interest;

(2) Fraud, negligence, and delinquency penalties, including interest;

(3) Penalties relating to declaration of estimated taxes;

(4) 100-percent penalties, as provided by sections 6671 and 6672 of the Internal Revenue Code, based either on doubt as to liabiilty or doubt as to collectibility;

(5) Penalties relating to failure to pay;

(6) Offers submitted under section 3469 of the Revised Statutes, as amended (31 U.S.C. 194);

(7) Consideration of all offers in default, regardless of whether the offer was based on doubt as to liability or doubt as to collectibility; and

(8) Disposition of offer cases referred from service center Collection functions.

(b) Investigative responsibility for Chief Counsel cases involving the types of offers in compromise enumerated above.

(c) Offers in compromise based on both doubt as to collectibility and doubt as to liability, but only as to the collectibility aspects of the offer. If a conclusion is reached that there is no doubt as to collectibility, the case will be transferred to the Examination function for investigation as a doubt as to liability case.

2 District Examination functions will have jurisdictional responsibility for consideration and disposition of offers in compromise based on doubt as to liability for taxes or for both taxes and statutory additions, except alcohol, tobacco, and firearms taxes, including investigative jurisdiction over such offers in compromise in Chief Counsel cases.

3 If the District Director recommends aceptance of an offer in compromise of a liability of $100,000 or more, the complete compromise file will be forwarded to the appropriate Regional Office for consideration. If the Director of International Operations recommends acceptance of an offer in compromise of a liability of $100,000 or more, the complete compromise file will be forwarded to the National Office for consideration.

.03 Regional Offices.—Prior to the Regional Commissioner exercising the delegated authority to accept an offer in compromise recommended for acceptance by district or service center officials the:

1 Review of cases covering liabilities of $100,000 or more based upon doubt as to collectibility or doubt as to both collectibility and liability is vested in the Office of the Assistant Regional Commissioner (Collection).

2 Review of tax cases covering liabilities of $100,000 or more based upon doubt as to liability is vested in the Office of the Assistant Regional Commissioner (Examination).

.04 National Office.—

1 The Collection Division coordinates all compromise activities for the National Office. Liaison is maintained with the Office of the Chief Counsel, the Examination Division, the Appeals Division, and with the Department of Justice in connection with the review of acceptance recommendations prior to approval.

2 The review of offers requiring the Assistant Commissioner's (Compliance) approval is vested in the Special Programs Branch, Special Examination Section, of the Examination Division.

SEC. 6. APPEALS PROCEDURES

.01 Referring Office Procedures.—Upon request, either before or after rejection of an offer in compromise, and subject to the exceptions set forth in section 3.01, the taxpayer or proponent—disagreeing with the recommendation of the examining officer—may request that the District Director, Service Center Director or Director of International Operations forward the case directly to the Office of Regional Director of Appeals. (If the offer pertains to a case concurrently under consideration in the Appeals office or the proponent wishes to appeal to the Appeals office, no written protest will be required unless the tax and/or proposed addition to tax, penalty and assessed interest exceeds $2,500 for any taxable year, taxable period, or taxable event.)

.02 Appeals Procedures. — Upon receipt of a protested rejection from the originating office, the facts in the case are independently considered by an Appeals office, the taxpayer is granted a hearing and if necessary, a further investigative report is procured. After consideration, the Appeals Office notifies the offeror of the disposition of the case in accordance with the conclusions reached at the Appeals level, subject to the requirements for review and approval by Counsel, Regional Office or National Office. The case file will then be returned to the originating office for other necessary closing actions.

Sec. 7. Public Inspection of Accepted Offers

.01 Authority.—Public inspection of any offer in compromise accepted under section 7122 of the Code is authorized by section 6103(k)(1).

.02 Procedure.—For a period of one year, a copy of the Abstract and Statement for each accepted offer is made available for examination in the office of the District Director, Service Center Director, or the Director of International Operations which originally accepted or recommended acceptance of the offer. No lists are prepared and no releases are distributed by the Internal Revenue Service in connection with these cases.

Sec. 8. Effect on Other Documents

Rev. Proc. 64-44, 1964-2 C.B. 974, and Rev. Proc. 66-53, 1966-2 C.B. 1266, are superseded.

Part IV. Items of General Interest

Continuity of Business Enterprise Requirement for Corporate Organizations—Public Hearing

Announcement 80-21 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations clarifying the continuity of business enterprise requirement for corporate reorganizations.

DATES: The public hearing will be held on March 18, 1980, beginning at 11:00 a.m. Outlines or oral comments must be delivered or mailed by March 4, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-93-79), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: George Bradley or Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under section 368 of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Friday, December 28, 1979 at page 76813 (44 FR 76813).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of the comments to be presented at the hearing and the time they wish to devote to each subject by March 4, 1980. Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 10:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive appearing in the Federal Register for Wednesday, November 8, 1978.

IRA—Active Participant

Announcement 80-22 [1]

For 1979, taxpayers may rely on the proposed regulations defining "active participant" to determine if they may deduct payments made to an individual retirement account (IRA).

The proposed regulations under section 219 of the Internal Revenue Code appear in the Federal Register of March 23, 1979, on page 17754.

Individuals who are active participants in certain types of deferred compensation plans may not make deductible contributions to an individual retirement account, annuity, or bond program.

Employers may rely on the proposed regulations to determine what information must be furnished on Form W-2 about an employee's coverage by a pension plan. Employers should enter "yes" in box 14 of Form W-2 if the employee is considered an active participant in the employer's pension plan.

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[1] Filed by the Office of the Federal Register on January 17, 1980, 8:45 a.m., and published in the issue of the Federal Register for January 18, 1980, 45 F.R. 3602.

[1] Based on News Release IR-2188, dated Dec. 21, 1979.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants and Enrolled Agents from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following persons have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Franke J. Marcone	Media, PA	Attorney	Twenty-four months effective December 11, 1979
William P. Renner	Hagerstown, MD	Certified Public Accountant	Twenty-four months effective December 11, 1979
Albert J. Kendall	Wyncote, PA	Attorney	Four months effective January 7, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR (1939) 16.1 through 17.19 deleted; 26 CFR Subchapter D retitled; Part 160 added.	Profit limitations of the Vinson-Trammell Act on certain contracts and subcontracts for naval vessels and military aircraft.	Oct. 26, 1979	Feb. 26, 1980
26 CFR 1.44B-1, 1.51-1, 1.53-1, 1.53-2, 1.381(c)(26)-1, added; 1.51, 1.51-1, 5.44B-1, 5.51, deleted; 1.52-1, 1.52-2, 1.280C-1, amended; 1.52-3 revised; 1.53-1, redesignated as 1.53-3 and amended.	Targeted Jobs Tax Credit.	Dec. 28, 1979	Feb. 25, 1980
26 CFR 1.1001-2 added; 1.61-12, 1.671-1, 1.741-1, 1.1011-2 amended; 1.1001 deleted.	Discharge of liabilities on sale or other disposition of property.	Dec. 28, 1979	Feb. 25, 1980
26 CFR 48.6420(a), (b), (c), (d), (e), (f), (g), (h) deleted; 48.6420(a)-1, 48.6420(b)-1, 48.6420(c)-1 amended; 140.6420-1, 140.6427-1, published as temporary regulations in T.D. 7662, page , this Bulletin, redesignated as 48.6420(c)-2 and 48.6427-1 respectively with all references to Part 140 changed to Part 48.	Claims by aerial applicators when fuels are used for farming purposes.	Dec. 27, 1979	Feb. 25, 1980
26 CFR 1.368 deleted; 1.368-1 amended.	The continuity of business enterprise requirement for corporate reorganizations.	Dec. 28, 1979	Feb. 25, 1980
26 CFR 1.707-1, amended; 1.709-1, 1.709-2, added.	Provisions relating to the treatment of partnership organization and syndication fees.	Jan. 11, 1980	Mar. 11, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

Numerical Finding List[1]

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1, dated January 7, 1980.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1 I.R.B., dated January 7, 1980.

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______	*1936–2*	*3.90*
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______	*1938–1*	*4.05*
______	*1938–2*	*3.50*
______	1939–1–1	8.25
______	1939–1–2	10.90
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______	1940–1	5.55
______	1940–2	14.00
______	1941–1	*$6.95*
______	*1941–2*	*3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
______	*1944*(*)	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*2.65*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
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______	1956–2	18.00
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______	1957–2	13.00
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______	1964–1–1	10.00
______	1964–1–2	11.00
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______	1965–1	10.70
______	1965–2	12.25
______	1966–1	9.25
______	1966–2	14.05
______	1967–1	10.00
______	1967–2	10.00
______	1968–1	14.00
______	1968–2	11.75
______	1969–1	7.50
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February 25, 1980
Bulletin No. 1980-8

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENT

Announcement 80-25, page 27.
A public hearing will be held on March 27, 1980, concerning proposed regulations relating to the application of conventions under the Class Life Asset Depreciation Range (CLADR) System.

INCOME TAX

Rev. Rul. 80-44, page 6.
Disability benefits; inclusion in gross income. The tax treatment of disability payments is discussed in a situation in which the retired employee is entitled to benefits that comprise the larger of an amount based on years of service or an amount determined without regard to either years of service or age. The effect of the employee's election to decrease the retirement allowance in order to increase the survivor's benefit is also discussed.

Rev. Rul. 80-45, page 7.
VITA volunteers; unreimbursed expenses. Unreimbursed expenses for transportation, paper and pencils, newspaper advertising, and similar items incurred by volunteers in connection with their participation in the Volunteer Income Tax Assistance (VITA) program are deductible under section 170 of the Code.

Rev. Rul. 80-46, page 8.
Acquisition to avoid tax; reorganization; control; attribution of sole owner's stock. An acquired corporation owned all the stock of two subsidiary corporations. The acquiring corporation, owning 45 percent of the stock of the acquired corporation before the merger, did not have control of the acquired corporation under section 269 of the Code where the acquiring corporation's sole stockholder also owned 10 percent of the stock of the acquired corporation because the attribution rules of constructive ownership do not apply. The acquiring corporation has acquired control of the acquired corporation's subsidiaries.

Rev. Rul. 80-48, page 11.
Mineral production payments; gas; "take or pay" purchase contract. Payments received for gas that is to be taken in the future under a "take or pay" gas purchase contract are not mineral production payments under section 636(a) of the Code and are includible in gross income under the provisions of section 451.

Rev. Rul. 80-49, page 13.
Oil and gas leases; first year payments. Examples illustrate certain first year payments made by a lessee upon obtaining an oil and gas lease that are delay rentals that may be capitalized or expensed at the election of the lessee or are lease bonuses that must be capitalized; Rev. Ruls. 56-252 and 67-25 superseded.

Rev. Rul. 80-50, page 14.
Regulated investment company or real estate investment trust; short taxable year; quarters. In the case of short taxable year, the phrase "at the close of each quarter of the taxable year" in sec-

(Continued on page 4)

Announcement of Voluntary Suspension and Disbarment begin on page 28.
Announcement of Notice of Proposed Rulemaking on page 29.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part includes rulings and decisions based on Subpart A, Tax Conventions and related Treasury Decisions and Revenue Rulings; Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

tions 851(b)(4) and 856(c)(5) of the Code refers to quarterly periods that end, to the extent possible, on the same dates as the quarters of a 12-month year, even though the use of 3-month quarters may result in one quarter of less than three months.

Rev. Rul. 80-52, page 12.

Barter club transactions. A barter club uses credit units to credit or debit members' accounts for goods or services provided or received. As soon as units are credited to a member's account, the member may use them to purchase goods or services or may sell or transfer the units to other members. The value of credit units received is includible in the gross incomes of members for the taxable year in which the units are credited to their accounts. The dollar value of units received for services by an employee of the club, who may use the units in the same manner as other members, is includible in gross income for the taxable year in which received.

Rev. Rul. 80-62, page 9.

Travel expenses; reimbursements or per diem mileage allowances. For taxable years beginning after 1978, reimbursement arrangements or per diem allowances for travel away from home not exceeding the greater of $44 per day, or the maximum authorized to be paid by the Federal Government in the locality in which the travel is performed, and a mileage allowance not exceeding 18.5 cents per mile for transportation paid by employers to employees will be regarded as satisfying the substantiation and adequate accounting requirements of sections 1.162-17(b) and 1.274-5 of the regulations; Rev. Ruls. 74-433 and 77-410 superseded.

Rev. Proc. 80-7, page 24.

Automobile expenses; standard mileage rate. For taxable years beginning after December 31, 1978, the standard mileage rate for the optional simplified method of computing deductible costs in operating passenger automobiles for business purposes is 18.5 cents per mile for the first 15,000 miles and 10 cents per mile for any excess over 15,000 miles each year. The standard mileage rate for charitable, medical, or moving expenses is eight cents per mile. Effective for taxable years beginning after December 31, 1979, for purposes of the optional method, an automobile that has been used for more than five years for business is considered to be fully depreciated. Rev. Procs. 74-23, 74-24, 74-25, 75-3, 77-36, and 77-40 superseded.

Notice, page 24.

Countries that may require participation in, or cooperation with, an international boycott are listed.

Announcement 80-26, page 27.

Corrections are made to the instructions for line 5 of the 1979 Schedule D (Form 1040).

EMPLOYEE PLANS

Rev. Rul. 80-47, page 11.

Coverage; participation limited; employee election. A plan will not fail to qualify under section 401(a) of the Code merely because it denies participation to employees who do not authorize salary withholding or take a physical examination to determine eligibility for life insurance, so long as these provisions do not result in discrimination and are applied in a nondiscriminatory manner.

EMPLOYMENT TAXES

Rev. Rul. 80-52, page 12.

Barter club transactions. A barter club uses credit units to credit or debit members' accounts for goods or services provided or received and values goods and services at the seller's normal retail price. As soon as units are credited to a member's account, the member may use them to purchase goods or services from other members or may sell or transfer the units to other members. The dollar value of the credit units received for services by an employee of the club, who may use the units in the same manner as other members, is wages for purposes of the FICA, the FUTA, and income tax withholding.

EXCISE TAXES

Rev. Rul. 80-53, page 15.

Postal Service; airport terminal handling charges. Terminal handling charges paid by the U.S. Postal Service to scheduled certificated air carriers for services in connection with handling mail at the airport are not subject to the tax im-

(Continued on page 5)

Highlights of this Issue—Continued

(Continued from page 4)

EXCISE TAXES—Cont'd

posed by section 4271(a) of the Code; Rev. Rul. 74-512 revoked.

TAX CONVENTIONS

Rev. Rul. 80-51, page 23.
France; research fellow. A French resident appointed as a research fellow to the faculty of an accredited university's medical school in the U.S. conducts basic research in the public interest under the school's direction and control in a laboratory located in a hospital associated with the school. The individual's compensation, although paid through the hospital under grants awarded by the National Institutes of Health, is exempt from federal income tax under Article 17 of the U.S.-France Income Tax Convention for a period not exceeding two years from the date of the individual's arrival in the U.S.

ADMINISTRATIVE

T.D. 7665, page 17.
Sections of the regulations that set forth statutory provisions of the Code are deleted.

T.D. 7666, page 15.
Amendments to the temporary regulations under section 6103(n) of the Code relate to the disclosure of returns and return information in connection with procurement of property and services for tax administration purposes.

Announcement 80-10, page 27.
The 1980 issue of Publication 676, Catalog of Federal Tax Forms, Form Letters, and Notices, may be purchased from the Superintendent of Documents, Washington, D.C.

Announcement 80-27, page 27.
Publication 764, Statistics of Income—1976, Estate Tax Returns, may be purchased from the Superintendent of Documents, Washington, D.C.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-1: Gross income.

Amount includible in the gross incomes of members of a barter club as a result of bartering transactions. See Rev. Rul. 80-52, page 12.

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26 CFR 1.61-2: Compensation for services, including fees, commissions, and similar items.

The amount includible in the gross income of an employee of a barter club who receives wages in cash and in credit units. See Rev. Rul. 80-52, page 12.

Section 62.—Adjusted Gross Income Defined

26 CFR 1.62-1: Deductions from adjusted gross income.

Whether interest and state and local taxes are deductible in addition to the amount of passenger vehicle expenses determined by use of the standard mileage rate. See Rev. Proc. 80-7, page 24.

Section 104.—Compensation for Injuries or Sickness

26 CFR 1.104-1: Compensation for injuries or sickness.
(Also Section 105; 1.105-1.)

Disability benefits; inclusion in gross income. The tax treatment of disability payments is discussed in a situation in which the retired employee is entitled to benefits that comprise the larger of an amount based on years of service or an amount determined without regard to either years of service or age. The effect of the employee's election to decrease the retirement allowance in order to increase the survivor's benefit is also discussed.

Rev. Rul. 80-44

ISSUE

Are amounts received by an employee and the employee's survivors excludable from gross income under the provisions of either section 104(a)(1) or section 105(d) of the Internal Revenue Code under the circumstances described below?

FACTS

Under statutes adopted by City *M*, any individual employed by *M* may retire on account of a disability that is incurred in such employment and is compensable under the workmen's compensation act of the state, provided that written notice is given to the city board of the intended retirement and its effective date, and provided further that a medical examiner, after examining the individual, certifies that the individual is mentally or physically incapacitated for the further performance of duty, that the incapacity is likely to be permanent, and that the individual should be retired. The statutes provide in general, that the service-connected disability retirement allowance shall be an amount equal to the greater of (A) 60 percent of the individual's average final compensation, or (B) the amount to which the individual would be entitled under the ordinary, nonoccupational disability pension provisions of *M*'s statutes (a pension based on years of service). Under these statutes the individual may elect to decrease the retirement allowance in order to increase the survivor's benefit to the employee's spouse.

Neither the occupational disability plan nor the nonoccupational disability plan is contributory.

As a result of a service-connected injury, *A*, an employee of *M*, retired in 1978 pursuant to the disability retirement provisions of the city plan. Because of years of service, *A* was entitled to an allowance of 80 percent of average final compensation. *A* elected to receive that allowance because it is greater than the disability retirement allowance of 60 percent of average final compensation. *A*'s average final compensation was $200 per week.

LAW

Section 61(a) of the Code and the Income Tax Regulations thereunder provide that, except as otherwise provided by law, gross income means all income from whatever source derived, including compensation for services.

Section 104(a)(1) of the Code provides, with certain exceptions not pertinent to this case, that gross income does not include amounts received under workmen's compensation acts as compensation for personal injuries or sickness.

Section 1.104-1(b) of the regulations states that section 104(a)(1) of the Code excludes from gross income amounts received by an employee under a workmen's compensation act or under a statute in the nature of a workmen's compensation act that provides compensation to the employee for personal injuries or sickness incurred in the course of employment. However, the exclusion under section 104(a)(1) does not apply to a retirement pension or annuity to the extent that it is determined by reference to the employee's age or length of service, or the employee's prior contributions, even though the employee's retirement is occasioned by an occupational injury or sickness.

Section 105(d) of the Code provides, subject to certain limitations, that gross income does not include amounts received by an employee through accident or health insurance for personal injury or sickness if those amounts constitute wages or payments in lieu of wages for a period during which the employee is absent from work on account of permanent and total disability. Generally, for taxable years beginning after December 31, 1976, the exclusion is available only if the taxpayer is retired on disability, was permanently and totally disabled at the time of retirement, and has not reached age 65 before the end of the taxable year.

ANALYSIS AND HOLDINGS

The lifetime benefits in question here are authorized by a statute that provides benefits to a class restricted to employees with service-incurred disabilities. These benefits are thus payments for those disabilities. Accordingly, this statute is a statute in the nature of a workmen's compensation act. Rev. Rul. 72-291, 1972-1 C.B. 36; Rev. Rul. 72-44, 1972-1 C.B. 31.

The allowance received by an employee under the service connected disability retriment provisions of *M*'s statutes is therefore excludable from a recipient's gross income under section 104(a)(1) of the Code to the extent that the allowance (before any reduction to increase the survivor's benefit) does not exceed 60 percent of the recipient's average final compensation. The excess of that allowance (before any reduction to increase the survivor's benefit), if any, is attributable to the length of service and is not excludable under section 104(a)(1). See Rev. Rul. 72-44.

A's average final compensation was $200 per week, so that *A* receives an allowance of $160 (80 percent of average final compensation). Of this amount, $120 (60 percent × $200) is treated as workmen's compensation and is excludable under section 104(a)(1) of the Code. $40 (20 percent × $200) is attributable to years of service and is not excludable under section 104(a)(1). However, this amount is excludable from gross income to the extent permitted by section 105(d) for years in which the requirements of that section are met. See Rev. Rul. 58-43, 1958-1 C.B. 45, which applies section 105(d) to military disability retirement pay in excess of the amounts that are excludable under section 104(a)(4).

If an employee elects to reduce the employee's lifetime allowance in order to increase the survivor's benefit, the reduction is attributable pro rata among the components of the lifetime allowance. Thus, if as a result of such an election *A*'s lifetime benefit were to be reduced to $100 per week, $75 (120/160 × $100) of the amount is treated as workmen's compensation. The balance, $25, is attributable to years of service and is not excludable under section 104(a)(1) of the Code. This $25 is excludable to the extent permitted by section 105(d) for taxable years in which the requirements of that section are met.

The resulting increase in survivor's benefits is directly attributable to a reduction in the employee's lifetime benefits. The percentage of the increase equal to the percentage of lifetime benefits excludable under section 104(a)(1) of the Code is thus a continuation of lifetime section 104(a)(1) benefits. This percentage of the increase thus qualifies as payments under a workmen's compensation act to survivors of a deceased employee, and under section 1.104-1(b) of the regulations it is excludable from gross income under section 104(a)(1). As a result, 75 percent (120/160) of any increase in benefits to *A*'s survivors is excludable under section 104(a)(1).

Section 105.—Amounts Received Under Accident and Health Plans

26 CFR 1.105-1: Amounts attributable to employer contributions.

Whether amounts received by an employee and the employee's survivors are excludable from gross income. See Rev. Rul. 80-44, page 6.

Section 162.—Trade or Business Expenses

26 CFR 1.162-1: Business expenses.

The proper federal income tax treatment of payments made by a lessee upon obtaining an oil and gas lease. See Rev. Rul. 80-49, page 13.

26 CFR 1.162-1: Business expenses.

Treatment of a commission paid to a barter club by a member purchaser with respect to a barter transaction with another member. See Rev. Rul. 80-52, page 12.

26 CFR 1.162-17: Reporting and substantiation of certain business expenses of employees.

Simplified, optional method for computing the allowable deduction for the cost of operating an automobile for business purposes. See Rev. Proc. 80-7, page 24.

26 CFR 1.162-17: Reporting and substantiation of certain business expenses of employees.

Substantiation of certain subsistence and travel expenses. See Rev. Rul. 80-62, page 9.

Section 170.—Charitable, Etc., Contributions and Gifts

26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance of deduction.

VITA volunteers; unreimbursed expenses. Unreimbursed expenses for transportation, paper and pencils, newspaper advertising, and similar items incurred by volunteers in connection with their participation in the Volunteer Income Tax Assistance (VITA) program are deductible under section 170 of the Code.

Rev. Rul. 80-45

ISSUE

Are unreimbursed expenses incurred by volunteers participating in the Volunteer Income Tax Assistance (VITA) program deductible under section 170 of the Internal Revenue Code?

FACTS

VITA is an on-going program established under the auspices of the Internal Revenue Service to further the policy of the Service to help taxpayers to comply voluntarily with federal tax laws and to assist taxpayers in meeting their obligations under the tax laws. The aim of the program is to provide free assistance to low-income, elderly, and non-English speaking individuals in the preparation of their federal income tax returns. VITA volunteers are trained by the Service, which provides instructors and materials at no cost to the volunteers. When the training is completed, the Service continues to assist the volunteers by making available area coordinators (who are Internal Revenue Service employees) and by providing IRS publications and technical assistance. A special telephone number is furnished to the volunteers so that they can obtain immediate assistance. The volunteers include members of retirement, religious, and civic organizations, college students, members of social action groups, and Internal Revenue Service employees. The Service monitors the program by requiring the volunteers to place the letters "VITA" on each return they prepare under the program.

Unreimbursed out-of-pocket expenses incurred by VITA volunteers include transportation costs to and from the training and tax assistance sites and, in some instances, the cost of paper and pencils used at tax assistance sites, newspaper advertising expenses incurred to publicize provision of tax assistance, and similar items directly connected with participation in the VITA program.

LAW AND ANALYSIS

Section 1.170A-1(g) of the regulations provides that no deduction is allowable under section 170 of the

Code for a contribution of services. However, unreimbursed expenditures made incident to the rendition of services to an organization contributions to which are deductible may constitute a deductible contribution. For example, out-of-pocket transportation expenses necessarily incurred in performing donated services are deductible.

Rev. Rul. 65-285, 1965-2 C.B. 56, holds that individuals invited by the Department of Justice and the Office of Economic Opportunity to attend a conference and contribute their advice and services regarding methods of meeting legal problems of the poor may deduct their out-of-pocket expenses in connection therewith under section 170 of the Code.

Rev. Rul. 67-362, 1967-2 C.B. 117, holds that retired business executives participating in the Small Business Administration's SCORE program by counseling owners of small businesses may deduct reasonable, unreimbursed expenditures necessarily incurred in providing such assistance.

HOLDING

Unreimbursed expenses for transportation, paper and pencils, newspaper advertising and similar items incurred by VITA volunteers while rendering gratuitous services pursuant to the VITA program are incurred "for the use of" the United States within the meaning of section 170(c)(1) of the Code and are deductible under section 170, subject to the limitations of section 170(b)(1)(B).

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26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance of deduction.

Standard mileage rate for computing the allowable deduction for the cost of operating an automobile for transportation in connection with rendering gratuitous services to a charitable organization. See Rev. Proc. 80-7, page 24.

Section 213.—Medical, Dental, Etc., Expenses

26 CFR 1.213-1: Medical, dental, etc., expenses.

Standard mileage rate for computing the allowable deduction for the cost of operating an automobile in connection with transportation for medical care. See Rev. Proc. 80-7, page 24.

Section 217.—Moving Expenses

26 CFR 1.217-2: Deduction for moving expenses paid or incurred in taxable years beginning after December 31, 1969.

Simplified, optional method that may be used for computing deductions for the costs of operating a passenger automobile for moving expense purposes. See Rev. Proc. 80-7, page 24.

Section 262.—Personal, Living, and Family Expenses

26 CFR 1.262-1: Personal, living, and family expenses.

Treatment of a commission paid to a barter club by a member purchaser with respect to a barter transaction with another member. See Rev. Rul. 80-52, page 12.

Section 263.—Capital Expenditures

26 CFR 1.263(a)-1: Capital expenditures; in general.

Treatment of a commission paid to a barter club by a member purchaser with respect to a barter transaction with another member. See Rev. Rul. 80-52, page 12.

Section 269.—Acquisitions Made to Evade or Avoid Income Tax

26 CFR 1.269-1: Meaning and use of terms.

Acquisition to avoid tax; reorganization; control; attribution of sole owner's stock. An acquired corporation owned all the stock of two subsidiary corporations. The acquiring corporation, owning 45 percent of the stock of the acquired corporation before the merger, did not have control of the acquired corporation under section 269 of the Code where the acquiring, corporation's sole stockholder also owned 10 percent of the stock of the acquired corporation because the attribution rules of constructive ownership do not apply. The acquiring corporation has acquired control of the acquired corporation's subsidiaries.

Rev. Rul. 80-46

ISSUE

Has the taxpayer acquired control of any corporation within the meaning of section 269(a)(1) of the Internal Revenue Code, under the circumstances described below?

FACTS

The taxpayer, M corporation, owned 45 percent of the stock of X corporation. A, an individual, owned 10 percent of the stock of X and 100 percent of the stock of M. The balance of the X stock was owned by unrelated third parties. The assets of X consisted solely of 100 percent of the stock of both Y corporation and Z corporation.

In June 1975, X was merged into M under the laws of state T. Pursuant to the merger agreement, all the stock of Y and Z was transferred to M. The transaction qualified as a statutory merger within the meaning of section 368(a)(1)(A) of the Code. Y and Z became subsidiaries of M and filed consolidated federal income tax returns with M for years subsequent to the merger.

The principal purpose of the merger was to avoid federal income tax by securing the benefit of a deduction, credit, or other allowance that M would not otherwise have enjoyed.

The specific questions presented are (1) whether the X stock owned directly by A before the merger can be attributed to M so that M had control of X before the merger and therefore did not acquire it within the meaning of section 269(a)(1) of the Code, and if not, (2) whether the acquisition of Y and Z stock pursuant to a statutory merger under section 368(a)(1)(A) is an acquisition of control within the meaning of section 269(a)(1).

LAW AND ANALYSIS

Section 269(a) of the Code provides that if—

> (1) any person or persons acquire, or acquired on or after October 8, 1940, directly or indirectly, control of a corporation, or
>
> (2) any corporation acquires, or acquired on or after October 8, 1940, directly or indirectly, property of another corporation, not controlled, directly or indirectly, immediately before such acquisition, by such acquiring corporation or its stockholders, the basis of which property in the hands of the acquiring corporation, is determined by reference to the basis in the hands of the transferor corporation,

and the principal purpose for which such acquisition was made is evasion or avoidance of federal income tax by securing the benefit of a deduction, credit, or other allowance that such person or corporation would otherwise enjoy, then the Secretary may disallow such deduction, credit, or other allowance. For purposes of paragraphs (1) and (2), control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote or at least 50 percent of the total value of shares of all classes of stock of the corporation.

Section 1.269-2(b) of the Income Tax Regulations provides that amounts otherwise constituting a deduction, credit, or other allowance will be disallowed under section 269 of the Code when the effect of the deduction, credit or other allowance would be to distort the liability of the taxpayer when the "essential nature" of the transaction or situation is examined in the light of the basic purpose or plan that the deduction, credit or other allowance was designed by the Congress to effectuate.

Section 1.269-3 of the regulations provides that if either section 269 (a)(1) or (a)(2) of the Code is applicable because the principal purpose of the acquisition was to evade or avoid federal income tax, it is immaterial by what method or by what conjunction of events the benefit was sought.

In *Brick Milling Company v. Commissioner,* T.C. Memo 1963-305, during 1956 two brothers acquired direct control of a manufacturing corporation that had net operating losses for several years before the acquisition. About a year before the acquisition, the brothers incorporated their family partnership, which operated several mills in the same area as the acquired manufacturing corporation. On October 23, 1957, the brothers transferred their stock in the manufacturing corporation to the milling corporation, which immediately liquidated the manufacturing corporation and received all of its assets in distribution. For its taxable years ending March 31, 1958, and 1959, the milling corporation deducted the net operating losses of the manufacturing corporation. The losses were disallowed under section 269 of the Code.

The court found that since the brothers had control of both corporations prior to the liquidation of one into the other, section 269(a)(2) of the Code was inapplicable. The milling corporation contended that section 269(a)(1) was also inapplicable because it had indirect control of the liquidated manufacturing corporation prior to the contribution of that corporation's stock to its capital by the brothers. The pre-existing indirect control purportedly arose because the stock ownership of the brothers in the liquidated corporation should be attributed to the milling corporation. As a result, the milling corporation contended that it did not acquire control of the liquidated corporation immediately prior to the liquidation. In reply, the court said that the attribution rules of section 318 do not apply in determining control within the meaning of section 269 because section 318 applies only to subchapter C of the Code and section 269 is in subchapter B. No other provisions of the Code would attribute ownership of the manufacturing corporation stock to the milling corporation. The court also said that section 269 applies to the acquisition of control of one corporation by another corporation even if both are owned by the same shareholder. The court held, therefore, that section 269 (a)(1) applied to the acquisition by the milling corporation of the controlling stock interest of the manufacturing corporation.

In the present situation, *M* directly owned only 45 percent of *X* and thereby indirectly owned only 45 percent of *Y* and *Z* before the merger. The 10 percent interest in *X* held by *A* cannot be attributed to *M* because there are no rules of constructive ownership of stock expressly made applicable to section 269 of the Code.

Further, while the merger may properly be characterized as a transfer of property for purposes of section 368 (a)(1)(A) of the Code, this characterization does not limit the application of section 269(a)(1). Section 269 (a)(1) refers to the acquisition of control of a corporation. It is immaterial how that control is acquired. In the present situation, *X* transferred all of the stock of *Y* and *Z* to *M*. Thus, the essential nature of the transaction is that *M* acquired control of *Y* and *Z* upon the merger of *X* into *M*.

HOLDING

Because the *X* stock owned by *A* is not attributed to *M*, *M* did not have control of *X*, *Y*, or *Z* within the meaning of section 269(a)(1) of the Code before the merger of *X* into *M*. Therefore, *M* acquired control of *Y* and *Z*, the subsidiaries of *X*, within the meaning of section 269(a)(1).

Section 274.—Disallowance of Certain Entertainment, Etc., Expenses

26 CFR 1.274-5: Substantiation requirements.
(Also Section 162; 1.162-17.)

Travel expenses; reimbursements or per diem and mileage allowances. For taxable years beginning after 1978, reimbursement arrangements or per diem allowances for travel away from home not exceeding the greater of $44 per day, or the maximum authorized to be paid by the Federal Government in the locality in which the travel is performed, and a mileage allowance not exceeding 18.5 cents per mile for transportation paid by employers to employees will be regarded as satisfying the substantiation and adequate accounting requirements of sections 1.162-17(b) and 1.274-5 of the regulations; Rev. Ruls. 74-433 and 77-410 superseded.

Rev. Rul. 80-62

The purpose of this revenue ruling is to update Rev. Rul. 74-433, 1974-2 C.B. 92, as modified by Rev. Rul. 77-410, 1977-2 C.B. 85, to provide rules for the substantiation of expenditures for ordinary and necessary business expenses for subsistence of an employee traveling away from home and ordinary and necessary expenses of transportation whether or not traveling away from home that most nearly represent present reasonable limits in light of current costs.

Section 274(d) of the Internal Revenue Code and section 1.274-5 of the Income Tax Regulations, provide rules for the substantiation of business expenditures for travel, and for reimbursement arrangements or per diem allowances for ordinary and necessary expenses of an employee traveling away from home (exclusive of transportation costs to and from destination), and mileage allowances for similar transportation expenses. Under the authority granted to the Commissioner by section 1.274-5(f) of the regulations, such arrangements or allowances that are in accordance with reasonable business practices may be regarded (1) as equivalent to substantiation by adequate records or other sufficient evidence of the amount of such traveling expenses for purposes of section 1.274-5(c), and (2) as satisfying the requirements of an adequate accounting to an employer with respect to such amounts for purposes of section 1.274-5(e).

Pursuant to such authority, it is held as follows:

If, in the case of expenses for travel away from home (exclusive of costs of transportation to and from destination), an employer reimburses employees for subsistence or provides the employees with a per diem allowance in lieu of subsistence in an amount that does not exceed the greater of (1) $44 per day or (2) the maximum per diem rate authorized to be paid by the Federal Government in the locality in which the travel is performed, such reimbursements and allowances shall be deemed substantiated within the meaning of section 1.274-5(c) of the regulations if (1) the employer reasonably limits payment of such travel expenses to those that are ordinary and necessary in the conduct of the trade or business and (2) the elements of time, place, and business purposes of travel are substantiated in accordance with paragraphs (b)(2) and (c) (other than subparagraph (2)(iii)(a) thereof) of section 1.274-5.

The district director will determine whether an employer reasonably limits the payment of expenses for travel away from home to such expenses as are ordinary and necessary in the conduct of trade or business by (1) in the case of reimbursements for actual subsistence expenses, determining whether the employer maintains adequate internal audit controls, such as requiring an employee's expense account to be verified and approved by a responsible person other than the employee incurring the expense, and (2) in the case of per diem allowances in lieu of subsistence, determining whether the employer's travel allowance practices are based on reasonably accurate estimates of travel costs, including recognition of cost variances encountered in different localities. If the amount of traveling expenses away from home is deemed substantiated for purposes of section 1.274-5(c) of the regulations, the adequate accounting requirements of section 1.274-5(e) shall be deemed satisfied.

As used in this revenue ruling, the term "subsistence" includes, but is not limited to, reasonable travel expenses for meals and lodging, laundry, cleaning and pressing of clothing, and fees and tips for services, such as for waiters and baggage handlers. The term "subsistence" does not include taxicab fares or the costs of telegrams or telephone calls.

If a fixed mileage allowance not exceeding 18.5 cents per mile is used by an employer in payment of an employee's ordinary and necessary expenses of transportation while traveling away from home and the elements of time, place, and business purpose of the travel are substantiated in accordance with paragraphs (b)(2) and (c) (other than subparagraph (2)(iii)(a) thereof) of section 1.274-5 of the regulations, such an allowance shall be deemed as satisfying, with respect to such travel amounts, the substantiation requirements of section 1.274-5(c) and the adequate accounting requirements of section 1.274-5(e). Also, if an employer grants an allowance not exceeding 18.5 cents per mile to an employee for ordinary and necessary transportation expenses not involving travel away from home, such an arrangement shall be considered to be an accounting to the employer within the meaning of section 1.162-17(b). However, an employer may grant an additional allowance for parking fees and tolls attributable to the traveling and transportation expenses as separate items.

Pursuant to section 1.274-5(e)(2) of the regulations if an employee, under a travel expense arrangement or allowance practice discussed above, receives an amount from an employer equal to the deductible business expenses (that do not include personal, living, or family expenses or travel expenses disallowed by section 274(c) of the Code), the employee need not report such reimbursement in gross income.

If an employee, under a travel expense arrangement or allowance practice discussed above, receives an amount from an employer in excess of the deductible business expenses (that is, expenses which do not include personal, living, or family expenses or travel expenses disallowed by section 274(c) of the Code), the employee must report such excess amount in gross income.

If an employee, under a travel expense arrangement or allowance practice discussed above, receives an amount from an employer less than the deductible business expenses (that do not include personal, living, or family expenses or travel expenses disallowed by section 274(c) of the Code), and the employee wants to claim a deduction for such excess expenses, the employee must report the reimbursements in gross income and claim deductions for all the ordinary and necessary business expenses.

The provisions of this revenue ruling relating to reimbursement arrangements or per diem allowances will not apply in any case when an employer and an employee are related within the meaning of section 267(b) of the Code, but for this purpose the percentage of ownership interest referred to in section 267(b)(2) shall be 10 percent.

With respect to expenses paid or incurred after December 31, 1978, this Revenue Ruling supersedes Rev. Rul. 74-433 and Rev. Rul. 77-410.

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26 CFR 1.274-5: Substantiation requirements.

Simplified, optional method for computing allowable deductions for the cost of operating an automobile for business purposes. See Rev. Proc. 80-7, page 24.

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401-1: Qualified pension, profit-sharing and stock bonus plans.
(Also Section 410; 1.410(b)-1.)

Coverage; participation limited; employee election. A plan will not fail to qualify under section 401(a) of the Code merely because it denies participation to employees who do not authorize salary withholding or take a physical examination to determine eligibility for life insurance, so long as these provisions do not result in discrimination and are applied in a nondiscriminatory manner.

Rev. Rul. 80-47

The purpose of this Revenue Ruling is to update and restate Rev. Rul. 71-312, 1971-2 C.B. 187, and Rev. Rul. 74-96, 1974-1 C.B. 92, in view of the enactment of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 1974-3 C.B. 1.

The issue in Rev. Rul. 71-312 and Rev. Rul. 74-96 is whether a pension plan will fail to qualify under section 401(a) of the Internal Revenue Code merely because employees are required to take certain specified actions as a condition of participation.

The plan of a corporation provides that all participants shall contribute a stated percentage of their compensation. The employee contributions, plus a portion of the employer's contributions, are used to provide incidental life insurance protection on the lives of insurable participants. The plan also provides that an employee shall become a participant only after signing a prescribed form authorizing salary withholding in accordance with the plan and taking a physical examination to determine eligibility for life insurance coverage. However, an employee who authorizes salary withholding and takes the physical examination is not barred from participation merely because that person is found to be uninsurable.

The plan further requires that all employees be informed at the time of their employment of their eligibility to participate in the plan and of the conditions for eligibility. Any employee who has not complied with the eligibility conditions within 30 days after the date of employment must then be given written notification of eligibility to participate in the plan and of the necessity for signing the prescribed salary withholding form and taking the physical examination. This written notice must also inform the employee that failure to sign the form or take the examination will prevent participation in the plan.

The plan further provides that any employee who does not sign the form or take the physical examination within six months after receiving this written notification, in accordance with the terms of the plan, will be barred from participation.

Section 410(b) of the Code and section 1.410(b)-1 of the Income Tax Regulations provide that a qualified plan must benefit a certain percentage of employees as set forth in section 410(b)(1)(A) or, as provided in section 410(b)(1)(B), if a classification is set up by the employer, it must not discriminate in favor of employees who are officers, shareholders, or highly compensated.

Thus, the qualification requirements of section 410(b)(1) of the Code may be met even though a plan provides for denial of participation for failure to enter the plan upon becoming eligible, if it can be shown that the provisions do not discriminate in favor of employees who are officers, shareholders, or highly compensated. Further such provisions must be applied in a nondiscriminatory manner.

Accordingly, this plan does not fail to qualify under section 401(a) of the Code merely because it denies participation to employees who do not authorize salary withholding or take a physical examination, so long as these provisions do not result in discrimination in favor of employees who are officers, shareholders, or highly compensated, and so long as such provisions are applied in a nondiscriminatory manner.

The same result would also apply with respect to a qualified plan which limits participation to employees who have elected to have amounts withheld from their salaries to purchase annuity contracts on their behalf.

The principles and conclusion stated herein are applicable to plans described in section 410(c) of the Code.

Rev. Rul. 71-312 is modified and superseded. Rev. Rul. 74-96 is superseded because the position stated therein is restated under current law in this Revenue Ruling.

Section 410.—Minimum Participation Standards

26 CFR 1.410(b)-1: Minimum coverage requirements.

Whether the coverage requirements of section 410(b)(1)(B) may be met even though a plan provides for denial of participation for failure to enter the plan upon becoming eligible. See Rev. Rul. 80-47, this page.

Section 451.—General Rule for Taxable Year of Inclusion

26 CFR 1.451-1: General rule for taxable year of inclusion.
(Also Section 636; 1.636-1.)

Mineral production payments; gas; "take or pay" purchase contract. Payments received for gas that is to be taken in the future under a "take or pay" gas purchase contract are not mineral production payments under section 636(a) of the Code and are includible in gross income under the provisions of section 451.

Rev. Rul. 80-48

ISSUE

Are the payments received by the taxpayer for gas, to be taken in the future under a "take or pay" gas purchase contract, mineral production payments for federal income tax purposes under section 636(a) of the Internal Revenue Code?

FACTS

The taxpayer sells gas to corporation *Y* under the provisions of a "take or pay" gas purchase contract.

Under the provisions of the contract, corporation *Y* purchases a specified amount of gas from the taxpayer each month. However, corporation *Y* is not obligated to take such monthly production.

The contract provides that the taxpayer will receive monthly payments from *Y* based upon a predetermined production schedule, whether or not *Y* takes the monthly production. To the extent the taxpayer receives payments from *Y* in excess of the production taken by *Y*, a deficiency in the "take" exists. *Y* has the right during any of the subsequent years of the 20 year contract life to make up any deficiency by taking production in excess of the monthly scheduled production.

LAW AND ANALYSIS

Section 451 of the Code provides that the amount of any item of gross income shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Section 1.451-5(g) of the Income Tax Regulations provides that a transaction that is treated as creating a mortgage loan pursuant to section 636 of the Code and the regulations thereunder rather than as a sale shall not be considered a "sale or other disposition" within the meaning of section 1.451-5(a)(1).

Consequently, any payment received pursuant to such a transaction, that would otherwise qualify as an "advance payment," will not be treated as an "advance payment."

Section 1.636-3(a)(1) of the regulations states that the term "production payment" for purposes of section 636 of the Code means a right to a specified share of the production from mineral in place, if, as, and when produced, or the proceeds from such production. Such right must be an economic interest in such mineral in place.

An economic interest is defined in section 1.611-1(b) of the regulations as being possessed in every case in which the taxpayer has acquired by investment any interest in mineral in place and secures, by any form of legal relationship, income derived from the extraction of the mineral, to which the taxpayer must look for a return of its capital. An agreement between the owner of an economic interest and another entitling the latter to purchase the product upon production does not convey a depletable economic interest in mineral in place.

The taxpayer, in this case, entered into an agreement with *Y* under the terms of which *Y* must purchase each month, for the life of the contract, a specified amount of gas. However, *Y* need not take the gas. Under the provisions of section 1.611-1(b) of the regulations such an agreement does not convey a depletable economic interest in mineral in place.

HOLDING

The payments received for gas to be taken in the future under a "take or pay" gas purchase contract are not mineral production payments for federal income tax purposes under the provisions of section 636(a) of the Code. Consequently, the payments received are includible in gross income under the provisions of section 451.

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26 CFR 1.451-1: General rule for taxable year of inclusion.
(Also Sections 61, 162, 262, 263, 3121, 3306, 3401; 1.61-1, 1.61-2, 1.162-1, 1.262-1, 1.263(a)-1, 31.3121(a)-1, 31.3306(b)-1, 31.3401(a)-1.)

Barter club transactions. A barter club uses credit units to credit or debit members' accounts for goods or services provided or received. As soon as units are credited to a member's account, the member may use them to purchase goods or services or may sell or transfer the units to other members. The value of credit units received is includible in the gross incomes of members for the taxable year in which the units are credited to their accounts. The dollar value of units received for services by an employee of the club, who may use the units in the same manner as other members, is includible in gross income for the taxable year in which received and is wages for purposes of the FICA, the FUTA, and income tax withholding.

Rev. Rul. 80-52

ISSUE

What is the amount includible in gross income as a result of the bartering transactions described below, and when is the amount includible in gross income?

FACTS

A and *B* are both members of a barter club. The barter club operates as a vehicle for the exchange of property and services among the members. The club uses "credit units" as a medium of exchange and makes available to members information concerning property and services other members are offering for exchange. The club debits or credits members' accounts for goods or services received from or rendered to other members. Exchanges are made on the basis that one credit unit equals one dollar of value. The rules of the club require that the value placed on goods or services exchanged be equal to the member seller's normal retail price. The transfer of credit units between members is accomplished by various source documents, such as invoices, and the club charges the member purchaser a 10 percent commission payable in cash on barter purchases. Any barter transaction between members is reflected in the form of bookkeeping entries on the books and records of the club. The club does not guarantee that a member will be able to use all of that member's credit units and does not pay a member cash for any credit units not used. However, a member's credit units can be used immediately to purchase goods or services offered by other members of the club, and the member may transfer or sell the member's credit units to another member of the club.

Situation 1. Both *A* and *B* use the cash receipts and disbursements method of accounting. Through the club, *A* bartered to *B* for 200 credit units services that *A* would normally perform for $200. During the same taxable year, *B* bartered to *A* for 200 credit units services that *B* would normally perform for $200.

Situation 2. C is an employee of the barter club. During the taxable year, *C*, who uses the cash receipts and disbursements method of accounting, received from the club in exchange for *C*'s services gross wages of $20,000, $10,000 in cash and 10,000 credit units. *C* is entitled to use the credit units in the same manner as other members of the club. However, the club does not charge *C* a commission on *C*'s barter purchases.

LAW AND ANALYSIS

Section 61 of the Internal Revenue Code and regulations thereunder provide that, except as otherwise provided by law, gross income means all income from whatever source derived.

Section 1.61-1 of the Income Tax Regulations provides, in part, that gross income includes income realized in any form, whether in money, property, or services.

Section 1.61-2(d)(1) of the regulations provides that, if services are paid for other than in money, the fair market value of the property or services taken in payment must be included in income as compensation.

Sections 3121(a), 3306(b), and 3401(a) of the Code provide that the term "wages" means all remuneration for services performed by an employee for the employee's employer, including the cash value of all remuneration paid in any medium other than cash.

Section 451 of the Code provides that the amount of any item of gross income is includible in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Section 1.451-1(a) of the regulations provides that income is includible in gross income for the taxable year in which it is actually or constructively received by the taxpayer, unless it is includible in a different year in accordance with the taxpayer's method of accounting.

Rev. Rul. 70-331, 1970-1 C.B. 14, concerns "prize points" that are earned by salespersons and are redeemable for merchandise prizes listed in a catalog. That revenue ruling holds that the fair market value of the prize points awarded to a salesperson who uses the cash receipts and disbursements method of accounting is includible in the salesperson's gross income when the prize points are paid or otherwise made available to the salesperson, whichever is earlier. The prize points in Rev. Rul. 70-331 and the credit units in this revenue ruling both represent payment for services in a form other than money.

In this case *A*, *B*, and *C* received income in the form of a valuable right represented by credit units that can be used immediately to purchase goods or services offered by other members of the barter club. There are no restrictions on their use of the credit units because *A*, *B*, and *C* are free to use the credit units to purchase goods or services when the credit units are credited to their accounts.

HOLDINGS

Situation 1. A and *B* must include $200 in their gross incomes for the taxable year in which the credit units are credited to their accounts. If *A* and *B* were merchants who used the accrual method of accounting and bartered goods to one another, $200 would be includible in their gross receipts.

Situation 2. C must include $20,000 in *C*'s gross income for the taxable year. For federal employment tax purposes, the $20,000 is wages under sections 3121(a), 3306(b), and 3401(a) of the Code.

If the commission paid to the barter club by a member purchaser was paid to acquire an item for use in connection with the member purchaser's trade or business, the amount of the commission is deductible as a business expense under section 162 of the Code, provided the item received in the barter transaction meets the requirements of that section. If the commission was paid to acquire a capital item, the amount of the commission must be capitalized pursuant to section 263. If the commission was paid to acquire an item for personal purposes, the amount of the commission is not deductible, pursuant to section 262.

Where members of a barter club exchange goods and services directly with one another and no credit units are received, see Rev. Rul. 79-24, 1979-1 C.B. 60.

Section 612.—Basis for Cost Depletion

26 CFR 1.612-3: Depletion; treatment of bonus and advanced royalty.
(Also Section 162; 1.162-1.)

Oil and gas leases; first year payments. Examples illustrate certain first year payments made by a lessee upon obtaining an oil and gas lease that are delay rentals that may be capitalized or expensed at the election of the lessee or are lease bonuses that must be capitalized; Rev. Ruls. 56-252 and 67-25 superseded.

Rev. Rul. 80-49

ISSUE

Whether, under the various factual situations described below, first year payments made by a lessee upon obtaining an oil and gas lease on tracts of land are delay rentals that may be capitalized or expensed in the year paid at the election of the lessee, rental payments that are ordinary and necessary business expenses in the year paid or incurred, or lease bonuses that must be capitalized.

FACTS

The taxpayer bid competitively for federal oil and gas leases, filed entries under the simultaneous filing procedure for noncompetitive leasing of federal oil and gas lands, and leased oil and gas properties from private individuals.

The various situations in which the taxpayer makes first year payments when leasing oil and gas properties are as follows:

Situation 1. Under the competitive bidding procedure, the leases are awarded to the bidder offering the largest bonus for a specified lease. The taxpayer when awarded the lease is required to pay the Bureau of Land Management any unpaid balance of the bonus, and also a payment designated as first year rental. Each year thereafter a similar rental payment is due on the anniversary date of the lease unless a discovery has been made or the lease terminated.

Situation 2. Under the simultaneous filing procedure for noncompetitive leasing of federal lands, a nonrefundable filing fee must accompany each lease application. The successful applicant is determined by lottery. The taxpayer, when awarded the lease, is required to make a first year rental payment. Similar payments will be due on the anniversary date of the lease unless a discovery has been made or the lease terminated.

Situation 3. The taxpayer negotiates for an oil and gas lease with a private individual for a term of three years. The terms of the lease require a bonus payment. A yearly payment designated as rent is required to be made at the end of the first year and, if drilling has not then commenced, at the end of each succeeding year of the primary term of the lease.

Situation 4. The taxpayer negotiates for an oil and gas lease with a private individual for a term of three years. The terms of the lease require a bonus payment. An additional payment, designated as rent, is required to be made at the time the lease is signed. The additional payment extends for two years the primary term of the lease.

LAW AND ANALYSIS

Section 1.162-1 of the Income Tax enue Code provides that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 1.162-1 of the Income Tax Regulations provides that the business expenses deductible under section 162 of the Code include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business.

Section 1.612-3(a)(3) of the regulations provides that lessee's payment of a bonus is a capital investment made to acquire an economic interest in a mineral deposit and is recoverable through the allowance for depletion.

Section 1.612-3(c)(1) of the regulations defines "delay rental" as payments made for the privilege of deferring development of the property that can be avoided by abandoning the lease, commencing development operations, or by obtaining production.

Section 1.612-3(c)(2) of the regulations provides that a delay rental is in the nature of rent and that the payor may, by election, deduct such amount as an expense or charge it to a depletable capital account.

In distinguishing a delay rental from a bonus in *Fitzsimmons v. Commissioner,* 37 T.C. 179 (1961), the court held that when payments designated as rentals could not be avoided by drilling, the leasing instrument did not indicate such payments were for delay in drilling, and the payments were greater than the sums provided for delay in drilling, such payments were in the nature of a bonus paid in installments.

The first year payments designated as rentals in the federal leasing transactions are in substance the same as the succeeding delay rental payments. *United States v. Dougan,* 214 F.2d 511 (10th Cir. 1954); *Commissioner v. Miller,* 227 F.2d 326 (9th Cir. 1956); and *Featherstone v. Commissioner,* 22 T.C. 763 (1954).

The first year payments in situations 1 and 2 are in substance delay rentals and not payable for subsequent years if the lessee abandons the lease for which such rentals were paid or obtains production on the lease.

In addition, those payments in situations 1, 3, and 4 that are designated as bonuses are for the right to enter upon and explore for oil and gas and therefore are bonuses within the meaning of section 1.612-3(a)(3). Bonuses are capital investments that must be recovered through the deduction for depletion.

The payment in situation 3 that extends the time period within which the lessee must commence drilling of a well is a delay rental.

The additional payment in situation 4, designated as rent by lessee, extends the primary term of the lease and therefore is a bonus. Bonuses are capital investments for federal income tax purposes.

HOLDINGS

In situation 1 above, the lessee must capitalize the bonus paid. The first year rental payment may, at the lessee's option, be capitalized or expensed in the year paid or incurred.

In situation 2, the lessee must capitalize the filing fee. The first year rental may, at the lessee's option, be capitalized or expensed in the year paid or incurred.

In situation 3, the lessee must capitalize the bonus paid and may elect to capitalize or expense the delay rental payment.

In situation 4, the lessee must capitalize the initial bonus and the additional payment.

EFFECT ON OTHER REV. RULS.

Rev. Rul. 56-252, 1956-1 C.B. 210, and Rev. Rul. 67-25, 1967-1 C.B. 156, are superseded because the positions set forth therein are restated in this Revenue Ruling.

Section 636.—Income Tax Treatment of Mineral Production Payments

26 CFR 1.636-1: Treatment of production payments as loans.

Whether the payments received for gas, to be taken in the future, are mineral production payments. See Rev. Rul. 80-48, page 11.

Section 851.—Definition of Regulated Investment Company

26 CFR 1.851-2: Limitations.
(Also Section 856; 1.856-2.)

Regulated investment company or real estate investment trust; short taxable year; quarters. In the case of short taxable year, the phrase "at the close of each quarter of the taxable year" in sections 851(b)(4) and 856(c)(5) of the Code refers to quarterly periods that end, to the extent possible, on the same dates as the quarters of a 12-month year, even though the use of 3-month quarters may result in one quarter of less than three months.

Rev. Rul. 80-50

ISSUE

In the case of an 8 month taxable year, does the phrase "at the close of each quarter of the taxable year" in section 851(b)(4) of the Internal Revenue Code refer to 3 or 4 quarters and when do the quarters end?

FACTS

Corporation *A,* which currently has a taxable year ending April 30, received permission to change its accounting period to the calendar year. This change will require a return for the short taxable year beginning May 1, 1979 and ending December 31, 1979. It is *A*'s intent to qualify and elect to be treated as a regulated investment company under subchapter M (sections 851-855) of the Code for the short taxable year and for future taxable years. *A* did not qualify as a regulated investment company for any prior taxable period.

LAW AND ANALYSIS

Section 851(b)(4)(A) of the Code states the general rule that at the close of each quarter of the taxable year at least 50 percent of the value of a regulated investment company's total assets must be represented by cash and cash items, Government securities, securities of other regulated investment companies and other securities limited in respect of any one issuer to an amount not greater in value than 5 percent of the value of the investment company's total assets and to not more than 10 percent of such issuer's outstanding voting securities.

Section 851(b)(4)(B) of the Code imposes additional quarterly limitations on concentrating investments. Section 851(d) provides that a regulated investment company has 30 days after the end of a quarter to eliminate any discrepancy between the requirements of section 851(b)(4) and the value of its various investments that existed at the end of the quarter.

A mere change of accounting period should not result in *A*'s being subjected to more stringent diversification testing. A stricter testing would occur if the 8-month year were divided into 4 quarters that are each 2 months long. The diversification testing would be done at shorter intervals than usual and some financial statement preparation dates would be dates as of which financial statements are not usually prepared.

In the case of a 12-month year, diversification testing of regulated investment companies is done at the end of each quarter of the year, usually a 3-month period. The 3-month testing scheme can best be adapted to a taxpayer's short year by having such quarters end, to the extent possible, on the same dates as a 12-month year. Although the use of 3-month quarters may result in 1 quarter of less than 3 months in the short year, it would be less disruptive of the diversification testing than simply dividing a short year into 4 equal parts and it would still satisfy the objective of the testing requirement.

HOLDING

The short taxable year beginning May 1, 1979 and ending on December 31, 1979, will have three quarterly periods ending on June 30 (2 months long), September 30 (3 months long), and December 31 (3 months long). The holding in this revenue ruling is also applicable to real estate investment trusts in applying section 856(c)(5) of the Code.

Section 856.—Definition of Real Estate Investment Trust

26 CFR 1.856-2: Limitations.

Determination of the effect of the phrase "at the close of each quarter of the taxable year" as used in section 856(c)(5) of the Code as it pertains to a short taxable year. See Rev. Rul. 80-50, page 14.

Section 1016.—Adjustments to Basis

26 CFR 1.1016-3: Exhaustion, wear and tear, obsolescence, amortization, and depletion for periods since February 28, 1913.

Automobile used in a trade or business by employees or self-employed individuals. See Rev. Proc. 80-7, page 24.

Section 3121.—Definitions [Federal Insurance Contributions Act]

26 CFR 31.3121(a)-1: Wages.

The amount includible in the gross income of an employee of a barter club who receives wages in cash and in credit units. See Rev. Rul. 80-52, page 12.

Section 3306.—Definitions [Federal Unemployment Tax Act]

26 CFR 31.3306(b)-1: Wages.

The amount includible in the gross income of an employee of a barter club who receives wages in cash and in credit units. See Rev. Rul. 80-52, page 12.

Section 3401.—Definitions [Collection of Income Tax at Source on Wages]

26 CFR 31.3401(a)-1: Wages.

The amount includible in the gross income of an employee of a barter club who received wages in cash and in credit units. See Rev. Rul. 80-52, page 12.

Section 4271.—Imposition of Tax

26 CFR 154.2-1: Tax on transportation of property by air.

Postal Service; airport terminal handling charges. Terminal handling charges paid by the U.S. Postal Service to scheduled certificated air carriers for services in connection with handling mail at the airport are not subject to the tax imposed by section 4271(a) of the Code; Rev. Rul. 74-512 revoked.

Rev. Rul. 80-53

Rev. Rul. 74-512, 1974-2 C.B. 371, holds that certain charges paid by the United States Postal Service to scheduled certificated air carriers for services in connection with handling mail at the airport are subject to the tax imposed by section 4271(a) of the Internal Revenue Code on amounts paid for the transportation of property by air.

Treasury and the Postal Service consulted with the Department of Justice as to the taxability of amounts paid by the Postal Service for these terminal handling charges. The Department of Justice concluded that the charges paid by the Postal Service were accessorial non-taxable charges because under the facts involved in the particular case it was held that (1) the charges were not for services that could only be provided by the air carrier and (2) the charges were separately stated.

Accordingly, Rev. Rul. 74-512 is hereby revoked.

Section 6103.—Confidentiality and Disclosure of Returns and Return Information

26 CFR 404.6103(n)-1: Disclosure or returns and return information in connection *with procurement of property and services for tax administration purposes.*

T.D. 7666

TITLE 26.—INTERNAL REVENUE.—CHAPTER 61, SUBCHAPTER B, PART 404.—TEMPORARY REGULATIONS ON PROCEDURE AND ADMINISTRATION UNDER THE TAX REFORM ACT OF 1976

Disclosure of returns and return information in connection with procurement of property and services for tax administration purposes

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary Regulations.

SUMMARY: This document contains amendments to the temporary regulations relating to the disclosure under section 6103(n) of the Internal Revenue Code of 1954 of returns and return information in connection with the processing, storage, transmission, and reproduction of the returns and return information, and the programming, maintenance, repair, testing, and procurement of equipment, for purposes of tax administration. These amendments extend to other bureaus and offices of the Treasury Department and to State tax agencies, bodies, and commissions described in section 6103(d) of the Code the authority to make these disclosures under section 6103(n) for Federal and State tax administration purposes, respectively. They affect all disclosures by the Treasury Department and State tax agencies, bodies, or commissions to persons described in section 6103(n). The regulations apply to disclosures of returns and return information after December 31, 1976.

FOR FURTHER INFORMATION CONTACT: David E. Dickinson of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3218).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains amendments to the temporary regulations relating to disclosure of returns and return information under section 6103 (n) of the Internal Revenue Code of 1954 as added by section 1202 of the Tax Reform Act of 1976 (Pub. L. 94-455, 90 Stat. 1681) [1976-3 C.B. (Vol. 1) 1].

Section 6103(n) of the Code authorizes the disclosure, pursuant to Treasury regulations, of returns and return information to the extent necessary in connection with the processing, storage, transmission, and reproduction of the returns and return information, and the programming, maintenance, repair, testing, and procurement of equipment, for purposes of tax administration. Section 6103(b)(4) defines "tax administration" to include the administration of the internal revenue laws and statutes of a State.

Existing § 404.6103(n)-1 of the temporary regulations authorizes disclosures under section 6103(n) only by the Internal Revenue Service and its Chief Counsel's office for Federal tax administration purposes. Because section 6103(n) authorizes disclosures of returns and return information by other bureaus and offices of the Treasury Department and by State tax agencies, bodies, and commissions for Federal and State tax administration purposes as well, these amendments to § 404.6103(n)-1 would so extend this disclosure authority.

WAIVER OF PROCEDURAL REQUIREMENT OF TREASURY DIRECTIVE

There is need for expeditious adoption of the regulations contained in this document in order to prevent impairment of the present ability of the Treasury Department and State tax agencies, bodies, and commissions to satisfactorily administer Federal and State tax laws. For this reason, Jerome Kurtz, Commissioner of Internal Revenue, has determined that the provisions of paragraphs 8 through 14 of the Treasury Directive implementing Executive Order 12044 must be waived.

DRAFTING INFORMATION

The principal author of this regulation was David E. Dickinson of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

In order to amend the Temporary Regulations on Procedure and Administration (26 CFR Part 404) to allow for certain disclosures by bureaus and offices of the Treasury Department and by an agency, body, or commission described in section 6103(d) of the Internal Revenue Code of 1954 for purposes described in section 6103(n) of the Code, paragraphs (a), (b), and (d) of § 404.6103(n)-1 of such regulations are amended, and a new paragraph (e) is added immediately after paragraph (d). These amended paragraphs and the added paragraph read as follows:

§ 404.6103(n)-1 Disclosure of returns and return information in connection with procurement of property and services for tax administration purposes.

(a) *General rule.* Pursuant to the provisions of section 6103(n) of the Internal Revenue Code of 1954 and subject to the requirements of paragraphs (b), (c), and (d) of this section, officers or employees of the Treasury Department or a State tax agency are authorized to disclose returns and return information (as defined in section 6103(b)) to any person (including, in the case of the Treasury Department, any person described in section 7513(a)), or to an officer or employee of such person, to the extent necessary in connection with contractual procurement of—

(1) Equipment or other property, or

(2) Services relating to the processing, storage, transmission, or reproduction of such returns or return information, or to the programming, maintenance, repair, or testing of equipment or other property,

for purposes of tax administration (as defined in section 6103(b)(4)). No person, or officer or employee of such person, to whom a return or return information is disclosed by an officer or employee of the Treasury Department or the State tax agency under the authority of this paragraph shall in turn disclose such return or return information for any purpose other than as described in this paragraph, and no such further disclosure for any such described purpose shall be made by such person, officer, or employee to anyone, other than another officer or employee of such person whose duties or reponsibilities require such disclosure for a purpose described in this paragraph, without written approval by the Internal Revenue Service.

(b) *Limitations.* For purposes of paragraph (a) of this section, disclosure of returns or return information in connection with contractual procurement of property or services described in such paragraph will be treated as necessary only if such procurement or the performance of such services cannot otherwise be reasonably, properly, or economically carried out or performed without such disclosure. Thus, for example, disclosures of returns or return information to employees of a contractor for purposes of programming, maintaining, repairing, or testing computer equipment used by the Internal Revenue Service or a State tax agency should be made only if such services cannot be reasonably, properly or economically performed by use of information or other data in a form which does not identify a particular taxpayer. If, however, disclosure of returns or return information is in fact necessary in order for such employee to reasonably, properly, or economically perform the computer related services, such disclosures should be restricted to returns or return information selected or appearing at random. Further, for purposes of paragraph (a) disclosure of returns or return information in connection with the contractual procurement of property or services described in such paragraph should be made only to the extent necessary to reasonably, properly, or economically conduct such procurement activity.

Thus, for example, if an activity described in paragraph (a) can be reasonably, properly, and economically conducted by disclosure of only parts or portions of a return or if deletion of taxpayer identity information (as defined in section 6103(b)(6)) reflected on a return would not seriously impair the ability of the contractor or his officers or employees to conduct the activity, then only such parts or portions of the return, or only the return with taxpayer identity information deleted, should be disclosed.

* * * * *

(d) *Safeguards.* Any person to whom a return or return information is disclosed as authorized by paragraph (a) of this section shall comply with all applicable conditions and requirements which may be prescribed by the Internal Revenue Service for the purposes of protecting the confidentiality of returns and return information and preventing disclosures of returns or return information in a manner unauthorized by paragraph (a). The terms of any contract between the Treasury Department or a State tax agency and a person pursuant to which a return or return information is or may be disclosed for a purpose described in paragraph (a) shall provide, or shall be amended to provide, that such person, and officers and employees of the person, shall comply with all such applicable conditions and restrictions as may be prescribed by the Internal Revenue Service by regulation, published rules or procedures, or written communication to such person. If the Service determines that any person, or an officer or employee of any such person, to whom returns or return information has been disclosed as provided in paragraph (a) has failed to, or does not, satisfy such prescribed conditions or requirements, the Service may take such actions as are deemed necessary to ensure that such conditions or requirements are or will be satisfied, including—

(1) Suspension or termination of any duty or obligation arising under a contract with the Treasury Department referred to in this paragraph or suspension of disclosures by the Treasury Department otherwise authorized by paragraph (a) of this section, or

(2) Suspension of further disclosures of returns or return information by the Service to the State tax agency, until the Service determines that such conditions and requirements have been or will be satisfied.

(e) *Definitions.* For purposes of this section—

(1) The term "Treasury Department" includes the Internal Revenue Service and the Office of the Chief Counsel for the Internal Revenue Service, and

(2) The term "State tax agency" means an agency, body, or commission described in section 6103(d).

Because there is need for immediate guidance with respect to the provisions contained in this Treasury decision, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitations of subsection (b) of that section.

This Treasury decision is issued under the authority contained in sections 6103(n) and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1681, 68A Stat. 917; 26 U.S.C. 6103(n), 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved January 8, 1980.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on January 18, 1980; 8:45 a.m., and published in the issue of the Federal Register for January 20, 1980, 45 F.R. 3904)

Section 7805.—Rules and Regulations

26 CFR 301.7805: Statutory provisions; rules and regulations.

T.D. 7665

TITLE 26.—INTERNAL REVENUE.—CHAPTER I

Removal of Statutory Sections from Title 26 of the Code of Federal Regulations

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document removes from Title 26 of the Code of Federal Regulations those regulation sections which recite verbatim provisions of the Internal Revenue Code of 1954. The purpose of this document is to complete the process, initiated about 2 years ago, of removing Internal Revenue Code provisions from Title 26 of the Code of Federal Regulations. The reproduction of Code provisions in Title 26 is considered to be unnecessary and their removal will significantly reduce the volume of Internal Revenue Service regulations. No substantive changes in the rules is intended by this document. Certain conforming changes to other sections of the regulations, made necessary by this removal of Code provisions, are also made.

DATE: These amendments to the regulations are effective January 25, 1980.

FOR FURTHER INFORMATION CONTACT: Jonathan P. Marget of the Employee Plans and Exempt Organizations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3651 (not a toll-free number).

DRAFTING INFORMATION: The principal author of this document was Jonathan P. Marget of the Employee Plans and Exempt Organizations Division, Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service participated in developing this document.

Adoption of amendments to the regulations

Accordingly, amendments to the regulations (26 CFR) are hereby adopted as set forth below:

INCOME TAX REGULATIONS
(26 CFR Part 1)

Paragraph 1. The following, sections are deleted: §§ 1.1, 1.2, 1.3, 1.4, 1.11, 1.21, 1.31, 1.32, 1.33, 1.34, 1.35, 1.36, 1.37, 1.38, 1.39, 1.40, 1.44, 1.45, 1.46, 1.47, 1.48, 1.49, 1.50, 1.50A, 1.50B, 1.51, 1.61, 1.71, 1.72, 1.73, 1.74, 1.75, 1.76, 1.77, 1.78, 1.79, 1.82, 1.101, 1.102, 1.103, 1.104, 1.105, 1.106, 1.107, 1.108(a), 1.108(b), 1.109, 1.110, 1.111, 1.112, 1.113, 1.114, 1.115, 1.116, 1.117, 1.118, 1.119, 1.120, 1.121, 1.123, 1.124, 1.141, 1.142, 1.143, 1.144, 1.145, 1.151, 1.152, 1.153, 1.161, 1.162, 1.163, 1.164, 1.166, 1.167(a), 1.167(b), 1.167(c), 1.167(d), 1.167(e), 1.167(f), 1.167(g), 1.167(h), 1.167(i), 1.167(j), 1.167(l), 1.167(m), 1.168, 1.169, 1.170, 1.170A, 1.171, 1.172, 1.173, 1.174, 1.175, 1.176, 1.177, 1.178, 1.179, 1.180, 1.182, 1.183, 1.185, 1.186, 1.187, 1.211, 1.212, 1.213, 1.214, 1.214A, 1.215, 1.216, 1.217, 1.218, 1.241, 1.242, 1.243, 1.244, 1.245, 1.246, 1.247, 1.248, 1.249, 1,250, 1.261, 1.262, 1.263(a), 1.263(b), 1.263(c), 1.263(d), 1.263(e), 1.263(f), 1.264, 1.265, 1.266, 1.267(a), 1.267(b), 1.267(c), 1.267(d), 1.268, 1.269, 1.270, 1.271, 1.272, 1.273, 1.274, 1.275, 1.276, 1.278, 1.279, 1.281, 1.301, 1.302, 1.303, 1.304, 1.305, 1.307, 1.311, 1.312, 1.316, 1.317, 1.318, 1.331, 1.332, 1.333, 1.334, 1.336, 1.337, 1.338, 1.341, 1.342, 1.346, 1.351, 1.355, 1.357, 1.361, 1.362, 1.363, 1.367, 1,368, 1.381(a), 1.381(b), 1.381(c), 1.381(c) (2), 1.381(c) (3), 1.381(c) (4), 1.381(c) (5), 1.381(c), (6), 1.381(c) (7), 1.381(c) (8), 1.381(c) (9), 1.381(c) (10), 1.381(c) (11), 1.381(c) (12), 1.381(c) (13), 1.381(c) (14), 1.381(c) (15), 1.381(c) (16), 1.381(c) (17), 1.381(c) (18), 1.381(c) (19), 1.381(c) (20), 1.381(c) (21), 1.381(c) (22), 1.381(c) (23), 1.381(c) (24), 1.381(d), 1.382(a), 1.382(b), 1.382(c), 1.383, 1.402(a), 1.402(b), 1.402(c), 1.402(d), 1.402(e), 1.403(a), 1.403(b), 1.404(f), 1.405, 1.421, 1.422, 1.423, 1.424, 1.425, 1.441, 1.442, 1.443, 1.446, 1.454, 1.455, 1.456, 1.461, 1.471, 1.472, 1.481, 1.482, 1.483, 1.501(a), 1.501(b), 1.501(c) (1), 1.501(c) (2), 1.501(c) (3), 1.501(c) (4), 1.501(c) (5), 1.501(c) (6), 1.501(c) (7), 1.501(c) (8), 1.501(c) (9), 1.501(c) (10), 1.501(c) (11), 1.501(c) (12), 1.501(c) (13), 1.501(c) (14), 1.501(c) (15), 1.501(c) (16), 1.501(c) (17), 1.501(c) (18), 1.501(c) (19), 1.501(d), 1.501(e), 1.502, 1.503(a), 1.503(b), 1.503(c), 1.503(d), 1.503(e), 1.503(f), 1.507, 1.508, 1.509(a), 1.509(b), 1.509(c), 1.509(d), 1.509(e), 1.511, 1.512(a), 1.512(b), 1.512(c), 1.513, 1.514(a), 1.514(b), 1.514(c), 1.514(d), 1.514(e), 1.514(f), 1.514(g), 1.514(h), 1.515, 1.521, 1.522, 1.526, 1.531, 1.532, 1.533, 1.534, 1.535, 1.536, 1.537, 1.541, 1.542, 1.543, 1.544, 1.545, 1.546, 1.547, 1.551, 1.552, 1.553, 1.554, 1.555, 1.556, 1.557, 1.558, 1.561, 1.562, 1.563, 1.564, 1.565, 1.581, 1.582, 1.583, 1.584, 1 .586, 1.591, 1.592, 1.594, 1.595, 1.596, 1.601, 1.611, 1.612, 1.613, 1.614, 1.615, 1.616, 1.617, 1.621, 1.631, 1.632, 1.636, 1.638, 1.641(a), 1.641(b), 1.642(a) (1), 1.642(a) (2), 1.642(a) (3), 1.642(b), 1.642(c), 1.642(d), 1.642(e), 1.642(f), 1.642(g), 1.642(h), 1.642(i), 1.643(a), 1.643(b), 1.643(c), 1.643(d), 1.651(a), 1.651(b), 1.652(a), 1.652(b), 1.652(c), 1.661(a), 1.661(b), 1.661(c), 1.662(a), 1.662(b), 1.662(c), 1.663(a), 1.663(b), 1.663(c), 1.664, 1.665(a)A, 1.665(b)A, 1.665(c)A, 1.665(d)A, 1.665(e)A, 1.665(f)A, 1.665(g)A, 1.665(a), 1.665(b), 1.665(c), 1.665(d), 1.665(e), 1.666(a)A, 1.666(b)A, 1.666(c)A, 1.666(d)A, 1.666(a), 1.666(b), 1.666(c), 1.667, 1.667(a)A, 1.667(b)A, 1.668(a)A, 1.668(b)A, 1.668(a), 1.668(b), 1.669(a)A, 1.669(b)A, 1.669(c)A, 1.669(d)A, 1.669(e)A, 1.669(f)A, 1.669(a), 1.669(b), 1.571, 1.672(a), 1.672(b), 1.672(c), 1.672(d), 1.673(a), 1.673(b), 1.673(c), 1.673(d), 1.674(a), 1.674(b), 1.674(c), 1.674(d), 1.675, 1.676(a), 1.676(b), 1.677(a), 1.677(b), 1.678(a), 1.678(b), 1.678(c), 1.678(d), 1.681(a), 1.681(b), 1.682(a), 1.682(b), 1.682(c), 1.683, 1.691(a), 1.691(b), 1.691(c), 1.691(d), 1.691(e), 1.691(f), 1.701, 1.702, 1.703, 1.704, 1.705, 1.706, 1.707, 1.708, 1.721, 1.722, 1.723, 1.731, 1.732, 1.733, 1.734, 1.735, 1.736, 1.741, 1.742, 1.743, 1.751, 1.752, 1.753, 1.754, 1.755, 1.761, 1.771, 1.801, 1.802, 1.803, 1.804, 1.805, 1.806, 1.807, 1.809, 1.810, 1.811, 1.812, 1.813, 1.815, 1.816, 1.817, 1.818, 1.819, 1.820. 1.821, 1.822, 1.823, 1.824, 1.825, 1.826, 1.831, 1.832, 1.841, 1.842, 1.843, 1.851, 1.852, 1.853, 1.854, 1.855, 1.856, 1.857, 1.858, 1.863, 1.864, 1.871A, 1.871, 1.872, 1.873, 1.874, 1.875, 1.876, 1.877, 1.878, 1.881, 1.882, 1.883, 1.884, 1.892, 1.893, 1.894, 1.895, 1.896, 1.902, 1.903, 1.904, 1.905, 1.911, 1.912, 1.921, 1.922, 1.931, 1.932, 1.933, 1.934, 1.935, 1.941, 1.942, 1.943, 1.951, 1.952, 1.953, 1.954, 1.955, 1.956, 1.957, 1.958, 1.959, 1.960, 1.961, 1.962, 1.963, 1.964, 1.970, 1.971, 1.972, 1.981, 1.991, 1.992, 1.993, 1.994, 1.995, 1.996, 1.997, 1.1001, 1.1002, 1.1011, 1.1012, 1.1013, 1.1014, 1.1015, 1.1016, 1.1017, 1.1018, 1.1019, 1.1020, 1.1021, 1.1022, 1.1031(a), 1.1031(b), 1.1031(c), 1.1031(d), 1.1031(e), 1.1032, 1.1033(a), 1.1033(b), 1.1033(c), 1.1033(d), 1.1033(e), 1.1033(f), 1.1033(g), 1.1033(h), 1.1034, 1.1035, 1.1036, 1.1037, 1.1038, 1.1039, 1.1051, 1.1052, 1.1053, 1.1054, 1.1055, 1.1056, 1.1071 1.1081, 1.1082, 1.1083, 1.1091, 1.1101, 1.1102, 1.1103, 1.1201, 1.1202, 1.1212, 1.1221, 1.1222, 1.1223, 1.1231, 1.1232, 1.1233, 1.1234, 1.1235, 1.1236, 1.1237, 1.1238, 1.1240, 1.1241, 1.1242, 1.1243, 1.1244(a), 1.1244(b), 1.1244(c), 1.1244(d), 1.1244(e), 1.1245, 1.1247, 1.1248, 1.1249, 1.1250, 1.1251, 1.1252, 1.1301, 1.1302, 1.1303, 1.1304, 1.1305, 1.1311(a), 1.1311(b), 1.1312, 1.1313(a), 1.1313(b)-(c), 1.1314(a), 1,1314(b), 1.1314(c), 1.1314(d)-(e), 1.1315, 1.1321, 1.1331, 1.1332, 1.1333, 1.1334, 1.1335, 1.1336, 1.1337, 1.1341, 1.1342, 1.1346, 1.1347, 1.1348, 1.1361, 1.1371, 1.1372, 1.1374, 1.1375, 1.1376, 1.1377, 1.1378, 1.1381, 1.1382, 1.1383, 1.1385, 1.1388, 1.1401, 1.1402(a), 1.1402(b), 1.1402(c), 1.1402(d), 1.1402(e), 1.1402(f), 1.1402(g), 1.1402(h), 1.1403, 1.1441, 1.1442, 1.1443, 1.1451, 1.1461, 1.1462, 1.1463, 1.1464, 1.1465, 1.1471, 1.1481, 1.1491, 1.1492, 1.1493, 1.1494, 1.1501, 1.1503, 1.1504, 1.1505, 1.1551, 1.1552, 1.1562, 1.1563, 1.1564, 1.6001, 1.6012, 1.6013, 1.6014, 1.6015(a), 1.6015(b), 1.6015(d), 1.6015(e), 1.6015(f), 1.6015(g), 1.6015(h), 1.6015(i), 1.6015(j), 1.6016, 1.6017, 1.6031, 1.6032, 1.6034, 1.6035, 1.6036, 1.6037, 1.6038, 1.6039, 1.6041, 1.6042, 1.6043, 1.6044, 1.6045, 1.6046, 1.6049, 1.6050, 1.6052, 1.6056, 1.6061, 1.6062, 1.6063, 1.6065, 1.6071, 1.6073, 1.6074, 1.6102, 1.6151, 1.6152, 1.6153, 1.6154, 1.6161, 1.6162, 1.6164, 1.6165, 1.6302, 1.6411, 1.6414, 1.6425, 1.6428, 1.6655, and 1.7476.

TEMPORARY INCOME TAX REGULATIONS RELATING TO EXPLORATION EXPENDITURES IN THE CASE OF MINING
(26 CFR Part 15)

Par. 2. Section 15.1 is deleted.

TEMPORARY REGULATIONS UNDER THE REVENUE ACT OF 1962
(26 CFR Part 16)

Par. 3. Section 16.3 is deleted.

ESTATE TAX REGULATIONS
(26 CFR Part 20)

Par. 4. Section 20.0-1(c) is revised to read as follows:

§ 20.0-1 Introduction.

* * * * *

(c) *Arrangement and numbering.* Each section of the regulations in this part (other than this section and § 20.0-2) is designated by a number composed of the part number followed by a decimal point (20.); the section of the Internal Revenue Code which it interprets; a hyphen (-); and a number identifying the section. By use of these designations one can ascertain the sections of the regulations relating to a provision of the Code. For example, the regulations pertaining to section 2012 of the Code are designated § 20.2012-1.

Par. 5. Sections 20.2001, 20.2002, 20.2011, 20.2012, 20.2013, 20.2014, 20.2015, 20.2016, 20.2031, 20.2032, 20.2033, 20.2034, 20.2035, 20.2036, 20.2037, 20.2038, 20.2040, 20.2041, 20.2042, 20.2043, 20.2044, 20.2051, 20.2052, 20.2053, 20.2054, 20.2055, 20.2056(a), 20.2056(b), 20.2056(c), 20.2056(d), 20.2056(e), 20.2101, 20.2102, 20.2103, 20.2104, 20.2105, 20.2106, 20.2107, 20.2108, 20.2201, 20.2202, 20.2203, 20.2204, 20.2205, 20.2206, 20.2207, 20.2208, 20.2209, 20.6001, 20.6011, 20.6018, 20.6036, 20.6061, 20.6065, 20.6071, 20.6075, 20.6081, 20.6091, 20.6151, 20.6161, 20.6163, 20.6165, 20.6166, 20.6314, 20.6322, 20.6323, 20.6324, 20.6325, 20.6601, 20.6905, 20.7101, and 20.7404 are deleted.

GIFT TAX REGULATIONS
(26 CFR Part 25)

Par. 6. Section 20.0-1(d) is revised to read as follows:

§ 25.0-1 Introduction.

* * * * *

(d) *Arrangement and numbering.* Each section of the regulations in this part (other than this section) is designated by a number composed of the part number followed by a decimal point (25.); the section of the Internal Revenue Code which it interprets; a hyphen (-); and a number identifying the section. By use of these designations one can ascertain the sections of the regulations relating to a provision of the Code. For example, the regulations pertaining to section 2521 of the Code are designated § 25.2521-1.

Par. 7. Sections 25.2501, 25.2502, 25.2503, 25.2504, 25.2511, 25.2512, 25.2513, 25.2514, 25.2515, 25.2516, 25.2521, 25.2522(a), 25.2522(b), 25.2522(c), 25.2522(d), 25.2523(a), 25.2523(b), 25.2523(c), 25.2523(d), 25.2523(e), 25.2523(f), 25.2524, 25.6001, 25.6011, 25.6019, 25.6061, 25.6065, 25.6075, 25.6081, 25.6091, 25.6151, 25.6161, 25.6165, 25.6321, 25.6322, 25.6323, 25.6324, 25.6601, 25.6905, and 25.7101 are deleted.

EMPLOYMENT TAX REGULATIONS
(26 CFR Part 31)

Par. 8. The following sections are deleted: §§ 31.3101, 31.3102, 31.3111, 31.3112, 31.3113, 31.3121(a), 31.3121(a)(1), 31.3121(a)(2), 31.3121(a)(3), 31.3121(a)(4), 31.3121(a)(5), 31.3121(a)(6), 31.3121(a)(7), 31.3121(a)(8), 31.3121(a)(9), 31.3121(a)(10), 31.3121(a)(11), 31.3121(a)(12), 31.3121(a)(13), 31.3121(a)(14), 31.3121(a)(15), 31.3121(b), 31.3121(b)(1), 31.3121(b)(2), 31.3121(b)(3), 31.3121(b)(4), 31.3121(b)(5), 31.3121(b)(6), 31.3121(b)(7), 31.3121(b)(8), 31.3121(b)(9), 31.3121(b)(10), 31.3121(b)(11), 31.3121(b)(12), 31.3121(b)(13), 31.3121(b)(14), 31.3121(b)(15), 31.3121(b)(16), 31.3121(b)(17), 31.3121(b)(18), 31.3121(b)(19), 31.3121(c), 31.3121(d), 31.3121(e), 31.3121(f), 31.3121(g), 31.3121(h), 31.3121(i), 31.3121(j), 31.3121(k), 31.3121(l), 31.3121(m), 31.3121(n), 31.3121(o), 31.3121(p), 31.3121(q), 31.3121(r), 31.3122, 31.3123, 31.3124, 31.3125, 31.3126, 31.3201, 31.3202, 31.3211, 31.3212, 31.3221, 31.3231(a), 31.3231(b), 31.3231(c), 31.3231(d), 31.3231(e), 31.3231(f), 31.3231(g), 31.3232, 31.3233, 31.3301, 31.3302(a), 31.3302(b), 31.3302(c), 31.3302(d), 31.3302(e), 31.3303, 31.3304, 31.3305, 31.3306(a), 31.3306(b), 31.3306(b) (1), 31.3306(b) (2), 31.3306(b) (3), 31.3306(b) (4), 31.3306(b) (5), 31.3306(b) (6), 31.3306(b) (7), 31.3306(b) (8), 31.3306(b) (9), 31.3306(b) (10), 31.3306(c), 31.3306 (c) (1), 31.3306(c) (2), 31.3306(c) (3), 31.3306(c) (4), 31.3306(c) (5), 31.3306(c) (6), 31.3306(c) (7), 31.3306(c) (8), 31.3306(c) (9), 31.3306(c) (10), 31.3306(c) (11), 31.3306(c) (12), 31.3306(c) (13), 31.3306(c) (14), 31.3306(c) (15), 31.3306(c) (16), 31.3306(c) (17), 31.3306(c) (18), 31.3306(d), 31.3306(e), 31.3306(f), 31.3306(g), 31.3306(h), 31.3306(i), 31.3306(j), 31.3306(k), 31.3306(l), 31.3306(m), 31.3306(n), 31.3307, 31.3308, 31.3309, 31.3401(a), 31.3401(a) (1), 31.3401(a) (2), 31.3401(a) (3), 31.3401(a) (4), 31.3401(a) (5), 31.3401(a) (6), 31.3401(a) (6) A, 31.3401(a) (7), 31.3401(a) (8) (A), 31.3401(a) (8) (B), 31.3401(a) (8) (C), 31.3401(a) (9), 31.3401(a) (10), 31.3401(a) (11), 31.3401(a) (12), 31.3401(a) (13), 31.3401(a) (14), 31.3401(a) (15), 31.3401(a) (16), 31.3401(b), 31.3401(c), 31.3401(d), 31.3401(e), 31.3401(f), 31.3402(a), 31.3402(b), 31.3402(c), 31.3402(d), 31.3402(e), 31.3402(f) (1), 31.3402 (f) (2), 31.3402(f) (3), 31.3402(f) (4), 31.3402(f) (5), 31.3402(f) (6), 31.3402(g), 31.3402(h) (1), 31.3402 (h) (2), 31,3402(h) (3), 31.3402(h) (4), 31.3402(i), 31.3402(j), 31.3402 (k), 31.3402(l), 31.3402(m), 31.3402 (n), 31.3402(o), 31.3402(p), 31.3403, 31.3404, 31.3501, 31.3502, 31.3503, 31.3504, 31.3505, 31.6001, 31.6011(a), 31.6011(b), 31.6051, 31.6053, 31.6061, 31.6065(a), 31.6071(a), 31.6081(a), 31.6091, 31.6101, 31.6109, 31.6151, 31.6157, 31.6161(a) (1), 31.6201(b), 31.6205, 31.6302(b), 31.6302(c), 31.6317, 31.6402(a), 31.6404(a), 31.6413(a), 31.6413(b), 31.6413(c), 31.6413(d), 31.6414, 31.6513(e), 31.6601(k), 31.6652, 31.6674, 31.6682, and 31.7805.

CONTRACT COVERAGE OF EMPLOYEES OF FOREIGN SUBSIDIARIES

(26 CFR Part 36)

Par. 9. Section 36.3121(l)-0(c) is revised by deleting the third sentence thereof which reads: "Each section of the regulations is preceded by the provision of the Code which it interprets."

Par. 10. Sections 36.3121(l) (1), 36.3121(l) (2), 36.3121(l) (3), 36.3121 (l) (4), 36.3121(l) (5), 36.3121(l) (6), 36.3121(l) (7), 36.3121(l) (8), 36.3121 (l) (9), and 36.3121(l) (10) are deleted.

EXCISE TAX ON USE OF CERTAIN HIGHWAY MOTOR VEHICLES

(26 CFR Part 41)

Par. 11. Section 41.0-1(c) is revised to read as follows:

§ 41.0-1 Introduction.

* * * * *

(c) *Arrangement and numbering.* Each section of the regulations in this part (other than subpart A) is designated by a number composed of the part number followed by a decimal point (41.); the section of the Internal Revenue Code which it interprets; a hyphen (-); and a number identifying the section. By use of these designations one can ascertain the sections of the regulations relating to a provision of the Code. For example, the regulations pertaining to section 4481 of the Code are designated § 41.4481-1, § 41.4481-2, and § 41.4481-3.

Par. 12. Sections 41.4483, 41.4484, 41.6001, 41.6011(a), 41.6071(a), 41.6081(a), 41.6091, 41.6101, 41.6109, 41.6151(a), 41.6156, 41.6161(a)-(1), 41.6302(b), 41.7701, and 41.7805 are deleted.

WAGERING EXCISE TAXES

(26 CFR Part 44)

Par. 13. Section 44.0-1(c) is revised to read as follows:

§ 44.0-1 Introduction.

* * * * *

(c) *Arrangement and numbering.* Each section of the regulations in this part (other than subpart A) is designated by a number composed of the part number followed by a decimal point (44.); the section of the Internal Revenue Code which it interprets; a hyphen (-); and a number identifying the section. By use of these designations one can ascertain the sections of the regulations relating to a provision of the Code. For example, the regulations pertaining to section 4401 of the Code are designated § 44.4401-1, § 44.4401-2, and § 44.4401-3.

Par. 14. Sections 44.4401, 44.4402, 44.4403, 44.4404, 44.4405, 44.4411, 44.4412, 44.4413, 44.4414, 44.4421, 44.4422, 44.4423, 44.4901, 44.4902, 44.4904, 44.4905, 44.4906, 44.6001, 44.6011(a), 44.6071, 44.6091, 44.6151, 44.6419, 44.7262, 44.7272, 44.7701, and 44.7805 are deleted.

MISCELLANEOUS STAMP TAXES

(26 CFR Part 45)

Par. 15. Section 45.0-1(c) is revised to read as follows:

§ 45.0-1 Introduction.

* * * * *

(c) *Arrangement and numbering.* Each section of the regulations in this part (other than subpart A) is designated by a number composed of the part number followed by a decimal point (45.); the section of the Internal Revenue Code which it interprets; a hyphen (-); and a number identifying the section. By use of these designations one can ascertain the sections of the regulations relating to a provision of the Code. For example, the regulations pertaining to section 4901 of the Code are designated § 45.4901-1.

Par. 16. Sections 45.4461, 45.4462, 45.4463, 45.4464, 45.4591, 45.4592(a), 45.4593(a), 45.4801, 45.4802, 45.4803, 45.4804, 45.4805, 45.4806, 45.4811, 45.4812, 45.4813, 45.4814, 45.4815(a), 45.4815(b), 45.4816, 45.4817, 45.4818, 45.4819, 45.4821, 45.4822, 45.4826, 45.4831, 45.4832, 45.4833, 45.4834, 45.4836, 45.4841, 45.4842, 45.4846, 45.4851, 45.4852, 45.4853, 45.4854, 45.4861, 45.4862, 45.4863, 45.4864, 45.4865, 45.4871, 45.4872, 45.4873, 45.4874, 45.4875, 45.4876, 45.4877, 45.4901, 45.4902, 45.4903, 45.4904, 45.4905, 45.4906, 45.4907, 45.6001, 45.6061, 45.6065, 45.6071, 45.6081(a), 45.6091, 45.6101, 45.6109, 45.6151, 45.6161(a)(1), 45.6804, 45.6805, 45.6806, 45.7011, 45.7208, 45.7209, 45.7233, 45.7234, 45.7235, 45.7236, 45.7239, 45.7263, 45.7264, 45.7265, 45.7266, 45.7267, 45.7271, 45.7272, 45.7273, 45.7274, 45.7303, 45.7326(a), 45.7328, 45.7492, 45.7493, 45.7510, 45.7641, 45.7701, and 45.7805 are deleted.

MISCELLANEOUS EXCISE TAXES PAYABLE BY RETURN
(26 CFR Part 46)

Par. 17. Section 46.0-1(c) is revised to read as follows:

§ 46.0-1 Introduction.

* * * * *

(c) *Arrangement and numbering.* Each section of the regulations in this part (other than subpart A) is designated by a number composed of the part number followed by a decimal point (46.); the section of the Internal Revenue Code which it interprets; a hyphen (-); and a number identifying the section. By use of these designations one can ascertain the sections of the regulations relating to a provision of the Code. For example, the regulations pertaining to section 4371 of the Code are designated § 46.4371-0, § 46.4371-1, and § 46.4371-2.

Par. 18. Sections 46.4371, 46.4372, 46.4373, 46.4374, 46.4375, 46.4501, 46.4502, 46.4503, 46.4504, 46.4881, 46.4882, 46.4883, 46.4884, 46.4885, 46.4886, 46.6001, 46.6011(a), 46.6061, 46.6065, 46.6071(a), 46.6081(a), 46.6091, 46.6101, 46.6109, 46.6151, 46.6161(a)(1), 46.6302(b), 46.6302(c), 46.6402(a), 46.6404(a), 46.6412(d), 46.6417, 46.6418, 46.6511(e), 46.7240, 46.7654, 46.7701, and 46.7805 are deleted.

DOCUMENTARY STAMP TAXES
(26 CFR Part 47)

Par. 19. Section 47.0-1(c) is revised to read as follows:

§ 47.0-1 Introduction.

* * * * *

(c) *Arrangement and numbering.* Each section of the regulations in this part (other than subpart A) is designated by a number composed of the part number followed by a decimal point (47.); the section of the Internal Revenue Code which it interprets; a hyphen (-); and a number identifying the section. By use of these designations one can ascertain the sections of the regulations relating to a provision of the Code. For example, the regulations pertaining to section 4371 of the Code are designated § 47.4371-0, § 47.4371-1, and § 47.4371-2.

Par. 20. Sections 47.4301, 47.4302, 47.4303, 47.4304, 47.4305, 47.4311, 47.4312, 47.4313, 47.4314, 47.4315, 47.4321, 47.4322, 47.4323, 47.4324, 47.4331, 47.4332, 47.4333, 47.4341, 47.4342, 47.4343, 47.4344, 47.4345, 47.4346, 47.4351, 47.4352, 47.4353, 47.4354, 47.4361, 47.6362, 47.4363, 47.4371, 47.4372, 47.4373, 47.4374, 47.4375, 47.4381, 47.4382, 47.4383, 47.4384, 47.6001, 47.6801, 47.6802, 47.6804, 47.6805, 47.7208, 47.7209, 47.7270, 47.7271, 47.7701, and 47.7805 are deleted.

MANUFACTURERS AND RETAILERS EXCISE TAXES
(26 CFR Part 48)

Par. 21. Sections 48.4218 and 48.4219 are deleted.

FACILITIES AND SERVICES EXCISE TAXES
(26 CFR Part 49)

Par. 22. Section 49.0-1(c) is revised to read as follows:

§ 49.0-1 Introduction.

* * * * *

(c) *Arrangement and numbering.* Each section of the regulations in this part (other than subpart A) is designated by a number composed of the part number followed by a decimal point (49.); the section of the Internal Revenue Code which it interprets; a hyphen (-); and a number identifying the section. By use of these designations one can ascertain the sections of the regulations relating to a provision of the Code. For example, the regulations pertaining to section 4261 of the Code are designated § 49.4261-1, § 49.4261-2, § 49.4261-3, § 49.4261-4, § 49.4261-5, § 49.4261-6, § 49.4261-7, § 49.4261-8, § 49.4261-9, and § 49.4261-10.

Par. 23. Sections 49.4241, 49.4242, 49.4243, 49.4251, 49.4252, 49.4253, 49.4254, 49.4261, 49.4262(a), 49.4262(b), 49.4262(c), 49.4263, 49.4264(a), 49.4264(b), 49.4264(c), 49.4264(d), 49.4264(e), 49.4264(f), 49.4286, 49.4287, 49.6011(a), 49.6071(a), 49.6091, 49.6109, 49.6151, and 49.6302(c) are deleted.

FOUNDATION AND SIMILAR EXCISE TAXES
(26 CFR Part 53)

Par. 24. Sections 53.4941(a), 53.4941(b), 53.4941(c), 53.4941(d), 53.4941(e), 53.4942, 53.4944, 53.4945, 53.4946, 53.4947, 53.4948, 53.6001, 53.6011, 53.6061, 53.6065, 53.6071, 53.6081, 53.6091, 53.6151, 53.6161, 53.6165, 53.6601, 53.6651, and 53.7101 are deleted.

TEMPORARY EXCISE TAX REGULATIONS RELATING TO TAX ON TIRES AND TUBES DELIVERED TO MANUFACTURER'S RETAIL OUTLET
(26 CFR Part 144)

Par. 25. Section 144.1 is deleted.

TEMPORARY REGULATIONS IN CONNECTION WITH THE EXCISE TAX REDUCTION ACT OF 1965
(26 CFR Part 145)

Par. 26. Sections 145.3 and 145.4 are deleted.

TEMPORARY REGULATIONS IN CONNECTION WITH THE AIRPORT AND AIRWAY REVENUE ACT OF 1970
(26 CFR Part 154)

Par. 27. Sections 154.1, 154.2, 154.3 and 154.4 are deleted.

PROCEDURE AND ADMINISTRATION REGULATIONS

(26 CFR Part 301)

Par. 28. The following sections are deleted: §§ 301.6001, 301.6011, 301.6012, 301.6013, 301.6014, 301.6015, 301.6016, 301.6017, 301.6018, 301.6019, 301.6020, 301.6021, 301.6031, 301.6032, 301.6033, 301.6034, 301.6035, 301.6036, 301.6037, 301.6038, 301.6039, 301.6040, 301.6041, 301.6042, 301.6043, 301.6044, 301.6045, 301.6046, 301.6047, 301.6048, 301.6049, 301.6050, 301.6051, 301.6052, 301.6061, 301.6062, 301.6063, 301.6064, 301.6065, 301.6071, 301.6073, 301.6074, 301.6075, 301.6081, 301.6091, 301.6096, 301.6101, 301.6102, 301.6103(a), 301.6103(b), 301.6103(c), 301.6103(d), 301.6103(e), 301.6103(f), 301.6104, 301.6105, 301.6106, 301.6108, 301.6109, 301.6111, 301.6151, 301.6152, 301.6153, 301.6154, 301.6155, 301.6156, 301.6157, 301.6161, 301.6162, 301.6163, 301.6164, 301.6165, 301.6166, 301.6201, 301.6202, 301.6203, 301.6204, 301.6205, 301.6206, 301.6207, 301.6211, 301.6212, 301.6213, 301.6214, 301.6215, 301.6216, 301.6301, 301.6302, 301.6303, 301.6304, 301.6311, 301.6312, 301.6313, 301.6314, 301.6315, 301.6316, 301.6317, 301.6321, 301.6322, 301.6323(a), 301.6323(b), 301.6323(c), 301.6323(d), 301.6323(e), 301.6323(f), 301.6323(g), 301.6323(h), 301.6323(i), 301.6324, 301.6325, 301.6326, 301.6331, 301.6332, 301.6333, 301.6334, 301.6335, 301.6336, 301.6337, 301.6338, 301.6339, 301.6340, 301.6341, 301.6342, 301.6343, 301.6344, 301.6401, 301.6402, 301.6403, 301.6404, 301.6405, 301.6406, 301.6407, 301.6411, 301.6412, 301.6413, 301.6414, 301.6415, 301.6416, 301.6417, 301.6418, 301.6419, 301.6420, 301.6421, 301.6422, 301.6423, 301.6425, 301.6501(a), 301.6501(b), 301.6501(c), 301.6501(d), 301.6501(e), 301.6501(f), 301.6501(h), 301.6501(i), 301.6501(j), 301.6501(k), 301.6501(l), 301.6501(m), 301.6501(o), 301.6502, 301.6503(a), 301.6503(b), 301.6503(c), 301.6503(d), 301.6503(e), 301.6503(f), 301.6503(g), 301.6504, 301.6511(a), 301.6511(b), 301.6511(c), 301.6511(d), 301.6511(e), 301.6511(f), 301.6512, 301.6513, 301.6514(a), 301.6514(b), 301.6515, 301.6521, 301.6531, 301.6532, 301.6533, 301.6601, 301.6602, 301.6611, 301.6612, 301.6621, 301.6651, 301.6652, 301.6653, 301.6654, 301.6655, 301.6656, 301.6657, 301.6658, 301.6659, 301.6671, 301.6672, 301.6673, 301.6674, 301.6675, 301.6676, 301.6678, 301.6679, 301.6682, 301.6684, 301.6685, 301.6688, 301.6801, 301.6802, 301.6803, 301.6804, 301.6805, 301.6806, 301.6807, 301.6808, 301.6851, 301.6861, 301.6862, 301.6863, 301.6864, 301.6871(a), 301.6871(b), 301.6872, 301.6873, 301.6901, 301.6902, 301.6903, 301.6904, 301.6905, 301.7001, 301.7011, 30.7012, 301.7101, 301.7102, 301.7103, 301.7121, 301.7122, 301.7123, 301.7201, 301.7202, 301.7203, 301.7204, 301.7205, 301.7206, 301.7207, 301.7208, 301.7209, 301.7210, 301.7211, 301.7212, 301.7213, 301.7214, 301.7215, 301.7216, 301.7231, 301.7232, 301.7233, 301.7234, 301.7235, 301.7236, 301.7237, 301.7238, 301.7239, 301.7240, 301.7261, 301.7262, 301.7263, 301.7264, 301.7265, 301.7266, 301.7267, 301.7268, 301.7269, 301.7270, 301.7271, 301.7272, 301.7273, 301.7274, 301.7275, 301.7301, 301.7302, 301.7303, 301.7304, 301.7321, 301.7322, 301.7323, 301.7324, 301.7325, 301.7326, 301.7327, 301,7328, 301.7329, 301.7341, 301.7342, 301.7343, 301.7344, 301.7401, 301.7402, 301.7403, 301.7404, 301.7405, 301.7406, 301.7407, 301.7421, 301.7422, 301.7423, 301.7424, 301.7425, 301.7426, 301.7427, 301.7441, 301.7442, 301.7443, 301.7444, 301.7445, 301.7446, 301.7447, 301.7448, 301.7451, 301.7452, 301.7453, 301.7454, 301.7455, 301.7456, 301.7457, 301.7458, 301.7459, 301.7460, 301.7461, 301.7462, 301.7463, 301.7471, 301.7472, 301.7473, 301.7474, 301.7476, 301.7481, 301.7482, 301.7483, 301.7484, 301.7485, 301.7486, 301.7487, 301.7491, 301.7492, 301.7493, 301.7501, 301.7502, 301.7503, 301.7504, 301.7505, 301.7506, 301.7507, 301.7508, 301.7509, 301.7510, 301.7512, 301.7513, 301.7514, 301.7515, 301.7516, 301.7601, 301.7602, 301.7603, 301.7604, 301.7605, 301.7606, 301.7607, 301.7609, 301.7621, 301.7622, 301.7623, 301.7641, 301.7651, 301.7652, 301.7653, 301.7654, 301.7655, 301.7701, 301.7801, 301.7802, 301.7803, 301.7804, 301.7805, 301.7806, 301.7807, 301.7808, 301.7809, 301.7810, 301.7851, and 301.7852.

TEMPORARY REGULATIONS UNDER THE FEDERAL TAX LIEN ACT OF 1966

(26 CFR Part 400)

Par. 29. Sections 400.1, 400.2, 400.3, 400.4, and 400.5 are deleted.

This Treasury decision removes recitations of provisions of the Internal Revenue Code of 1954 from Title 26 of the Code of Federal Regulations and makes necessary conforming changes in the regulations to reflect this action. Because this Treasury decision does not change any existing rules, it is found unnecessary to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of Internal Revenue.

Approved January 8, 1980.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 24, 1980, 8:45 a.m., and published in the issue of the Federal Register for January 25, 1980, 45 F.R. 6088)

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions

United States-France Income Tax Convention

1968-2 C.B. 691

France; research fellow. A French resident appointed as a research fellow to the faculty of an accredited university's medical school in the U.S. conducts basic research in the public interest under the school's direction and control in a laboratory located in a hospital associated with the school. The individual's compensation, although paid through the hospital under grants awarded by the National Institutes of Health, is exempt from federal income tax under Article 17 of the U.S.-France Income Tax Convention for a period not exceeding two years from the date of the individual's arrival in the U.S.

Rev. Rul. 80-51

ISSUE

Does Article 17 of the United States-France Income Tax Convention exempt the compensation received by a French resident from federal income tax under the circumstances described below?

FACTS

The taxpayer, a resident of France, is in the United States at the invitation of an accredited university's medical school to engage in scientific research. The taxpayer received an appointment to the faculty of the university's medical school as a Research Fellow in Medicine. The compensation to the taxpayer, who has a Ph.D. degree in a scientific field rather than an M.D., is paid through the university's hospital under grants awarded to the principal researchers by the National Institutes of Health.

The laboratory in which the taxpayer works is located in the hospital associated with the university's medical school. The work of the laboratory is entirely basic research in the public interest with no clinical activities or responsibilities. The university's medical school and not the university's hospital directs and controls the taxpayer's research activities.

LAW AND ANALYSIS

Article 17 of the United States-France Income Tax Convention provides that an individual who is a resident of France and who visits the United States at the invitation of the United States Government or of a university or other accredited educational institution for the primary purpose of teaching or engaging in research or both, at a university or other accredited institution, shall be exempt from United States taxation on income from personal services for teaching or research at such educational institution for a period not exceeding 2 years from the date of arrival in the United States. Article 17 shall not apply to income from research not undertaken in the public interest.

In determining whether an individual is engaged in research at a university or other accredited educational institution for purposes of Article 17 of the Convention, it is necessary to determine by whom such individual is employed, the university or the hospital, because the hospital may not be an accredited educational institution. See Rev. Rul. 77-175, 1977-1 C.B. 415. Whether the research fellow in the subject case is determined to be an employee of the university or an employee of the hospital depends upon an examination of all the facts and circumstances pertaining to the relationship among the parties. An important factor is the right to control and direct an individual in the performance of the individual's work.

In the present situation, the hospital does not exercise control over the laboratory research performed by the taxpayer even though the laboratory is located in the university's hospital and the taxpayer's compensation is paid through the hospital from a grant from the National Institutes of Health. The taxpayer is performing research for, and is subject to the direction and control of the university medical school, an accredited educational institution.

HOLDING

Under Article 17 of the United States-France Income Tax Convention, the compensation received by the taxpayer for research services performed at the laboratory is exempt from United States income taxation for a period not exceeding 2 years from the date of the taxpayer's arrival in the United States.

Part III. Administrative, Procedural, and Miscellaneous

Notice—List of Countries Requiring Cooperation with an International Boycott

In order to comply with the mandate of section (a)(3) of the Internal Revenue Code of 1954, the Department of the Treasury is publishing a current list of countries which may require participation in, or cooperation with, an international boycott (within the meaning of section 999(b)(3) of the Internal Revenue Code of 1954). This list is the same as the list published in the October 3, 1979, Federal Register.

On the basis of the best information currently available to the Department of the Treasury, the following countries may require participation in, or cooperation with, an international boycott (within the meaning of section 999(b)(3) of the Internal Revenue Code of 1954): Bahran, Egypt, Iraq, Jordan, Kuwait, Lebanon, Libya, Oman, Qatar, Saudi Arabia, Syria, United Arab Emirates, Yemen Arab Republic, Peoples Democratic Republic of Yemen.

Dated: December 21, 1979.

(Filed by the Office of the Federal Register on December 21, 1979, 8:45 a.m., and published in the issue of the Federal Register for January 2, 1980, 45 F.R. 123)

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability.
(Also Part I, Sections 62, 162, 170, 213, 217, 274, 1016; 1.62-1, 1.162-17, 1.170A-1, 1.213-1, 1.217-2, 1-274-5, 1.1016-3.)

Rev. Proc. 80-7

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide increased standard mileage rates under the simplified, optional method described below for employees or self-employed individuals to use in computing deductible costs of operating passenger automobiles (including vans, pickup, or panel trucks) for business purposes, or for taxpayers to use in computing deductions for transportation expenses relating to charitable contributions, medical expenses, or moving expenses.

A further purpose of this revenue procedure is to provide that, for this optional method, an automobile that has been used more than five years for business is considered to be fully depreciated unless the taxpayer has elected to depreciate the automobile over a shorter useful life.

SEC. 2. BACKGROUND

Rev. Proc. 74-23, 1974-2 C.B. 476, as updated by Rev. Proc. 77-40, 1977-2 C.B. 574, provides standard mileage rates for employeees and self-employed individuals who claim deductions for the costs of operating automobiles for business purposes. Rev. Proc. 74-24, 1974-2 C.B. 477, provides the standard mileage rate for computing the cost of rendering gratuitous services to a charitable organization or for transportation for medical care. Rev. Proc. 74-25, 1974-2 C.B. 477, provides the standard mileage rate for computing deductible costs of operating an automobile in connection with moving expenses. Rev. Proc. 75-3, 1975-1 C.B. 643, provides the standard mileage rate for automobiles that have been fully depreciated under the straight-line method of depreciation. Rev. Proc. 77-36, 1977-2 C.B. 568, clarified Rev. Proc. 74-23 to point out that interest and state and local taxes are deductible in addition to the amounts computed using the standard mileage rate.

Section 162(a) of the Internal Revenue Code provides that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business. Under that provision, an employee or self-employed individual may deduct the cost of operating a passenger automobile to the extent that it is used in a trade or business. However, under section 262, no portion of the operating cost that is attributable to personal use, rather than use for a business purpose, is deductible.

Section 1.162-17 of the Income Tax Regulations provides rules for the reporting of information on income tax returns relating to business expenses in connection with the performance of services as an employee and furnishes guidance as to the type of records that will be useful in compiling such information and in its substantiation, if required.

In order to relieve taxpayers from the necessity of maintaining detailed transportation expense records, employees or self-employed individuals may choose to compute the deductible costs of operating passenger automobiles for business purposes by a simplified, optional method that the Service will accept in examining income tax returns filed by such employees or self-employed individuals.

SEC. 3. OPTIONAL METHOD OF COMPUTING TRANSPORTATION EXPENSES BY AUTOMOBILE

.01 *Business Expenses.*

1 *Standard mileage rate.*

Subject to the conditions and limitations set forth below, with respect to transportation expenses paid or incurred after December 31, 1978, deductions will be accepted if computed at a standard mileage rate of (a) 18.5 cents per mile for the first 15,000 miles of use each year for business purposes, and (b) 10 cents per mile for use for business purposes in excess of 15,000 miles per year. Computation under this method is optional on a yearly basis.

A deduction computed under this method shall be in lieu of all operating and fixed costs of the automobile allocable to business purposes. Such items as depreciation, maintenance and repairs, tires, gasoline (including all taxes thereon), oil, insurance, and registration fees are included in operating and fixed costs. However, parking fees and tolls attributable to use for business purposes may be deducted as separate items.

The rates prescribed do not affect a deduction for interest relating to the purchase of the automobile that is allowable under section 163 of the Code, nor a deduction for state and local taxes (other than those included in the cost of gasoline) otherwise allowable under section 164. If the automobile is operated less than 100 percent for business purposes, an allocation is required to determine the business and nonbusiness portion of the taxes and interest deduction allowable. That portion of the allowable deduction for interest and state and local taxes attributable directly to the operation of the automobile for business purposes may be deducted from gross income in arriving at adjusted gross income by an employee under section 62(2)(C), and by a self-employed individual under section 62(1). The remaining portion of the interest and state and local taxes attributable to the nonbusiness use of the automobile may be deducted from adjusted gross income in arriving at taxable income provided the taxpayer itemizes deductions.

2 *Limitations.*

When an employee or a self-employed individual alternates in using different automobiles on different occasions for business purposes, the standard mileage rates apply to the total business mileage of such automobiles, as if they were one, to arrive at a deduction. Similarly, if an individual replaces an automobile during the year, the total business mileage for the year of both automobiles must be used, as if they were one, in applying the standard mileage rate.

The optional method is not acceptable for computing the deductible costs of (A) vehicles used for hire, such as taxicabs, or (B) two or more automobiles used simultaneously, such as in fleet operations.

In any year in which this optional method has been used, straight-line depreciation will be considered to have been allowed. The allowable depreciation will act to reduce the basis of the automobile in determining adjusted basis as required by section 1016(a) of the Code. This optional method may not be used if the automobile has previously been depreciated on a depreciation method other than straight-line, or if additional first-year depreciation has been claimed.

For taxable years beginning after December 31, 1979, an automobile used by a taxpayer who uses this optional method of computing costs of an automobile for business purposes is deemed to have a useful life of five years and the automobile will be considered to have become fully depreciated at the end of five years.

If, at any time during the period that the taxpayer uses the automobile for business purposes, the taxpayer computes and deducts the actual costs of all operating and fixed costs of the automobile for business purposes using a useful life of less than five years, the useful life of the automobile to that taxpayer is the estimated period on which the taxpayer bases the computation of the allowable straight-line depreciation deduction for that year. Thereafter, regardless of whether the taxpayer uses the "actual cost" method or this optional method for subsequent taxable years, the automobile will be considered fully depreciated at the end of the period estimated to be its useful life to that taxpayer.

With respect to automobiles that have been, or are considered to be, fully depreciated under the straight-line method, based upon their use for business purposes, deductions will be accepted if computed at a standard mileage rate of 10 cents per mile for all miles of use of such automobiles attributable to business purposes.

The optional method of computing transportation expenses provided by this section will be accepted in examining the return of an employee irrespective of whether the employee received a reimbursement or allowance for such business automobile expense from the employer, provided that such reimbursement or allowance is reflected in the return.

For this optional method of computing transportation expenses to be acceptable, an employee or self-employed individual is required to establish business mileage (A) for local transportation, in accordance with section 1.162-17(d) of the regulations, and (B) for other travel, in accordance with section 1.274-5. This revenue procedure operates in lieu of the provisions of such regulations relating to substantiation of the amount of an expenditure.

.02 *Charitable, medical, or moving expenses.*

A taxpayer who incurs costs of operating an automobile for transportation in connection with rendering gratuitous services to a charitable organization under section 170 of the Code, in connection with medical care under section 213, or for moving expenses under section 217 will be permitted to claim as a deduction the standard mileage rate of eight cents per mile, subject to the conditions and limitations set forth in these sections.

Because certain items, such as the proportionate share of general maintenance or general repairs, liability insurance, or depreciation, in connection with the use of an automobile, may not be taken into account in computing the amount paid for transportation with respect to the rendering of gratuitous services to charitable organizations or with respect to medical care or moving expenses, an individual may not use the same standard mileage rate as is permitted in section 3.01 of this revenue procedure.

The use of this optional method of computing transportation expenses is in lieu of any actual transportation expenses otherwise allowable under sections 170, 213 and 217 of the Code by reason of the use of a taxpayer's automobile for transportation. However, parking fees and tolls attributable to such transportation may be deducted as separate items. The use of this optional method does not affect a deduction for any expenses relating to the automobile that are allowable under section 163 (interest) or section 164 (taxes). Since depreciation may not be taken into account in determining the deduction for charitable contributions, medical expenses, or moving expenses, no adjustment to the basis of the automobile is required because of the use of this method.

The optional method of computing transportation expenses described in this section will be accepted by the Internal Revenue Service as being representative of the cost of operating an automobile for purposes of sections 170, 213, and 217 of the Code regardless of the method used to compute depreciation for business use of the automobile, and regardless of the number of automobiles that the taxpayer may have in operation.

.03 *Actual expenses.*

Use of the optional method of computing transportation expenses set out in this section is not mandatory and a taxpayer may use actual allowable expenses if records are maintained for proper substantiation.

SEC. 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 74-23, Rev. Proc. 74-24, Rev. Proc. 74-25, Rev. Proc. 75-3, Rev. Proc. 77-36, and Rev. Proc. 77-40 are superseded.

SEC. 5. EFFECTIVE DATES

The rates provided in this revenue procedure are effective with respect to transportation expenses paid or incurred after December 31, 1978.

The provision in section 3.012 deeming an automobile used for business purposes to be fully depreciated at the end of five years is effective for taxable years beginning after December 31, 1979.

Part IV. Items of General Interest

Publication 676 (Rev. 1-80)

Announcement 80-10

The 1980 issue of Publication 676, Catalog of Federal Tax Forms, Form Letters, and Notices, is now available. It is published as an aid for those interested in knowing the purpose and use of the various Federal tax forms and related forms, form letters, notices, etc., developed by the Internal Revenue Service.

This catalog is in two parts. Part I contains a listing of Federal tax forms and related forms, which the taxpayer may need to originate an internal revenue tax matter. Part II contains a listing of forms, form letters, notices, etc., the Internal Revenue Service uses to communicate with the public on tax-related matters.

Publication 676 (Rev. 1-80) is sold by Superintendent of Documents, U.S. Government Printing Office, for $4.25.

Application of Conventions Under Class Life Asset Depreciation Range System—Public Hearing on Proposed Regulations

Announcement 80-25 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to the application of conventions under the Class Life Asset Depreciation Range System (CLADR System).

DATES: The public hearing will be held on March 27, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by March 13, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-107-78), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: George Bradley or Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under section 167 of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Thursday, November 15, 1979, at page 65777 (44 FR 65777).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of the comments to be presented at the hearing and the time they wish to devote to each subject by March 13, 1980. Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive appearing in the Federal Register for Wednesday, November 8, 1978.

Instructions for 1979 Schedule D (Form 1040), Capital Gains and Losses

Announcement 80-26

The instruction for line 5 of the 1979 Schedule D (Form 1040) contains an error. It should read as follows:

"Enter the amount from your 1978 Schedule D (Form 1040), line 41 or 1978 Form 4798, Part II, line 20."

It currently reads:

"Enter the amount from your 1978 Schedule D (Form 1040), line 41 or 1978 Form 4798, Part II, line 14."

This Schedule D instruction can be found on page 21 of the Instructions for Form 1040.

Statistics from 1976 Estate Tax Returns

Announcement 80-27 [1]

Publication 764, Statistics of Income—1976, Estate Tax Returns, is now available and may be purchased for $3.25 from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

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[1] Filed by the Office of the Federal Register on January 25, 1980, 8:45 a.m., and published in the issue of the Federal Register for January 28, 1980, 45 F.R. 6415.

[1] Based on News Release IR-80-11, dated January 16, 1980.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants and Enrolled Agents from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following persons have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Franke J. Marcone	Media, PA	Attorney	Twenty-four months effective December 11, 1979
William P. Renner	Hagerstown, MD	Certified Public Accountant	Twenty-four months effective December 11, 1979
Albert J. Kendall	Wyncote, PA	Attorney	Four months effective January 7, 1980

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from further practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants or enrolled agents to practice before the Internal Revenue Service.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant or enrolled agent so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and hearing before the administrative law judge, the following person was disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
Roy W. Hunt	Redwood City, CA	Certified Public Accountant	January 14, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR (1939) 16.1 through 17.19 deleted; 26 CFR Subchapter D retitled; Part 160 added.	Profit limitations of the Vinson-Trammell Act on certain contracts and subcontracts for naval vessels and military aircraft.	Oct. 26, 1979	Feb. 26, 1980
26 CFR 1.401-2, 1.403(b)-1, 1.405-1, amended; 1.401-8A redesignated 1.401-8 and as redesignated amended; 1.401-8 redesignated 1.401(f)-1 and as redesignated amended; 1.401(a)-1, 1.401(a)-2, 1.401(a)-16, 1.415-1 through 1.415-10 added.	Limitations on benefits and contributions under qualified plans.	Jan. 24, 1980	Apr. 23, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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The Introduction on page 3 describes the purpose and content of this publication. The weekly Internal Revenue Bulletin is sold on a yearly subscription basis by the Superintendent of Documents. Current subscribers are notified by the Superintendent of Documents when their subscriptions must be renewed.

CUMULATIVE BULLETINS

The contents of the weekly Bulletin are consolidated semiannually into a permanent, indexed, Cumulative Bulletin. These are sold on a single copy basis and *are not* included as part of the subscription to the Internal Revenue Bulletin. Subscribers to the weekly Bulletin are notified when copies of the Cumulative Bulletin are available. Certain issues of Cumulative Bulletins are out of print and are not available. Persons desiring available Cumulative Bulletins, which are listed on the reverse, may purchase them from the Superintendent of Documents.

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The Bulletin Index-Digest System (12-78) provides a fast and easy way to research Revenue Rulings, Revenue Procedures, Public Laws, Treasury Decisions, and other matters of a permanent nature published in the weekly Internal Revenue Bulletin or Cumulative Bulletin from 1953 on. It is a comprehensive and up-to-date research tool that requires no filing or other clerical maintenance. The current revision consists of four Services, available on a subscription basis, each including a basic volume that covers the period 1953-1978 and a cumulative supplement covering material published in subsequent Bulletins for the following two-year period. Cumulative supplements are issued quarterly for the Income Tax Service and semiannually for the Estate and Gift, Employment, and Excise Tax Services.

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March 3, 1980
Bulletin No. 1980-9

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9258

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-54, page 6.
Investment interest; net lease property; contract with HUD. The owner and operator of an apartment complex received direct payments under a contract with the Department of Housing and Urban Development (HUD), under section 8 of the National Housing Act, for providing low income housing. The net lease provisions of section 163(d)(4)(A)(ii) of the Code do not apply and the income and expenses from such units are not subjected to the interest limitations imposed by section 163(d)(1).

Rev. Rul. 80-55, page 7.
Rental expenses; house swapping. Two homeowners agreed to rent their houses to each other for fair rental value for use as personal residences. In addition to those items deductible without regard to rental of the dwellings, such as interest and taxes, the homeowners are entitled to deduct operating expenses and depreciation, in that order, but only to the extent gross rental income exceeds those deductions allowable without regard to the rental.

Rev. Rul. 80-56, page 14.
Real estate investment trust; foreclosure; property value exceeding bid. A real estate investment trust that engaged primarily in short term financing activities, such as making construction and development loans, made a construction loan on which it later foreclosed. At the foreclosure sale the trust bid in the property for less than its fair market value. The trust's basis in the mortgage note exceeded the property's value, and the balance due on the note was wholly uncollectable. The gain realized by the trust, the difference between the fair market value of the property and the bid price, is ordinary income.

Rev. Rul. 80-57, page 16.
Real estate investment trust; deed in lieu of foreclosure; property value exceeding basis. A real estate investment trust that engaged primarily in short term financing activities, such as making construction and development loans, made a construction loan to a borrower who later defaulted. The trust accepted a deed in lieu of foreclosure when the fair market value of the property exceeded the trust's basis in the mortgage note. The gain realized by the trust, the difference between its basis in the note and the value of the property, is ordinary income, and such income qualifies under section 856(c)(2)(D) and (3)(C) of the Code.

Rev. Rul. 80-58, page 16.
Reconveyance of real property to seller. No gain is recognized under section 1001 of the Code on the sale of land by a taxpayer who accepts reconveyance of the land and returns the buyer's funds in the taxable year of the sale. If the reconveyance occurs after the taxable year of sale, the seller reports the sale in the taxable year of sale and acquires a new basis in the property when

(Continued on page 4)

Finding Lists begin on page 25.
Announcement Relating to Decisions of the Tax Court on page 5.
Announcement of Disbarment and Suspensions on page 22.
Announcement of Notice of Proposed Rulemaking on page 23.
Monthly Index for February begins on page 27.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part includes rulings and decisions based on Subpart A, Tax Conventions and related Treasury Decisions and Revenue Rulings; Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of Revenue Rulings, Revenue Procedures, and other published items, and (3) topical Indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

it is reconveyed equal to the amount paid for the reconveyance.

Rev. Rul. 80-61, page 18.
Information returns; financial institution. A financial institution gives merchandise to an individual for inducing another person to make a time deposit. If the fair market value of the merchandise given to an individual during the calendar year is $600 or more, the institution is required to file information returns, Forms 1096 and 1099.

T.D. 7667, page 7.
Temporary regulations under sections 852 and 857 of the Code, as amended by the Revenue Act of 1978, relate to the treatment of certain capital gains by regulated investment companies, real estate investment trusts, and their shareholders.

Announcement 80-28, page 21.
Various areas of the States of California and Hawaii have been declared disaster areas in which losses qualify for the special tax treatment under section 165(h) of the Code.

Announcement 80-29, page 21.
The election to deduct the costs of removing architectural and transportation barriers to the handicapped and elderly for taxable years beginning after December 31, 1976 and before January 1, 1983 is to be made by identifying the deduction as a separate item on the taxpayer's timely filed income tax return.

EXEMPT ORGANIZATIONS

Notice, page 20.
The proposal to designate a depository for annual reports of private foundations will not be implemented.

SELF-EMPLOYMENT TAX

Rev. Rul. 80-59, page 18.
Social security coverage; exemption for religious reasons. The church referred to in Form 4361, Application for Exemption from Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners, must be the church that ordained, commissioned, or licensed the minister who is applying for the exemption and must be a church described in section 170(b)(1)(A)(i) of the Code; Rev. Rul. 76-415 clarified.

ADMINISTRATIVE

Announcement 80-30, page 21.
Forms 3921 and 3922, relating to the transfer or exercise of stock options, will be obsolete for transactions occurring after 1979. Form 4629, Transfer of Property to an Exempt Organization, will be obsolete for transactions occurring after December 29, 1979.

Announcement 80-31, page 21.
The 12⅛ percent Treasury Notes of Series Z-1981, the 10⅜ percent Treasury Notes of Series C-1985, the 11⅜ percent Treasury Notes of Series AB-1981, and the 10½ percent Treasury Notes of Series H-1983 will not be acceptable in payment of taxes.

Announcement Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issues or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by Revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the Court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the Tax Court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Belz Investment Co.	7079-77	72	1209
Moseley, Ned W., et ux	925-76	72	183

The Commissioner does NOT ACQUIESCE in the following decision:

Taxpayer	Docket No.	Report	
		Volume	Page
Hoover Co.	2697-77 9646-77	72	206

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-6: Gains derived from dealings in property.

Whether gain is realized by a real estate investment trust when it accepts a deed to mortgaged property in lieu of foreclosing the mortgage. See Rev. Rul. 80-57, page 16.

26 CFR 1.61-6: Gains derived from dealings in property.

Federal income tax consequences of a reconveyance to a taxpayer of property previously sold by the taxpayer. See Rev. Rul. 80-58, page 16.

Section 162.—Trade or Business Expenses

26 CFR 1.162-1: Business expenses.

Whether expenses attributable to the rental of a house are deductible. See Rev. Rul. 80-55, this page.

Section 163.—Interest

Investment interest; net lease property; contract with HUD. The owner and operator of an apartment complex received direct payments under a contract with the Department of Housing and Urban Development (HUD), under section 8 of the National Housing Act, for providing low income housing. The net lease provisions of section 163(d)(4)(A)(ii) of the Code do not apply and the income and expenses from such units are not subjected to the interest limitations imposed by section 163(d)(1).

Rev. Rul. 80-54

ISSUE

Under the circumstances described below, are certain apartment units owned and operated by the taxpayer property subject to the net lease provisions of section 163(d) (4) (A) of the Internal Revenue Code?

FACTS AND LAW

The taxpayer, an individual, is the owner and operator of an apartment complex. Pursuant to section 8 of the National Housing Act, as amended, 12 U.S.C.A. section 1701 (Supp. 1978), the taxpayer entered into a five year contract with the Department of Housing and Urban Development (HUD) with regard to a certain number of apartments in the complex.

Section 8 of the Act provides for direct payments to apartment owners providing housing for low income families. The assistance payments are equal to the maximum monthly rent, based on schedules established by HUD of the fair market rental for similar dwelling units in the market area, less an amount varying between 15 and 25 percent of the family's monthly income.

Section 8 of the Act further provides that the maximum monthly rent shall be revised annually to reflect changes in the fair market rentals. Special additional adjustments may be granted, when approved by the Government, to reflect increases in the actual and necessary expenses of owning and maintaining the rental units if the increases have resulted from substantial general increases in real property taxes, utility rates, or similar costs. The owner must demonstrate that the general increases have caused increases in the owner's operating costs that are not adequately compensated for by automatic annual adjustments.

The contract between the taxpayer and HUD provides that the Government has not assumed any obligation for the amount of rent payable by any family or the satisfaction of any claim by the owner against any family other than for security and utility deposits. The contract further provides that if a family vacates its unit (other than as a result of action by the owner that is in violation of the contract or any applicable law), the owner shall receive housing assistance payments in the amount of 80 percent of the contract rent for a vacancy period not exceeding 60 days. In addition, the contract provides a maximum Government payment each year subject to provisions allowing for amendment of this amount.

For each taxable year in question the sum of the taxpayer's deductions with respect to the apartment units covered by the contract with HUD that are allowable solely by reason of section 162 of the Code will not be less than 15 percent of the rental produced by these apartment units.

Section 163(d) of the Code provides a limitation on the amount of investment interest that may be deducted by a taxpayer other than a corporation. Interest on funds borrowed in connection with property subject to a net lease is considered investment interest and, therefore, is subject to the limitation. A lease is considered a net lease under section 163 (d) if the taxpayer's trade or business expenses with respect to the property, which are deductible solely by reason of section 162, are less than 15 percent of the rental income from the property, or if the taxpayer is guaranteed, in whole or in part, against loss of income.

HOLDING

Because for each taxable year in question the sum of the taxpayer's deductions with respect to the apartment units covered by the contract with HUD that are allowable solely by reason of section 162 of the Code will not be less than 15 percent of the rental income and because the taxpayer is neither guaranteed a specified return nor guaranteed in whole or in part against loss, the net lease provisions of section 163(d)(4)(A) of the Code do not apply.

Therefore, the income and expenses from the apartment units covered by the contract with HUD are not subject to the interest limitations imposed by section 163(d)(1) of the Code.

Section 166.—Bad Debts

26 CFR 1.166-6: Sale of mortgaged or pledged property.

Whether gain realized by a real estate investment trust upon the acquisition of mortgaged property at foreclosure is recognized as capital gain to the trust. See Rev. Rul. 80-56, page 14.

Section 280A.—Disallowance of Certain Expenses in Connection with Business Use of Home, Rental of Vacation Homes, Etc.

(*Also Section 162; 26 CFR 1.162-1.*)

Rental expenses; house swapping. Two homeowners agreed to

rent their houses to each other for fair rental value for use as personal residences. In addition to those items deductible without regard to rental of the dwellings, such as interest and taxes, the homeowners are entitled to deduct operating expenses and depreciation, in that order, but only to the extent gross rental income exceeds those deductions allowable without regard to the rental.

Rev. Rul. 80-55

ISSUE

Are the expenses attributable to the rental of houses deductible under the following circumstances?

FACTS

Taxpayers *A* and *B* each own a house. Under a rental agreement, *A*'s house is rented to *B* for a fair rental value of 6*x* dollars per year, and *B*'s house is rented to *A* for a fair rental value of 6*x* dollars per year. *A* and *B* use the rented houses as their personal residences. At no time during the taxable year of *A* and *B* do they reside in their own houses.

For the taxable year, *A* and *B* each received rental income of 6*x* dollars and paid real estate taxes of 2*x* dollars and interest on the mortgage of 2*x* dollars. *A* and *B* each reported the 6*x* dollars as rental income and took deductions of 2*x* dollars for taxes, 2*x* dollars for interest, 6*x* dollars for depreciation, and 1*x* dollars for expenses attributable to the rental of the house.

LAW AND ANALYSIS

Section 280A(a) of the Internal Revenue Code of 1954 provides that no deductions are allowed with respect to a dwelling unit that is used by the taxpayer as a residence, unless specifically provided and otherwise allowable. Section 280A(b) provides that subsection (a) does not apply to deductions such as taxes and interest that are otherwise allowable without regard to a connection with a taxpayer's trade or business.

Section 280A(d) of the Code provides that a taxpayer uses a dwelling unit during the taxable year as a residence if the taxpayer uses the unit for personal purposes for a number of days which exceeds the greater of 14 days or ten percent of the number of days during the year for which the unit is rented at fair rental. The unit is used for personal purposes for any day it is used by an individual who uses the unit under an arrangement that enables the taxpayer to use some other dwelling unit, whether or not a rental is charged for the use of the other unit.

If the dwelling unit is used as a residence, section 280A(c)(5) of the Code limits the deductions attributable to the rental activity to the amount by which the gross income derived from the rental activity exceeds the deductions otherwise allowable with respect to the rental activity such as interest and taxes.

Section 280A(e) of the Code provides that if there is personal use of a dwelling unit during the taxable year the amount deductible with respect to the expenses allocable to the rental of the dwelling unit is limited to an amount that bears the same ratio to the expenses as the number of days the unit is actually rented out for the year at a fair rental bears to the number of days the unit is actually used for all purposes during the year. This limitation, however, does not apply to the excess amounts of interest or taxes that are allowable even if not attributable to rental activity.

Because *A* and *B* are renting each other's house under an arrangement within the meaning of section 280A(d) of the Code, *A* is using the house owned by *A* for personal purposes and *B* is using the house owned by *B* for personal purposes. Therefore, any deductible expenses allocable to the rental are subject to the limitations of section 280A(e). In determining the relationship of rental days to total days of use for purposes of making this allocation, the number of rental days includes each day the house was rented for a fair rental value during the taxable year even though the taxpayer is considered to have personally used the house for that day under section 280A(d).

HOLDING

A and *B* are entitled to deduct the properly allocated expenses attributable to the rental of the houses, limited to the amount by which the gross income from the rental exceeds the deductions otherwise allowable such as interest and taxes. *A* and *B* must deduct these expenses in the following sequence: items that are deductible without regard to a connection to a business activity, such as interest and taxes; operating expenses; items that affect basis, such as depreciation. Because the rental income is 6*x* dollars, *A* and *B* are entitled to the following deductions: 2*x* dollars for taxes, 2*x* dollars for interest, 1*x* dollars for expenses, and 1*x* dollars for depreciation. The other 5*x* dollars of depreciation expenses are not deductible since they exceed the 6*x* dollars of rental income.

Section 852.—Taxation of Regulated Investment Companies and Their Shareholders.

26 CFR 5.852-1: Treatment of certain capital gains of regulated investment companies.
(Also Section 857; 5.857-1.)

T.D. 7667

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 5.—TEMPORARY INCOME TAX REGULATIONS UNDER THE REVENUE ACT OF 1978

Treatment of certain capital gains of regulated investment companies and real estate investment trusts.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides temporary regulations relating to the treatment of certain capital gains by regulated investment companies, real estate investment trusts, and their shareholders. Changes to the applicable tax law were made by the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1]. These regulations affect regulated investment companies, real estate investment trusts, and their shareholders and provide them with guidance needed to comply with the law.

EFFECTIVE DATES: The temporary regulations are effective for taxable years of a regulated investment company or a real estate investment trust beginning before November 1, 1978, and ending after October 31, 1978, or beginning before January 1, 1979, and ending after December 31, 1978. They are also effective for a regulated investment company or real estate investment trust with any taxable year paying dividends after October 31, 1978, under sections 855, 858, 859 (as in effect prior to enactment of the Revenue Act of 1978) and 860 of the Internal Revenue Code of 1954.

FOR FURTHER INFORMATION CONTACT: Kent J. Schreiner of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T, 202-566-3289).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains temporary regulations relating to the treatment of certain capital gains by regulated investment companies, real estate investment trusts, and their shareholders. The temporary regulations are necessary because of the amendments made to sections 1202 and 1201 by sections 402 and 403 of the Revenue Act of 1978 (Pub. L. 95-600, 82 Stat. 2867, 2868). These temporary regulations replace the temporary regulations relating to the treatment of capital gains by regulated investment companies, real estate investment trusts and their shareholders adopted by T.D. 7586 [1979-1 C.B. 228] published in the Federal Register for January 4, 1979 (44 FR 1106).

STATUTORY PROVISIONS

Section 402 of the Revenue Act of 1978 amends section 1202 of the Code (relating to deduction for capital gains) by increasing the deduction for capital gains from 50 percent to 60 percent of the amount of net capital gain. Section 1202(c) provides a transitional rule for determining the applicable deduction for capital gains for a taxpayer other than a corporation. Under the transitional rule, a deduction is allowed equal to 60 percent of the lesser of the net capital gain for the taxable year or the net capital gain taking into account only sales and exchanges after October 31, 1978. The transitional rule also provides for a deduction equal to 50 percent of the excess of the net capital gain for the taxable year over the amount taken into account in computing the 60 percent deduction.

Section 403 of the Revenue Act of 1978 reduces the alternative rate of tax on the net capital gain of a corporation from 30 percent to 28 percent. Section 1201(c), as amended by the Revenue Act of 1978, provides a transitional rule for determining the applicable rate of tax on the net capital gain of a corporation. Under the transitional rule, a tax is provided equal to 28 percent of the lesser of the net capital gain for the taxable year or the net capital gain taking into account only sales and exchanges after December 31, 1978. In addition, the transitional rule provides for a tax of 30 percent on the excess of the net capital gain for the taxable year over the amount subject to the 28 percent tax.

REPLACEMENT OF T.D. 7586

Temporary regulations (T.D. 7586) were published in the Federal Register for January 4, 1979, 44 FR 1106, to provide taxpayers with guidance needed to comply with the changes made by section 402 of the Revenue Act of 1978. That temporary regulation provided rules that were limited to the treatment of certain capital gains of regulated investment companies and real estate investment trusts with respect to their shareholders that are not corporations and with respect to taxable years ending before January 1, 1979. It also announced that additional temporary regulations would be adopted for taxable years ending after December 31, 1978, and for dividends paid after that date.

This new temporary regulation replaces T.D. 7586 without changing the rules provided by that Treasury decision. However, this temporary regulation incorporates the transitional rules provided by both sections 402 and 403 of the Revenue Act of 1978. Thus, rules are provided for all capital gains realized by the regulated investment company or real estate investment trust during the transitional periods, regardless of the time that the gains are actually distributed, and regardless of whether or not the shareholder is a corporation.

EXPLANATION OF PROVISIONS

Under sections 852(b)(3)(B) and 857(b)(3)(B), capital gain dividends received by shareholders of a regulated investment company and real estate investment trust are treated as gain from the sale or exchange of a capital asset held for more than 1 year and are included in income in the taxable year of the shareholder in which the dividend is received. The temporary regulations require that the regulated investment company or real estate investment trust designate the portion of a shareholder's capital gain dividend that is to be taken into account in computing the 60 percent capital gain deduction and the amount subject to the 28 percent capital gains tax. In making the designation, the regulated investment company or real estate investment trust must allocate their capital gain dividends to specified periods during which the capital gains were realized. The temporary regulations contain rules for determining the shareholder's proportionate share of the capital gain dividend.

Under section 852(b)(3)(D) a regulated investment company may designate an amount of undistributed capital gains that shareholders must include in gross income as gain from the sale or exchange of a capital asset held for more than 1 year. The temporary regulations prescribe similar rules for designated undistributed capital gains as those prescribed for capital gain dividends.

The Income Tax Regulations (26 CFR Part 1) under subchapter M, chapter 1 of the Code continue to apply while the temporary regulations provided by this document are effective. However, where the temporary regulations contained in this document are inconsistent with such Income Tax

Regulations, the temporary regulations are to apply.

TECHNICAL CORRECTIONS BILL OF 1979

The Technical Corrections Bill of 1979 (S. 614, 96th Cong., 1st Sess. (1979); H.R. 2797, 96th Cong., 1st Sess. (1979)) was passed by the House of Representatives on July 16, 1979. If enacted into law in the form passed by the House of Representatives, then these temporary regulations would not apply to (a) dividends includible in gross income of shareholders, other than corporations, with taxable years beginning after October 31, 1979, or (b) dividends includible in gross income of shareholders that are corporations with taxable years beginning after December 31, 1979.

WAIVER OF CERTAIN PROCEDURAL REQUIREMENTS

There is need for expeditious adoption of the provisions contained in this document because regulated investment companies, real estate investment trusts and their shareholders must be provided with immediate guidance in applying the transitional rules provided by sections 402 and 403 of the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, 101, 102]. For this reason, Jerome Kurtz, Commissioner of Internal Revenue, has determined that the provisions of paragraphs 8 through 14 of the Treasury Department directive implementing Executive Order 12044 must be waived.

DRAFTING INFORMATION

The principal author of this regulation is Kent J. Schreiner of the Legislation and Regulations Divisions of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 5 is amended by deleting § 5.852-1, § 5.852-2, § 5.857-1 and §5.857-2 and inserting in lieu thereof the following new sections:

§ 5.852-1 Treatment of certain capital gains of regulated investment companies.

(a) *Taxation of certain capital gains of regulated investment companies.* Section 403 of the Revenue Act of 1978 reduces the alternative rate of tax imposed by section 1201(a) on the net capital gain of a corporation from 30 percent to 28 percent for taxable years ending after December 31, 1978. Section 1201(c), as amended by the Revenue Act of 1978, provides a transitional rule for determining the applicable rate of tax under section 1201(a) on net capital gain for a corporation with a taxable year beginning before January 1, 1979, and ending after December 31, 1978. A regulated investment company that is taxable under part I, subchapter M, chapter 1 of the Code (hereinafter regulated investment company) must pay a tax on its capital gains under section 852(b)(3)(A). The tax is determined at a rate provided in section 1201(a) on the excess of the company's net capital gain over its deduction for dividends paid (as defined in section 561) determined with reference to capital gain dividends only. For a regulated investment company with a taxable year beginning before January 1, 1979 and ending after December 31, 1978, in computing the deduction for dividends paid, any capital gain dividends (including any capital gain dividends declared after the close of the taxable year but considered as having been paid during the taxable year under section 855) shall be considered made first from the company's post-1978 capital gain, to the extent thereof, and then from its pre-1979 capital gain. For definitions of "pre-1979 capital gain" and "post-1978 capital gain", see paragraph (e) of this section.

(b) *Capital gain dividends*—(1) *Designation of capital gain dividends.* In general, under section 852(b)(3)(C) a capital gain dividend is any dividend, or part thereof, that is designated by a regulated investment company as a capital gain dividend in a written notice mailed to its shareholders not later than 45 days after the close of its taxable year. A regulated investment company with a taxable year beginning before November 1, 1978, and ending after October 31, 1978, or beginning before January 1, 1979, and ending after December 31, 1978, designating capital gain dividends with respect to such years, or a regulated investment company with any taxable year distributing capital gain dividends after October 31, 1978, under sections 855 or 860, also must include in its written notice to its shareholders a statement showing the shareholder's proportionate share of the dividend that is post-October 1978 capital gain (for use by the shareholder if the shareholder is not a corporation) and post-1978 capital gain (for use by the shareholder if the shareholder is a corporation). For the definition of "post-October 1978 capital gain", see paragraph (e) of this section.

(2) *Special procedural requirements.* In determining the portion of the capital gain dividend that is post-October 1978 capital gain in the hands of shareholders other than corporations, the regulated investment company shall consider that capital gain dividends for the taxable year are made first from its post-October 1978 capital gain, to the extent thereof, and then from its pre-November 1978 capital gain. For the definition of "pre-November 1978 capital gain", see paragraph (e) of this section. In determining the portion of the capital gain dividend that is post-1978 capital gain in the hands of shareholders that are corporations, the regulated investment company shall consider that capital gain dividends for the taxable year are made first from its post-1978 capital gain, to the extent thereof, and then from its pre-1979 capital gain. For purpose of this paragraph (b)(2), the company's post-October 1978 capital gain and post-1978 capital gain shall each be allocated first to capital gain dividends (taking into account dividends under section 855 first), to the extent thereof, second to designated undistributed capital gains, to the extent thereof, and third to other capital gains retained by the company. The proportionate share of post-October 1978 capital gain desig-

nated for a shareholder other than a corporation is the amount that bears the same ratio to the amount paid to the shareholder as a capital gain dividend for the year as (i) the aggregate amount of the company's post-October 1978 capital gain paid to all shareholders (including shareholders that are corporations) bears to (ii) the aggregate amount of the capital gain dividend paid for the year. The proportionate share of post-1978 capital gain designated for a shareholder that is a corporation is the amount that bears the same ratio to the amount paid to it as a capital gain dividend for the year as (i) the aggregate amount of the company's post-1978 capital gain paid to all shareholders (including shareholders that are not corporations) bears to (ii) the aggregate amount of the capital gain dividend paid for the year. Every regulated investment company shall keep a record of the proportion of each capital gain dividend (to which this paragraph (b) applies) that is post-October 1978 capital gain and post-1978 capital gain.

(c) *Undistributed capital gains*—(1) *In general.* A regulated investment company that designates undistributed capital gains shall notify its shareholders of the designation according to the provisions of § 1.852-9(a)(1). In addition, a regulated investment company with a taxable year beginning before November 1, 1978, and ending after October 31, 1978, or beginning before January 1, 1979, and ending after December 31, 1978, that designates undistributed capital gains for such year shall also show on Form 2439 the shareholder's proportionate share of the designated undistributed capital gains that is considered post-October 1978 capital gain (for use by the shareholder if the shareholder is not a corporation) and post-1978 capital gain (for use by the shareholder if the shareholder is a corporation), the tax paid with respect to the company's designated undistributed capital gains deemed to have been paid by the shareholder, and the amount (determined pursuant to paragraph (c)(3) of this section) by which the shareholder's adjusted basis in its shares shall be increased.

(2) *Special procedural requirements.* In determining the portion of the designated undistributed capital gains that is post-October 1978 capital gain for shareholders other than corporations, the regulated investment company shall consider the designated amount as being first from its post-October 1978 capital gain, to the extent thereof, and then from its pre-November 1978 capital gain. In determining the portion of the designated undistributed capital gains that is post-1978 capital gain for shareholders that are corporations, the regulated investment company shall consider the designated amount as being first from its post-1978 capital gain, to the extent thereof, and then from its pre-1979 capital gain. For purposes of this paragraph (c)(2), the company's post-October 1978 capital gain and post-1978 capital gain shall each be allocated first to capital gain dividends, to the extent thereof, second to designated undistributed capital gains, to the extent thereof, and third to other capital gains retained by the company. For a shareholder other than a corporation, the proportionate share of undistributed capital gains for a taxable year that is from post-October 1978 capital gain is the amount that bears the same ratio to the amount included in the shareholder's income as designated undistributed capital gains for the year as (i) the aggregate amount of the company's post-October 1978 capital gain for the year designated as undistributed capital gains (including amounts designated for shareholders that are corporations) bears to (ii) the aggregate amount of the company's gains for the year that are designated as undistributed capital gains. For a shareholder that is a corporation, the proportionate share of undistributed capital gains for a taxable year that is from post-1978 capital gain is the amount that bears the same ratio to the amount included in its income as designated undistributed capital gains for the year as (i) the aggregate amount of the company's post-1978 capital gain for the year designated as undistributed capital gains (including amounts designated for shareholders other than corporations) bears to (ii) the aggregate amount of the company's gains for the year that are designated as undistributed capital gains. Every regulated investment company shall keep a record of the proportion of undistributed capital gains (to which this paragraph applies) that is from post-October 1978 capital gain and post-1978 capital gain.

(3) *Increase in adjusted basis.* Each shareholder's adjusted basis in its shares shall be increased by the amount includible in its gross income under section 852(b)(3)(D)(i), minus the tax that the shareholder is deemed to have paid under section 852(b)(3)(D)(ii). The tax that each shareholder is deemed to have paid is the amount that bears the same ratio to the amount of the tax imposed by section 852(b)(3)(A) on the aggregate amount of the undistributed capital gains designated for the year as the amount of such gains includible in the shareholder's gross income bears to the aggregate amount of undistributed capital gains designated for all shareholders.

(4) *Effect of certain undistributed capital gains on earnings and profits.* If a regulated investiment company designates an amount as undistributed capital gains for a taxable year under section 852(b)(3)(D), its earnings and profits for the year are reduced by the total amount of the designated undistributed capital gains. The company's capital account shall be increased by the total amount designated minus the amount of tax imposed by section 852(b)(3)(A) with respect to the designated amount. For purposes of determining the tax imposed by section 852(b)(3)(A) for amounts designated under section 852(b)(3)(D), for taxable years beginning before January 1, 1979, and ending after December 31, 1978, after taking into account capital gain dividends according to the rules of paragraph (b) of this section, the designated amount shall be treated as being first from post 1978 capital gain, to the extent thereof, and then from pre-1979 capital gain.

(d) *Taxation of certain capital gains of shareholders of regulated investment companies*—(1) *In general.* Section 402 of the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B.

(Vol. 1) 1, 101] increases the deduction for capital gains from 50 percent to 60 percent of the amount of net capital gain for taxable years ending after October 31, 1978. Section 1202 (c), as amended by the Revenue Act of 1978, provides a transitional rule for determining the applicable deduction for capital gains for a taxpayer, other than a corporation, with a taxable year beginning before November 1, 1978, and ending after October 31, 1978. Section 403 of the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, 102] reduces the rate of tax imposed by section 1201(a) on the net capital gain of a corporation from 30 percent to 28 percent for taxable years ending after December 31, 1978. Section 1201(c), as amended by the Revenue Act of 1978, provides a transitional rule for determining the applicable rate of tax under section 1201(a) on the net capital gain of a corporation with a taxable year beginning before January 1, 1979, and ending after December 31, 1978.

(2) *Capital gain dividends.* Under section 852(b)(3)(B), capital gain dividends received by shareholders of a regulated investment company are treated as gain from the sale or exchange of a capital asset held for more than 1 year and are included in income in the taxable year of the shareholder in which the dividend is received.

(i) *Shareholders other than corporations.* In the case of a regulated investment company with a taxable year beginning before November 1, 1978, and ending after October 31, 1978, paying capital gain dividends with respect to such year, or in the case of a regulated investment company with any taxable year distributing capital gain dividends after October 31, 1978, under sections 855 or 860, the portion of the capital gain dividend of a shareholder other than a corporation that is post-October 1978 capital gain is only the portion of the total dividend designated by the regulated investment company pursuant to paragraph (b) of this section. Any capital gain dividend, or portion thereof, not designated post-October 1978 capital gain is to be considered pre-November 1978 capital gain. For dividends paid before November 1, 1978, for taxable years ending before November 1, 1978, see § 1.852-4.

(ii) *Shareholders that are corporations.* In the case of a regulated investment company with a taxable year beginning before January 1, 1979, and ending after December 31, 1978, paying capital gain dividends with respect to such year, or in the case of a regulated investment company with any taxable year distributing capital gain dividends after December 31, 1978, under sections 855 or 860, the portion of the capital gain dividend of a shareholder that is a corporation that is post-1978 capital gain is only the portion of the total dividend designated by the regulated investment company pursuant to paragraph (b) of this section. Any capital gain dividend, or portion thereof, not designated post-1978 capital gain is to be considered pre-1979 capital gain. For dividends paid before January 1, 1979, for taxable years ending before January 1, 1979, see § 1.852-4.

(3) *Undistributed capital gains.* (i) A shareholder of a regulated investment company at the close of the company's taxable year shall include in its gross income as gain from the sale or exchange of a capital asset held for more than 1 year any amount of undistributed capital gains designated by the company under section 852(b)(3)(D). The amount shall be included in the shareholder's gross income for the taxable year that includes the last day of the taxable year of the regulated investment company for which the undistributed capital gains were designated. However, for undistributed capital gains designated for any taxable year of a regulated investment company beginning before November 1, 1978, and ending after October 31, 1978, or beginning before January 1, 1979, and ending after December 31, 1978, the portion of each shareholder's designated undistributed capital gains that is post-October 1978 capital gain or post-1978 capital gain is only the portion designated by the regulated investment company pursuant to paragraph (c) of this section. Any designated undistributed capital gains, or portion thereof, not designated post-October 1978 capital gain is to be considered pre-November 1978 capital gain. Any designated undistributed capital gains, or portion thereof, not designated post-1978 capital gain is to be considered pre-1979 capital gain. For undistributed capital gains designated for taxable years ending before November 1, 1978, for shareholders other than corporations, and for undistributed capital gains designated for taxable years ending before January 1, 1979, for shareholders that are corporations, see § 1.852-9.

(ii) Any shareholder required to include an amount of undistributed capital gains in gross income under section 852(b)(3)(D)(i) and paragraph (d)(3)(i) of this section shall be deemed to have paid, for its taxable year for which the amount is includible, a tax equal to the tax designated under paragraph (c)(1) of this section as the shareholder's proportionate share of the capital gains tax paid with respect to such amount by the regulated investment company.

(iii) Any shareholders required to include an amount of undistributed capital gains in gross income under section 852(b)(3)(D)(i) and paragraph (d)(3)(i) of this section shall increase the adjusted basis of the shares of stock in respect of which such amount is includible by the amount designated under paragraph (c)(3) of this section by the regulated investment company.

(e) *Definitions*—(1) *Pre-November 1978 capital gain.* For purposes of this section, the term "pre-November 1978 capital gain" means net capital gain described in section 1202 (c)(2), as amended by the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1].

(2) *Post-October 1978 capital gain.* For purposes of this section, the term "post-October 1978 capital gain" means net capital gain described in section 1202(c)(1), as amended by the Revenue Act of 1978.

(3) *Pre-1979 capital gain.* For purposes of this section, the term "pre-1979 capital gain" means net capital gain that is subject to tax at a rate of 30 percent as provided by section 1201

(c), as amended by the Revenue Act of 1978.

(4) *Post-1978 capital gain.* For purposes of this section, the term "post-1978 capital gain" means net capital gain that is subject to tax at a rate of 28 percent as provided by section 1201(c), as amended by the Revenue Act of 1978.

(f) *Example.* The rules of this section are illustrated by the following example:

Example. (*1*) *Facts.* XYZ Company, a regulated investment company, makes its return using a fiscal year. Its taxable year begins on June 1 and ends on May 31. During its taxable year ending on May 31, 1979, XYZ Company realized the following capital gains and losses:

	August	*December*	*February*
Long-term capital gain	$1600	$2400	$5200
Long-term capital loss	200	400	600
Short-term capital gain	800	200	0
Short-term capital loss	0	600	200

Net capital gain for the year = $8000

Under section 855, XYZ Company elects to treat $3400 as a capital gain dividend that will be distributed in the following taxable year. XYZ Company distributes $800 as a dividend during its taxable year ending on May 31, 1979, to its shareholders and designates the amount as capital gain. The company also designates $2600 as undistributed capital gains and retains the remaining $1200 of capital gains.

(2) *Application of definitions*—(i) *Post-October 1978 capital gain.* Under paragraph (e)(2) of this section, post-October 1978 capital gain is defined as the net capital gain described in section 1201(c)(1) or $6000 (the lesser of $8000 net capital gain for the taxable year or $6000 net capital gain taking into account only sales and exchanges after October 31, 1978).

(ii) *Pre-November 1978 capital gain.* Under paragraph (e)(1) of this section, pre-November 1978 capital gain is defined as the net capital gain described in section 1201(c)(2) or $2000 (the excess of $8000 net capital gain for the taxable year over $6000 taken into account in computing post-October 1978 capital gain).

(iii) *Post-1978 capital gain.* Under paragraph (e)(4) of this section, post-1978 capital gain is defined as the net capital gain that is subject to tax at a rate of 28 percent as provided by section 1201(c) or $4400 (the lesser of $8000 net capital gain for the taxable year or $4400 net capital gain taking into account only sales and exchanges after December 31, 1978).

(iv) *Pre-1979 capital gain.* Under paragraph (e)(3) of this section, pre-1979 capital gain is defined as net capital gain that is subject to tax at a rate of 30 percent as provided by section 1201(c) or $3600 (the excess of $8000 net capital gain for the taxable year over $4400 taken into account in computing post-1978 capital gain).

(3) *Allocation of capital gains*—(i) *Capital gain dividends.* Under paragraph (b)(2) of this section, of the $4200 capital gain dividend ($3400 treated under section 855 plus $800 distributed), $4200 is post-October 1978 capital gain. Similarly, under paragraph (b)(2) of this section, $4200 is post-1978 capital gain.

(ii) *Undistributed capital gains.* Under paragraph (c)(2) of this section, of the $2600 designated as undistributed capital gains, $1800 (the excess of $600 total post-October 1978 capital gain over $4200 taken into account in computing capital gain dividends) is post-October 1978 capital gain and the remaining $800 is pre-November 1978 capital gain. Similarly, under paragraph (c)(2) of this section, of the $2600 designated as undistributed capital gain, $200 (the excess of $4400 total post-1978 capital gain over $4200 taken into account in computing capital gain dividends) is post-1978 capital gain and the remaining $2400 is pre-1979 capital gain.

(iii) *Other capital gains.* The $1200 of capital gains retained by the company is pre-1979 capital gain.

(4) *Determination of proportionate share*—(i) *Capital gain dividends.* Under paragraph (b)(2) of this section, each shareholder's proportionate share of post-October 1978 capital gain is 100 percent of the total capital gain dividend received ($6000 total post-October 1978 capital gain dividend divided by $6000 total capital gain dividends for the taxable year). Similarly, each shareholder's proportionate share of post-1978 capital gain is 100 percent of the total capital gain dividends.

(ii) *Undistributed capital gains.* Under paragraph (c)(2) of this section, each shareholder's proportionate share of post-October 1978 designated undistributed capital gains is 69.23 percent of the undistributed capital gains designated for him ($1800 total post-October 1978 designated undistributed capital gains divided by $2600 total designated undistributed capital gains). Similarly, under paragraph (c)(2), each shareholder's proportionate share of post-1978 designated undistributed capital gains is 7.69 percent of the undistributed capital gains designated for him ($200 total post-1978 designated undistributed capital gains divided by $2600 total designated undistributed capital gains).

(g) *Other applicable regulations.* In general, the Income Tax Regulations (26 CFR Part 1) under part I, subchapter M, chapter 1 of the Code are to apply to the treatment of capital gains by regulated investment companies. However, where this section is inconsistent with such Income Tax Regulations, this section is to apply.

§ 5.857-1 Treatment of certain capital gains of real estate investment trusts.

(a) *Taxation of certain capital gains of real estate investment trusts.* Section 403 of the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, 102] reduces the alternative rate of tax imposed by section 1201(a) on the net capital gain of a corporation from 30 percent to 28 percent for taxable years ending after December 31, 1978. Section 1201(c), as amended by the Revenue Act of 1978, provides a transitional rule for determining the applicable rate of tax under section 1201(a) on the net capital gain of a corporation with a taxable year beginning before January 1, 1979, and ending after December 31, 1978. A real estate investment trust that is taxable under part II, subchapter M, chapter 1 of the Code (hereinafter real estate investment trust) is provided with an alternative tax on its capital gains under section 857(b)(3)(A). The alternative tax is determined, in part, at a rate provided in section 1201(a) on the excess of the trust's net capital gain over its deduction for dividends paid (as defined in section 561) determined with reference to capital gain dividends only. For a real estate investment trust with a taxable year beginning before January 1, 1979, and ending after December 31, 1978, in computing the deduction for dividends paid, any capital gain dividends (including any dividends declared after the close of such taxable year but considered as having been paid during such taxable year under section 858) shall be considered made first from the trust's post-1978 capital gain, to the extent thereof, and then from its pre-1979 capital gain. For definitions of "pre-1979 capital gain" and "post-1978 capital gain", see paragraph (d) of this section.

(b) *Capital gain dividends*—(1) *Designation of capital gain dividends.* In general, under section 857(b)(3)(C) a capital gain dividend is any dividend, or part thereof, that is designated by a real estate investment trust as a capital gain dividend in a written notice mailed to its shareholders (or holders of beneficial interests) not later than 30 days after the close of its taxable year. A real estate investment trust with a taxable year beginning before November 1, 1978, and ending after October 31, 1978, or beginning before January 1, 1979, and ending after December 31, 1978, designating capital gain dividends with respect to such years, or a real estate investment trust with any taxable year distributing capital gain dividends under sections 858, 859 (as in effect prior to enactment of the Revenue Act of 1978) or 860 after October 31, 1978, also must include in its written notice to its shareholders a statement showing the shareholder's proportionate share of the dividend that is post-October 1978 capital gain (for use by the shareholder if the shareholder is not a corporation) and post-1978 capital gain (for use by the shareholder if the shareholder is a corporation). For the definition of "post-October 1978 capital gain", see paragraph (d) of this section.

(2) *Special procedural requirements.* In determining the portion of the capital gain dividend that is post-October 1978 capital gain in the hands of shareholders other than corporations, the real estate investment trust shall consider the capital gain dividends for the taxable year are made first from its post-October 1978 capital gain, to the extent thereof, and then from its pre-November 1978 capital gain. For the definition of "pre-November 1978 capital gain", see paragraph (d) of this section. In determining the portion of the capital gain dividend that is post-1978 capital gain in the hands of shareholders that are corporations, the real estate investment trust shall consider that capital gain dividends for the taxable year are made first from its post-1978 capital gain, to the extent thereof, and then from its pre-1979 capital gain. For purposes of this paragraph (b)(2), the trust's post-October 1978 capital gain and post-1978 capital gain shall be allocated first to capital gain dividends (taking into account dividends under section 858 first), to the extent thereof, and second to other capital gains retained by the trust. The proportionate share of post-October 1978 capital gain designated for a shareholder other than a corporation is the amount that bears the same ratio to the amount paid to him as capital gain dividend for the year as (i) the aggregate amount of the trust's post-October 1978 capital gain paid to all shareholders (including shareholders that are corporations) bears to (ii) the aggregate amount of the capital gain dividend paid for the year. The proportionate share of post-1978 capital gain designated for a shareholder that is a corporation is the amount that bears the same ratio to the amount paid to it as a capital gain dividend for the year as (i) the aggregate amount of the trust's post-1978 capital gain paid to all shareholders (including shareholders that are not corporations) bears to (ii) the aggregate amount of the capital gain dividend paid for the year. Every real estate investment trust shall keep a record of the proportion of each capital gain dividend (to which this paragraph applies) that is post-October 1978 capital gain and post-1978 capital gain.

(c) *Taxation of certain capital gains of shareholders of real estate investment trust*—(1) *In general.* Section 402 of the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, 101] increases the deduction for capital gains from 50 percent to 60 percent of the amount of net capital gain for taxable years ending after October 31, 1978. Section 1202(c), as amended by the Revenue Act of 1978, provides a transitional rule for determining the applicable deduction for capital gains for a taxpayer, other than a corporation, with a taxable year beginning before November 1, 1978, and ending after October 31, 1978. Section 403 of the Revenue Act of 1978 reduces the alternative rate of tax imposed by section 1201 (a) on the net capital gain of a corporation from 30 percent to 28 percent for taxable years ending after December 31, 1978. Section 1201(c), as amended by the Revenue Act of 1978, provides a transitional rule for determining the applicable rate of tax under section 1201(a) on the net capital gain of a corporation with a taxable year beginning before January 1, 1979, and ending after December 31, 1978.

(2) *Capital gain dividends.* Under section 857(b)(3)(B), capital gain dividends received by shareholders of a real estate investment trust are treated as gain from the sale or exchange of a capital asset held for more than 1 year and are included in income in the taxable year of the shareholder in which the dividend is received.

(i) *Shareholders other than corporations.* In the case of a real estate investment trust with a taxable year beginning before November 1, 1978, and ending after October 31, 1978, paying capital gain dividends with respect to such year, or in the case of a real estate investment trust with any taxable year distributing capital gain dividends after October 31, 1978, under sections 858, 859 (as in effect prior to enactment of the Revenue Act of 1978) or 860, the portion of the capital gain dividend of a shareholder other than a corporation that is post-October 1978 capital gain is only the portion of the total dividend designated by the real estate investment trust pursuant to paragraph (b) of this section. Any capital gain dividend, or portion thereof, not designated post-October 1978 capital gain is to be considered pre-November 1978 capital gain. For dividends paid before November 1, 1978, for taxable years ending before November 1, 1978, see § 1.857-4.

(ii) *Shareholders that are corporations.* In the case of a real estate investment trust with a taxable year beginning before January 1, 1979, and ending after December 31, 1978, paying capital gain dividends with respect to such year, or in the case of a real estate investment trust with any taxable year distributing capital gain dividends after December 31, 1978, under sections 858, 859 (as in effect prior to enactment of the Revenue Act of 1978) or 860, the portion of the capital gain dividend of a shareholder that is a corporation that is post-1978 capital gain is only the portion of the total dividend designated by the real estate investment trust pursuant to paragraph (b) of this section. Any capital gain dividend, or portion thereof, not designated post-1978 capital gain is to be considered pre-1979 capital gain. For dividends paid before January 1, 1979, for taxable years ending before January 1, 1979, see § 1.857-4.

(d) *Definitions*—(1) *Pre-November 1978 capital gain.* For purposes of this section, the term "pre-November 1978 capital gain" means net capital gain described in section 1202 (c)(2), as amended by the Revenue Act of 1978.

(2) *Post-October 1978 capital gain.* For purposes of this section, the term "post-October 1978 capital gain" means net capital gain described in section 1202(c)(1), as amended by the Revenue Act of 1978.

(3) *Pre-1979 capital gain.* For purposes of this section, the term "pre-1979 capital gain" means net capital gain that is subject to tax at a rate of 30 percent as provided by section 1201(c), as amended by the Revenue Act of 1978.

(4) *Post-1978 capital gain.* For purposes of this section, the term "post-1978 capital gain" means net capital gain that is subject to tax at a rate of 28 percent as provided by section 1201(c), as amended by the Revenue Act of 1978.

(e) *Example.* The rules of this section are illustrated by the following example:

Example. (1) *Facts.* XYZ, a real estate investment trust, makes its return using a fiscal year. Its taxable year begins on June 1 and ends on May 31. During its taxable year ending on May 31, 1979, XYZ realized the following capital gains and losses:

	August	*December*	*February*
Long-term capital gain	$1000	$4400	$2000
Long-term capital loss	800	200	400
Short-term capital gain	0	100	300
Short-term capital loss	500	100	200

Net capital gain for the year = $5600

Under section 858, XYZ elects to treat $3000 as a capital gain dividend that will be distributed in the following taxable year. XYZ distributes $500 as a dividend during its taxable year ending on May 31, 1979, and designates the amount as capital gain. The trust retains the remaining $2100 of capital gains.

(2) *Application of definitions*—(i) *Post-October 1978 capital gain.* Under paragraph (d)(2) of this section, post-October 1978 capital gain is defined as the net capital gain described in section 1202(c)(1) or $5600 (the lesser of $5600 net capital gain for the taxable year or $5800 net capital gain taking into account only sales and exchanges after October 31, 1978).

(ii) *Pre-November 1978 capital gain.* Under paragraph (d)(1) of this section, pre-November 1978 capital gain is defined as the net capital gain described in section 1202(c)(2) or $0 (the excess of $5600 net capital gain for the taxable year over $5600 taken into account in computing post-October 1978 capital gain).

(iii) *Post-1978 capital gain.* Under paragraph (d)(4) of this section, post-1978 capital gain is defined as the net capital gain that is subject to tax at a rate of 28 percent as provided by section 1201(c) or $1600 (the lesser of $5600 net capital gain for the taxable year or $1600 net capital gain taking into account only sales and exchanges after December 31, 1978).

(iv) *Pre-1979 capital gain.* Under paragraph (d)(3) of this section, pre-1979 capital gain is defined as net capital gain that is subject to tax at a rate of 30 percent as provided by section 1201(c) or $4000 (the excess of $5600 net capital gain for the taxable year over $1600 taken into account in computing post-1978 capital gain).

(3) *Allocation of capital gains*—(i) *Capital gain dividends.* Under paragraph (b)(2) of this section, of the $3500 capital gain dividend ($3000 treated under section 858 plus $500 distributed) $3500 is post-October 1978 capital gain and $0 is pre-November 1978 capital gain. Similarly, under paragraph (b)(2) of this section, of the $3500 capital gain dividend, $1600 is post-1978 capital gain and the remaining $1900 is pre-1979 capital gain.

(ii) *Other capital gains.* The $2100 retained by the trust is pre-1979 capital gain.

(4) *Determination of proportionate share.* Under paragraph (b)(2) of this section, each shareholder's proportionate share of post-October 1978 capital gain is 100 percent of the total capital gain dividend ($3500 total post-October 1978 capital gain divided by $3500 total capital gain dividends for the taxable year). Similarly, each shareholder's proportionate share of post-1979 capital gain is 45.71 percent of the total capital gain dividends ($1600 total post-1978 capital gain divided by $3500 total capital gain dividends for the taxable year).

(f) *Other applicable regulations.* In general, the Income Tax Regulations (26 CFR Part 1) under part II, subchapter M, chapter 1 of the Code are to apply to the treatment of capital gains by real estate investment trusts. However, where this section is inconsistent with such Income Tax Regulations, this section is to apply.

There is need for the immediate guidance provided by the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved January 2, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on January 23, 1980, 8:45 a.m., and published in the issue of the Federal Register for January 24, 1980, 45 F.R. 5688)

Section 856.—Definition of Real Estate Investment Trust

26 CFR 1.856-1: Definition of real estate investment trust.
(Also Sections 166, 1221; 1.166-6, 1.1221-1.)

Real estate investment trust; foreclosure; property value exceeding bid. A real estate investment trust that engaged primarily in short term financing activities, such as making construction and development loans, made a construction loan on which it later foreclosed. At the foreclosure sale the trust bid in the property for less than its fair market value. The trust's basis in the mortgage note exceeded the property's value, and the balance due on the note was wholly uncollectable. The gain realized by the trust, the difference between the fair market value of the property and the bid price, is ordinary income.

Rev. Rul. 80-56

ISSUE

Is gain realized by a real estate investment trust upon the acquisition or mortgaged property at a foreclosure sale ordinary income or capital gain under the circumstances described below?

FACTS

X, which qualifies as a real estate investment trust under section 856 of the Internal Revenue Code, engages primarily in short-term financing activities, such as originating, making, and servicing construction and development loans that are secured by mortgages on real property.

In 1977, *X* made a construction loan of 1000*x* dollars to *Y*, a corporation. The loan was secured by a first mortgage on land and the building to be constructed thereon. In 1978, *Y* defaulted on the loan and *X* acquired the property by bidding it in at the foreclosure sale. No deficiency judgment was obtained in the foreclosure proceedings, and at the time of the acquisition of the property by *X* the mortgage note was wholly uncollectible. On the date of the foreclosure sale the fair market value of the property was clearly established to be 500*x* dollars and the bid price was 400*x* dollars. *X*'s basis in the note was 900*x* dollars.

LAW AND ANALYSIS

Section 166(a)(1) of the Code provides the general rule that there shall be allowed as a deduction any debt that becomes worthless within the taxable year.

Section 1.166-6 of the Income Tax Regulations provides for the treatment of the sale of mortgaged or pledged property. Section 1.166-6(a)(1) provides that if mortgaged or pledged property is lawfully sold for less than the amount of the debt, and the portion of the indebtedness remaining unsatisfied after the sale is wholly or partially uncollectible, the mortgagee or pledgee may deduct such amount under section 166(a) of the Code (to the extent that it constitutes capital or represents an item the income from which has been returned by the mortgagee or pledgee) as a bad debt for the taxable year in which it becomes wholly worthless or is charged off as partially worthless.

Section 1.166-6(b)(1) of the regulations provides that in the case of a sale described in section 1.166-6(a) if the mortgagee or pledgee buys in the mortgaged or pledged property, loss or gain is also realized measured by the difference between the amount of those obligations of the debtor that are applied to the purchase or bid price of the property (to the extent such obligations constitute capital or represent an item the income from which has been returned by the mortgagee or pledgee) and the fair market value of the property.

As a result of the foreclosure sale, under section 1.166-6(a)(1) of the regulations, *X* is entitled to a bad debt deduction of 500*x* dollars (the difference between the bid price, 400*x* dollars, and the basis of the note, 900*x* dollars). In addition, under section 1.166-6(b)(1), *X* realized a gain in 1978 of 100*x* dollars (the difference between the fair market value of the property, 500*x* dollars, and the bid price, 400*x* dollars).

X's loss is an ordinary loss under section 166(a) and 166(c) of the Code.

Section 1221(4) of the Code provides that the term "capital asset" means property held by the taxpayer but does not include accounts or notes receivable acquired in the ordinary course of trade or business for services rendered.

Rev. Rul. 80-57, page 16, this Bulletin, describes a real estate investment trust that, like *X*, is primarily engaged in short-term financing activities. Based upon *Burbank Liquidating Corporation v. Commissioner,* 39 T.C. 999 (1963), *acq., sub. nom. United Associates, Inc.,* 1965-1 C.B. 5, *modified on other grounds,* 335 F.2d 125 (9th Cir 1964) and Rev. Rul. 72-238, 1972-1 C.B. 65, the ruling concludes that the short-term financing activities of the real estate investment trust are a trade or business and that, under section 1221(4), a note taken in the course of this business is not a capital asset.

Rev. Rul. 72-238 also concludes that because a mortgage note held by a bank was not a capital asset, the gain realized by the bank when it purchased the mortgaged property at a foreclosure sale for a bid price less than the fair market value of the property was ordinary income rather than capital gain. Although the taxpayer in Rev. Rul. 72-238 was a bank, the ruling is equally applicable in the case of a real estate investment trust when the mortgage note is not a capital asset.

Even if the mortgage note held by *X* were a capital asset, the gain realized when *X* purchased the mortgaged property at a foreclosure sale for less than its fair market value would not be capital gain. Under tax benefit principles, if a taxpayer receives an ordinary income deduction, any offsetting gain is taxable as ordinary income. See *National Bank of Commerce of Seattle v. Commissioner,* 115 F.2d 875 (9th Cir. 1940).

In *Merchants National Bank of Mobile v. Commissioner,* 199 F.2d 657 (5th Cir. 1952), the taxpayer bank charged off and deducted certain notes as worthless and then sold them for $18,000 in the following year. The court held that regardless of the fact that the notes were capital assets and that there was a sale or exchange, the recovery was taxable as ordinary income. The court reasoned at page 659:

> When these notes were charged off as a bad debt in the first instance, the bank deducted the amount thereof from its ordinary income, thus escaping taxation on that portion of its income in those years. The amount subsequently recovered on the notes restores *pro tanto* the amount originally deducted from ordinary income, and is accordingly taxable as ordinary income, not as a capital gain. When the notes were charged off, and the bank recouped itself for the capital loss by deducting the amount thereof from its current income, the notes were no longer capital assets for income tax purposes. To permit the bank to reduce its ordinary income by the amount of the loss in the first instance, thus gaining a maximum tax advantage on that basis, and then permit it to treat the amount later recovered on the notes as a capital gain, taxable on a much lower basis than ordinary income, would afford the bank a tax advantage on the transaction not contemplated by the income tax laws.

HOLDING

Any gain under section 1.166-6(b)(1) of the regulations that offsets a bad debt deduction under section 1.166-6(a)(1) is taxable as ordinary income even if the mortgage note is a capital asset.

Because the mortgage note is not a capital asset in the hands of *X*, and because the gain realized under section 1.166-6(b)(1) of the regulations upon the acquisition of mortgaged property at foreclosure offsets the bad debt deduction allowed the taxpayer under section 1.166-6(a)(1) of the regulations, the gain of 100*x* dollars is ordinary income.

Section 857.—Taxation of Real Estate Investment Trusts and Their Beneficiaries

26 CFR 1.857-2: Method of taxation of real estate investment trusts.
(Also Sections 61, 1221, 1232; 1.61-6, 1.1221-1, 1.1232-2.)

Real estate investment trust; deed in lieu of foreclosure; property value exceeding basis. A real estate investment trust that engaged primarily in short term financing activities, such as making construction and development loans, made a construction loan to a borrower who later defaulted. The trust accepted a deed in lieu of foreclosure when the fair market value of the property exceeded the trust's basis in the mortgage note. The gain realized by the trust, the difference between its basis in the note and the value of the property, is ordinary income, and such income qualifies under section 856(c)(2)(D) and (3)(C) of the Code.

Rev. Rul. 80-57

ISSUE

What are the income tax consequences to a real estate investment trust of its acceptance of a deed to mortgaged property in lieu of foreclosing on the mortgage?

FACTS

X, which qualifies as a real estate investment trust under section 856 of the Internal Revenue Code, engages primarily in short-term financing activities such as construction and development loans that are secured by mortgages on real property. In addition to making construction and development loans, *X* frequently originates and services these loans. In 1976, *X* made a construction loan to *Y*, a corporation. The loan was secured by a first mortgage on the land and the building to be constructed on it. In 1979, *Y* defaulted on the loan. In lieu of foreclosing on the mortgage, *X* accepted a deed to the real property in full satisfaction of the outstanding indebtedness. At the time of the conveyance the fair market value of the real property exceeded the amount of *X*'s basis in the mortgage note.

LAW AND ANALYSIS

Section 61(a) of the Code and the Income Tax Regulations thereunder provide that, except as otherwise provided by law, gross income means all income from whatever source derived, including gains derived from dealings in property.

Section 1222 of the Code provides that capital gain means gain from the sale or exchange of a capital asset.

Section 1232(a)(1) of the Code provides that any amount received by a holder of an evidence of indebtedness issued by a corporation, upon retirement of such evidence of indebtedness, is considered an amount received in an exchange if the underlying evidence of indebtedness is a capital asset. In *McClain v. Commissioner,* 311 U.S. 527 (1941), 1941-1 C.B. 378, the Supreme Court of the United States stated that the term "retirement" is construed broadly and in accordance with its ordinary meaning and includes a conveyance in lieu of foreclosure.

Section 1221(4) of the Code excludes from the definition of a capital asset accounts or notes receivable acquired in the ordinary course of a trade or business for services rendered. In *Burbank Liquidating Corp. v. Commissioner,* 39 T.C. 999 (1963), *acq. sub. nom. United Associates Inc.,* 1965-1 C.B. 5, *modified on other grounds,* 335 F.2d 125 (9th Cir. 1964), the Tax Court of the United States held that one of the business activities of a savings and loan association could properly be described as "rendering the service" of making loans and that, by reason of section 1221(4), the taxpayer's notes receivable, which were secured by real estate mortgages, were ordinary assets rather than capital assets. Thus, the court concluded that the loss from the sale of such notes receivable was deductible as an ordinary loss.

Rev. Rul. 72-238, 1972-1 C.B. 65, holds that when a bank purchases real property at a mortgage foreclosure sale and the bid price is less than the fair market value of the property, the gain realized is characterized as ordinary income because such gain results from the ordinary operation of the bank's business, which includes the rendering of the services of originating and making loans that are secured by mortgages.

In this case, *X* is engaged primarily in originating, making, and servicing short-term construction and development loans. Under the authorities cited above, such activities are normally considered an active trade or business. See also section 542(d) of the Code. The fact that the taxpayer in this case is a real estate investment trust and subject to certain restrictions with respect to types and sources of income does not change the inherent nature of these activities. The income from the activities is of the type permitted a real estate investment trust under section 856(c)(2) and (3) and is not income from prohibited transactions under section 857(b)(6).

Because the loan to *Y* was made in the ordinary course of *X*'s trade or business, the note held by *X* was not a capital asset. Thus, section 1232 of the Code does not apply.

HOLDING

The gain realized by *X* when it accepted the deed to the mortgaged property in lieu of foreclosure is ordinary income. The amount of the gain is the difference between *X*'s basis in the mortgage note and the fair market value of the mortgaged premises on the date of the conveyance to *X*.

For purposes of the income requirements of section 856(c) of the Code, the income qualifies under section 856(c)(2)(D) and (3)(C) as gain from the sale or other disposition of real property (including interests in real property and interests in mortgages on real property) that is not property described in section 1221(1).

26 CFR 5.857-1: Treatment of certain capital gains of real estate investment trusts.

Treatment of certain capital gains and dividends by regulated investment companies, real estate investment trusts, and their shareholders. T.D. 7667, page 7.

Section 1001.—Determination of Amount of and Recognition of Gain or Loss

26 CFR 1.1001-1: Computation of gain or loss.
(Also Sections 61, 1038; 1.61-6, 1.1038-1.)

Reconveyance of real property to seller. No gain is recognized under

section 1001 of the Code on the sale of land by a taxpayer who accepts reconveyance of the land and returns the buyer's funds in the taxable year of the sale. If the reconveyance occurs after the taxable year of sale, the seller reports the sale in the taxable year of sale and acquires a new basis in the property when it is reconveyed equal to the amount paid for the reconveyance.

Rev. Rul. 80-58

ISSUE

In the situations described below, what are the federal income tax consequences of a reconveyance to a taxpayer of property previously sold by the taxpayer?

FACTS

Situation 1: In February 1978, *A*, a calendar year taxpayer, sold a tract of land to *B* and received cash for the entire purchase price. The contract of sale obligated *A*, at the request of *B*, to accept reconveyance of the land from *B* if at any time within nine months of the date of sale, *B* was unable to have the land rezoned for *B*'s business purposes. If there were a reconveyance under the contract, *A* and *B* would be placed in the same positions they were prior to the sale.

In October 1978, *B* determined that it was not possible to have the land rezoned and notified *A* of its intention to reconvey the land pursuant to the terms of the contract of sale. The reconveyance was consummated during October 1978, and the tract of land was returned to *A*, and *B* received back all amounts expended in connection with the transaction.

Situation 2: Same as above, except that the period within which *B* could reconvey the property to *A* was one year. In January 1979, *B* determined that it was not possible to have the land rezoned and notified *A* of its intention to reconvey the land pursuant to the terms of the contract of sale. The reconveyance was consummated during February 1979, and the tract of land was returned to *A*. *B* received back all amounts expended in connection with the transaction.

LAW AND ANALYSIS

Section 61(a)(3) of the Internal Revenue Code provides that, except as otherwise provided, gross income means all income from whatever source derived, including gains derived from dealings in property.

Section 1001(c) of the Code provides that, except as otherwise provided, the entire amount of gain or loss, determined under section 1001, on the sale or exchange of property shall be recognized.

The legal concept of rescission refers to the abrogation, canceling, or voiding of a contract that has the effect of releasing the contracting parties from further obligations to each other and restoring the parties to the relative positions that they would have occupied had no contract been made. A rescission may be effected by mutual agreement of the parties, by one of the parties declaring a rescission of the contract without the consent of the other if sufficient grounds exist, or by applying to the court for a decree of rescission.

The annual accounting concept requires that one must look at the transaction on an annual basis using the facts as they exist at the end of the year. That is, each taxable year is a separate unit for tax accounting purposes. *See Security Flour Mills Co. v. Commissioner,* 321 U.S. 281 (1944), Ct. D. 1603, 1944 C.B. 526.

In *Penn v. Robertson,* 115 F.2d 167 (4th Cir. 1940), the taxpayer was a participant in an employees' stock benefit fund created by the directors of the company without the approval of the shareholders. Under the plan the taxpayer was credited with earnings from the fund for the years 1930 and 1931. In 1931, as a result of suits filed by a shareholder, the directors of the company passed a resolution whereby the plan would be rescinded as to all participants in the plan who agreed to relinquish their previous credits and rights. The United States Court of Appeals held that although the plan was rescinded for 1930, the annual accounting period principle required the determination of income at the close of the taxable year without regard to subsequent events. That is, the rescission in 1931 was disregarded for purposes of determining 1930 taxable income.

With regard to whether the 1931 income should be taxed, the Court of Appeals said in the *Penn* case that the rescission in 1931 extinguished what otherwise would have been taxable income for that year.

The facts of the *Penn* case are similar to those in *Situation 1* and *Situation 2*. In *Penn,* earnings were credited in 1930 and 1931 and there was a rescission in 1931 (that was intended to affect both years). *Situation 1* relates to the earnings credited in 1931, the year of the rescission; and *Situation 2* relates to the earnings credited in 1930, that is, a year different from the year of the rescission.

In *Situation 1* the rescission of the sale during 1978 placed *A* and *B* at the end of the taxable year in the same positions as they were prior to the sale. Thus, in light of the *Penn* case, the original sale is to be disregarded for federal income tax purposes because the rescission extinguished any taxable income for that year with regard to that transaction. See Rev. Rul. 74-501, 1974-2 C.B. 98, which holds that there is no adjustment to the basis of the old stock where a shareholder exercised stock rights and paid the subscription price for the new stock, which subscription price was later returned to the shareholder in the same taxable year in which the rights were issued because the market price of the stock had depreciated to a price below the subscription offer.

In *Situation 2,* as in *Situation 1,* there was a completed sale in 1978. However, unlike *Situation 1,* because only the sale and not the rescission occurred in 1978, at the end of 1978 *A* and *B* were not in the same positions as they were prior to the sale. Again, in light of the *Penn* case, the rescission in 1979 is disregarded with respect to the taxable events occurring in 1978.

In both situations, the annual accounting period principle requires the determination of income at the close of the taxable year without regard to subsequent events.

HOLDINGS

In *Situation 1*, no gain on the sale will be recognized by *A* under section 1001 of the Code.

In *Situation 2*, *A* must report the sale for 1978. In 1979, when the property was reconveyed to *A*, *A* acquired a new basis in the property, which was the price paid to *B* for such reconveyance.

See section 1038 of the Code for treatment of reacquisition of real property where a secured indebtedness to the original seller is involved.

Section 1038.—Certain Reacquisitions of Real Property

26 CFR 1.1038-1: Reacquisitions of real property in satisfaction of indebtedness.

Federal income tax consequences of a reconveyance to a taxpayer of property previously sold by the taxpayer. See Rev. Rul. 80-58, page 16.

Section 1221.—Capital Asset Defined

26 CFR 1.1221-1: Meaning of terms.

Whether gain realized by a real estate investment trust upon the acquisition of mortgaged property at foreclosure or in lieu of foreclosure is recognized as capital gain to the trust. See Rev. Rul. 80-56, page 14, and Rev. Rul. 80-57, page 16.

Section 1232.—Bonds and Other Evidences of Indebtedness

26 CFR 1.1232-2: Retirement.

Whether gain is realized by a real estate investment when it accepts a deed to mortgaged property in lieu of foreclosing the mortgage. See Rev. Rul. 80-57, page 16.

Section 1402.—Definitions [Tax on Self-Employment Income]

26 CFR 1.1402(e)-2A: Ministers, members of religious orders and Christian Science practitioners; application for exemption from self-employment tax.

Social security coverage; exemption for religious reasons. The church referred to in Form 4361, Application for Exemption from Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners, must be the church that ordained, commissioned, or licensed the minister who is applying for the exemption and must be a church described in section 170(b)(1)(A)(i) of the Code; Rev. Rul. 76-415 clarified.

Rev. Rul. 80-59

FACTS

Rev. Rul. 76-415, 1976-2 C.B. 255, holds that for the purpose of filing Form 4361, Application for Exemption from Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners, an ordained, commissioned or licensed minister of a church is eligible to exercise the election contained in section 1402(e) of the Internal Revenue Code only if the minister is able to establish that the church qualifies as an organization exempt from income tax under section 501(a) as a religious organization described in section 501(c)(3).

HOLDING

The church referred to in the Form 4361 must be the church that ordained, commissioned, or licensed the minister. In addition to establishing that the church qualifies as being exempt from income tax under section 501(a) of the Code as a religious organization described in section 501(c)(3), the minister must also establish that the church (or convention or association of churches) is one described in section 170(b)(1)(A)(i).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 76-415 is clarified.

Section 6041.—Information at Source

26 CFR 1.6041-1: Return of information as to payments of $600 or more.

Information returns; financial institution. A financial institution gives merchandise to an individual for inducing another person to make a time deposit. If the fair market value of the merchandise given to an individual during the calendar year is $600 or more, the institution is required to file information returns, Forms 1096 and 1099.

Rev. Rul. 80-61

ISSUE

Must a financial institution that gives merchandise to an individual for inducing another person to make a time deposit in the financial institution file information returns, Forms 1096 and 1099, reporting the fair market value of the merchandise given to the individual?

FACTS

A financial institution initiated a promotional campaign to obtain time deposit accounts. The financial institution gives merchandise with a value of $100 to $800 to any individual, not an employee, who induces another person to deposit a sum of money in a time deposit account. The value of the merchandise received depends on the amount of money deposited in the account. The fair market value of the merchandise received is includible in the individual's gross income under section 61 of the Internal Revenue Code.

LAW AND ANALYSIS

Section 6041(a) of the Code requires that all persons engaged in a trade or business and making payment in the course of such trade or business to another person of rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits and income, of $600 or more in any taxable year, shall render a true and accurate return in such form and manner and to such extent as may be prescribed by the regulations.

Section 1.6041-1(a)(2) of the Income Tax Regulations provides that the return required by section 6041(a) of the Code shall be made on Forms 1096 and 1099.

Section 1.6041-1(c) of the regulations defines "fixed or determinable income." Income is fixed when it is paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained.

The fair market value of the merchandise received by the taxpayer is determinable income within the meaning of section 1.6041-1(c) of the regulations.

HOLDING

The financial institution is required to file Forms 1096 and 1099 if, during the calendar year, the fair market value of the merchandise given to an individual is $600 or more.

Notice.—Proposal to Designate a Depository for Annual Reports of Private Foundations

AGENCY: Internal Revenue Service, Treasury.

ACTION: Action on proposal.

SUMMARY: As a result of a Notice published August 27, 1979, in the Federal Register at page 50128 (44 F.R. 50128), 186 persons or organizations commented on the proposal to designate The Foundation Center as a depository for certain private foundation annual reports. The comments, both pro and con, have been given careful consideration by the Internal Revenue Service. For the reasons discussed below it has been decided not to implement this proposal.

FOR FURTHER INFORMATION CONTACT: Edmund J. Butler of the Exempt Organizations Technical Branch, Office of the Assistant Commissioner (Employee Plans and Exempt Organizations): 202-566-4050 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

RATIONALE FOR DECISION

Implementation of the proposal would result in conferring a private benefit on a non-governmental entity at the expense of other private organizations. While the expense to an individual organization that would result from designating The Foundation Center as a depository might be minor, no assurance can be given that other depositories or libraries would not request a similar designation. The Service would be obligated to give equal consideration to all such requests. If several organizations were to be designated as depositories, the additional paperwork burden on affected private foundations will be increased to an unwarranted degree.

The principal public benefit accruing from implementation of the proposal is alleged to be quicker access to grant-maker information if the annual reports were sent directly to a depository. However, each Internal Revenue regional service center microfilms three copies of the annual reports, keeps one and sends the others to the Philadelphia Service Center and to the National Office Freedom of Information Reading Room. The microfiche cards must be shipped within thirty days of receipt of the report. The Service will provide photocopies from or film copies of these microfiche cards for a fee to any citizen who requests them. Allowing for delays in mailing and processing, annual reports of any foundation can be in the hands of interested parties within 60 days of the time they are filed. Direct filing of these reports with a depository would not speed up this process sufficiently to provide an appreciable public benefit.

Section 6652(d)(3) of the Code requires a penalty to be assessed against any organization that does not meet the filing requirements of section 6056. This penalty would apply to failure to file with a designated depository. Enforcement of this provision would be impractical in the light of the funds available to the Service for handling exempt organization matters.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive appearing in the Federal Register for Wednesday, November 8, 1978.

JEROME KURTZ,
Commissioner of
Internal Revenue.

(Filed by the Office of the Federal Register on February 14, 1980, 8:45 a.m., and published in the issue of the Federal Register for February 15, 1980, 45 F.R. 10501)

Part IV. Items of General Interest

Disaster Areas

Announcement 80-28

The President of the United States has determined that the areas listed below were adversely affected by disasters of sufficient severity and magnitude to warrant Federal disaster assistance.

Taxpayers who suffered losses in these areas as a result of these disasters may elect the special tax treatment provided under section 165(h) of the Internal Revenue Code of 1954. Section 1.165-11 of the Income Tax Regulations sets forth the procedure for making this election. Losses not incurred with respect to a trade or business or any transaction entered into for profit will not qualify for treatment under section 165(h) unless such losses qualify as casualty losses.

State: California

Areas affected: Webb and Holland Tracts in Contra Costa County for emergency repair work to damaged levees and subsequent dewatering of inundated tracts

Type of disaster: Torrential rains, high tides and strong winds

Begun on or about: January 13, 1980

State: Hawaii

Counties affected: Maui

Type of disaster: Severe storms, high surf and flooding

Begun on or about: January 7-16, 1980

Extension of Election to Deduct the Costs of Removing Architectural and Transportation Barriers to the Handicapped and Elderly

Announcement 80-29

Public Law 96-167 [1980-5 I.R.B. 12], extends the period for electing to deduct, rather than capitalize, the costs of removing architectural and transportation barriers to the handicapped and elderly (as described under section 190 of the Internal Revenue Code). Before the extension, the election to deduct these costs could be made for taxable years beginning after December 31, 1976 and before January 1, 1980. Now, the election may be made for taxable years beginning after December 31, 1976 and before January 1, 1983.

The election is made by identifying the deduction as a separate item on the taxpayer's income tax return for the taxable year. For the election to be valid, the return must be filed no later than the time (including any extensions) prescribed by law for filing the return.

Forms 3921, 3922, and 4629 Will Be Obsolete

Announcement 80-30

Public Law 96-167 [1980-5 I.R.B. 12], enacted December 29, 1979, repealed the statutory requirement for filing Form 3921, Exercise of a Qualified or Restricted Stock Option, and Form 3922, Transfer of Stock Acquired by Certain Options, effective for calendar years beginning after 1979. It also repealed the statutory requirement for filing Form 4629, Transfer of Property to an Exempt Organization, for transfers taking place after December 29, 1979. Therefore, Forms 3921, 3922, and 4629 will be obsolete for transactions occurring after the above effective dates.

12⅛ Percent Treasury Notes of Series Z-1981

10⅜ Percent Treasury Notes of Series C-1985

11⅜ Percent Treasury Notes of Series AB-1981

10½ Percent Treasury Notes of Series H-1983

Announcement 79-31

The Secretary of the Treasury announced the offering of Treasury Notes as follows:

Treasury Department Circular, Public Debt Series 28-79, dated November 14, 1979, and published in the Federal Register for November 19, 1979, 44 F.R. 66274, and the supplement published in the Federal Register for November 28, 1979, 44 F.R. 68058; 12⅛ percent Treasury Notes of November 30, 1981, Series Z-1981.

Treasury Department Circular, Public Debt Series 29-79, dated November 21, 1979, and published in the Federal Register for November 26, 1979, 44 F.R. 67556, and the supplement published in the Federal Register for December 4, 1979, 44 F.R. 69755; 10⅜ percent Treasury Notes of May 15, 1985, Series C-1985.

Treasury Department Circular, Public Debt Series 30-79, dated December 13, 1979, and published in the Federal Register for December 18, 1979, 44 F.R. 74957, and the supplement published in the Federal Register for December 27, 1979, 44 F.R. 76614; 11⅜ percent Treasury Notes of December 31, 1981, Series AB-1981.

Treasury Department Circular, Public Debt Series 31-79, dated December 13, 1979, and published in the Federal Register for December 18, 1979, 44 F.R. 74959, and the supplement published in the Federal Register for December 28, 1979, 44 F.R. 76903; 10½ percent Treasury Notes of December 31, 1983, Series H-1983.

The income derived from the notes is subject to all taxes imposed by the Internal Revenue Code of 1954. The notes are subject to estate, inheritance, gift, or other excise taxes whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, any possession of the United States, or any local taxing authority.

The notes will be acceptable to secure deposits of public moneys. They will not be acceptable in payment of taxes.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants and Enrolled Agents from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following person has been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Albert J. Kendall	Wyncote, PA	Attorney	Four months effective January 7, 1980

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from further practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants or enrolled agents to practice before the Internal Revenue Service.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant or enrolled agent so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and hearing before the administrative law judge, the following person was disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
Roy W. Hunt	Redwood City, CA	Certified Public Accountant	January 14, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.401-2, 1.403(b)-1, 1.405-1, amended; 1.401-8A redesignated 1.401-8 and as redesignated amended; 1.401-8 redesignated 1.401(f)-1 and as redesignated amended; 1.401(a)-1, 1.401(a)-2, 1.401(a)-16, 1.415-1 through 1.415-10 added.	Limitations on benefits and contributions under qualified plans.	Jan. 24, 1980	Apr. 23, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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Key to Abbreviations:

RR	Revenue Ruling
RP	Revenue Procedure
TD	Treasury Decision
CD	Court Decision
PL	Public Law
EO	Executive Order
DO	Delegation Order
TDO	Treasury Department Order
TC	Tax Convention
SPR	Statement of Procedural Rules
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1939–1–1	8.25
1939–1–2	10.90
1939–2	9.40
1940–1	5.55
1940–2	14.00
1941–1	*$6.95*
1941–2	*3.55*
1942–1	7.25
1942–2	*5.55*
1943(*)	*9.55*
1944(*)	*7.85*
1945(*)	9.40
1946–1	*2.55*
1946–2	5.20
1947–1	*1.80*
1947–2	3.40
1948–1	*3.15*
1948–2	7.50
1949–1	*6.90*
1949–2	*2.80*
1950–1	6.35
1950–2	*4.70*
1951–1	*2.65*
1951–2	*5.05*
1952–1	*2.55*
1952–2	7.05
1953–1	*4.25*
1953–2	12.00
1954–1	12.00
1954–2	12.00
1955–1	10.25
1955–2	13.00
1956–1	15.00
1956–2	18.00
1957–1	$10.10
1957–2	13.00
1958–1	9.60
1958–2	13.00
1958–3	15.00
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1960–1	9.00
1960–2	11.50
1961–1	14.00
1961–2	10.00
1962–1	6.20
1962–2	7.15
1962–3	15.00
1963–1	9.00
1963–2	10.75
1964–1–1	10.00
1964–1–2	11.00
1964–2	9.80
1965–1	10.70
1965–2	12.25
1966–1	9.25
1966–2	14.05
1967–1	10.00
1967–2	10.00
1968–1	14.00
1968–2	11.75
1969–1	7.50
1969–2	6.50
1969–3	$12.50
1970–1	11.00
1970–2	14.00
1971–1	10.55
1971–2	8.50
1972–1	13.50
1972–2	13.70
1973–1	13.20
1973–2	8.30
1974–1	11.00
1974–2	9.95
1974–3	*8.20*
1974–3 Supp.	10.00
1975–1	13.25
1975–2	13.00
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1976–2	10.25
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1976–3–2	16.00
1976–3–3	10.00
1977–1	10.75
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March 10, 1980
Bulletin No. 1980-10

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9258

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-60, page 5.
Accounting methods; change; inventory write-down. Taxpayers using a method of inventory valuation for "excess" inventory that is not in accordance with the method prescribed in the regulations must change their method of accounting to such prescribed method for their first taxable year ending on or after December 25, 1979.

Rev. Rul. 80-64, page 9.
Income source; U.S. outer continental shelf; exploratory drilling. Income derived by a foreign corporation from exploratory drilling in the outer continental shelf of the U.S. is income from sources within the U.S. for purposes of section 861 of the Code and is not excludable from gross income under section 883(a).

Rev. Rul. 80-65, page 10.
Casualty loss; condemnation award; business property. The application and interaction of sections 1033 and 165 of the Code explained in Rev. Rul. 74-206 with respect to residential property are applicable to property held in a trade or business within the meaning of section 1231(b). Reimbursement attributable to the first $100 of a casualty loss that is not an allowable deduction and that did not give rise to a tax benefit is not includible in gross income. Rev. Rul. 74-206 amplified and clarified.

Rev. Proc. 80-5, page 15.
Accounting methods; change; inventory write-down. A procedure is provided for taxpayers to change their method of accounting for "excess" inventory pursuant to the decision of the Supreme Court in *Thor Power Tool Co. v. Commissioner.* This procedure is mandatory for the first taxable year ending on or after December 25, 1979.

T.D. 7668, page 8.
Temporary regulations under section 856(e) of the Code relate to extension of the 2-year grace period with respect to foreclosure property held by a real estate investment trust.

EXEMPT ORGANIZATIONS

Rev. Rul. 80-63, page 7.
Homeowners' associations. Answers are provided to specific questions as to whether the conduct of certain activities will affect the exempt status under section 501(c)(4) of the Code of otherwise qualifying homeowners' associations; Rev. Rul. 74-99 clarified.

Announcement 80-32, page 25.
A listing is given of organizations now classified as private foundations.

ESTATE TAX

Rev. Rul. 80-66, page 10.
Charitable deduction; residuary estate; state inheritance taxes. A decedent's will created a trust giving an individual a lifetime income interest and a testamentary general power of appointment over

(Continued on page 4)

Finding List on page 30.
Announcement of Disbarments and Suspensions on page 28.
Announcement of Notice of Proposed Rulemaking on page 29.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part includes rulings and decisions based on Subpart A, Tax Conventions and related Treasury Decisions and Revenue Rulings; Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of Revenue Rulings, Revenue Procedures, and other published items, and (3) topical Indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

ESTATE TAX—Cont'd

the corpus. Failure to exercise the power of appointment would cause the trust corpus to pass to a charity described in section 2055(a) of the Code. State law exempts property passing to such charities from inheritance taxes and taxes the estate of the creator of a power of appointment upon the exercise of the power. A charitable deduction for the residue of the estate passing to the same charity is not reduced by the hypothetical state inheritance taxes that would be imposed upon the exercise of the power, if the donee of the power dies before exercising the power and before the due date for filing the estate tax return.

EMPLOYMENT TAXES

Rev. Rul. 80-67, page 11.
Wages; domestic services; noncash remuneration. Noncash remuneration paid for domestic services in a private home is not wages under section 3306 (b) of the Code. However, noncash remuneration paid for domestic services in a local college club or local chapter of a college fraternity or sorority is wages under section 3306(b).

ADMINISTRATIVE

Rev. Rul. 80-68, page 12.
Withholding; false Form W-4 information. An employer must request another Form W-4 Employee's Withholding Allowance Certificate, from an employee who indicates, other than on Form W-4, on or before the date on which the employee furnishes a Form W-4 to the employer, that the name, address, social security number, or number of exemptions shown on the employee's Form W-4 is false. If the employee fails to provide a valid Form W-4, the employer must withhold income tax from the employee as from a single person claiming no exemptions.

Rev. Proc. 80-8, page 18.
Magnetic tape reporting for Forms W-4. Procedures provide the requirements and conditions for employers who desire to submit Forms W-4, Employee's Withholding Allowance Certificates, on magnetic tape for employees who claim 10 or more withholding allowances or claim exempt status and usually earn more than $200 a week at the time the Form W-4 is filed.

Del. Order No. 4 (Rev. 10), page 13.
Summonses; examinations. The authority to serve summonses, examine books and records, take testimony under oath, and set the time and place for examinations is delegated to various officers and employees of the Service; Del. Order No. 4 (Rev. 9) superseded.

Del. Order No. 152 (Rev. 1), page 14.
Collections from delinquent Internal Revenue officers and employees. Authority has been delegated to the Service Center Directors to take collection action with respect to amounts due from officers and employees of the Service who fail to account for any pay over any amount collected in connection with internal revenue laws; Del. Order No. 152 superseded.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 165.—Losses

26 CFR 1.165-1: Losses.

Whether the principles set forth in Rev. Rul. 74-206, 1974-1 C.B. 198, with respect to residential property are equally applicable to property held in a trade or business within the meaning of section 1231(b) of the Code. See Rev. Rul. 80-65, page 10.

Section 446.—General Rule for Methods of Accounting

26 CFR 1.446-1: General rule for methods of accounting.
(Also Sections 471, 481, 6011; 1.471-2, 1.471-4, 1.481-1.)

Accounting methods; change; inventory write-down. Taxpayers using a method of inventory valuation for "excess" inventory that is not in accordance with the method prescribed in the regulations must change their method of accounting to such prescribed method for their first taxable year ending on or after December 25, 1979.

Rev. Rul. 80-60 [1]

ISSUE

Whether a taxpayer using a method of inventory valuation for "excess" inventory that is not in accordance with the Income Tax Regulations must change its method of accounting to a method permitted by the regulations, pursuant to the decision of the Supreme Court of the United States in *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522 (1979), 1979-1 C.B. 167.

FACTS

In the *Thor Power* case, the taxpayer used the "lower of cost or market" method of valuing inventories for both financial accounting and for income tax purposes. See section 1.471-4 of the regulations. The taxpayer wrote down what it regarded as "excess" inventory to its net realizable value which, in most cases, was determined to be scrap value. The taxpayer determined that these articles were "excess" inventory because they were held in excess of any reasonably foreseeable future demand although such inventory was not scrapped or sold at reduced prices. The taxpayer retained the excess items in inventory and continued to sell them at original prices. The taxpayer contended that by writing down "excess" inventory to scrap value, it thereby reduced its inventory to "market" (net realizable value) in accord with its "lower of cost or market" method of accounting. The Commissioner of Internal Revenue disallowed this write-down. (The taxpayer also wrote down the cost of inventory that was either promptly scrapped or actually sold at reduced prices below cost. The Commissioner allowed these write-downs.)

The Supreme Court in *Thor Power* stated that sections 446 and 471 of the Internal Revenue Code vests the Commissioner with wide discretion in determining whether a particular method of inventory accounting should be disallowed as not clearly reflecting income. The Court affirmed the lower court's decision, sustaining the Commissioner, that although the taxpayer's write-down of excess inventory did conform to the best accounting practice in the trade or business and thus satisfied the first test of section 1.471-2(a) of the regulations, it failed to satisfy the second test of section 1.471-2(a), that it clearly reflect the taxpayer's income. The Court stated that where a taxpayer, under the "lower of cost or market" method of accounting, values its inventory for tax purposes at "market" (replacement cost), the taxpayer is permitted to depart from replacement cost only in specified situations described in sections 1.471-2(c) and 1.471-4(b) of the regulations. When such a departure to a lower inventory valuation is made, the regulations require that it be substantiated by objective evidence of actual offerings, sales, or contract cancellations and further require that records of actual dispositions be kept. The Court concluded that because the taxpayer provided no objective evidence of the reduced market value of its excess inventory, its write-down was plainly inconsistent with the regulations and was properly disallowed by the Commissioner. The taxpayer could not have properly taken advantage of any permitted write-downs since it did not scrap its "excess" inventory nor sell or offer it for sale at prices below replacement cost.

The *Thor Power* case affirmed the method of accounting for inventory valuation established under the income tax regulations where the lower of cost or market method is applicable. In using the lower of cost or market method the regulations require a taxpayer having "excess" inventory to value such "excess" inventory at replacement cost (if lower than actual cost as defined in section 1.471-4 of the regulations) unless the goods have been scrapped, or they have been sold or offered for sale (at a lower price) within the meaning of the regulations under section 471 of the Code. (The "prescribed method.")

In Rev. Proc. 80-5, page 15, this Bulletin, the Commissioner has granted consent for taxpayers to change from a method of accounting for inventory valuation of "excess" inventory, that is not in accordance with the "prescribed method," to such "prescribed method." The Commissioner's consent is applicable for the taxpayer's first taxable year ending on or after December 25, 1979. In order to implement the decision of the Supreme Court and under the authority contained in section 1.446-1(e)(3)(ii) of the regulations, the Commissioner has prescribed certain procedures with respect to the change in method of accounting including a provision that will allow taxpayers to treat the change in method either as a change initiated by the taxpayer or as a change *not* initiated by the taxpayer.

LAW

Section 446(e) of the Code and section 1.446-1(e)(2)(i) of the regulations state that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446-1(e)(3)(i) provides, in relevant part, that except as otherwise provided in subdivision (ii), in order to secure the Commissioner's consent, the taxpayer must file an application on Form 3115 with the National Office within 180 days after the beginning of the taxable year in which the taxpayer desires to make the change. Subdivision (ii) provides that notwithstanding subdivision (i), the Commissioner may prescribe administrative procedures, subject to such limitations, terms, and conditions as he deems necessary to obtain his consent, to permit taxpayers to change their accounting methods to an acceptable method consistent with applicable regulations.

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[1] Also released in News Release IR-80-19, dated February 8, 1980.

Section 481(a) of the Code provides, in part, that if a taxpayer's taxable income for any taxable year is computed under a method of accounting different from the method used for the preceding taxable year, then there shall be taken into account those adjustments which are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted. Section 481(c) provides that in the case of any change described in subsection (a), the taxpayer may, in such manner and subject to such conditions as the Secretary may by regulations prescribe, take the adjustments required by subsection (a)(2) into account in computing the tax for the taxable year or years permitted under such regulations.

Section 6011 of the Code provides that any person made liable for any tax imposed by this title, or for the collection thereof, shall make a return or statement according to the forms or regulations prescribed by the Secretary.

ANALYSIS

The requirement to secure the Commissioner's consent before changing a method of accounting was first required in 1919 by Section 212, Article 23, Regualtion 45 (T.D. 2873, 1 C.B. 58). Similar regulations were contained under the 1939 Code in regulation 118, section 39.41. These regulations were then codified in section 446(e) of the 1954 Code. The Senate Finance Committee expressly stated that section 446(e) was added to "codify existing regulations" (S. Rep. No. 1622, 83rd Cong., 2d Sess. 300 (1954)). The purpose of the regulations and the subsequent enactment of section 446(e) was to provide the Commissioner with the authority to monitor changes in method of accounting; to insure that no duplication or omission of items of income or expense resulted; and to allow the Commissioner to obtain agreement from the taxpayer as to the terms and conditions under which the change would be effected. At the same time section 446(e) was enacted, section 481 was also enacted to take into account those adjustments which are determined to be necessary solely by reason of the change in method of accounting.

In the *Thor Power* case, the Supreme Court determined that the method of inventory valuation did not clearly reflect income and, accordingly, was impermissible. Taxpayers and the Commissioner are bound by the decisions of the Supreme Court. Therefore, any taxpayer that is using a method of accounting of inventory valuation for writing down "excess" inventory that is not in accordance with the "prescribed method" must change such method of accounting to the "prescribed method." Consent under section 446(e) is required prior to a change in method of accounting. In Rev. Proc. 80-5 the Commissioner has granted advance consent for taxpayers who are using a method of inventory valuation of "excess" inventory that is not in accordance with the "prescribed method," to change to the "prescribed method" for the taxpayer's first taxable year ending on or after December 25, 1979. Therefore, section 446(e) does not prevent a taxpayer who is not using the "prescribed method" to change on the taxpayer's federal income tax return for the first taxable year ending on or after December 25, 1979, to the "prescribed method."

Taxpayers have an obligation to file returns prepared in accordance with appropriate laws and regulations; income tax return preparers are subject to a similar obligation in preparing returns. Therefore, if a taxpayer files a Federal income tax return not using the "prescribed method" of inventory valuation the taxpayer will have filed a return not in accordance with the law.

HOLDING

A taxpayer using a method of inventory valuation for "excess" inventory that is not in accordance with the "prescribed method" must change its method of accounting to such method for its first taxable year ending on or after December 25, 1979.

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26 CFR 1.446-1: General rule for methods of accounting.

Procedures for taxpayers that must change their methods of accounting in order to comply with the decision of the Supreme Court of the United States in *Thor Power Tool Co. v. Commissioner*, 435 U.S. 914 (1979), 1979-1 C.B. 167. See Rev. Proc. 80-5, page 15.

Section 471.—General Rule for Inventories

26 CFR 1.471-2: Valuation of inventories.

Procedures for taxpayers that must change their methods of accounting in order to comply with the decision of the Supreme Court of the United States in *Thor Power Tool Co. v. Commissioner*, 435 U.S. 914 (1979), 1979-1 C.B. 167. See Rev. Proc. 80-5, page 15.

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26 CFR 1.471-2: Valuation of inventories.

Whether a taxpayer using a method of inventory valuation for "excess" inventory that is not in accordance with the Income Tax Regulations must change its method of accounting to a method permitted by the regulations, pursuant to the decision of the Supreme Court of the United States in *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522 (1979), 1979-1 C.B. 167. See Rev. Rul. 80-60, page 5.

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26 CFR 1.471-4: Inventories at cost or market, whichever is lower.

Whether a taxpayer using a method of inventory valuation for "excess" inventory that is not in accordance with the Income Tax Regulations must change its method of accounting to a method permitted by the regulations, pursuant to the decision of the Supreme Court of the United States in *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522 (1979), 1979-1 C.B. 167. See Rev. Rul. 80-60, page 5.

Section 481.—Adjustments Required by Changes in Method of Accounting

26 CFR 1.481-1: Adjustments in general.

Procedures for taxpayers that must change their methods of accounting in order to comply with the decision of the Supreme Court of the United States in *Thor Power Tool Co. v. Commissioner*, 435 U.S. 914 (1979), 1979-1 C.B. 167. See Rev. Proc. 80-5, page 15.

26 CFR 1.481-1: Adjustments in general.

Whether a taxpayer using a method of inventory valuation for "excess" inventory that is not in accordance with the Income Tax Regulations must change its method of accounting to a method permitted by the regulations, pursuant to the decision of the Supreme Court of the United States in *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522 (1979), 1979-1 C.B. 167. See Rev. Rul. 80-60, page 5.

Section 501.—Exemption from Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(c)(4)-1: Civic organizations and local associations of employees.
(Also 1.501(c)(7)-1.)

Homeowners' associations. Answers are provided to specific questions as to whether the conduct of certain activities will affect the exempt status under section 501(c)(4) of the Code of otherwise qualifying homeowners' associations; Rev. Rul. 74-99 clarified.

Rev. Rul. 80-63

The Internal Revenue Service has received several inquiries asking whether the conduct of certain activities will affect the exempt status under section 501(c)(4) of the Internal Revenue Code of otherwise qualified homeowners' associations.

Section 501(c)(4) of the Code provides for exemption from federal income tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(a)(2)(i) of the Income Tax Regulations provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated for the purpose of bringing about civic betterments and social improvements.

Rev. Rul. 72-102, 1972-1 C.B. 149, holds that certain nonprofit organizations of a type usually called homeowners' associations, which are formed to administer and enforce covenants for preserving the architecture and appearance of a housing development and to maintain streets, sidewalks, and other non-residential, non-commercial properties in the development of the type normally owned and maintained by a municipal government, may qualify for exemption under section 501(c)(4) of the Code.

Rev. Rul. 74-99, 1974-1 C.B. 131, modified Rev. Rul. 72-102, to make clear that a homeowners' association of the kind described in Rev. Rul. 72-102 must, in addition to otherwise qualifying for exemption under section 501(c)(4) of the Code, satisfy the following requirements: (1) It must engage in activities that confer benefit on a community comprising a geographical unit which bears a reasonably recognizable relationship to an area ordinarily identified as a governmental subdivision or a unit or district thereof; (2) It must not conduct activities directed to the exterior maintenance of private residences; and (3) It owns and maintains only common areas or facilities such as roadways and parklands, sidewalks and street lights, access to, or the use and enjoyment of which is extended to members of the general public and is not restricted to members of the homeowners' association.

Specific questions that have been raised and their answers are as follows:

Question 1.

Does Rev. Rul. 74-99 contemplate that the term "community" for purposes of section 501(c)(4) of the Code embraces a minimum area or a certain number of howeowners?

Answer:

No. Rev. Rul. 74-99 states that it was not possible to formulate a precise definition of the term "community". The ruling merely indicates what the term is generally understood to mean. Whether a particular homeowners' association meets the requirements of conferring benefit on a community must be determined according to the facts and circumstances of the individual case. Thus, although the area represented by an association may not be a community within the meaning of that term as contemplated by Rev. Rul. 74-99, if the association's activities benefit a community, it may still qualify for exemption. For instance, if the association owns and maintains common areas and facilities for the use and enjoyment of the general public as distinguished from areas and facilities whose use and enjoyment is controlled and restricted to members of the association then it may satisfy the requirement of serving a community.

Question 2.

May a homeowners' association, which represents an area that is not a community, qualify for exemption under section 501(c)(4) of the Code if it restricts the use of its recreational facilities, such as swimming pools, tennis courts, and picnic areas, to members of the association?

Answer:

No. Rev. Rul. 74-99 points out that the use and enjoyment of the common areas owned and maintained by a homeowners' association must be extended to members of the general public, as distinguished from controlled use or access restricted to the members of the association. For purposes of Rev. Rul. 74-99, recreational facilities are included in the definition of "common areas".

Question 3.

Can a homeowners' association establish a separate organization to own and maintain recreational facilities and restrict their use to members of the association?

Answer:

Yes. An affiliated recreational organization that is operated totally separate from the howeowners' association may be exempt. See Rev. Rul. 69-281, 1969-1 C.B. 155, which holds that a social club providing exclusive and automatic membership to homeowners in a housing development, with no part of its earnings inuring to the benefit of any member, may qualify for exemption under section 501(c)(7) of the Code.

Question 4.

Can an exempt homeowners' association own and maintain parking facilities only for its members if it represents an area that is not a community?

Answer:

No. By providing these facilities only for the use of its members the association is operating for the private benefit of its members, and not for the promotion of social welfare within the meaning of section 501(c)(4) of the Code.

Rev. Rul. 74-99 is clarified.

26 CFR 1.501(c)(7)-1: Social clubs.

Whether the separate organization that is established by a homeowners' association to own and maintain recreational facilities and that restricts their use to members of the association may qualify for exemption under section 501(c)(7) of the Code. See Rev. Rul. 80-63, page 7.

Section 638.—Continental Shelf Areas

26 CFR 1.638-1: Continental shelf areas.

Whether income derived from exploratory drilling in the outer continental shelf of the United States is income from sources within the United States for purposes of section 861 of the Code. See Rev. Rul. 80-64, page 9.

Section 856.—Definition of Real Estate Investment Trust

26 CFR 10.3: Extension of 2-year grace period with respect to foreclosure property held by a real estate investment trust.

T.D. 7668

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 10.—TEMPORARY INCOME TAX REGULATIONS UNDER PUBLIC LAW 93-625

Extension of 2-year grace period with respect to foreclosure property held by a real estate investment trust

AGENCY: Internal Revenue Service, Treasury.

ACTION: Amendment of Temporary Regulations.

SUMMARY: This document amends temporary income tax regulations that apply to an extension of the grace period for foreclosure property held by a real estate investment trust (REIT). Changes in the applicable law were made by the Revenue Act of 1978, Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, (the 1978 Act).

DATES: The amendment applies to certain foreclosure property the grace period (including extensions) for which expires after December 31, 1977. The amendment extends the deadline for filing certain requests for an extension of the grace period until March 28, 1980.

FOR FURTHER INFORMATION CONTACT: Charles M. Whedbee of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (202-566-3487, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

Section 856(e)(3) of the Code provides rules for extensions of the 2-year grace period for foreclosure property held by a REIT. Before amendment by the 1978 Act, section 856(e)(3) provided that the Secretary or his delegate could grant a REIT no more than two extensions, neither of which could exceed 1 year. The 1978 Act amended section 856(e)(3) to allow any number of extensions, subject to the limitation that the grace period cannot be extended beyond the date that is 6 years after the REIT acquired the property. The amendment to the regulations made by this document makes clear that the 1978 Act amendment is effective for extensions granted after November 6, 1978, with respect to extension periods beginning after December 31, 1977.

Section 10.3 of the Income Tax Regulations (temporary regulations containing rules for extensions of the grace period) provides that, in general, a request for an extension must be filed more than 60 days before the date the grace period would otherwise expire. The 1978 Act amendment to section 856(e)(3), however, in effect allows a retroactive additional extension of grace periods that could not be extended beyond November 6, 1978, under prior law. Accordingly, this document provides an exception to the general filing deadline for REITs that would have been barred from being granted an extension by the limitation on the number and length of extensions in section 856(e)(3), as in effect before the 1978 Act. The extended filing period under this exception expires on March 28, 1980.

DRAFTING INFORMATION

The principal author of this regulation is Charles M. Whedbee of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

WAIVER OF CERTAIN PROCEDURAL REQUIREMENTS OF FINAL TREASURY DIRECTIVE

A determination has been made by Jerome Kurtz, Commissioner of Internal Revenue, that there is need for immediate guidance in order to make clear that the amendment to section 856(e)(3) of the Code made by section 363(c) of the Revenue Act of 1978 allows real estate investment trusts to be granted extensions of certain foreclosure property grace periods that could not have been extended under prior law and would otherwise expire after December 31, 1977. Because of the immediate need for this regulation, compliance with the procedural requirements of paragraphs 8 through 14 of the final Treasury directive (43 FR 52121), relating to improving regulations, would be impractical and, therefore, these requirements have not been followed.

Adoption of amendment to the regulations

Accordingly, section 10.3 of 26 CFR Part 10 is amended as follows:

1. The second sentence of paragraph (c)(1) is deleted and two new

sentences are inserted in lieu thereof, to read as set forth below.

2. Paragraph (d)(2) is revised to read as set forth below.

§ 10.3 Extension of 2-year grace period with respect to foreclosure property held by a real estate investment trust.

* * * * *

(c) *Extension of grace period*—(1) * * * In the case of extensions granted after November 6, 1978, with respect to extension periods beginning after December 31, 1977, the district director may grant one or more extensions of the grace period for the property, subject to the limitation that no extension shall extend the grace period beyond the date which is 6 years after the date the REIT acquired the property. In any other case, an extension shall be for a period of not more than 1 year, and not more than two such extensions shall be granted with respect to the property. * * *

* * * * *

(d) Time for requesting an extension of the grace period. * * *

(2) *Exceptions.* (i) In the case of a grace period which would otherwise expire before August 6, 1976, a request for an extension will be considered to be timely filed if filed on or before June 7, 1976.

(ii) In the case of an extension period beginning after December 31, 1977, a request for an extension filed on or before March 28, 1980 will be considered to be timely if the limitation on the number and length of extensions in section 856(e)(3), as in effect before the amendment made by section 363(c) of the Revenue Act of 1978, would have barred the extension.

* * * * *

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of Internal Revenue.

Approved January 8, 1980.

DONALD C. LUBICK,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on January 25, 1980, 8:45 a.m., and published in the issue of the Federal Register for January 28, 1980, 45 F.R. 6378)

Section 861.—Income from Sources within the United States

26 CFR 1.861-1: Income from sources within the United States.
(Also Sections 638, 883; 1.638-1, 1.883-1.)

Income source; U.S. outer continental shelf; exploratory drilling. Income derived by a foreign corporation from exploratory drilling in the outer continental shelf of the U.S. is income from sources within the U.S. for purposes of section 861 of the Code and is not excludable from gross income under section 883(a).

Rev. Rul. 80-64

ISSUES

(1) Is income derived from exploratory drilling in the outer continental shelf of the United States income from sources within the United States for purposes of section 861 of the Internal Revenue Code?

(2) Is this income excludable from gross income under section 883(a) of the Code?

FACTS

X, a corporation organized under the laws of foreign country *M*, was hired to perform a Continental Offshore Stratigraphic Test (COST) project in the outer continental shelf of the United States.

A COST project drills to get information about the soil conditions before an offshore lease transaction is entered into. The drilling is done to obtain core samples of the subsoil and not to develop or remove oil or gas.

X used a dynamic positioning drill ship to perform the COST project. The ship, which is documented under the laws of foreign country *M*, was chartered by *X* from *Z* corporation, and was operated by *X*'s employees. This type of ship does not anchor while on location. It floats above the seabed or subsoil except for the drill pipe and bit that penetrates the seabed and subsoil in drilling.

Foreign country *M* grants an exemption to United States citizens and corporations that is equivalent to the exemption provided by section 883(a) of the Code.

LAW AND ANALYSIS—ISSUE I

Section 861(a)(3) of the Code provides that compensation for labor or personal services performed in the United States is treated as gross income from sources within the United States.

Under sections 638 of the Code and 1.638-1(a)(1) of the Income Tax Regulations, for purposes of provisions dealing with the performance of personal services, including section 861(a)(3), with respect to mines, oil and gas wells, and other natural deposits the term "United States," when used in a geographical sense, includes the seabed and subsoil of the submarine areas adjacent to the territorial waters of the United States over which the United States has exclusive rights, in accordance with international law, with respect to the exploration for and exploitation of natural resources.

Section 1.638-1(c)(1) of the regulations provides that persons, property, or activities that are engaged in or related to the exploration for or exploitation of mines, oil and gas wells, or other natural deposits need not be physically upon, connected, or attached to the seabed or subsoil to be deemed to be within the United States.

In Example (5) of section 1.638-1(f) of the regulations, a ship chartered from a domestic corporation and operated by the domestic corporation's personnel, explored for oil in the continental shelf of foreign country *Y*. Foreign country *Y* exercises taxing jurisdiction with respect to the exploration for or exploitation of natural resources as provided in section 1.638-1(b). The ship is treated as being within foreign country *Y* under section 638 of the Code for the period it was exploring for oil in the foreign continental shelf.

Example (5) of section 1.638-1(f) of the regulations illustrates by analogy that section 638 of the Code extends United States taxing jurisdiction to a drill ship operating in the United States continental shelf even though the ship does not rest on, or is not anchored to, the seabed and does not penetrate the subsoil except to remove core samples.

LAW AND ANALYSIS—ISSUE 2

Section 883(a)(1) of the Code provides that earnings derived from the operation of a ship documented under the laws of a foreign country that grants an equivalent exemption to United States citizens and corporations is not included in the gross income of a foreign corporation. Section 883(a)(2) and (a)(3) grant this same exemption to earnings derived from the operation of aircraft and railroad rolling stock.

Although section 883(a) of the Code excludes from gross income earnings derived from several types of transportation activities, it does not extend to nontransportation activities such as those undertaken by *X*. In the present situation, *X*'s earnings were not derived from the "operation of a ship," as that phrase is used in section 883(a)(1), but rather from *X*'s exploratory drilling activities. See Rev. Rul. 74-170, 1974-1 C.B. 175, which concerns whether a taxpayer has earnings derived from the operation of a ship in four specific situations.

HOLDINGS

(1) Income derived from exploratory drilling in the outer continental shelf of the United States is income from sources within the United States for purposes of section 861 of the Code.

(2) This income is not excludable from gross income under section 883(a) of the Code.

Section 883.—Exclusions from Gross Income

26 CFR 1.883-1: Exclusions from gross income of foreign corporations.

Whether income derived from exploratory drilling in the outer continental shelf of the United States is excludable from gross income. See Rev. Rul. 80-64, page 9.

Section 1033.—Involuntary Conversions

26 CFR 1.1033(a)-1: Involuntary conversion; nonrecognition of gain.
(Also Sections 165, 1231; 1.165-1, 1.1231-1.)

Casualty loss; condemnation award; business property. The application and interaction of sections 1033 and 165 of the Code explained in Rev. Rul. 74-206 with respect to residential property are applicable to property held in a trade or business within the meaning of section 1231(b). Reimbursement attributable to the first $100 of a casualty loss that is not an allowable deduction and that did not give rise to a tax benefit is not includible in gross income. Rev. Rul. 74-206 amplified and clarified.

Rev. Rul. 80-65

ISSUE AND FACTS

The Internal Revenue Service has received inquiries as to whether the principles set forth in Rev. Rul. 74-206, 1974-1 C.B. 198, with respect to residential property are applicable to property held in a trade or business within the meaning of section 1231(b) of the Internal Revenue Code.

Rev. Rul. 74-206 explains the application and interaction of section 1033 of the Code, which relates to the nonrecognition of gain resulting from the involuntary conversion of property, and section 165, which relates to the allowance of casualty loss deductions, in a factual situation involving the destruction of a taxpayer's residence by a flood and its subsequent replacement.

HOLDING

The principles set forth in Rev. Rul. 74-206 with respect to residential property are equally applicable to property held in a trade or business within the meaning of section 1231(b) of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 74-206 is amplified.

Rev. Rul. 74-206 is also clarified t take into account the $100 limitatio provided in section 165(c)(3) of th Code on the amount of loss allowabl as a deduction with respect to losses o property not connected with a trade o business. Section 1.165-7(b)(4) of th Income Tax Regulations provides tha the deduction allowable for a loss tha is sustained in respect of property no used in a trade or business or for income producing purposes from a singl casualty shall be limited to that portio of the loss that is in excess of $100 that is, the first $100 is not allowabl as a deduction. Therefore, the reimbursement attributable to this amoun will not be taken into gross income because it did not give rise to a ta benefit.

Section 1231.—Property Used in a Trade or Business and Involuntary Conversions

26 CFR 1.1231-1: Gains and losses fron the sale or exchange of certain propert used in a trade or business.

Whether the principles set forth in Rev Rul. 74-206, 1974-1 C.B. 198, with respec to residential property are equally applicable to property held in a trade or busines within the meaning of section 1231(b) o the Code. See Rev. Rul. 80-65, above.

Section 2055.—Transfers for Public, Charitable, and Religious Uses

26 CFR 20.2055-2: Transfers not exclusively for charitable purposes.

Charitable deduction; residuar estate; state inheritance taxes. A decedent's will created a trust giving an individual a lifetime incom interest and a testamentary genera power of appointment over th corpus. Failure to exercise th power of appointment would caus the trust corpus to pass to a charit described in section 2055(a) of th Code. State law exempts propert passing to such charities from inheritance taxes and taxes the estat of the creator of a power of appointment upon the exercise of th power. A charitable deduction fo

the residue of the estate passing to the same charity is not reduced by the hypothetical state inheritance taxes that would be imposed upon the exercise of the power, if the donee of the power dies before exercising the power and before the due date for filing the state tax return.

Rev. Rul. 80-66

ISSUE

Is the amount of the charitable deduction allowable under section 2055 of the Internal Revenue Code reduced by the amount of state inheritance taxes that could have been imposed upon the exercise of a power of appointment over the assets in a trust and that would have been payable from the residue of the estate passing to charity, if the donee of the power dies before the due date for filing the federal estate tax return, without having exercised the power?

D, a resident of State *X*, died in 1978. *D*'s will provides for the creation of a trust, in which *A* has the right to all the income during life and a testamentary general power of appointment over the trust corpus. If *A* does not exercise the power of appointment, the trust corpus passes to *Y* Charity. The will also provides that the residue of the estate, after the payment of all debts, expenses and taxes arising by reason of *D*'s death, passes to *Y* Charity, an organization that meets the requirements of section 2055(a) of the Code and that is a qualified charitable organization under the law of State *X*.

Under the inheritance tax law of State *X*, property subject to a power of appointment is taxed only as a part of the estate of the person creating the power. The rate of tax is based on the classes of the persons who receive the property upon the donee's exercise or nonexercise of the power of appointment. Property passing to qualified charitable organizations is exempt from inheritance tax.

A died three months after *D*, and before the due date for filing *D*'s estate tax return. *A* did not exercise the testamentary power of appointment over the trust created by *D*'s will.

LAW AND ANALYSIS

Section 2055(a) of the Code provides that, for purposes of the estate tax, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of all bequests, legacies, devises, or transfers to or for the use of charity. Section 2055(a) also provides that if a power to consume, invade or appropriate property for the benefit of an individual is completely terminated by the death of the individual before the date prescribed for filing the decedent's estate tax return (including extensions granted under section 6081) and before such power has been exercised, the termination of the power shall be deemed to be a qualified disclaimer with the same force and effect as though the individual had filed such a disclaimer. *See* section 20.2055-2(c)(2) of the Estate Tax Regulations.

Section 2055(c) of the Code provides that the amount of the charitable deduction shall be reduced by the inheritance taxes which are required to be paid out of the bequests, legacies, or devises passing to charity.

In the present situation, *A* died without having exercised the power of appointment over the trust created by *D*'s will. *A*'s death operates to terminate *A*'s power to appoint the trust corpus. Such a termination prior to the due date for filing *D*'s estate tax return is deemed to be a qualified disclaimer under section 2055(a). Because the power is deemed disclaimed for purposes of section 2055(a) and, under the laws of State *X*, no inheritance tax will be imposed on the trust corpus, the amount of the charitable deduction is not reduced by the maximum hypothetical state inheritance tax that would have been imposed, if *A* had exercised the power of appointment. See *Farmers Trust Company v. United States,* 458 F. Supp. 94 (M.D. Pa. 1978).

The present situation is distinguishable from the situations presented in *Brook's Estate v. Commissioner,* 250 F.2d 937 (3rd Cir. 1958), and *Connecticut Bank and Trust Company v. United States,* 439 F.2d 931 (2nd Cir. 1971), in which the holders of the powers of appointment were living on the date the estate tax returns were due. In each case, the amount of the charitable deduction was reduced by the maximum amount of state inheritance taxes that could be imposed upon the exercise of the power of appointment and that would be payable from the property otherwise passing to charity.

HOLDING

The charitable deduction allowable for the residue of the estate is not reduced by the hypothetical state inheritance taxes that would be imposed upon the exercise of a power of appointment over trust property, if the donee of the power dies before the due date for filing the decedent's estate tax return, without having exercised the power.

Section 3306.—Definitions [Federal Unemployment Tax Act]

26 CFR 31.3306(a)-1: Who are employers.

Whether individuals who hire people to perform domestic services are employers. See Rev. Rul. 80-67, below.

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26 CFR 31.3306(b)-1: Wages.
(Also 31.3306(a)-1, 31.3306(c)(2)-1.)

Wages; domestic services; noncash remuneration. Noncash remuneration paid for domestic services in a private home is not wages under section 3306(b) of the Code. However, noncash remuneration paid for domestic services in a local college club or local chapter of a college fraternity or sorority is wages under section 3306(b).

Rev. Rul. 80-67

Noncash remuneration paid for domestic services in a private home is not wages under section 3306(b) of the Internal Revenue Code. However, noncash remuneration paid for domestic service in a local college club, or local chapter of a college fraternity or sorority, is wages under section 3306(b). See Rev. Rul. 55-631, 1955-2 C.B. 619 for the similar treatment of noncash remuneration for domestic services under the predecessor to section 3121(a) of the Code.

26 CFR 31.3306(c)(2)-1: Domestic service.

Whether domestic services are employment. See Rev. Rul. 80-67, page 11.

Section 3402.—Income Tax Collected at Source

26 CFR 31.3402(b)-1: Percentage method of withholding.

Requirements and conditions for the submission of Forms W-4, Employee's Withholding Allowance Certificate, on magnetic tape. See Rev. Proc. 80-8, page 18.

26 CFR 31.3402(f)(2)-1: Withholding exemption certificates.

Withholding; false Form W-4 information. An employer must request another Form W-4, Employee's Withholding Allowance Certificate, from an employee who indicates, other than on Form W-4, on or before the date on which the employee furnishes a Form W-4 to the employer, that the name, address, social security number, or number of exemptions shown on the employee's Form W-4 is false. If the employee fails to provide a valid Form W-4, the employer must withhold income tax from the employee as from a single person claiming no exemptions.

Rev. Rul. 80-68

ISSUE

What is an employer's obligation if an employee indicates that the name, address, social security number, or the number of exemptions shown on his or her Form W-4, Employee's Withholding Allowance Certificate, is false where such indication is not on the Form W-4 itself?

LAW AND ANALYSIS

Section 3402(f)(2)(A) of the Code provides that on or before the date of commencement of employment with an employer, the employee shall furnish the employer with a signed withholding exemption certificate relating to the number of withholding exemptions which the employee claims, which shall in no event exceed the number to which the employee is entitled.

Section 31.3402(f)(2)-1(e) of the Employment Tax Regulations provides that a withholding exemption certificate is invalid if the employee clearly indicates it to be false by an oral statement or a written statement (other than one made on the certificate itself) made to the employer on or before the date on which the employee furnishes the certificate. It also provides that, if the employer receives an invalid certificate and the employee does not subsequently submit a valid certificate, the employer must withhold from the employee as from a single person claiming no exemptions for withholding purposes.

HOLDING

If on or before the date on which an employee furnishes a Form W-4 to his or her employer, the employee indicates to the employer, other than on the Form W-4 itself, that the name, address, social security number, or the number of exemptions shown on the Form W-4 is false, the Form W-4 is invalid. Therefore, the employer must request another Form W-4 from the employee, and if the employee fails to provide a valid Form W-4, the employer must withhold from the employee as from a single person claiming no exemptions.

26 CFR 31.3402(f)(5)-1: Form and contents of withholding exemption certificates.

Requirements and conditions for the submission of Forms W-4, Employee's Withholding Allowance Certificates, on magnetic tape. See Rev. Proc. 80-8, page 18.

26 CFR 31.3402(h)(4)-1: Other methods.

Requirements and conditions for the submission of Forms W-4, Employee's Withholding Allowance Certificate, on magnetic tape. See Rev. Proc. 80-8, page 18.

26 CFR 31.3402(p)-1: Voluntary withholding agreements.

Requirements and conditions for the submission of Forms W-4, Employee's Withholding Allowance Certificate, on magnetic tape. See Rev. Proc. 80-8, page 18.

Section 6001.—Notice or Regulations Requiring Records, Statements, and Special Returns

26 CFR 31.6001-5: Additional records in connection with collection of income tax at source on wages.

Requirements and conditions for the submission of Forms W-4, Employee's Withholding Allowance Certificate, on magnetic tape. See Rev. Proc. 80-8, page 18.

Section 6011.—General Requirement of Return, Statement, or List

Whether a taxpayer using a method of inventory valuation for "excess" inventory that is not in accordance with the Income Tax Regulations must change its method of accounting to a method permitted by the regulations, pursuant to the decision of the Supreme Court of the United States in *Thor Power Tool Co. v. Commissioner*, 439 U.S. 522 (1979), 1979-1 C.B. 167. See Rev. Rul. 80-60, page 5.

Section 6361.—General Rules

26 CFR 31.6361-1: Collection and administration of qualified State individual income taxes.

Requirements and conditions for the submission of Forms W-4, Employee's Withholding Allowance Certificate, on magnetic tape. See Rev. Proc. 80-8, page 18.

Part III. Administrative, Procedural, and Miscellaneous

Delegation Order No. 4 (Rev. 10) (Effective February 1, 1980)

Authority to Issue Summonses, to Administer Oaths and Certify, and to Perform Other Functions

1(a). The authorities granted to the Commissioner of Internal Revenue by 26 CFR 301.7602-1(b), 301.7603-1, 301.7604-1 and 301.7605-1(a) and the authorities contained in Section 7609 of the Internal Revenue Code of 1954 and vested in the Commissioner of Internal Revenue by Treasury Department Order No. 150-37, dated March 17, 1955, to issue summonses; to set the time and place for appearance; to serve summonses; to take testimony under oath of the person summoned; to receive and examine books, papers, records or other data produced in compliance with the summons; to enforce summonses; to apply for court orders approving the service of John Doe Summonses issued under Section 7609(f) of the Internal Revenue Code; and to apply for court orders suspending the notice requirements in the case of summonses issued under Section 7609(g) of the Internal Revenue Code, are delegated to the officers and employees of the Internal Revenue Service specified in paragraphs 1(b), 1(c), and 1(d) of this Order and subject to the limitations stated in paragraphs 1(b), 1(c), 1(d), and 6 of this Order.

(b) The authorities to issue summonses and to perform the other functions related thereto specified in paragraph 1(a) of this Order, are delegated to all District Directors, the Director of International Operations, and the following officers and employees, provided that the authority to issue a summons in which the proper name or names of the taxpayer or taxpayers is not identified because unknown or unidentifiable (hereinafter called a "John Doe" summons) may be exercised only by said officers and employees and by them only after obtaining preissuance legal review by Regional Counsel, Deputy Regional Counsel (General Litigation) or District Counsel, or the Director, General Litigation Division in the case of Inspection.

(1) Inspection: Assistant Commissioner and Director, Internal Security Division.

(2) District Criminal Investigation: Chief of Division, except this authority in streamlined districts is limited to the District Director.

(3) International Operations: Chiefs of Divisions.

(4) District Collection Activity: Chief of Division, except this authority in streamlined districts is limited to the District Director.

(5) District Examination: Chief of Division, except this authority in streamlined districts is limited to the District Director.

(6) District Employee Plans and Exempt Organizations: Chief of Division.

(c) The authorities to issue summonses except "John Doe" summonses, and to perform other functions related thereto specified in paragraph 1(a) of this Order, are delegated to the following officers and employees:

(1) Inspection: Regional Inspectors and Assistant Regional Inspectors (Internal Security) and Chief, Investigations Branch.

(2) District Criminal Investigation: Assistant Chief of Division; Chiefs of Branches; and Group Managers.

(3) International Operations: Assistant Director; Chiefs of Branches; Case Managers; and Group Managers.

(4) District Collection Activity: Assistant Chief of Division; Chiefs of Collection Section; Chiefs of Field Branches and Office Branches; Chiefs, Special Procedures Staffs; Chiefs of Technical and Office Compliance Branches and Groups and Group Managers.

(5) District Examination: Chiefs of Branches, Case Managers, Group Managers and, in streamlined districts Chiefs, Examination Section.

(6) District Employee Plans and Exempt Organizations: Group Managers.

(d) The authority to issue summonses except "John Doe" summonses and to perform the other functions related thereto specified in paragraph 1(a) of this Order is delegated to the following officers and employees except that in the instance of a summons to a third party witness, the issuing officer's case manager, group manager, or any supervisory official above that level, has in advance personally authorized the issuance of the summons. Such authorization shall be manifested by the signature of the authorizing officer on the face of the original and all copies of the summons or by a statement on the face of the original and all copies of the summons, signed by the issuing officer, that he/she had prior authorization to issue said summons and stating the name and title of the authorizing official and the date of authorization.

(1) International Operations: Internal Revenue Agents; Attorneys, Estate Tax; Estate Tax Examiners; Special Agents; Revenue Service and Assistant Revenue Service Representatives; Tax Auditors; and Revenue Officers, GS-9 and above.

(2) District Criminal Investigation: Special Agents.

(3) District Collection: Revenue Officers, GS-9 and above.

(4) District Examination: Internal Revenue Agents; Tax Auditors; Attorneys, Estate Tax; and Estate Tax Examiners.

(5) District Employee Plans and Exempt Organizations: Internal Revenue Agents; Tax Law Specialists; and Tax Auditors.

(e) Each of the officers and employees referred to in paragraphs 1(b), 1(c) and 1(d) of this Order may serve a summons whether it is issued by him/her or another official.

(f) Revenue Representatives, GS-7, and Revenue Officers, who are assigned to the District Collection Activity and to International Operations may serve any summons issued by the officers and employees referred to in paragraphs 1(b), 1(c) and 1(d) of this Order.

2. Each of the officers and employees referred to in paragraphs 1(b), 1(c), and 1(d) of this Order authorized to issue summonses, is delegated the authority under 26 CFR 301.7602-1(b) to designate any other officer or

employee of the Internal Revenue Service referred to in paragraph 4(b) of this Order, as the individual before whom a person summoned pursuant to Section 7602 of the Internal Revenue Code shall appear. Any such other officer or employee of the Internal Revenue Service when so designated in a summons is authorized to take testimony under oath of the person summoned and to receive and examine books, papers, records or other data produced in compliance with the summons.

3. Internal Security Inspectors are delegated the authority under 26 CFR 301.7603-1 to serve summonses issued in accordance with this Order by any of the officers and employees of the Inspection Service referred to in paragraphs 1(b)(1) and 1(c)(1) of this Order even though Internal Security Inspectors do not have the authority to issue summonses.

4(a). The authorities granted to the Commissioner of Internal Revenue by 26 CFR 301.7602-1(a), and 301.7605-1(a) to examine books, papers, records or other data, to take testimony under oath and to set the time and place of examination are delegated to the officers and employees of the Internal Revenue Service specified in paragraphs 4(b), 4(c), and 4(d) of this *Order and subject to the limitations* stated in paragraphs 4(c) and 6 of this Order.

(b) General Designations

(1) Inspection: Assistant Commissioner; Director, Internal Security Division; Director, Internal Audit Division; Regional Inspectors; Internal Auditors; and Internal Security Inspectors.

(2) District Criminal Investigation: Chief and Assistant Chief of Division; Chiefs of Branches; Group Managers; and Special Agents.

(3) International Operations: Director, Assistant Director; Chief of Divisions and Branches; Special Agents; Case Managers; Group Managers, Internal Revenue Agents; Attorneys, Estate Tax; Estate Tax Examiners; Revenue Service and Assistant Revenue Service Representatives; Tax Auditors; and Revenue Officers.

(4) District Collection Activity: Chiefs and Assistant Chiefs of Division; Chiefs of Field Branches and Office Branches; Chiefs, Special Procedures Staffs; Chiefs, Technical and Office Compliance Branches; Chiefs, Collection Section; Chiefs, Technical and Office Compliance Branches and Groups; Group Managers and Revenue Officers.

(5) District Examination: Chiefs of Division; Chiefs of Examination Sections; Chiefs of Examination Branches; Case Managers; Group Managers; Internal Revenue Agents; Tax Auditors; Attorneys, Estate Tax; and Estate Tax Examiners.

(6) District Employee Plans and Exempt Organization: Chief of Division; Chief, Examination Branch; Chief, Technical Staff; Group Managers; Internal Revenue Agents; Tax Law Specialists; and Tax Auditors.

(7) Service Center: Chief, Compliance Division; Chief, Examination Branch; Chief, Collection Branch; Chief, Criminal Investigation Branch; Revenue Agents; Tax Auditors; Tax Examiners in the correspondence examination function; and Special Agents.

(c) District Directors, Service Center Directors, Regional Inspectors, the Chief of Investigation Branch, and the Director of International Operations may redelegate the authority under 4(a) of this Order to Law Clerks (Estate Tax), aides or trainees, respectively, for the positions of Revenue Agent, Tax Auditor, Tax Examiner in the Service Center Correspondence and Processing function, Tax Law Specialists, Revenue Officer, Internal Auditor, Internal Security Inspector, Attorney (Estate Tax) and Special Agent, provided that each such Law Clerk (Estate Tax), aide or trainee shall exercise said authority only under the direct supervision, respectively, as applicable of a Revenue Agent, Tax Auditor, Tax Examiner in the Service Center Correspondence and Processing function, Tax Law Specialist, Revenue Officer, Special Agent, Internal Auditor or Internal Security Inspector or Attorney (Estate Tax).

(d) District Directors may redelegate the authority under 4(a) of this Order to Revenue Representatives and Office Collection Representatives.

5. Under the authority granted to the Commissioner of Internal Revenue by 26 CFR 301.7622-1, the officers and employees of the Internal Revenue Service referred to in paragraphs 1(b), 1(c), 1(d), and 4(b) and 4(c) of this Order are designated to administer oaths and affirmations and to certify to such papers as may be necessary under the internal revenue laws and regulations *except* that the authority to certify shall not be construed as applying to those papers or documents the certification of which is authorized by separate order or directive. Revenue Representatives and Office Collection Representatives referred to in paragraph 4(d) of this Order are not designated to administer oaths or to perform the other functions mentioned in this paragraph, except that Revenue Representatives, GS-7, are authorized to certify the method and manner of service, and the method and manner of giving notice, when performing the functions and duties contained in paragraph 1(f) of this order.

6. The authority delegated herein may not be redelegated except as provided in paragraphs 4(c) and 4(d).

7. This Order supersedes Delegation Order No. 4 (Rev. 9), issued June 27, 1979.

Jerome Kurtz,
Commissioner.

(Filed by the Office of the Federal Register on January 23, 1980, 8:45 a.m., and published in the issue of the Federal Register for January 24, 1980, 45 F.R. 5879)

Delegation Order No. 152 (Rev. 1) (Effective January 22, 1980)

Collections from Delinquent Officers and Employees of the Internal Revenue Service

Pursuant to authority vested in the Commissioner of Internal Revenue by Treasury Department Order 150-69 Service Center Directors are hereby authorized to issue a notice and demand for payment of any funds due the United States from any officer or employee of the Internal Revenue Service who fails to account for and pay over any amount of money or property collected or received by them in connection with Internal Revenue Laws. If payment is not received within the time limit prescribed by the notice and demand, the unpaid amount is deemed assessed as of the date of the notice and appropriate action will be taken as required by subsection 7803(c) of the Internal Revenue Code.

The authority herein delegated may not be redelegated.

Delegation Order No. 152, issued July 16, 1975, is superseded.

WILLIAM E. WILLIAMS,
Acting Commissioner.

(Filed by the Office of the Federal Register on January 25, 1980, 8:45 a.m., and published in the issue of the Federal Register for January 28, 1980, 45 F.R. 6532)

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, Sections 446, 471, 481; 1.446-1, 1.471-2, 1.481-1.)

Rev. Proc. 80-5 [1]

SECTION 1. PURPOSE AND SCOPE

The purpose of this revenue procedure is to provide a procedure for taxpayers to change their method of accounting for "excess" inventory pursuant to the decision of the Supreme Court of the United States in *Thor Power Tool v. Commissioner,* 439 U.S. 522 (1979), Ct. D. 1996, 1979-1 C.B. 167. This procedure is mandatory for the first taxable year (calendar or fiscal) ending on or after December 25, 1979. See Rev. Rul. 80-60, page 5, this Bulletin.

SEC. 2. BACKGROUND

.01 In the *Thor Power* case, the taxpayer used the "lower of cost or market" method of valuing inventories for both financial accounting and for income tax purposes. See section 1.471-4 of the Income Tax Regulations. The taxpayer wrote down what it regarded as "excess" inventory to its net realizable value which, in most cases, was determined to be scrap value. The taxpayer determined that these articles were excess inventory because they were held in excess of any reasonably foreseeable future demand although such inventory was not scrapped or sold at reduced prices. The taxpayer retained the excess items in inventory and continued to sell them at original prices. The taxpayer contended that by writing down excess inventory to scrap value, it thereby reduced its inventory to "market" (net realizable value) in accord with its "lower of cost or market" method of accounting. The Commissioner of Internal Revenue disallowed this write-down. (The taxpayer also wrote down the cost of inventory that was either promptly scrapped or actually sold at reduced prices below cost. The Commissioner allowed these write-downs.)

The Supreme Court in *Thor Power* stated that sections 446 and 471 of the Internal Revenue Code vests the Commissioner with wide discretion in determining whether a particular method of inventory accounting should be disallowed as not clearly reflecting income. The Court affirmed the lower court's decision, sustaining the Commissioner, that although the taxpayer's write-down of excess inventory did conform to the best accounting practice in the trade or business and thus satisfied the first test of section 1.471-2(a) of the regulations, it failed to satisfy the second test of section 1.471-2(a), that it clearly reflect the taxpayer's income. The Court stated that where a taxpayer, under the "lower of cost or market" method of accounting, values its inventory for tax purposes at "market" (replacement cost), the taxpayer is permitted to depart from replacement cost only in specified situations described in sections 1.471-2(c) and 1.471-4(b) of the regulations. When such a departure to a lower inventory valuation is made, the regulations require that it be substantiated by objective evidence of actual offerings, sales, or contract cancellations and further require that records of actual dispositions be kept. The Court concluded that because the taxpayer provided no objective evidence of the reduced market value of its excess inventory, its write-down was plainly inconsistent with the regulations and was properly disallowed by the Commissioner. The taxpayer could not have properly taken advantage of any permitted write-downs since it did not scrap its "excess" inventory nor sell or offer it for sale at prices below replacement cost.

.02 The *Thor Power* case affirmed the method of accounting for inventory valuation established under the income tax regulations where the lower of cost or market method is applicable. In using the lower of cost or market method the regulations require a taxpayer having "excess" inventory to value such "excess" inventory at replacement cost (if lower than actual cost as defined in section 1.471-4 of the regulations) unless the goods have been scrapped, or they have been sold or offered for sale (at a lower price) within the meaning of the regulations under section 471 of the Code. (The "prescribed method.")

.03 Although the *Thor Power* case involved a method of inventory write-down that the taxpayer had initiated in the year in question, the Supreme Court's decision clearly applies to a taxpayer that has been consistently taking prohibited inventory write-downs described in the *Thor Power* decision. See *Will-Burt Co. v. Commissioner,* 38 T.C.M. 861 (1979).

.04 Section 446(e) of the Code and section 1.446-1(e)(2)(i) of the regulations state that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for Federal income tax purposes. Section 1.446-1(e)(3)(i) provides, in relevant part, that except as otherwise provided in subdivision (ii), in order to secure the Commissioner's consent, the taxpayer must file an application on Form 3115 with the National Office within 180 days after the beginning of the taxable year in which the taxpayer desires to make the change. Subdivision (ii) provides that notwithstanding subdivision (i), the Commissioner may prescribe administrative procedures, subject to such limitations, terms, and conditions as he deems necessary to obtain his consent, to permit taxpayers to change their accounting methods to an acceptable method consistent with applicable regulations.

Section 481(a) of the Code provides, in part, that if a taxpayer's taxable income for any taxable year is computed under a method of accounting different from the method used for the preceding taxable year, then there shall be taken into account those adjustments which are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted. Section 481(c) provides that in the case of any change described in subsection (a), the taxpayer may, in such manner and subject to such conditions as the Secretary may by regulations prescribe, take the adjustments required by subsection (a)(2) into account in computing the tax for the taxable year or years permitted under such regulations.

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[1] Also released in News Release IR-80-19, dated February 8, 1980.

SEC. 3. APPLICATION

.01 In accordance with section 1.446-1(e)(3)(ii) of the regulations the 180 day rule is waived and consent is hereby granted taxpayers to change from a method of accounting for inventory valuation of "excess" inventory, that is not in accordance with the "prescribed method," to such "prescribed method." See section 2.02 above. Such consent is granted for the first taxable year ending on or after December 25, 1979, and shall be made in accordance with the provisions of this revenue procedure, including the adjustment under section 481(a) described in section 3.03 below.

.02 Pursuant to the consent granted in section 3.01, a taxpayer that is using a method of accounting for inventory valuation by writing down "excess" inventory in a manner that is not in accordance with the "prescribed method" must change such method of accounting to the "prescribed method" on its federal income tax return for the first taxable year ending on or after December 25, 1979. See Rev. Rul. 80-60.

.03 An adjustment is required to prevent amounts of income from being duplicated or omitted within the meaning of section 481 of the Code and the regulations thereunder when the change in method of accounting is made pursuant to the provisions set forth in this revenue procedure. Such adjustment, whether positive or negative, referred to as the "net section 481(a) adjustment," shall be taken into account as provided in either section 3.04 or section 3.05 below.

.04(1) The taxpayer may treat the change in method of accounting as a change initiated by the taxpayer. In such case, unless otherwise provided in this revenue procedure, the net section 481(a) adjustment shall be taken into account ratably over a period of taxable years equal to the number of taxable years the taxpayer used a method of accounting where inventory was written down using an impermissible method. This period may not exceed 10 taxable years. In addition, the rules described in sections 3.07, 3.08, and 3.09 apply.

(2) When the entire net amount of an adjustment is attributable to the taxable year immediately preceding the year of change (first preceding year), the total net adjustment will be taken into account in computing taxable income for the year of change. The amount attributable to the taxable year immediately preceding the year of change is the difference in the amount required under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the same change in accounting method had been made in such preceding year.

(3) When 67 percent or more of the net amount of an adjustment is attributable to the 1 taxable year period, 2 taxable year period, or 3 taxable year period immediately preceding the year of change, the highest percent attributable to such 1, 2, or 3 taxable year period will be taken into account ratably over a 3 taxable year period beginning with the year of change. An amount attributable to such 1, 2, or 3 taxable year period is the difference in the amount required under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the same change in accounting method had been made at the beginning of such preceding 1, 2, or 3 taxable year period. Any remaining balance will be taken into account ratably over an additional period equal to the remainder of the number of taxable years the taxpayer has used the accounting method that is being changed. However, the total adjustment period will not exceed 10 taxable years. This paragraph 3.04(3) only applies if the taxpayer has used the method being changed for at least 3 taxable years and the entire amount of the adjustment is not attributable to the taxable year immediately preceding the year of change.

(4) In all other situations the total net adjustment will be taken into account ratably over the number of taxable years (not to exceed 10) the taxpayer has used the accounting method that is being changed.

(5) See section 4 of this revenue procedure for an example of the computation of a net section 481(a) adjustment pursuant to this revenue procedure where the taxpayer elected to treat the change in accounting method as a change initiated by the taxpayer.

.05 The taxpayer may treat the change in method of accounting as a change *not* initiated by the taxpayer within the meaning of section 481(a)(2) of the Code. In such case, the net section 481(a) adjustment, as modified by the "pre-1954 Code years" adjustment described in section 1.481-3 of the regulations, shall be taken into account in the year of change in full; in addition, see section 481(b) for the limitation on tax. See section 4 of this revenue procedure for an example of the computation of a net section 481(a) adjustment where the taxpayer elected to treat the change in accounting method as a change not initiated by the taxpayer.

.06 This Revenue Procedure does not apply to a taxpayer that has used a method of accounting for inventory valuation of "excess goods" that is not in accordance with the "prescribed method" and the use of such impermissible method has been raised and is pending as an issue as of February 8, 1980, in connection with the examination of the taxpayer's federal income tax return. In such case, Rev. Proc. 70-27, 1970-2 C.B. 509, clarified by Rev. Proc. 75-18, 1975-1 C.B. 687, and as subsequently modified or superseded, is available.

.07 If a taxpayer elects the last-in, first-out (LIFO) method of inventory valuation during the "spread period" referred to in section 3.04, the balance of the unamortized section 481(a) adjustment, referred to in section 3.03, must be taken into account in full as an item of ordinary income in the year for which such election is made.

.08 If at the end of any taxable year during the "spread period" referred to in section 3.04, if the value of the taxpayer's inventory as of the last day of any taxable year is reduced by more than 33⅓ percent of the inventory valued at the beginning of the first taxable year ending on or after December 25, 1979 (see section 3.03), the balance of the unamortized net section 481(a) adjustment at such time, must be taken into account in full as an item of ordinary income in the year of such inventory reduction. This section shall not apply in the event such reduction is attributable to a strike or involuntary conversion.

.09 (a) With respect to a corporation:

If the taxpayer ceases to engage in the trade or business, to which this adjustment (section 3.03) relates, at any time prior to the expiration of the "spread period" referred to in section 3.04, the taxpayer will take into account in such year the balance of the adjustment not previously taken into account in computing taxable income. For purposes of this condition, the taxpayer is not considered to have ceased the trade or business if such cessation is the result of a transaction to which section 381 of the Code applies, but in such case the acquiring corporation shall continue to be subject to this revenue procedure as though it were the acquired corporation.

(b) With respect to a partnership:

In the event the partnership terminates or ceases to engage in the trade or business, to which this adjustment (section 3.03) relates, at any time prior to the expiration of the "spread period" referred to in section 3.04, the balance of the adjustment not previously taken into account in computing ordinary income shall be taken into account in such year. A partnership ceasing to engage in the trade or business includes the incorporation of such trade or business in a transaction to which section 351 of the Code applies; see Rev. Rul. 77-264, 1977-2 C.B. 187.

(c) With respect to a sole proprietor:

If the taxpayer ceases to engage in the trade or business, to which this adjustment (section 3.03) relates, at any time prior to the expiration of the "spread period" referred to in section 3.04, the balance of the adjustment not previously taken into account in computing taxable income shall be taken into account in such year. A sole proprietor ceasing to engage in the trade or business includes the incorporation of such trade or business in a transaction to which section 351 of the Code applies; see Rev. Rul. 77-264, 1977-2 C.B. 187.

Sec. 4. Example (1)

X is a domestic corporation incorporated in 1950 and engaged in the business of manufacturing that reports its income on a calendar year basis. In the normal course of its business, *X* maintains an inventory of replacement parts for its products for sale to the public. *X* has consistently written down the value of excess inventory of replacement parts as a result of anticipated losses with respect to such inventory. As of December 31, 1978, *X* had on hand inventory items which it had written down to its estimate of scrap value by taking an inventory write-down for excess goods in the amount of $100,000. The write-down by *X* did not conform with the regulations under section 471 of the Code.

X filed a Form 3115 (Application for Change in Method of Accounting) with its tax return for taxable year 1979 in accordance with the provisions set forth in section 5 of this revenue procedure. Accordingly, *X* restored the write-down of $100,000 to its opening inventory for the taxable year 1979. As a result of such restoration, *X* will, in effect, receive a double deduction through the cost of goods sold in the amount of $100,000. Thus, under section 481(a) of the Code, an adjustment is necessary solely by reason of the change in method of accounting in order to prevent the $100,000 from being duplicated. Less than 67 percent of the adjustment is attributable to taxable years 1976, 1977, and 1978. If *X* had changed its method of accounting in 1954, the adjustment would have been $10,000.

If *X* elects to treat its change in method of accounting as a change initiated by the taxpayer pursuant to section 3.04 above, an adjustment in the amount of $100,000 shall be taken into account as an item of gross income ratably over 10 taxable years (1/10 each year).

If *X* elects to treat its change in method of accounting as a change not initiated by the taxpayer pursuant to section 3.05 above, an adjustment in the amount of $90,000 ($100,000 — $10,000) shall be taken into account as an item of gross income in taxable year 1979, the year of change. The tax for 1979 on the adjustment shall be limited as provided in section 481(b) of the Code.

Example (2)

The facts are the same as presented in Example (1) with the exception that *X* has used the improper write-down method for 6 taxable years and the net section 481(a) adjustment if the year of change had been one of the 3 preceding taxable years, would have been $60,000 in 1976, $28,000 in 1977, and $50,000 in 1978. In this example, the difference between the net section 481(a) adjustment if the year of change had been 1977, and such adjustment in 1979, the year of change, is more than 67% ($100,000—$28,000 =$72,000/$100,000=72%) and represents the highest percent of the adjustment attributable to any one of the 1, 2, or 3 taxable year period preceding the year of change. Under the provisions of section 3.04 of this revenue procedure the adjustment for 1979 of $100,000, therefore, shall be taken into account in the amount of $24,000 in 1979, 1980, and 1981 ($72,000 spread ratably over 3 years) and $9,333 in 1982, 1983, and 1984 (the remainder of $28,000 from the $100,000 adjustment spread over 3 years, the remaining number of years that *X* used the accounting method that is being changed).

Sec. 5. Manner of Effecting the Change

.01 Taxpayers to which this revenue procedure applies must effect the change in their methods of accounting for their first taxable year ending on or after December 25, 1979, pursuant to the provisions set forth in this revenue procedure by filing a Form 3115 in duplicate. The original shall be attached to the taxpayer's timely filed federal income tax return for such year or to an amended return for such year filed no later than the extended time period prescribed in section 6081 of the Code and regulations thereunder. For example, a domestic corporation whose taxable year ends December 31, 1979, must effect the change described in this revenue procedure on an original timely filed return, or on an amended return filed no later than September 15, 1980. At the same time a copy of the Form 3115 shall be filed with the National Office addressed to the Commissioner of Internal Revenue, Attention: T:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. In addition to the information on Form 3115, the taxpayer must state whether section 3.04 or section 3.05 has been applied and must provide (1) a computation of the net section 481(a) adjustment, (2) the pre-1954 Code year adjustment, if applicable, and (3) the period over which the net section 481(a) adjustment will be taken into account and the basis for such conclusion. The National Office will sample the Form 3115's to determine whether the requirements of this revenue procedure have been followed. The National Office or the District Director may advise the taxpayer of required adjustments to the change in method of inventory valuation. Any adjustment made by the National Office will be limited to those necessary to properly comply with this revenue procedure.

.02 In order to assist in the processing of these changes in methods of accounting and to insure proper handling, reference to this revenue procedure shall be made a part of the Form 3115 by either typing or legibly printing the following statement: "FILED UNDER REV. PROC. 80-5."

SEC. 6. INQUIRIES

Inquiries regarding this revenue procedure may be addressed to the Commissioner of Internal Revenue, Attention: T:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

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26 CFR 601.602: Forms and instructions. (Also Part I, Sections 3402, 6001, 6361; 31.3402(b)-1, 31.3402(f)(5)-1, 31.3402 (h)(4)-1, 31-3402(p)-1, 31.6001-5, 31. 6361-1.)

Rev. Proc. 80-8

PART "A" GENERAL

SECTION 1. PURPOSE

.01 The purpose of this Revenue Procedure is to provide the requirements and conditions for submitting certain Forms W-4, Employee's Withholding Allowance Certificates, on magnetic tape instead of filing paper returns. All employers are required to send to the Internal Revenue Service copies of all Forms W-4 submitted by their employees who claim the following:

(a) 10 or more withholding allowances, or

(b) exempt status and usually earn more than $200 a week at the time the Form W-4 was filed.

Forms W-4 information may be filed on magnetic tape and sent quarterly to the Service beginning with the quarter ending June 30, 1980. The due date for the first submission of Forms W-4 on magnetic tape to the Internal Revenue Service is July 31, 1980.

SEC. 2. APPLICATION FOR TAPE REPORTING

.01 Tape reporting is not restricted to employers with the ability to submit all their information on magnetic tape; a combination of tape records and paper documents is acceptable as long as there is no duplication or omission of documents.

.02 Employers or transmitters who desire to file statements in the form of magnetic tape must first file a letter of application. This letter should be addressed to the attention of the magnetic media coordinator of one of the following service centers:

(a) Internal Revenue Service
Andover Service Center
Post Office Box 311
Andover, MA 01810

(b) Internal Revenue Service
Brookhaven Service Center
Post Office Box 486
Holtsville, NY 11742

(c) Internal Revenue Service
Philadelphia Service Center
Post Office Box 245
Bensalem, PA 19020

(d) Internal Revenue Service
Atlanta Service Center
Post Office Box 47421
Doraville, GA 30362

(e) Internal Revenue Service
Memphis Service Center
Post Office Box 1900
Memphis, TN 38101

(f) Internal Revenue Service
Cincinnati Service Center
Post Office Box 267
Covington, KY 41019

(g) Internal Revenue Service
Kansas City Service Center
Post Office Box 5321
Kansas City, MO 64131

(h) Internal Revenue Service
Austin Service Center
Post Office Box 934
Austin, TX 78767

(i) Internal Revenue Service
Ogden Service Center
Post Office Box 9941
Ogden, UT 84409

(j) Internal Revenue Service
Fresno Service Center
Post Office Box 12866
Fresno, CA 93779

The letter of request must contain the following:

(a) Name, address, and employer identification number of the person, organization, or entity making the request.

(b) Name, title, and telephone number of the person to contact regarding the request.

(c) Estimate of the number of Forms W-4 to be reported in tape format, and the number, if any, expected to be reported on copies of paper Forms W-4.

(d) Type and nature of equipment to be used to prepare the tape; i.e., manufacturer and model of the mainframe and tape drives, tape width (½", ¾", etc.), density (characters per inch), recording code (BCD, Excess 3, Octal, etc.).

(e) Signature of the official responsible for the preparation and submission of Forms W-4 to the Service.

.03 The Service will act on applications and notify applicants of authorization to file or of disapproval within 30 days of receipt of an application. No magnetic tape returns may be filed with the Service until authorization to file is received.

.04 Only employers or transmitters using equipment compatible with the Service's equipment will have their applications approved. Compatible tape characteristics are shown in PART "B" Section 1.01.

.05 In general, once authorization to file on magnetic tape has been granted, such approval will continue in effect in succeeding years, providing that the requirements of this Revenue Procedure are met and there are no equipment changes by the employer or transmitter. However, new applications are required whenever any of the following situations arise:

(a) If the users change from equipment producing compatible tapes.

(b) If the users submit tapes that are not listed as compatible.

(c) If the users discontinue tape reporting for one or more years, then decide to resume this method of reporting.

SEC. 3. FILING DATES

.01 Magnetic tape reporting to the Service must be quarterly, following the quarter ending due dates below:

Period Covered	*Due Date*
Jan. 1 thru March 31	April 30
Apr. 1 thru June 30	July 31
July 1 thru Sept. 30	October 31
Oct. 1 thru Dec. 31	January 31

The first due date of either paper or tape Forms W-4 is July 31, 1980.

SEC. 4. FILING OF TAPE REPORTS

.01 Packaging, shipping, and mailing instructions will be provided by the Service to all approved filers within 45 days of the granting of approval. A magnetic tape reporting package, which includes all necessary transmittals and labels, will be mailed to all approved filers.

.02 Employers or transmitters may submit a portion of their Forms W-4 information on magnetic tape and the remainder on paper forms, provided there is NO DUPLICATE FILING. The magnetic tape records and paper forms must be filed at the same location, i.e., the appropriate service center, but in separate shipments. A Service-provided transmittal form must accompany all magnetic tape shipments to the service center. (For all paper Forms W-4 sent to IRS, employers or transmitters must supply a cover letter which includes the employer's name, address, employer identification number, and number of Forms W-4 being submitted.)

.03 The affidavit which appears on the Service-provided transmittal for tape submission must be signed by the employer, the transmitter, service bureau, or disbursing agent who must:

a. have the authority to sign the affidavit under an agency agreement (either oral, written, or implied) that is valid under State law; and

b. have the responsibility (either oral, written, or implied) conferred on it by the employer to request taxpayer identifying numbers of employees reported on magnetic tape or paper returns; and

c. sign the affidavit and add the caption "For: (name of employer)."

.04 Although a duly authorized agent signs the affidavit, the employer is held responsible for the accuracy of Forms W-4 contained on magnetic tape.

.05 The magnetic tape specifications contained in PART "B" of this Revenue Procedure must be strictly adhered to. Deviations will not be permitted under any circumstances. All magnetic tape filings will be reviewed for completeness of required fields and for proper format. Tapes failing to meet the specifications contained herein will not be processed but will be returned to the filer for either correction and resubmission of tapes or for submission of copies of paper Forms W-4.

SEC. 5. PROCESSING OF TAPE STATEMENTS

.01 The Service will copy the information from the original tapes and will return the original tapes to the employer. Normally tapes will be returned either within three months after the quarterly due date for submission to the Service, or within three months after actual receipt of acceptable tapes, whichever is later.

SEC. 6. EFFECT ON PAPER DOCUMENTS

.01 Magnetic tape reporting to the Internal Revenue Service eliminates the need for submission of copies of paper Forms W-4. However, employers must maintain the original Form W-4 for their records.

.02 If only a portion of the statements is reported on magnetic tape and the remainder is reported on paper forms, those paper statements must be filed on the prescribed forms.

SEC. 7. ADDITIONAL INFORMATION

Requests for adidtional copies of this Revenue Procedure or for additional information on tape reporting of Forms W-2, W-2P, 1099, 1087, or 1042S should be addressed to the attention of the magnetic media coordinator of the appropriate Internal Revenue Center listed in Section 2.02 above.

PART "B" MAGNETIC TAPE SPECIFICATIONS

SECTION 1. GENERAL

.01 These specifications prescribe the required format and content of the records to be included in the file, but not the methods or equipment to be used in their preparation. Usually, the Service will be able to process, without translation, any compatible tape file. To be compatible, a tape file must meet all of the following specifications:

(a) Type of Tape—½ inch Mylar base, oxide coated

(b) Recording Density—556 or 800 bits per inch (BPI)

(c) Parity—Even or Odd

(d) Interrecord gap—¾ inch

(e) Recording Code—7 channel binary coded decimal (BCD)

.02 Conversion facilities are currently available for the following tapes:

(a) 9 channel EBCDIC (Extended Binary Coded Decimal Interchange Code) with

(1) Odd Parity

(2) 800, 1600, or 6250 Densities

(b) 9 channel ASCII (American Standard Coded Information Interchange) with

(1) Odd Parity

(2) 800, 1600, or 6250 Densities

.03 Although the Service can process, after translation, tapes created at 6250 BPI, it is preferred that filers submit 1600 BPI tapes if possible.

.04 The employer or the transmitter must affix an external label to each tape with the following information:

(a) Name of Transmitter

(b) Number of data records on that reel

(c) Density (556, 800, 1600, or 6250 BPI)

(d) Channel (7 or 9)

(e) Parity (odd or even)

(f) Manufacturer and model of main frame and tape drives

(g) Sequence number of reel, and total number of reels in the file (i.e., 1 of 3, 2 of 4)

.05 All records, including Header and Trailer Labels (if used), must be transmitted at the same density.

.06 Do not submit an employee W-4 record without the required employer identification information. Every record must contain both employee and employer data.

SEC. 2. LABEL CONVENTIONS

.01 Header Labels, Trailer Labels, Record Marks, and Tape Marks are all optional. They may be used as required by the transmitter's equipment or programming. If used they must conform to the following standards:

(a) Header Labels

(1) Transmitters may use standard headers, provided they begin with 1HDR, HDR1, VOL1, or VOL2.

(2) Header labels may not exceed 80 characters in length.

(b) Trailer Labels

(1) Standard trailer labels may be used provided that they begin with 1EOR, 1EOF, EOR1, or EOF1.

(2) Trailer labels may not exceed 80 characters in length.

(c) Record Marks

(1) Special character used to separate blocked records on tape.

(2) Can be written only at the end of a record or block.

(3) For odd parity tapes, use BCD bit configuration of 011010; for even parity use 111010.

(4) All records are of uniform length; therefore, marks are not necessary on this file.

(d) Tape Marks

(1) Used to signify the physical end of the recording on tape.

(2) Tape marks, if used, must be BCD configuration 001111 in even parity.

(3) May follow the header label and precede and/or follow the trailer label.

SEC. 3. RECORD LENGTH AND BLOCKING

.02 Tape records prescribed in the specifications may be blocked or unblocked, subject to the following:

(a) All data records are of a fixed length of 400 positions.

(b) All records may be blocked, except header and trailer labels.

(c) If blocking is used (more than one record per block) the desired blocking factor is ten records per block. At no time may a block contain more than 4,000 characters, but a smaller blocksize may be used if necessary. If sufficient records are not available for a full block, the remainder should be "padded" with 9's to fill all unused positions. Do not pad the block with blanks, or create blank records.

RECORD NAME: W-4 MAGNETIC TAPE RECORD

Tape Position	Field Title	Length	Description and Remarks
1-9	Employee Social Security Number (SSN)	9	Required. Must be the valid 9-digit number assigned to the employee. DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9's, or ALL ZEROES.
10-44	Employee Name Line 1	35	Required. Enter the name of the employee whose SSN appears in tape positions 1-9. Enter the complete name in the following order: first name, middle name (if present), and surname. (Use initials for the first and middle names where necessary to insure that the entire employee surname fits in tape positions 10-44.) If fewer than 35 characters are required, left justify and fill unused positions with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, HYPHENS, BLANKS, A MINIMUM OF ONE AND A MAXIMUM OF TWO CARETS (<). (1) Blanks must be surrounded by alphas or continued to the end of the field (e.g., ab___b, aba). (2) Hyphens must never occur in the first position of a name, must not be surrounded by blanks, and must be followed by at least one alpha (e.g., a-aaa, aaa-a). (3) A caret is used to define an internal name control. It must immediately precede the employee surname in place of the blank. A second caret is used to separate a suffix from the surname (e.g., JOHN J<BLACK; BILL<OAK<JR; AMY FERN<BROWN<DECD).

RECORD NAME: W-4 MAGNETIC TAPE RECORD—Continued

Tape Position	Field Title	Length	Description and Remarks
45-79	Employee Name Line 2	35	Optional. This line is designated for an "in care of" (c/o) situation. Left justify with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, HYPHENS, AND SLASHES.
80-114	Employee Street Address	35	Required. Enter street address of employee. Left justify and fill unused positions with blanks. Fill with blanks if street address is unavailable. ALLOWABLE CHARACTERS ARE ALPHAS, NUMERICS, BLANKS, HYPHENS, SLASHES, AND NO MORE THAN ONE AMPERSAND.
115-139	Employee City	25	Required. Enter city of employee. Left justify and fill unused positions with blanks. Fill with blanks if city is unavailable. If foreign address, enter city and country.
140-141	Employee State	2	Required. Enter state of employee; must be one of the following:

State	*Code*
Alabama	AL
Alaska	AK
Arizona	AZ
Arkansas	AR
California	CA
Colorado	CO
Connecticut	CT
Delaware	DE
District of Columbia	DC
Florida	FL
Georgia	GA
Guam	GU
Hawaii	HI
Idaho	ID
Illinois	IL
Indiana	IN
Iowa	IA
Kansas	KS
Kentucky	KY
Louisiana	LA
Maine	ME
Maryland	MD
Massachusetts	MA
Michigan	MI
Minnesota	MN
Mississippi	MS
Missouri	MO
Montana	MN
Nebraska	NE
Nevada	NV
New Hampshire	NH
New Jersey	NJ
New Mexico	NM
New York	NY
North Carolina	NC
North Dakota	ND
Ohio	OH

RECORD NAME: W-4 MAGNETIC TAPE RECORD—Continued

Tape Position	Field Title	Length	Description and Remarks
140-141	Employee State (continued)	2	*State* *Code* Oklahoma OK Oregon OR Pennsylvania PA Puerto Rico PR Rhode Island RI South Carolina SC South Dakota SD Tennessee TN Texas TX Utah UT Vermont VT Virgin Islands VI Virginia VA Washington WA West Virginia WV Wisconsin WI Wyoming WY Foreign Address XX Fill with blanks if Employee State is unavailable and address is not "Foreign Address."
142-146	Employee ZIP Code	5	Required. Enter ZIP Code of employee. Fill with blanks if unavailable. ALLOWABLE CHARACTERS ARE FIVE (5) NUMERICS OR FIVE (5) BLANKS.
147	Marital Status	1	Required. Enter appropriate code from the table below: *Marital Status Designated* *Code* Single S Married M Married, withhold at single rate W No marital status designated A
148	Exempt Status	1	Required. Enter "E" if employee claims exempt status; otherwise, enter blank.
149	Student Status	1	Required. If full-time student status is claimed, enter "Y"; if not, enter "N". If no entry, enter "B".
150-151	Allowances	2	Required. Must be a two (2) digit numeric field corresponding to the number of allowances claimed by employee. (It is not necessary to file this W-4 with IRS if the number of allowances is less than ten (10) and exempt status is not claimed.) If no entry, enter zeroes.
152-158	Additional Amount of Withholding	7	Required. Enter numerics only. Enter the additional amount of withholding each pay period. Field is dollars and cents. Right-justify and zero-fill. Do not enter dollar signs, commas, decimal points, or negative numbers. If no entry, zero-fill.
159-163	Number of W-4's Submitted	5	Required. This field is a running total of all W-4's submitted by the employer. The first W-4 on the file must start with the value of one (1); increment by one (1) for each subsequent W-4 thereafter. Values should be right justified and zero filled.

RECORD NAME: W-4 MAGNETIC TAPE RECORD—Continued

Tape Position	Field Title	Length	Description and Remarks
164-169	W-4 Date	6	Required. Enter date located on signature line of W-4. If no date entered, generate current system date. Format as MMDDYY where MM = 01-12, DD = 01-31 and YY = 80, 81, etc.
170-178	Employer Identification Number	9	Required. The 9-digit number assigned to the employer by IRS. DO NOT ENTER HYPHENS, ALPHA CHARACTERS, ALL 9's, or ALL ZEROES.
179-213	Employer Name Line 1	35	Required. Enter the name of the employer as it apears on your employment tax forms (e.g., Form 941). Any extraneous information must be deleted from this name line. Left justify and fill with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, NUMERICS, AMPERSAND, AND HYPHENS.
214-248	Employer Name Line 2	35	Optional. If the employer name requires more space than is available in Employer Name Line 1, enter the remaining portion of the name in this field. Left-justify and fill with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, NUMERICS, AMPERSAND, HYPHENS, AND SLASHES.
249-283	Employer Name Line 3	35	Optional. If the employer name requires more space than is available in Employer Name Lines 1 and 2, enter the remaining portion of the name in this field. Left-justify and fill with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, NUMERICS, AMPERSAND, HYPHENS AND SLASHES.
284-318	Employer Name Line 4	35	Optional. If the employer name requires more space than is available in Employer Name Lines 1, 2 and 3, enter the remaining portion of the name in this field. Left-justify and fill with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, BLANKS, NUMERICS, AMPERSAND, HYPHENS, AND SLASHES.
319-353	Employer Street Address	35	Required. Enter street address of employer. Left justify and fill unused positions with blanks. Fill with blanks if street address is unavailable. ALLOWABLE CHARACTERS ARE ALPHAS, NUMERICS, HYPHENS, AMPERSAND, SLASHES, AND BLANKS.
354-378	Employer City	25	Required. Enter city of employer. Left justify and fill unused positions with blanks. ALLOWABLE CHARACTERS ARE ALPHAS, HYPHENS, AND BLANKS.
379-380	Employer State	2	Required. Enter State Code of Employer. Must be one of the state abbreviations shown above in the state abbreviation table for Employee State (Tape Positions 140-141).
381-385	Employer ZIP Code	5	Required. Enter ZIP Code of Employer. ALLOWABLE CHARACTERS ARE FIVE (5) NUMERICS OR FIVE (5) BLANKS.
386-390	Transmitter Control Code (TCC)	5	Required. Enter 5-digit Transmitter Control Code assigned by the IRS.

RECORD NAME: W-4 MAGNETIC TAPE RECORD—Continued

Tape Position	Field Title	Length	Description and Remarks
391	"BLANK" Representation	1	Required. Enter character used to represent a blank.
392	"HYPHEN" Representation	1	Required. Enter character used to represent a hyphen.
393	"SLASH" Representation	1	Required. Enter character used to represent a slash.
394	"AMPERSAND" Representation	1	Required. Enter character used to represent an ampersand.
395	"CARET" Representation	1	Required. Enter character used to represent a caret.
396-400	IRS USE	5	Blanks.

Part IV. Items of General Interest

Foundation Status of Certain Organizations

Announcement 80-32

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3) of the Code, eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Abolitionist Fund, Inc., The, Santa Clara, CA
Academy of Public Defender Training, Oakland, CA
Akron Jaycee Foundation, The, Akron, OH
Alano Club West of San Jose California, Inc., San Jose, CA
Ale Kaph, Oakland, CA
American Indian Association of Architectural and Engineering Students, Albuquerque, NM
American Institute for Professional Education, Madison, NJ
Angels of Light Free Theater, Inc., San Francisco, CA
Archibald Miller Young Family Association, Inc., Salt Lake City, UT
Arroyo Corp., The, Alexandria, VA
Asheville High Band Association, Asheville, NC
Association for Psychotheatrics, Sacramento, CA
Audobon Band Parents Association Audobon High School, Audobon, NJ
Austin Pro-Life Fund, Austin, TX
Auxiliary to the Burlington County Society of Osteopathic Physicians, Marlton, NJ
Banneker-Douglas Museum Foundation, Inc., Annapolis, MD
Baton Rouge Council for Child Protection, Baton Rouge, LA
Bay Area Life Management, Inc., Oakland, CA
Beaudry Foundation, San Francisco, CA
Belle Peabody Brown Foundation, Tilton, NH
Better Life Foundation, Inc., Fresno, CA
Big Valley Village Corp., Finley, CA
Black Archives of Mid-America, Inc., Kansas City, MO
Blind Foreign Students Project, Inc., Oakland, CA
California All-Stars Overseas Corp., Berkeley, CA
California Marriage Encounter, Inc., Modesto, CA
California Mini-Rugby Football League, Foster City, CA
Camden Transitional Residency Independence Program, Stratford, NJ
Cantors Assembly Foundation, Inc., Baltimore, MD
Career Dimensions, Palo Alto, CA
Carty Development Foundation, Inc., Pompano Beach, FL
Case Community Development Corp., Jersey City, NJ
Castle Summer Theatre Co., Spanish Fork, UT
Center for Early Detection of Breast Cancer, Sacramento, CA
Center for Media Ethics, Kearns, UT
Center for Social Change, Half Moon Bay, CA
Centro Familias Unidas Servicio Ayuda, Junction, TX
Charity Enterprises of North Carolina, Inc., Roxboro, NC
Chesapeake Organization for Mentally Retarded Adults, Inc., Chesapeake, VA
Children's Medifund Corp., San Francisco, CA
Children's Service and Training Center, Meadville, PA
Chippewa Falls Youth Football, Inc., Chippewa Falls, WI
Christ the King Booster Club, Lubbock, TX
City of San Francisco Performing Arts Center Corp., San Francisco, CA
Cleveland Jaycees Foundation, The, Cleveland, OH
Colorado Association for the Gifted and Talented, Inc., Boulder, CO
Community Arts Council, New Castle, PA
Community Cultural Activity Center, Inc., Parma, OH
Concerned Citizens for Charity, San Francisco, CA
Cook Evangelistic Association, David, Yuba City, CA
Creative Fun Camps, Inc., Las Vegas, NV
Creative Garden Theatre Co., Thornton, WV
Daly City Community Multi-Purpose, Daly City, CA
Della's China Cup Symposium, Oakland, CA
Development Strategies Corp., Washington, D.C.
Distinguished Virginians Fund, The, Richmond, VA
Dolphin Embassy, San Francisco, CA
Early Childhood Development Planning Association for Forsyth County, The, Winston-Salem, NC
Early Childhood Learning Centers of New Jersey, West Orange, NJ
Earth Ministries Evangelistic Association, Oklahoma City, OK
East Franklin Township Community Council, Inc., Akron, OH
Edinboro State College Alumni Association, Edinboro, PA
Electrical Corporation of the Handicapped, Cincinnati, OH
Fairview Park Youth Association, Fairview Park, OH
First Assembly of Mankind Corp., San Francisco, CA
First Night, Inc., Brookline Village, MA
Fluid Foundation, The, Sausalito, CA
Flying Fins Synchronized Swim Club, Inc., Castro Valley, CA
Foundation for Christian Self-Government, Martinez, CA

Friends of the Library Paradise Branch, Paradise, CA
Full Faith Foundation, Fresno, CA
Garnet Austin Memorial Fund, The, Livermore, CA
Godinme Ministries, North Las Vegas, NV
Goodwill Handicapped Workers Foundation, Ballwin, MO
Grand Jury Defense Office, National Lawyers Guild, San Francisco, CA
Guild of the Wilmington-New Hanover Museum, Inc., The, Wilmington, NC
Handicap Research Institute, Oakland, CA
Heart of San Francisco, The, San Francisco, CA
Help A Victim Enter Newbirth, Inc., North Highlands, CA
Here's Life, Greater South Bay Area, Inc., San Jose, CA
Here's Life North Coast, Inc., Eureka, CA
Herter Center, Inc., Christian A., Woburn, MA
Humane Environmental Education Development, Inc., Whiting, IN
Hunt Singers, The, Riderwood, MD
Hyde County Rural Health Corp., Swan Quarter, NC
Illinois Rangers Emergency Radio Team, Caseyville, IL
Independent Living for Adults, Bergenfield, NJ
Indiana Public Interest Research Foundation, Inc., Bloomington, IN
Institute for Equal Rights, Washington, DC
Iris Films, Inc., Austin, TX
Irvington Residence for the Retarded, Irvington, NJ
Janella Chambers Ministries, Rinard Mills, OH
Kidder Creek Orchard Camps, Inc., Etna, CA
Kiski Valley Medical Facilities, Inc., North Apollo, PA
Koinonia Homes, Inc., Garfield Hts., OH
Lake Geauga County Public Defenders Office, Mentor, OH
Lake Merced Neighborhood Organization, San Francisco, CA
Lawrence High School Athletic Booster Club, Lawrenceville, NJ
Liberation Information Center, Inc., Berkeley, CA
Lincoln High School Booster Club, Inc., Stockton, CA
Madison Medical Facility, Inc., Madison, NC
Measure of Faith Ministries, Inc., The, Jonesboro, AR
Medicine Bow First Aid Society, Albuquerque, NM
Mendham Township Home/School Association, Brookside, NJ
Merla's Little School, Inc., St. Helena, CA
Mid Carmel Valley Volunteers, Inc., Carmel, CA
Morality In Media Of Wichita Falls, Inc., Wichita Falls, TX
Mount Hope Foundation Corp., San Francisco, CA
Nantucket Towers, Inc., Oklahoma City, OK
National Stuttering Project, Walnut Creek, CA
Neighborhood Foundation, The, San Francisco, CA
Neighborhood Housing Services of Wilmington, Inc., Wilmington, NC
Nevada Dance Theatre, Inc., Las Vegas, NV
New Dimensions Foundation, Sausalito, CA
Niasbic Youth Activity Board, Tipton, IN
North Bay Senior Planning Council, Inc., San Rafael, CA
North Central Technical College Foundation, Mansfield, OH
North Coast Broadcasting Corp., Mendocino, CA
Northern California Young People's Ensemble, Eureka, CA
Northwest Arkansas Chapter of the American Institute of Banking, Springdale, AR
Ohio State University Public Interest Research Group, Columbus, OH
Paetsch Chamber Music Ensemble, Inc., Colorado Springs, CO
Petaluma Civic Softball Association, Petaluma, CA
Picnic, Washington, DC
Pitching for the Master Foundation, Kansas City, MO
Pleasanton Junior Football League, Pleasanton, CA
Prison & Jail Project, Inc., The, Durham, NC
Progressive Development Project, Inc., Petersburg, VA
Project Concern-Racine, Inc., Racine, WI
Prune Productions, Inc., San Jose, CA
Raines Evangelistic Association, The Ronnie, Atlanta, TX
Rakeiho Musical Offerings, Inc., San Francisco, CA
Release to Renew, Orinda, CA
Rotary Club of Germantown Charitabel Trust, Germantown, TN
Roxbury High School Band Parents Association, Succassunna, NJ
Samoa Art Workshop, San Francisco, CA
San Francisco Careers Class, Inc., San Francisco, CA
San Jose Hotline, San Jose, CA
San Pablo Baseball League, Inc., San Pablo, CA
Santa Cruz Hostel Society, Santa Cruz, CA
Sexual Trauma Center, San Francisco, CA
Simmons Genealogical Research Association, Orem, UT
Somerville Family Organization, William, Bountiful, UT
Southeast Asian Cultural Center, San Francisco, CA
Southern Perinatal Association, Inc., The, Durham, NC
Survival Christian Club, Inc., Keithville, LA
Thomas/Richins Genealogical Association, Inc., Salt Lake City, UT
Titus Memorial Scholarship Fund, Randolph, Fairfield, TX
Tucker County Senior Citizens, Inc., Parsons, WV
Turnpike 4-Radio Emergency Team, Mount Laurel, NJ
Tutorial and Educational Assistance for Confined Humans, Inc., San Francisco, CA
United States Ski Team National Training Center Foundation, Park City, UT
University Foundation of Medicine, Bryan, TX
Uranian Foundation, Inc., Washington, DC

Volunteers In Corrections, Inc., Nashville, TN

Wabanaki Corporation, Inc., Crono, ME

Watoto Kuumba Communications, Inc., San Francisco, CA

White Oaks of Charlotte, Inc., Charlotte, NC

Women's Action Training Center, Oakland, CA

World Wide Good Samaritan Club for Youth and Handicapped, San Jose, CA

Yarrow, Inc., San Francisco, CA

Youth Focus Group Home, Inc., Fort Collins, CO

Youth Provisions, Inc., Boston, MA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants and Enrolled Agents from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following person has been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Albert J. Kendall	Wyncote, PA	Attorney	Four months effective January 7, 1980

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from further practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants or enrolled agents to practice before the Internal Revenue Service.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant or enrolled agent so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and hearing before the administrative law judge, the following person was disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
Roy W. Hunt	Redwood City, CA	Certified Public Accountant	January 14, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.401-2, 1.403(b)-1, 1.405-1, amended; 1.401-8A redesignated 1.401-8 and as redesignated amended; 1.401-8 redesignated 1.401(f)-1 and as redesignated amended; 1.401(a)-1, 1.401(a)-2, 1.401(a)-16, 1.415-1 through 1.415-10 added.	Limitations on benefits and contributions under qualified plans.	Jan. 24, 1980	Apr. 23, 1980
26 CFR 1.337 deleted; 1.337-6 amended.	Election to extend the 12-month period for certain corporate liquidations where there is an involuntary conversion.	Jan. 30, 1980	Mar. 31, 1980

Finding List of Current Action on Previously Published Rulings[1]

Bulletin 1980-1 through 1980-9

* Denotes entry since last publication

Delegation Orders:

42 (Rev. 12)
Superseded by
42 (Rev. 13), 1980-4 I.R.B. **40**

Revenue Procedures:

64-44
Superseded by
Rev. Proc. 80-4, 1980-7 I.R.B. **16**

66-53
Superseded by
Rev. Proc. 80-4, 1980-7 I.R.B. **16**

70-6
Amplified by
Rev. Proc. 80-4, 1980-6 I.R.B. **17**

74-23
Superseded by
Rev. Proc. 80-7, 1980-8 I.R.B. **24**

74-24
Superseded by
Rev. Proc. 80-7, 1980-8 I.R.B. **24**

74-25
Superseded by
Rev. Proc. 80-7, 1980-8 I.R.B. **24**

75-3
Superseded by
Rev. Proc. 80-7, 1980-8 I.R.B. **24**

77-36
Superseded by
Rev. Proc. 80-7, 1980-8 I.R.B. **24**

77-40
Superseded by
Rev. Proc. 80-7, 1980-8 I.R.B. **24**

79-12
Amplified by
Rev. Proc. 80-1, 1980-5 I.R.B. **22**

Revenue Rulings:

56-252
Superseded by
80-49, 1980-8 I.R.B. **13**

56-432
Obsoleted by
80-27, 1980-4 I.R.B. **8**

56-497
Obsoleted by
80-16, 1980-3 I.R.B. **6**

62-197
Distinguished by
80-17, 1980-3 I.R.B. **5**

63-180
Obsoleted by
80-16, 1980-3 I.R.B. **6**

64-149
Distinguished by
80-17, 1980-3 I.R.B. **5**

Rev. Ruls.—Continued

64-284
Clarified & Superseded by
80-20, 1980-3 I.R.B. **10**

65-16
Amplified by
80-4, 1980-1 I.R.B. **14**

67-25
Superseded by
80-49, 1980-8 I.R.B. **13**

67-431
Amplified by
80-7, 1980-1 I.R.B. **17**

68-89
Obsoleted by
80-16, 1980-3 I.R.B. **6**

68-382
Distinguished by
80-30, 1980-5 I.R.B. **7**

71-312
Modified & Superseded by
80-47, 1980-8 I.R.B. **11**

74-96
Superseded by
80-47, 1980-8 I.R.B. **11**

74-433
Superseded by
80-62, 1980-8 I.R.B. **9**

74-512
Revoked by
80-53, 1980-8 I.R.B. **15**

75-296
Distinguished by
80-34, 1980-6 I.R.B. **9**

75-368
Modified by
80-6, 1980-1 I.R.B. **16**

76-415
Clarified by
80-59, 1980-9 I.R.B. **18***

77-392
Revoked by
80-31, 1980-5 I.R.B. **8**

77-410
Superseded by
80-62, 1980-8 I.R.B. **9**

78-110
Clarified by
80-22, 1980-3 I.R.B. **15**

78-161
Distinguished by
80-9, 1980-2 I.R.B. **5**

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1 I.R.B., dated January 7, 1980.

INTERNAL REVENUE CUMULATIVE BULLETINS

____	1927–1	$6.90
____	*1927–2*	*2.95*
____	1928–1	6.95
____	1928–2	9.50
____	*1929–1*	*2.50*
____	*1929–2*	*3.15*
____	1930–1	7.30
____	1930–2	9.50
____	*1931–1*	*3.60*
____	*1931–2*	*3.25*
____	*1932–1*	*2.80*
____	1932–2	8.65
____	*1933–1*	*3.35*
____	*1933–2*	*3.45*
____	*1934–1*	*3.70*
____	*1934–2*	*4.10*
____	1935–1	6.90
____	*1935–2*	*4.00*
____	*1936–1*	*3.55*
____	*1936–2*	*3.90*
____	*1937–1*	*3.75*
____	1937–2	7.70
____	*1938–1*	*4.05*
____	*1938–2*	*3.50*
____	1939–1–1	8.25
____	1939–1–2	10.90
____	1939–2	9.40
____	1940–1	5.55
____	1940–2	14.00
____	1941–1	*$6.95*
____	*1941–2*	*3.55*
____	1942–1	7.25
____	*1942–2*	*5.55*
____	*1943*(*)	*9.55*
____	*1944*(*)	*7.85*
____	1945(*)	9.40
____	*1946–1*	*2.55*
____	1946–2	5.20
____	*1947–1*	*1.80*
____	1947–2	3.40
____	*1948–1*	*3.15*
____	1948–2	7.50
____	*1949–1*	*6.90*
____	*1949–2*	*2.80*
____	1950–1	6.35
____	*1950–2*	*4.70*
____	*1951–1*	*2.65*
____	*1951–2*	*5.05*
____	*1952–1*	*2.55*
____	1952–2	7.05
____	*1953–1*	*4.25*
____	1953–2	12.00
____	1954–1	12.00
____	1954–2	12.00
____	1955–1	10.25
____	1955–2	13.00
____	1956–1	15.00
____	1956–2	18.00
____	1957–1	$10.10
____	1957–2	13.00
____	1958–1	9.60
____	1958–2	13.00
____	1958–3	15.00
____	1959–1	15.00
____	1959–2	9.60
____	1960–1	9.00
____	1960–2	11.50
____	1961–1	14.00
____	1961–2	10.00
____	1962–1	6.20
____	1962–2	7.15
____	1962–3	15.00
____	1963–1	9.00
____	1963–2	10.75
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____	1964–1–2	11.00
____	1964–2	9.80
____	1965–1	10.70
____	1965–2	12.25
____	1966–1	9.25
____	1966–2	14.05
____	1967–1	10.00
____	1967–2	10.00
____	1968–1	14.00
____	1968–2	11.75
____	1969–1	7.50
____	1969–2	6.50
____	1969–3	$12.50
____	1970–1	11.00
____	1970–2	14.00
____	1971–1	10.55
____	1971–2	8.50
____	1972–1	13.50
____	1972–2	13.70
____	1973–1	13.20
____	1973–2	8.30
____	1974–1	11.00
____	1974–2	9.95
____	*1974–3*	*8.20*
____	1974–3 Supp.	10.00
____	1975–1	13.25
____	1975–2	13.00
____	1976–1	11.00
____	1976–2	10.25
____	1976–3–1	9.50
____	1976–3–2	16.00
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March 17, 1980
Bulletin No. 1980-11

9258

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENT

Announcement 80-33, page 39.
A public hearing will be held on April 16, 1980, concerning proposed regulations relating to the deposit requirements for social security and withheld income taxes.

INCOME TAX

Rev. Rul. 80-69, page 5.
Charitable contributions; fair market value; gems. A taxpayer purchased an assortment of gems from a promoter who asserted that the price was "wholesale" and who claimed that, if the taxpayer held the gems for over one year and then contributed them to charity, the taxpayer would be entitled to deduct three times the price paid. The deduction allowable is the fair market value of the gems at the time of the contribution, not an artificially calculated estimate of value. The best evidence of the maximum fair market value is the price at which the promoter sold the gems to the taxpayer.

Rev. Rul. 80-70, page 5.
Advanced mineral royalties paid or incurred under minimum royalty provisions. An advanced mineral royalty resulting from a minimum royalty provision and covering a 12-month period extending beyond the taxable year when paid or incurred is not fully deductible in the year when paid or incurred. Only the portion properly attributable to the current taxable year is deductible in the current taxable year. The cost of minerals extracted in subsequent years must be reduced by the advanced royalties deducted to date. Rev. Rul. 77-489 amplified.

Rev. Rul. 80-71, page 7.
Intangible drilling costs; limited partnership; year of deduction. An oil and gas limited partnership made advance payments, at a fixed rate per well, for the costs of drilling oil and gas wells to the parent of its corporate general partner. The parent owned no drilling equipment and subcontracted the actual drilling of the wells to independent drilling contractors, who were paid on a footage and day work basis upon completion of the contracts. These prepayments are not deductible until paid to the independent contractors. Rev. Rul. 71-252 distinguished.

Rev. Rul. 80-72, page 9.
Foreign gold mine; amount at risk. A taxpayer invested a specified amount in a tax shelter arrangement whereby the taxpayer leased a foreign mining company's interest in a gold reserve. The taxpayer authorized the promoter of the arrangement to sell an option on the gold to be extracted and stipulated that the proceeds from the sale of the option and the original investment were to be used for development of the gold reserve. The option can only be exercised after the gold has been extracted, and the holder of the option cannot compel the extraction. The taxpayer is not at risk, within the meaning of section 465 of the Code, with respect to the proceeds from the sale of the option.

(Continued on page 4)

Announcement of Disbarment and Suspensions on page 40.
Announcement of Notice of Proposed Rulemaking on page 41.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part includes rulings and decisions based on Subpart A, Tax Conventions and related Treasury Decisions and Revenue Rulings; Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

Rev. Rul. 80-73, page 10.

Advanced royalties; cash and nonrecourse notes. Under section 1.612-3(b) of the regulations, neither a cash nor an accrual basis taxpayer may deduct as advanced mineral royalties the amount of nonrecourse notes that are payable only to the extent of the proceeds received from the sale of the minerals. Cash paid as advanced royalties is a deferred expense to be taken into account when the minerals are sold.

Rev. Rul. 80-74, page 13.

"Foreign tax haven double trust"; income for benefit of grantor. An example is set forth of a "foreign tax haven double trust" in which an agent in a foreign country, who is named as the "creator", created a trust in that country, naming the taxpayer as trustee. The trust received certain income-producing property from the taxpayer. The "creator" then created a second trust in the same country naming the first trust as trustee. The creation of both trusts will be considered a sham, and the substance of the transaction will control.

Rev. Rul. 80-75, page 26.

Trust treated as association; income beneficiaries' deductions. An example is provided of a business arrangement that is a trust under local law, but is classified as an association taxable as a corporation for federal tax purposes. The income beneficiaries of such an arrangement may not deduct any depreciation or amortization on any property held by the association.

T.D. 7669, page 11.

Temporary regulations under section 612 of the Code relate to the option to capitalize or deduct intangible drilling and development costs in the case of wells drilled for any geothermal deposit.

T.D. 7670, page 14.

Amendments to the regulations relate to the election under section 6013 of the Code by nonresident aliens to be treated as residents and the treatment of community income when the election is not made.

Announcement 80-34, page 39.

Corrections are made to the instructions for the 1979 Form 4972 and the 1979 Form 5544.

EMPLOYMENT TAXES

T.D. 7670, page 14.

Amendments to the regulations relate to the election under section 6013 of the Code by nonresident aliens to be treated as residents and the treatment of community income when the election is not made.

EXCISE TAXES

T.D. 7674, page 22.

Temporary regulations under sections 4064 and 4222 of the Code relate to the gas guzzler tax imposed on manufacturers of automobiles that fail to meet certain fuel economy levels.

ADMINISTRATIVE

Statement of Procedural Rules, page 28.

Miscellaneous amendments to the Statement of Procedural Rules relate to certain changes in the Service's procedure, the elimination of discriminatory language, and the updating of certain provisions.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 167.—Depreciation

26 CFR 1.167(h)-1: Life tenants and beneficiaries of trusts and estates.

Whether income beneficiaries of a trust arrangement may deduct depreciation. See Rev. Rul. 80-75, page 26.

Section 170.—Charitable, Etc., Contributions and Gifts

26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance of deduction.

Charitable contributions; fair market value; gems. A taxpayer purchased an assortment of gems from a promoter who asserted that the price was "wholesale" and who claimed that, if the taxpayer held the gems for over one year and then contributed them to charity, the taxpayer would be entitled to deduct three times the price paid. The deduction allowable is the fair market value of the gems at the time of the contribution, not an artificially calculated estimate of value. The best evidence of the maximum fair market value is the price at which the promoter sold the gems to the taxpayer.

Rev. Rul. 80-69

ISSUE

How is the fair market value of property contributed to charity determined for federal income tax purposes under the circumstances described below?

FACTS

During 1978, an individual taxpayer who was not a dealer in gems purchased an assortment of gems for 500*x* dollars from a promoter who asserted that the price was "wholesale", even though the promoter and various other dealers engaged in numerous similar sales at similar prices with individuals who were not dealers in gems. The promoter represented that if the taxpayer held the gems for over one year and then contributed them to charity the taxpayer would be entitled to a deduction of 1500*x* dollars at the time of contribution. The promoter contended that the value at the time of contribution would be at least three times as much as the price paid by the taxpayer. The taxpayer contributed the gems to a public museum 13 months after purchase, claiming a charitable contributions deduction of 1500*x* dollars. The museum is an organization described in section 170(c) of the Internal Revenue Code, contributions to which are deductible under section 170(a)(1). The museum will use the gems in a manner related to its exempt purposes.

LAW AND ANALYSIS

Section 170(a)(1) of the Code allows as a deduction any charitable contribution (as defined in section 170(c)) payment of which is made within the taxable year.

Section 1.170A-1(c)(1) of the Income Tax Regulations provides that if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of contribution, reduced as provided in section 170(e)(1) of the Code.

Section 1.170A-1(c)(2) of the regulations provides that the fair market value is the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having a reasonable knowledge of relevant facts.

The definition of fair market value depends upon a knowledgeable willing buyer and a knowledgeable willing seller. To determine fair market value, reference is made to the most active marketplace at the time of the donor's contribution. The best evidence of fair market value depends on actual transactions and not on some artificially calculated estimate of value contrary to the prices at which the very gems at issue changed hands in the marketplace. The 500*x* dollars at which the promoter sold the gems to the taxpayer and others, rather than a mere speculative claim of what the gems would be worth, is the best evidence of the maximum fair market value of the gems.

HOLDING

For federal income tax purposes the fair market value of the gems was no greater than 500*x* dollars.

Section 263.—Capital Expenditures

26 CFR 1.263(c)-1: Intangible drilling and development costs in the case of oil and gas wells.

Whether a cash basis taxpayer may, under the circumstances described, deduct the prepayment of intangible drilling and development costs in the taxable year the prepayment is made or must deduct the prepayment rateably as the costs are actually incurred. See Rev. Rul. 80-71, page 7.

Section 461.—General Rule for Taxable Year of Deduction

26 CFR 1.461-1: General rule for taxable year of deduction.
(Also Section 612; 1.612-3.)

Advanced mineral royalties paid or incurred under minimum royalty provisions. An advanced mineral royalty resulting from a minimum royalty provision and covering a 12-month period extending beyond the taxable year when paid or incurred is not fully deductible in the year when paid or incurred. Only the portion properly attributable to the current taxable year is deductible in the current taxable year. The cost of minerals extracted in subsequent years must be reduced by the advanced royalties deducted to date. Rev. Rul. 77-489 amplified.

Rev. Rul. 80-70

ISSUE

Is an advanced mineral royalty resulting from a minimum royalty provision and covering a 12 month period extending beyond the taxable year when the liability is paid or incurred deductible in full in the year when paid or incurred by a taxpayer using either the cash receipts and disbursements method or the accrual method of accounting?

FACTS

Situation 1

X uses the cash receipts and disbursements method of accounting and files its federal income tax returns on a calendar year basis. On December 1, 1977, *X* and *Y* entered into a lease agreement under which *X* obtained the operating mineral interest in a mineral property from *Y*. The agreement requires *X* to pay *Y* a production royalty of 5 percent of the proceeds received from the sale of minerals extracted during each lease year over the 10 year lease term. Regardless of production, *X* is required to make a nonrefundable payment to *Y* of 60*x* dollars on the first day (December 1) of each annual leasing period. Production royalties otherwise due each lease year are to be reduced by the 60*x* dollars paid on December 1 of each year. In any year in which the minimum royalty exceeds the production royalties, the excess is to be applied to reduce the production royalties due for any subsequent year.

The mineral reserves committed to the lease are substantially in excess of those sufficient for complete pay-out of the total minimum royalty and it is practical to extract a quantity of the mineral over the term of the agreement in excess of that necessary for complete payout of the total minimum royalty.

On December 1, 1977, *X* paid 60*x* dollars to *Y* for the lease period December 1, 1977, through November 30, 1978. *X* extracted no minerals from the leased property during December 1977. In accordance with section 1.612-3(b)(3) of the Income Tax Regulations, *X* elected to treat the advanced royalties as deductions from gross income for the year in which the advanced royalties are paid or accrued.

Situation 2

The facts are the same as in *Situation 1* except that *X* uses the accrual method of accounting and executes a negotiable promissory note on December 1 of each lease year payable on demand to *Y* as payment for the 60*x* dollars.

LAW AND ANALYSIS

Section 461(a) of the Internal Revenue Code provides that the amount of any deduction shall be taken for the taxable year that is the proper taxable year under the method of accounting used in computing taxable income.

Section 1.461-1(a)(1) of the regulations provides that, under the cash receipts and disbursements method of accounting, amounts representing allowable deductions shall, as a general rule, be taken into account for the taxable year in which paid.

Section 1.461-1(a)(2) of the regulations provides that, under the accrual method of accounting, an expense is deductible for the taxable year in which all the events have occurred that determine the fact of the liability and the amount thereof can be determined with reasonable accuracy.

Section 1.612-3(b)(3) of the regulations provides that the payor shall treat the advanced royalties paid or accrued in connection with mineral property as deductions from gross income for the year the mineral product, in respect of which the advanced royalties were paid or accrued, is sold. However, in the case of advanced mineral royalties paid or accrued in connection with mineral property as a result of a minimum royalty provision, the payor, at its option, may instead treat the advanced royalties as deductions from gross income for the year in which the advanced royalties are paid or accrued. This subparagraph further provides that no deduction is allowed under this provision that is disallowed under other provisions of the Code such as section 461.

Rev. Rul. 77-489, 1977-2 C.B. 177, addresses the deductibility of cumulative advanced minimum royalties due over the term of a ten year lease. Rev. Rul. 77-489 provides two situations in which a taxpayer using the cash receipts and disbursements method of accounting and a taxpayer using the accrual method of accounting attempt to accelerate the deduction for the payment of the cumulative advanced minimum royalties either by paying the full amount of these royalties due over the ten year lease term in cash or by executing a negotiable promissory note payable on demand for these royalties. In both situations in Rev. Rul. 77-489, payment of the cumulative advanced minimum royalties due over the ten year lease was made on the first day of the taxable year. Rev. Rul. 77-489 concludes that, for both the taxpayers, only that portion of the advanced minimum royalties that is properly attributable to the initial year of the lease is deductible in that year. The present situation differs from Rev. Rul. 77-489 in that it involves only a 12 month portion of the cumulative advanced minimum royalty due over the ten year lease and the period used for fixing liability under the lease is not coextensive with the taxable year of payment or accrual.

In *Zaninovich v. Commissioner,* 69 T.C. 605 (1978), a taxpayer deducted in the year of payment a full 12 months' rent that was attributable to 2 taxable years. In disallowing the deduction, the court stated the general rule for rental deductions as provided in *University Properties, Inc. v. Commissioner,* 45 T.C. 416, 421 (1966), *aff'd,* 378 F.2d 83 (9th Cir. 1967):

> Rentals may be deducted as such only for the year or years to which they are applied. If they are paid for the continued use of the property beyond the years in which paid they are not deductible in full in the year paid but must be deducted ratably over the years during which the property is so used.

In both situations 1 and 2, *X* has elected pursuant to section 1.612-3(b)(3) of the regulations to treat the advanced royalties as deductions from gross income for the year in which the advanced royalties are paid or accrued. This election is in lieu of deducting the advanced royalties in the year the mineral product in respect of which the advanced royalties were paid or accrued is sold.

In *Burnet v. Hutchinson Coal Co.,* 64 F.2d 275 (4th Cir. 1933), and *Commissioner v. Jamison Coal and Coke Co.,* 67 F.2d 342 (3rd Cir. 1933), the courts indicated that minimum royalty payments are like rent. In accordance with *Zaninovich,* the portion of the payment made by cash or negotiable promissory note for the advanced royalties applicable to the months in the lease period occurring in 1978 is not deductible in 1977. This result is the same for both the taxpayer using the cash receipts and disbursements method of accounting and the taxpayer using the accrual method of accounting. See *Smith v. Commissioner,* 51 T.C. 429 (1968).

In both *Situation 1* and *Situation 2,* *X* may deduct only 5*x* dollars of the advanced royalty resulting for the minimum royalty provision for the taxable year 1977. For subsequent taxable years remaining on the lease *X* may deduct 60*x* dollars of advanced royalties, consisting of 55*x* dollars from the lease year beginning in the prior taxable year and 5*x* dollars from the lease year beginning in the current taxable year. However, if production occurs in subsequent taxable years, the taxpayer must reduce the cost of minerals extracted by the amount of the advanced royalties that have been deducted to date.

HOLDING

An advanced mineral royalty resulting from a minimum royalty provision and covering a 12 month period extending beyond the taxable year when paid or the liability is incurred is not deductible in full in the year when paid or the liability is incurred by either a taxpayer using the cash method of accounting or a taxpayer using the accrual method of accounting. Only that portion of an advanced minimum royalty paid or incurred that is properly attributable to the current taxable year is deductible by either of these taxpayers. Furthermore, if production occurs in subsequent taxable years, the taxpayer must reduce the cost of minerals extracted by the amount of the advanced royalties that have been deducted to date.

EFFECT ON OTHER RULINGS

Rev. Rul. 77-489 is amplified.

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26 CFR 1.461-1: General rule for taxable year of deduction.
(Also Sections 263, 612; 1.263(c)-1, 1.612-4.)

Intangible drilling costs; limited partnership; year of deduction. An oil and gas limited partnership made advance payments, at a fixed rate per well, for the costs of drilling oil and gas wells to the parent of its corporate general partner. The parent owned no drilling equipment and subcontracted the actual drilling of the wells to independent drilling contractors, who were paid on a footage and day work basis upon completion of the contracts. These prepayments are not deductible until paid to the independent contractors. Rev. Rul. 71-252 distinguished.

Rev. Rul. 80-71

ISSUE

Whether under the circumstances described below a limited partnership that uses the cash receipts and disbursements method of accounting is entitled to deduct in the tax year amounts that are paid within the tax year as "intangible drilling and development costs," and optionally expensed under the provisions of section 1.612-4 of the Income Tax Regulations.

FACTS

A limited partnership (*LP*) was organized in 1975 for the exploration and development of oil and gas lands. *LP* was formed by 100*x* limited partners who each contributed $1,000*x* to the limited partnership. The general partner of *LP* is corporation *X* whose parent, corporation *Y*, is the general contractor that will arrange for the drilling, completion, and equipping of the oil and gas wells. The partnership reports its income on a calendar year basis.

The partnership agreement provides that corporation *X* will transfer to *LP*, as its contribution to capital, certain oil and gas leases, mineral rights, equipment, and a specified amount of cash. The limited partners are allocated the deduction for intangible drilling and development costs.

As general partner, corporation *X* has control over the operations of the partnership, including the authority to make any expenditures and incur any obligation that it deems necessary, as well as to make the determination of which wells will be drilled. Corporation *Y*, as general contractor, will conduct the drilling, testing, and completion, or if nonproductive, the abandonment of each well in which *LP* participates. *Y* will charge a fixed fee for such services.

In October 1975, corporation *X*, acting on behalf of *LP*, entered into an agreement with corporation *Y* for the drilling of wells on tracts covered by leasehold interests previously contributed to *LP* by *X*. For certain of the proposed drill sites the entire working or operating interests were held by *LP*. For other proposed drill sites, *LP* owned only an undivided fraction of the working interest, and drilling was to be a joint undertaking between *LP* and other co-owners.

The agreement set forth a fixed price ($10,000*x*) for the intangible costs of drilling and completion of each well and a separate fixed price ($8,000*x*) for the drilling and abandonment without attempted completion of any that was abandoned after drilling commenced. For all wells to be drilled for *LP*, the agreement required that the designated fixed prices for drilling and completion be remitted to *Y* on or before December 31, 1975. In the event that any well was drilled and abandoned without completion, the difference between the price advanced on or before December 31 and the fixed price for drilling without completion was to be credited toward the cost of drilling another well or wells at locations to be designated in the future. The agreement did not specify any date for commencement of drilling operations by corporation *Y*.

In accordance with the terms of the agreement, on December 31, 1975, *LP* advanced to *Y* sums representing *LP*'s portion of the fixed prices for well drilling to be performed on or after January 1, 1976. Having previously elected to expense intangible drilling and development costs, *LP* deducted the advance payments in its Form 1065 partnership return for the year 1975, a year in which *LP* had no income or other expense.

Y owned no drilling equipment, and the actual drilling of the wells was subcontracted to independent drilling contractors. The contracts were of the conventional footage and day work variety and did not require any payments to be made by *Y* to the drillers prior to completion of performance by the drillers.

LAW AND ANALYSIS

Section 263(c) of the Internal Revenue Code provides that, notwithstanding section 263(a), regulations shall be prescribed by the Secretary granting taxpayers an election to deduct, as expenses, intangible drilling and development costs in the case of oil and gas wells. In accordance with section 263(c), section 1.612-4(a) of the regulations provides that intangible drilling and development costs incurred by an operator in the development of oil and gas properties may at the taxpayer's option be chargeable to capital or to expense.

Section 446(a) of the Code provides that taxable income shall be computed under the method of accounting the taxpayer employs to regularly compute its income in keeping its books. Section 446(c) provides that certain methods are permissible subject to the requirement of section 446(b). Section 446(b) provides that if the method used by the taxpayer does not clearly reflect income, the computation of taxable income shall be made under such method as, in the opinion of the Secretary, does clearly reflect income.

Section 461 of the Code provides that the amount of any deduction allowed by subtitle A shall be taken for the taxable year that is the proper taxable year under the method of accounting used in computing taxable income.

Section 1.446-1(a)(1) of the regulations provides that the term, "method of accounting", includes not only the overall method of accounting of a taxpayer but also the accounting treatment of any item of income or deduction.

Section 1.461-1(a) of the regulations provides that if an expenditure results in the creation of an asset having a useful life that extends substantially beyond the close of the taxable year, such expenditure may not be deductible or may be deductible only in part, for the taxable year in which made.

Therefore, if the method adopted by the taxpayer for a particular item or transaction does not clearly reflect income, section 446(b) specifically empowers the Commissioner to compute taxable income under such method as, in the opinion of the Commissioner, does clearly reflect income.

In Rev. Rul. 71-252, 1971-1 C.B. 146, a taxpayer using the cash receipts and disbursements method of accounting deducted in the year paid intangible drilling and development costs. In that revenue ruling the taxpayer began in 1969 investigating the oil and gas producing potential of a certain tract of land. After receiving a favorable report thereon the taxpayer acquired, in October 1969, a lease of the oil and gas operating interest in the tract. On December 31, 1969, the taxpayer executed a written drilling contract with a drilling contractor. On the same day, as required by the terms of the contract, the taxpayer paid 100*x* dollars to the contractor. In March 1970, the well was completed successfully for the production of oil and gas. After discussing *Pauley v. United States*, (S.D. Cal., 1963), Rev. Rul. 71-252 holds that the 100*x* dollars intangible drilling and development costs were deductible by the taxpayer in 1969, the year they were paid.

The prepayment in *Pauley* was occasioned by the drillers' concern with Pauley's willingness and ability to pay when the driller needed operating funds. The driller had no earlier business dealings with Pauley, but knew that he was involved in many other business activities. The court found that the driller required prepayment of the drilling expenses for sufficient business reasons. The drilling permit was not issued until December 30, 1947, and other "complicated and diverse" negotiations were being carried out late in 1947 by Pauley. Drilling activities commenced immediately after December 31, 1947, and proceeded without any substantial delay until completion on March 12, 1948.

These findings evidenced a bona fide, arm's length transaction entered into for a valid business purpose, and provided the basis for the court's holding that the prepayment was an allowable expense in the year payment was made and deductible in that year. Further, the prepayment was exhausted within two and one-half months of payment.

Intangible drilling and development costs are capital in nature. However, section 263(c) of the Code, as implemented by section 1.612-4(a) of the regulations, provides taxpayers an election to expense intangible drilling and development expenditures that otherwise would be capitalized under section 263(a). Merely because a taxpayer has elected to charge intangible drilling and developments costs to expense, it does not follow that all amounts paid are deductible in the year of payment when such payment is made in advance of the rendering of services by the drilling contractor. Prepaid intangible drilling and development costs are subject to the same standards applicable to other prepaid expense items. Section 263(c) does not permit a taxpayer unlimited control of the timing of the deduction for drilling and development costs. Instead, the timing of a deduction must meet the specific limitations of section 1.461-1(a) of the regulations in order to meet the clear reflection of income requirement contained in section 446(b).

Here, at the time the prepayments were made neither the date for commencing nor completing drilling of the wells was specified. Furthermore, the prepayments for the intangible drilling costs were made by *LP* (the investor group partnership) to *Y*, the general contractor (and the parent of *X*, the general partner), who in turn was to contract with the actual drilling contractor for the drilling of the well. The prepayments could also be applied to later, not as yet contracted for, wells to the extent of unsuccessful completions. All of this indicates that the prepayments by *LP* to *Y* were not made in accordance with customary business practice.

The prepayments themselves were assets having useful lives that extended substantially beyond the close of *LP*'s 1975 tax year. Since *LP* had no income for the year of the deduction, the facts indicate the expenditures here were prompted by the federal income tax advantages that resulted from the deduction.

Considering the facts and circumstances in the present case in the light of the above analysis, *LP*'s deduction for the prepaid intangible drilling and development costs results in a substantial distortion of *LP*'s income for the year of payments.

HOLDING

LP's prepayments are not deductible in 1975. However, the payments are deductible in the tax year or years *Y* pays the independent drilling contractors under their conventional footage and day work contracts with *Y*, if the clear reflection of income requirements of section 446(b) of the Code are satisfied.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 71-252 is distinguished.

Section 465.—Deductions Limited to Amount at Risk in Case of Certain Activities

Foreign gold mine; amount at risk. A taxpayer invested a specified amount in a tax shelter arrangement whereby the taxpayer leased a foreign mining company's interest in a gold reserve. The taxpayer authorized the promoter of the arrangement to sell an option on the gold to be extracted and stipulated that the proceeds from the sale of the option and the original investment were to be used for development of the gold reserve. The option can only be exercised after the gold has been extracted, and the holder of the option cannot compel the extraction. The taxpayer is not at risk, within the meaning of section 465 of the Code, with respect to the proceeds from the sale of the option.

Rev. Rul. 80-72

ISSUE

Do the "at risk" provisions of section 465 of the Internal Revenue Code apply under the circumstances described below?

FACTS

In 1979, *M*, a consortium of private foreign corporations, marketed a tax shelter arrangement purporting to give investors a tax write-off equal to four times the cash invested. *A*, an individual, invested 100*x* dollars in the arrangement.

In connection with this investment, *A* executed the following documents:

1. A "mineral claim lease" whereby *A* leases from *P*, a foreign mining company, the mineral rights to a gold reserve located in *X*, a foreign country. Under the lease, *A* is entitled to explore, develop and extract all recovered gold on the premises until 1986, the date of expiration of the lease. *A* must pay *P* a certain royalty per gram for all the recovered gold after first deducting all the tax due to *X*, extraction costs and the development costs. *A* also agreed to expend 400*x* dollars for the development to ready the claim for extraction no later than December 31, 1979. However, *A* is not obligated to extract the gold. Whether and when the gold is actually extracted is within the control of *A*.

2. An authorization agreement under which *A* authorizes *M* to sell for 300*x* dollars a gold option, described below, on the total minerals to be extracted under the terms of the mineral claim lease. The authorization further specifies that the proceeds from the sale of the gold option shall be used with the 100*x* dollars remitted by *A* to pay for development of the claim by a contractor that *M* retains on *A*'s behalf.

3. A gold option by which for a 300*x* dollar premium, *A* grants to *C*, a party obtained by *M*, the option to purchase all the gold contained in the mineral claim lease subject to the tax due to *X*, lessor royalty, development costs, and extraction cost. After payment of the above costs, the exercise price for the remaining gold shall be approximately one-third the current fair market value of gold. *C* as option holder agrees that the option can only be exercised after the gold has been extracted. Further, *C* cannot compel the extraction of gold. If necessary arrangements are not made for extracting the gold prior to the expiration date of the option in 1986, *A* acknowledges and agrees that the option holder has the first right of refusal for entering into a new lease for the mineral claim with *P*. In the gold option, *M* represents that gold in commercially marketable quantities has been shown to exist in the mineral claim.

After receipt of the above, *M* sent *A* copies of the executed documents in addition to invoices and cancelled checks for development of the mining claim in the amount of 400*x* dollars. These were dated on or before December 31, 1979. On *A*'s 1979 tax return, *A* claimed a 400*x* dollars deduction for development expenditures under section 616(a) of the Code.

LAW AND ANALYSIS

Section 616(a) of the Code provides that except where the taxpayer elects otherwise as provided in section 616(b), there shall be allowed as a deduction in computing taxable income all expenditures paid or incurred during the taxable year for the development of a mine or other natural deposit (other than an oil or gas well) if paid or incurred after the existence of ores or minerals in commercially marketable quantities has been disclosed.

Section 465 of the Code provides that in the case of an individual engaged in an activity to which this section applies, any loss from such activity for the taxable year shall be allowed only to the extent of the aggregate amount with respect to which the taxpayer is at risk (within the meaning of subsection (b)) for such activity at the close of the taxable year.

For taxable years beginning after December 31, 1978, section 465(c)(3)(A) of the Code provides that section 465 applies to each activity engaged in by the taxpayer in carrying on a trade or business or for the production of income.

Section 465(b)(1) of the Code provides that a taxpayer shall be considered at risk for an activity with respect to amounts, including the amount of money and the adjusted basis of other property, contributed by the taxpayer to the activity, and amounts borrowed with respect to such activity (as determined under paragraph (2)).

Section 465(b)(2) of the Code provides that a taxpayer shall be considered at risk with respect to amounts borrowed for use in an activity to the extent that the taxpayer is personally liable for the repayment of such amounts or has pledged property, other than property used in such activity, as security for such borrowed amount.

Section 465(b)(4) of the Code provides that notwithstanding any other provision of this section, a taxpayer shall not be considered at risk with respect to amounts protected against loss through nonrecourse financing, guarantees, stop loss agreements, or other similar arrangements.

See the Senate Committee on Finance Report on the Tax Reform Act of 1976, S. Rep. No. 94-938, 94th Cong., 2d Sess. 1 (1976), 1976-3 C.B. (Vol. 3) 57, at 87.

The legislative history indicates that Congress intended the at risk provisions to cover arrangements the effect of which is to insulate taxpayers from "economic loss."

In this case, *A* has obtained 300*x* dollars by selling an option that can be exercised only if gold is found and extracted by or on behalf of *A*. If no gold is found, or if *A* fails to extract any gold found, *A* will have no obligation to the option holder, *C*. Moreover, as part of the same arrangement, *A* will expend the 300*x* dollars (plus the 100*x* dollars remitted by *A*) to pay for development of the claim. Thus, *A*'s at risk position in relation to the 300*x* dollars is substantially the same as if the 300*x* dollars had been borrowed from *C* on a nonrecourse basis repayable only from *A*'s interest in the activity. Under these facts the selling of the option is an "other similar arrangement" to nonrecourse financing as provided in section 465(b)(4), whereby *A* is effectively protected from any true economic risk.

HOLDING

A is not at risk within the meaning of section 465 of the Code with respect to the 300*x* dollars premium received on the sale of the option. Further the 100*x* deduction attributable to *A*'s actual cash investment is deductible on *A*'s 1979 tax return only to the extent that *A* can prove that it was expended during the taxable year for the development of a mine and that the existence of ores in commercially marketable quantities had previously been disclosed in that mine.

Section 612.—Basis for Cost Depletion

26 CFR 1.612-3: Depletion; treatment of bonus and advanced royalty.

Advanced royalties; cash and nonrecourse notes. Under section 1.612-3(b) of the regulations, neither a cash nor an accrual basis taxpayer may deduct as advanced mineral royalties the amount of nonrecourse notes that are payable only to the extent of the proceeds received from the sale of the minerals. Cash paid as advanced royalties is a deferred expense to be taken into account when the minerals are sold.

Rev. Rul. 80-73

ISSUE

In what year and to what extent may a taxpayer using the cash receipts and disbursements method of accounting deduct cash and notes given as advanced royalties; and similarly, in what year and to what extent may a taxpayer using the accrual method of accounting deduct notes given as advance royalties?

FACTS

On January 1, 1977, *A*, an individual, and *Y* entered into a lease agreement under which *A* obtained an operating mineral interest in mineral property owned by *Y*. The agreement provides that a minimum advanced royalty is due *Y* each lease year over the 10-year lease term in the amount of 600*x* dollars, payable at the beginning of each lease year. The lease further provides that, for the first year, payment of the royalty is to be made in cash and a promissory note, and for all subsequent years payments may be made entirely with notes. The amount of the minimum annual royalty reasonably reflects the value of the leasehold interest. *A* is a cash method, calendar year taxpayer.

On January 1, 1977, *B*, an individual, also entered into the same type of agreement with *Y* except that the advanced mineral royalties payable at the beginning of each lease year may be made entirely with promissory notes. *B* is an accrual method, calendar year taxpayer.

In both cases the notes are unsecured, nonrecourse, non-interest bearing, have no maturity date, and are payable only to the extent of the proceeds received from the sale of the minerals.

On January 1, 1977, *A* gave *Y* 150*x* dollars in cash and a note for 450*x* dollars. *B* gave *Y* a note for 600*x* dollars.

LAW AND ANALYSIS

Section 1.612-3(b)(1) of the Income Tax Regulations provides that advanced royalties exist when the owner of an operating interest in a mineral deposit or standing timber is required to pay royalties on a specified number of units of such mineral or timber annually whether or not extracted or cut within the year, and the owner may apply any amounts paid on account of units not extracted or cut within the year against the royalty on the mineral or timber thereafter extracted or cut.

Section 1.612-3(b)(3) of the regulations provides that the payor shall treat the advanced royalties paid or accrued in connection with mineral property as deductions from gross income for the year the mineral product, in respect of which the advanced royalties were paid or accrued, is sold. However, if advanced mineral royalties are paid or accrued in connection with mineral property as a result of a minimum royalty provision, the payor, at its option, may instead treat the royalties as deductions from gross income for the years in which the advanced royalties are paid or accrued. A minimum royalty provision requires that a substantially uniform amount of royalties be paid at least annually either over the life of the lease or for a period of 20 years.

Under section 1.612-3(b) of the regulations advanced royalties may only be deducted when payment is not contingent upon the extraction of the mineral. Here, payments of the notes are contingent upon extraction and sale of the minerals. Consequently, except for the cash payment, all royalties both as to *A* and *B* are not advanced royalties paid or accrued within the meaning of section 1.612-3(b) of the regulations because there is no fixed liability to pay any royalty until the minerals are produced and sold. The cash payment is an advanced royalty, but does not result from a minimum royalty provision because substantially uniform royalties are not required to be paid each year over the life of the lease.

Moreover, the giving of the note by *A* does not constitute payment. For a payment to be deductible by a cash method taxpayer there must be a depletion of assets and, therefore, the payment must be in cash or its equivalent. If the note is never paid, the cash method maker has not parted with anything other than a promise to pay. A promise to pay is not cash or its equivalent. *See Eckert v. Burnet,* 283 U.S. 140 (1931), X-1 C.B. 241; *Page v. Rhode Island Hospital Trust Co. Executor,* 88 F.2d 192 (1st Cir. 1937).

HOLDING

A deduction is not allowable to *A* or *B* for the amount of the notes because under section 1.612-3(b) of the regulations an advanced royalty must be payable whether or not the minerals are extracted and sold. Here the notes are payable only out of the proceeds received from the sale of the minerals. While the 150x dollars actually paid in cash by *A* is an advanced royalty under section 1.612-3(b), it is deductible only for the year the mineral product, in respect of which the advance royalties were paid, is sold because it does not result from a minimum royalty provision.

For years after December 31, 1978, see also section 465 as amended by the Revenue Act of 1978.

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26 CFR 1.612-3: Depletion; treatment of bonus and advanced royalty.

Whether an advanced mineral royalty resulting from a minimum royalty provision and covering a 12 month period extending beyond the taxable year when the liability is paid or incurred is deductible in full in the year when paid or incurred by a taxpayer using either the cash receipts and disbursements method or the accrual method of accounting. See Rev. Rul. 80-70, page 5.

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26 CFR 1.612-4: Charges to capital and to expense in case of oil and gas wells.

Whether a cash basis taxpayer may, under the circumstances described, deduct the prepayment of intangible drilling and development costs in the taxable year the prepayment is made or must deduct the prepayment rateably as the costs are actually incurred. See Rev. Rul. 80-71, page 7.

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26 CFR 5a.612-1: Changes to capital and to expense in case of geothermal wells.

T.D. 7669

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 5a.—TEMPORARY INCOME TAX REGULATIONS UNDER THE ENERGY TAX ACT OF 1978

Option to Capitalize or Deduct Intangible Drilling and Development Costs in the Case of Wells Drilled for any Geothermal Deposit

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides Temporary Income Tax Regulations relating to the option to capitalize or deduct intangible drilling and development costs in the case of wells drilled for any geothermal deposit. Changes to the applicable tax law were made by the Energy Tax Act of 1978 [Pub. L. 95-618, 1978-3 C.B. (Vol. 2) 1]. In addition, the rules contained in the temporary regulations set forth in this document also serve as a notice of proposed rulemaking by which the rules contained therein are proposed to be prescribed as final regulations.

DATES: These temporary regulations are effective for taxable years ending on or after October 1, 1978, with respect to getothermal wells commenced on or after that date. Written comments and requests for a public hearing must be delivered or mailed by March 31, 1980.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-202-78), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: David B. Cubeta of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3926).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains temporary regulations under section 612 of the Internal Revenue Code of 1954. The temporary regulations are required to implement section 402(a) and (e) of the Energy Tax Act of 1978 (92 Stat. 3174).

The regulations promulgated in this document are also proposed to be prescribed as final Income Tax Regulations (26 CFR Part 1) under section 612 of the Internal Revenue Code of 1954.

WAIVER OF PROCEDURAL REQUIREMENTS OF TREASURY DIRECTIVE

The expeditious adoption of the provisions contained in this document is necessary because of the need for immediate guidance to taxpayers eligible for the option to deduct as expenses intangible drilling and development costs in the case of wells drilled for any geothermal deposit. For this reason, Jerome Kurtz, Commissioner of Internal Revenue, has determined that the provisions of paragraphs 8 through 14 of the Treasury Department directive implementing Executive Order 12044 must be waived.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adoption of the final regulations proposed in this document, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing, is held, notice of the time and place will be published in the Federal Register.

DRAFTING INFORMATION

The principal author of these regulations is David B. Cubeta of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, a new Part 5a, Temporary Income Tax Regulations under the Energy Tax Act of 1978, is added to Title 26 of the Code of Federal Regulations and the following temporary regulations are adopted:

§ 5a.612-1 Charges to capital and to expense in case of geothermal wells.

(a) *Option with respect to intangible drilling and development costs.* In accordance with the provisions of section 263(c), intangible drilling and development costs incurred by an operator (one who holds a working or operating interest in any tract or parcel of land either as a fee owner or under a lease or any other form of contract granting working or operating rights) in the development of a geothermal deposit (as defined in section 613(e)(3) and the regulations thereunder) may at the operator's option be chargeable to capital or to expense. This option applies to all expenditures made by an operator for wages, fuel, repairs, hauling, supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of geothermal steam or hot water. Such expenditures have for convenience been termed intangible drilling and development costs. They include the cost to operators of any drilling or development work (excluding amounts payable only out of production or gross or net proceeds from production, if such amounts are depletable income to the recipient, and amounts properly allocable to cost of depreciable property) done for them by contractors under any form of contract, including turnkey contracts. Examples of items to which this option applies are all amounts paid for labor, fuel, repairs, hauling, and supplies, or any of them, which are used—

(1) In the drilling, shooting, and cleaning of wells,

(2) In such clearing of ground, draining, road making, surveying, and geological work as are necessary in preparation for the drilling of wells, and

(3) In the construction of such derricks, tanks, pipelines, and other physical structures as are necessary for the drilling of wells and the preparation of wells for the production of geothermal steam or hot water.

In general, this option applies only to expenditures for those drilling and developing items which in themselves do not have a salvage value. For the purpose of this option, labor, fuel, repairs, hauling, supplies, etc. are not considered as having a salvage value, even though used in connection with the installation of physical property which has a salvage value. Included in this option are all costs of drilling and development undertaken (directly or through a contract) by an operator of a geothermal property whether incurred by the operator prior or subsequent to the formal grant or assignment of operating rights (a leasehold interest, or other form of operating rights, or working interest); except that in any case where any drilling or development project is undertaken for the grant or assignment of a fraction of the operating rights, only that part of the costs thereof which is attributable to such fractional interest is within this option. In the excepted cases, costs of the project undertaken, including depreciable equipment furnished, to the extent allocable to fractions of the operating rights held by others, must be capitalized as the depletable capital cost of the fractional interest thus acquired.

(b) *Recovery of optional items, if capitalized.* (1) Items recoverable through depletion: If the taxpayer charges such expenditures as fall within the option to capital account, the amounts so capitalized and not deducted as a loss are recoverable through depletion insofar as they are not represented by physical property. For the purposes of this section the expenditures for clearing ground, draining, road making, surveying, geological work, excavation, grading, and the drilling, shooting, and cleaning of wells, are considered not to be represented by physical property, and when charged to capital account are recoverable through depletion.

(2) Items recoverable through depreciation: If the taxpayer charges such expenditures as fall within the option to capital account, the amounts so capitalized and not deducted as a loss are recoverable through depreciation insofar as they are represented by physical property. Such expenditures are amounts paid for wages, fuel, repairs, hauling, supplies, etc. used in the installation of casing and equipment and in the construction on the property of derricks and other physical structures.

(3) In the case of capitalized intangible drilling and development costs incurred under a contract, such costs shall be allocated between the foregoing classes of items specified in subparagraphs (1) and (2) for the purpose of determining the depletion and depreciation allowances.

(4) Option with respect to cost of nonproductive wells: If the operator has elected to capitalize intangible drilling and development costs, then an additional option is accorded with respect to intangible drilling and development costs incurred in drilling a nonproductive well. Such costs incurred in drilling a nonproductive well may be deducted by the taxpayer as an ordinary loss provided a proper election is made in the taxpayer's original or amended return for the first taxable year ending on or after October 1, 1978, in which such a nonproductive well is completed. The taxpayer must make a clear statement of election under this option in the return or amended return. The election may be revoked by the filing of an amended return that does not contain such a statement. The absence of a clear indication in such return of an election to deduct as ordinary losses intangible drilling and development

costs of nonproductive wells shall be deemed to be an election to recover such costs through depletion to the extent that they are not represented by physical property, and through depreciation to the extent that they are represented by physical property. Upon the expiration of the time for filing a claim for credit or refund of any overpayment of tax imposed by chapter 1 of the Code with respect to the first taxable year ending on or after October 1, 1978 in which a nonproductive well is completed, the taxpayer is bound for all subsequent years by his exercise of the option to deduct intangible drilling and development costs of nonproductive wells as an ordinary loss or his deemed election to recover such costs through depletion or depreciation.

(c) *Nonoptional items distinguished.* (1) Capital items: The option with respect to intangible drilling and development costs does not apply to expenditures by which the taxpayer acquires tangible property ordinarily considered as having a salvage value. Examples of such items are the costs of the actual materials in those structures which are constructed in the wells and on the property, and the cost of drilling tools, pipe, casing, tubing, tanks, engines, boilers, machines, etc. The option does not apply to any expenditure for wages, fuel, repairs, hauling, supplies, etc., in connection with equipment, facilities, or structures, not incident to or necessary for the drilling of wells, such as structures for treating geothermal steam or hot water. These are capital items and are recoverable through depreciation.

(2) Expense items: Expenditures which must be charged off as expense, regardless of the option provided by this section, are those for labor, fuel, repairs, hauling, supplies, etc., in connection with the operation of the wells and of other facilities on the property for the production of geothermal steam or hot water.

(d) *Manner of making election.* The option granted in paragraph (a) of this section to charge intangible drilling and development costs to expense may be exercised by claiming intangible drilling and development costs as a deduction on the taxpayer's original or amended return for the first taxable year ending on or after October 1, 1978, in which the taxpayer pays or incurs such costs with respect to a geothermal well commenced on or after that date. No formal statement is necessary. The exercise of the option may be revoked by the filing of an amended return that does not claim such a deduction. If the taxpayer fails to deduct such costs as expenses in any such return, he shall be deemed to have elected to recover such costs through depletion to the extent that they are not represented by physical property, and through depreciation to the extent that they are represented by physical property. Upon the expiration of the time for filing a claim for credit or refund of any overpayment of tax imposed by chapter 1 of the Code with respect to the first taxable year ending on or after October 1, 1978, in which the taxpayer pays or incurs intangible drilling and development costs with respect to a geothermal well commenced on or after that date, the taxpayer is bound by his exercise of the option to charge such costs to expense or his deemed election to recover such costs through depletion or depreciation for that year and for all subsequent years.

(e) *Effective date.* The option granted by paragraph (a) of this section is available only for taxable years ending on or after October 1, 1978, with respect to geothermal wells commenced on or after that date.

There is need for the immediate guidance provided by the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in sections 263 and 7805 of the Internal Revenue Code of 1954 (92 Stat. 3201; 26 U.S.C. 263; 68A Stat. 917; 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved January 16, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on January 29, 1980, 8:45 a.m., and published in the issue of the Federal Register for January 30, 1980, 45 F.R. 6778)

Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners

26 CFR 1.671-1: Grantors and others treated as substantial owners; scope.

"Foreign tax haven double trust"; income for benefit of grantor. An example is set forth of a "foreign tax haven double trust" in which an agent in a foreign country, who is named as the "creator", created a trust in that country, naming the taxpayer as trustee. The trust received certain income-producing property from the taxpayer. The "creator" then created a second trust in the same country naming the first trust as trustee. The creation of both trusts will be considered a sham, and the substance of the transaction will control.

Rev. Rul. 80-74

ISSUE

What are the federal income tax consequences of the scheme to create trusts in a foreign country in the circumstances described below?

FACTS

The taxpayer is a U.S. citizen. In 1979, the taxpayer attended a meeting arranged by a promoter of the "foreign tax haven double trust." The promoter represented that the "double trust" would radically reduce or eliminate the United States income tax liabilities of the taxpayer. According to the promoter, the "double trust" would also provide various other benefits such as avoidance of probate, elimination of federal estate and gift tax liability, and avoidance of various state and local taxes. Also, according to the promoter, the "double trust" is a contractual arrangement known as a "pure trust" and the taxpayer has a constitutional right to create such trusts without fear of interference by federal or state authority.

Under the promoter's direction, the taxpayer agreed to the creation of a "double trust" arrangement. Pursuant to this agreement, the promoter directed an agent in a foreign country to create a trust in that country, referred to as "Trust 1," for the taxpayer. The foreign agent, referred to as the "creator," named the taxpayer as trustee and the taxpayer transferred to Trust 1 certain income-producing real estate and corporate securities, and the assets of the taxpayer's sole proprietorship. The foreign "creator" of Trust 1 then created a second trust (Trust 2) in the same foreign country, naming Trust 1 as trustee of Trust 2.

Except for the names of the trustees, Trust 1 and Trust 2 are identical. Each trust instrument provides that the original trustee may select a second trustee and that the two trustees may name a third trustee. The trusts each provided for broad powers of the trustees to deal with trust property, in their sole discretion, in any fashion that they choose. The instruments also contain the statement that a resolution by the trustees to take an action shall itself be evidence that such action is within their authority. The trustees are empowered to distribute trust property, as they see fit, to whomever they choose.

The term of each trust is stated to be 25 years, but the trustees are explicitly empowered to extend or shorten the term. Each trust instrument also contains a statement that nothing in its terms shall be construed as intended to evade or contravene any law.

The taxpayer, in accordance with the promoter's advice, distributed income received by Trust 1 to Trust 2, as soon as it was received by Trust 1. Trust 2 retains the income amounts, and, from time to time, makes distributions to the taxpayer and to other members of the taxpayer's family as directed by the taxpayer as trustee of Trust 1.

The business assets and operations transferred to Trust 1 continue to be managed by the taxpayer in essentially the same fashion as before the taxpayer entered into the "double trust" arrangement.

LAW AND ANALYSIS

Section 61 of the Internal Revenue Code provides that the term gross income means all income "from whatever source" derived, including, among other things, income from an interest in an estate or trust.

The substance, rather than the form, of a transaction in which a taxpayer is involved govern the tax consequences of the transaction. See, for example, *Commission v. Court Holding Company,* 324 U.S. 331 (1945), Ct. D. 1636, 1945 C.B. 58; *Helvering v. Clifford,* 309 U.S. 331 (1940), Ct. D. 1444, 1940-1 C.B. 105; *Gregory v. Helvering,* 293 U.S. 465, Ct. D. 911, XIV-1 C.B. 193 (1935).

Subpart E of subchapter J of the Code (sections 671-679) deals with grantor trusts. Under section 671, if the grantor is treated as the owner of a trust as a result of application of the rules in subpart E, then those items of income, deductions, and credits that are attributable to the trust are includible, in computing the grantor's taxable income, to the extent that such items would be taken into account in determining the tax liability of an individual.

Section 7701(a)(31) of the Code defines "foreign trust" to mean a trust, the income of which, from sources without the United States which is not effectively connected with the conduct of a trade or business within the United States, is not includible in gross income under subtitle A.

Under Subpart E of the Code income of a trust over which the grantor has retained substantial dominion or control is taxable to the grantor rather than to the trust which received the income or to the beneficiary to whom the income may be distributed. In the present case, the taxpayer, while purporting to, did not give up ownership and control of the assets. The use of a "creator" in the foreign country is irrelevant as the taxpayer is the grantor of both trusts for federal tax purposes. The taxpayer's transfer of property to Trust 1 is a contribution by the taxpayer as the grantor. The taxpayer is also the grantor of Trust 2, because of the taxpayer's control over Trust 1. See sections 674, 675, 676, and 677 of the Code.

HOLDINGS

The purported creation of Trust 1 and Trust 2 is a sham and the form of the transaction will be given no tax effect. Since the taxpayer effectively continues to own and control the assets, the arrangements between the trusts will be given no effect for tax purposes. See Rev. Rul. 75-257, 1975-2 C.B. 251, dealing with the income tax treatment of transfers of an individual's property and "lifetime services" to a "family estate" trust, and the case of *Wesenberg v. Commissioner,* 69 T.C. 1005 (1978), where a similar transaction was described by the court as a "flagrant tax avoidance scheme."

Moreover, Subpart E of the Code (sections 671-679) requires the taxpayer, as the grantor of the trusts, to include all items of income, deductions, or credits against tax attributable to either Trust 1 or Trust 2 in computing the taxpayer's taxable income.

See also section 679 (treating the grantor of a foreign trust as owner) and section 1491 (imposing an excise tax on transfers to foreign trusts).

No deduction is allowable under section 212 of the Code for the taxpayer's expenses with respect to the "double trusts." *See* Rev. Rul. 79-324, 1979-42 I.R.B. 12.

Section 879.—Tax Treatment of Certain Community Income in the Case of a Resident or Citizen of the United States who is Married to a Nonresident Alien Individual

26 CFR 1.879-1: Treatment of community income.
(Also Section 6013; 1.6013-6.)

T.D. 7670 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 7.—TEMPORARY INCOME TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1976; SUBCHAPTER C, PART 31.—EMPLOYMENT TAXES APPLICABLE ON AND AFTER JANUARY 1, 1955; SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Election by nonresident alien to be treated as resident and treatment of community income when election not made

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the election by a nonresident alien to be treated as a resident and the treatment of community income where the election is not made. Certain provisions were added to the applicable tax law by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1] and title VII of the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, 131]. The regulations provide the public with the guidance needed to take advantage of these new provisions. The regulations affect certain taxpayers who are nonresident aliens or who are married to nonresident aliens and certain nonresident aliens who are not taxpayers but who are married to citizens or residents of the United States.

DATE: The regulations are effective as follows: in regard to the treatment of community income (§§1.879-1, 1.981, 1.981-0, and 1.981-1), for taxable years beginning after December 31, 1976; in regard to wage withholding under chapter 24 (§§ 31.3401(a)-1, 31.3401(a)(6)-1, 31.3402(f)(1)-1, and 31.3402(f)(6)-1, for remuneration paid after February 28, 1979; and in regard to the remaining sections, for taxable years ending on or after December 31, 1975.

FOR FURTHER INFORMATION CONTACT: Kenneth Klein of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3289, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On July 14, 1978, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) and the Regulations on Procedure and Administration (26 CFR Part 301) under sections 871, 879, 981, 6012, 6013, 6072, 6073, 6091, 6109, and 6851 of the Internal Revenue Code of 1954 (43 FR 30308). These amendments were proposed to conform the regulations to section 1012 of the Tax Reform Act of 1976 (90 Stat. 1612) and are to be issued under sections 6013 and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1612, 26 U.S.C. § 6013; 68A Stat. 917, 26 U.S.C. § 7805). After consideration of all comments submitted regarding the proposed amendments, the amendments are adopted as revised by this Treasury decision. The Treasury decision also reflects the technical amendments to the Tax Reform Act of 1976 made by section 701 (u)(15) and (16) of the Revenue Act of 1978 (92 Stat. 2919). The Revenue Act has required minor revisions to the proposed amendments. Additional amendments to the Income Tax Regulations, the Temporary Income Tax Regulations under the Tax Reform Act of 1976 (26 CFR Part 7), and the Employment Tax Regulations (26 CFR Part 31) under sections 1441, 3401, and 3402 are included.

STATUTORY BASES

Section 1012(a) of the Tax Reform Act of 1976 amended section 6013 of the Internal Revenue Code of 1954 by adding subsections (g) and (h), which provide that a nonresident alien may, under certain circumstances, elect to be treated as a U.S. resident. The principal effect of this election is to permit the nonresident alien to file a joint return with a spouse who is a resident or citizen of the United States. Section 1012(b) of the Act repeals section 981 of the Code and adds in its place section 879 to provide rules for the treatment of community income where an election under section 6013(g) or (h) is not in effect with respect to a nonresident alien spouse. Section 1012(c) of the Act amends section 6073 of the Code to provide that nonresident aliens are not required to file a declaration of estimated tax until the alien's income tax return for the prior taxable year is due. Section 701(u)(15) and (16) of the Revenue Act of 1978 makes several technical amendments to section 6013(g) and (h). The technical amendments provide that an individual making the section 6013(g) or (h) election will be treated as a resident for purposes of chapters 5 (tax on transfers to avoid the income tax) and 24 (collection of the income tax at the source on wages) in addition to chapter 1 (normal taxes and surtaxes).

ELECTIONS

The regulations provide that an election under section 6013(g) or (h) generally is made by attaching a statement to the income tax return for the first year to which the election is to apply. The statement must contain a declaration that the election is being made and the names, addresses, and taxpayer identifying numbers of the electing spouses. The regulations provide that in most circumstances a voluntary revocation of the election under section 6013(g) is to be made in a similar manner.

The regulations provide that the determination of whether taxpayers meet the requirements of section 6013 (g) or (h) for any taxable year shall be made at the close of that taxable year. The regulations require as a prerequisite to the making of an election under section 6013(g) or (h) that the spouse of the nonresident alien be a U.S. citizen or resident on the last day of the first taxable year to which the election applies.

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[1] This publication of the Treasury Decision contains the complete text of the amendments to the regulations. The instructions for modifying the notice of proposed rulemaking have been omitted.

COMMUNITY INCOME

The regulations explain the treatment given various types of community income in those cases where the spouses do not make an election under section 6013(g) or (h).

SUMMARY OF CHANGES AND PUBLIC COMMENT

A number of revisions of the proposed regulations have been made by the final regulations, many in response to public comments. Several commenters inquired whether the spouse who is a citizen or resident must be a citizen or resident for the entire taxable year or only at the close of the taxable year in order to qualify for the section 6013(g) election. Example (2) of § 1.6013-6(c) illustrates the rule of § 1.6013-6(a)(1), that the resident or citizen spouse need be a resident or citizen only at the close of the year, not for the entire year. Similarly, several commenters inquired whether two married individuals who are both nonresident aliens at the beginning of the taxable year and resident aliens at the close of the year qualify for the section 6013(h) election. An amendment to § 1.6013-7(a)(1) (designated § 1.6013-8(a)(1) in the proposed regulations) makes it clear that the two individuals would qualify for the election.

Section 1.6013-7(a)(2)(v) of the proposed regulations concerned the general relationship of the section 6013(g) and (h) elections to U.S. income tax treaties. The provision (now designated § 1.6013-6(a)(2)(v)) has been reserved in the final regulations for further consideration.

Section 1.6013-7(a)(4)(iii) of the proposed regulations provided that the election could be made with an amended return for taxable years ending or or after December 31, 1975, but before December 31, 1976. Several commenters suggested that the years for which the election can be made with an amended return should be extended. Section 1.6013-6(a)(4)(i) (designated § 1.6013-7(a)(4)(i) in the proposed regulations) has been amended to allow an election with an amended return to be made for all taxable years ending on or after December 31, 1975.

Section 1.6013-7(b)(1)(iii) of the proposed regulations provided that the filing of a separate return by either spouse would be considered a revocation of the election. The rule has been deleted in the final regulations. However, the election can only be made by filing a statement with a joint return for the first taxable year to which the election applies (see § 1.6013-6(a)(4)(i)).

Section 1.1441-1 of the regulations is amended to make it clear that withholding at the source of income will continue even though a nonresident alien individual makes an election under section 6013(g) or (h).

One person commented that the definition of community income in § 1.879-1(a)(1) of the proposed regulations was unclear. The definition has been clarified in the final regulations. The final regulations also clarify the treatment of trade or business income as community income.

Some suggestions from the public were not incorporated into the final regulations, two of which are indicated below.

Several commenters suggested that the final regulations permit a second election to be made by an electing individual whose spouse dies or is divorced or legally separated from the individual. These suggestions were not followed because the statute and the legislative history make it clear that second elections are prohibited, even in cases of death, divorce, or legal separation.

Several commenters suggested that the final regulations should state that elections made under Temporary Regulation § 7.0(a)(2) are effective under the final regulations. As proper elections made under temporary regulations are valid and have continuing legal effect, unless stated otherwise in the regulations, it was decided not to follow the suggestion.

DRAFTING INFORMATION

The principal author of these regulations is Kenneth Klein of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing these regulations both on matters of substance and style.

Adoption of amendments to the regulations

The following amendments to 26 CFR Parts 1, 7, 31, and 301 are hereby adopted.

Paragraph 1. Paragraph (a) of § 1.871-1 is amended by adding three sentences at the end that read as follows:

§ 1.871-1 Classification and manner of taxing alien individuals.

(a) *Classes of aliens.* * * * However, nonresident alien individuals may elect, under section 6013(g) or (h), to be treated as U.S. residents for purposes of determining their income tax liability under chapters 1, 5, and 24 of the Code. Accordingly, any reference in §§ 1.1-1 through 1.1388-1 and §§ 1.1491-1 through 1.1494-1 of this part to nonresident alien individuals does not include those with respect to whom an election under section 6013(g) or (h) is in effect, unless otherwise specifically provided. Similarly, any reference to resident aliens or U.S. residents includes those with respect to whom an election is in effect, unless otherwise specifically provided.

Par. 2. Paragraph (a)(1) of § 1.871-13 is amended by adding two sentences at the end that read as follows:

§ 1.871-13 Taxation of individuals for taxable year of change of U.S. citizenship or residence.

(a) *In general.* (1) * * * This section does not apply to alien individuals treated as residents for the entire taxable year under section 6013(g) or (h). These individuals are taxed under the rules in § 1.1-1(b).

* * * * *

Par. 3. There is added after § 1.878 the following new section:

§ 1.879-1 Treatment of community income.

(a) *Treatment of community income*—(1) *In general.* For taxable years beginning after December 31, 1976, community income of a citizen or resident of the United States who is married to a nonresident alien individual, and the deductions properly allocable to that income, shall be divided between the United States citizen or resident spouse and the nonresident alien spouse in accordance with the rules in section 879 and paragraph (a)(2) through (a)(6) of this section. This section does not apply for any taxable year with respect to which an election under section 6013 (g) or (h) is in effect. Community income for this purpose includes all gross income, whether derived from sources within or without the United States, which is treated as community income of the spouses under the community property laws of the State, foreign country, or possession of the United States in which the recipient of the income is domiciled. Income from real property also may be community income if so treated under the laws of the jurisdiction in which the real property is located.

(2) *Earned income.* Wages, salaries, or professional fees, and other amounts received as compensation for personal services actually performed, which are community income for the taxable year, shall be treated as the income of the spouse who actually performed the personal services. This paragraph (a)(2) does not apply, however, to the following items of community income:

(i) Community income from any trade or business carried on by the husband or the wife.

(ii) Community income attributable to a spouse's distributive share of the income of a partnership to which paragraph (a)(4) of this section applies.

(iii) Community income consisting of compensation for personal services rendered to a corporation which represents a distribution of the earnings and profits of the corporation rather than a reasonable allowance as compensation for the personal services actually performed, but not including any income that would be treated as earned income under the second sentence of section 911(b).

(iv) Community income derived from property which is acquired as consideration for personal services performed.

These items of community income are divided in accordance with the rules in paragraph (a)(3) through (a)(6) of this section.

(3) *Trade or business income.* If any income derived from a trade or business carried on by the husband or wife is community income for the taxable year, all of the gross income, and the deductions attributable to that income, shall be treated as the gross income and deductions of the husband. However, if the wife exercises substantially all of the management and control of the trade or business, all of the gross income and deductions shall be treated as the gross income and deductions of the wife. This paragraph (a)(3) does not apply to any income derived from a trade or business carried on by a partnership of which both or one of the spouses is a member (see paragraph (a)(4) of this section). For purposes of this paragraph (a)(3), income derived from a trade or business includes any income derived from a trade or business in which both personal services and capital are material income producing factors. The term "management and control" means management and control in fact, not the management and control imputed to the husband under the community property laws of a state, foreign country, or possession of the United States. For example, a wife who operates a pharmacy without any appreciable collaboration on the part of a husband is considered as having substantially all of the management and control of the business despite the provisions of any community property laws of a state, foreign country, or possession of the United States vesting in the husband the right of management and control of community property. The income and deductions attributable to the operation of the pharmacy are considered the income and deductions of the wife.

(4) *Partnership income.* If any portion of a spouse's distributive share of the income of a partnership, of which the spouse is a member, is community income for the taxable year, all of that distributive share shall be treated as the income of that spouse and shall not be taken into account in determining the income of the other spouse. If both spouses are members of the same partnership, the distributive share of the income of each spouse which is community income shall be treated as the income of that spouse. A spouse's distributive share of the income of a partnership that is community income shall be determined as provided in section 704 and the regulations thereunder.

(5) *Income from separate property.* Any community income for the taxable year, other than income described in section 978(a)(1) or (2) and paragraph (a)(2), (3), or (4) of this section, which is derived from the separate property of one of the spouses shall be treated as the income of that spouse. The determination of what property is separate property for this purpose shall be made in accordance with the laws of the State, foreign country, or possession of the United States in which, in accordance with paragraph (a)(1) of this section, the recipient of the income is domiciled or, in the case of income from real property, in which the real property is located.

(6) *Other community income.* Any community income for the taxable year, other than income described in section 879(a)(1), (2), or (3), and paragraph (a)(2), (3), (4), or (5) of this section, shall be treated as income of that spouse who has a proprietary vested interest in that income under the laws of the State, foreign country, or possession of the United States in which, in accordance with paragraph (a)(1) of this section, the recipient of the income is domiciled or, in the case of income from real property, in which the real property is located. Thus, for example, this paragraph (a)(6) applies to community income not described in paragraph (a)(2), (3), (4), or (5) of this section which consists of dividends, interest, rents, royalties, or gains, from community property or of the earnings of unemancipated minor children.

(7) *Illustrations.* The application of this paragraph may be illustrated by the following examples:

Example (1). H, a U.S. citizen, and W, a nonresident alien individual, each of whose taxable years is the calendar year, were married throughout 1977. H and W were residents of, and domiciled in, foreign country Z during the entire taxable year. No election under section 6013(g) or (h) is in effect for 1977. During 1977, H earned $10,000 from the performance of personal services as an employee. H also received $500 in dividend income from stock which under the community property laws of country Z is considered to be the separate property of H. W had no separate income for 1977. Under the community property laws of country Z all income earned by either spouse is considered to be community income, and one-half of this income is considered to belong to the other spouse. In addition, the laws of country Z provide that all income derived from property held separately by either spouse is to be treated as community income and treated as belonging one-half to each spouse. Thus, under the community property laws of country Z, H and W are both considered to have realized income of $5,250 during 1977, even though Z's laws recognize the stock as the separate property of H. Under the rules of paragraph (a)(2) and (5) of this section all of the income of $10,500 derived during 1977 is treated, for U.S. income tax purposes, as the income of H.

Example (2). (a) The facts are the same as in example (1), except that H is the sole proprietor of a retail merchandising company, which has a $10,000 profit during 1977. W exercises no management and control over the business. In addition, H is a partner in a wholesale distributing company, and his distributive share of the partnership profit is $5,000. Both of these amounts of income are treated as community income under the community property laws of country Z, and under these laws both H and W are treated as realizing $7,500 of the income. Under the rule of paragraph (a)(3) and (4) of this section all $15,000 of the income is treated as the income of H for U.S. income tax purposes.

(b) If W exercises substantially all of the management and control over the retail merchandising company, then for U.S. income tax purposes the $10,000 profit is treated as the income of W.

Example (3). The facts are the same as in example (1), except that H also received $1,000 in dividends on stock held separately in his name. Under the community property laws of country Z the stock is considered to be community property, the dividends to be community income, and one-half of the income to be the income of each spouse. Under the rule of paragraph (a)(6) of this section, $500 of the dividend income is treated, for U.S. income tax purposes, as the income of each spouse.

(b) *Definitions and other special rules*—(1) *Spouses with different taxable years.* A special rule applies if the nonresident alien and the United States citizen or resident spouse of the alien do not have the same taxable years, as defined in section 441(b) and the regulations thereunder. The special rule is as follows. With respect to the United States citizen or resident spouse, section 879 and this section shall apply to each taxable year of the United States citizen or resident spouse for which no election under section 6013(g) or (h) is in effect. With respect to the nonresident alien spouse, section 879 and this section apply to each period falling within the consecutive taxable years of the nonresident alien spouse which coincides with a taxable year of the United States citizen or resident spouse to which section 879 and this section apply.

(2) *Determination of marital status.* For purposes of this section, marital status shall be determined under section 143(a).

Par. 4. Section 1.981 is repealed.

Par. 5. There is added after § 1.972-1 the following new section:

§ 1.981-0 Repeal of section 981; effective dates.

The provisions of section 981 are not effective for taxable years beginning after December 31, 1976. For the treatment of the community income of aliens and their spouses for taxable years beginning after December 31, 1976, see section 879 and the regulations thereunder.

Par. 6. Section 1.981-1 is amended as follows:

1. The title is amended to read as follows:

§ 1.981-1 Foreign law community income for taxable years beginning after December 31, 1966 and before January 1, 1977.

2. Paragraph (a)(1) is amended by inserting the phrase "and before January 1, 1977," in the first sentence between the phrases "after December 31, 1966" and the phrase ", may make a binding election".

Par. 7. Section 1.1441-1 is amended by adding a sentence at the end to read as follows:

§ 1.1441-1 Requirement for withholding of tax on nonresident aliens, foreign partnerships, and foreign corporations.

* * * The rules of chapter 3 of the Code and §§ 1.1441-1 through 1.1441-6 and §§ 1.1461-1 through 1.1464-1 apply to a nonresident alien individual even though the individual has an election in effect under section 6013 (g) or (h) of the Code.

Par. 8. Section 1.6012-1 is amended as follows:

1. Paragraph (b)(1)(i) is amended by inserting the phrase "(other than one treated as a resident under section 6013(g) or (h)" in the first sentence between the phrases "nonresident alien individual" and "who is engaged".

2. Paragraph (b)(2)(i) is amended by inserting the phrase "(other than one treated as a resident under section 6013(g) or (h))" in the first sentence between the phrases "A nonresident alien individual" and "who at no time".

3. Paragraph (b)(2)(ii)(*a*) is amended by deleting the period at the end of the second sentence and inserting in its place the phrase ", unless an election under section 6013(g) or (h) is in effect for the alien."

4. Paragraph (b)(2)(ii)(*b*) is amended by deleting the period at the end of the first sentence, and inserting in its place the phrase ", even if an election under section 6013(g) was in effect for the taxable year preceding the year of abandonment."

Par. 9. Paragraph (b) of § 1.6013-1 is revised to read as follows:

§ 1.6013-1 Joint returns.

* * * * *

(b) *Nonresident alien.* A joint return shall not be made if either the husband or wife at any time during the taxable year is a nonresident alien, unless an election is in effect for the taxable year under section 6013(g) or (h) and the regulations thereunder.

* * * * *

Par. 10. Section 1.6013-2 is amended by adding a new paragraph (a)(4) which reads as follows:

§ 1.6013-2 Joint return after filing separate return.

(a) *In general.*

* * * * *

(4) A nonresident alien treated as a resident under section 6013(g) or

(h) for any taxable year ending on or after December 31, 1975 and the alien's United States citizen or resident spouse may file a joint return for that taxable year, even though one or both of the spouses have previously filed separate returns for that taxable year. In this case, the rule in paragraph (a)(3) of this section does not apply.

* * * * *

Par. 11. There is added immediately after § 1.6013-5 the following new sections:

§ 1.6013-6 Election to treat nonresident alien individual as resident of the United States.

(a) *Election for special treatment*—(1) *In general.* Two individuals who are husband and wife at the close of a taxable year ending on or after December 31, 1975 may make an election under this section for that taxable year if, at the close of that year, one spouse is a citizen or resident of the United States and the other spouse is a nonresident alien. The effect of the election is that each spouse is treated as a resident of the United States for purposes of chapters 1, 5, and 24 and sections 6012, 6013, 6072, and 6091 of the Code for the entire taxable year. An election made under this section is in effect for the taxable year for which made and for all subsequent years of the husband and wife, except—

(i) Any taxable year for which the election is suspended, as described in paragraph (a)(3) of this section, and

(ii) Any taxable year for which the election is terminated in accordance with paragraph (b) of this section and all subsequent taxable years.

A husband and wife may not make an election if an election previously made under this section by either spouse has been terminated under paragraph (b) of this section.

(2) *Particular rules.* (i) As used in paragraph (a)(3) of this section, the term "United States spouse" means any married individual who is a citizen or resident of the United States at any time during a taxable year.

(ii) An individual's residence is determined by application of the principles of §§ 1.871-2 through 1.871-5 relating to what constitutes residence in the United States by an alien individual.

(iii) Whether two individuals are married at the close of a taxable year is determined by application of the rules in §1.6013-4(a).

(iv) The provisions of section 879 and the regulations thereunder shall not apply for any taxable year for which an election under this section is in effect.

(v) [Reserved]

(3) *Suspension of election.* (i) An election made under this section is suspended and is not in effect for a taxable year subsequent to the first taxable year for which made if neither spouse is a United States spouse during that subsequent taxable year. Thus, for example, the election is in suspense if both spouses are nonresident aliens for the entire taxable year.

(ii) If either spouse dies during any taxable year for which the election under this section is in effect, other than the first taxable year for which the election is to be in effect, the taxable year shall include, solely for purposes of this paragraph (a)(3), only those days during the taxable year on which both spouses are alive. Thus, for example, if the United States spouse dies during the taxable year, the election is not suspended for that year even if the surviving nonresident alien spouse never acquires United States citizenship or residency. Similarly, if the nonresident alien spouse dies during the taxable year, the election is not suspended for that year even if the surviving United States spouse subsequently abandons United States citizenship or residency. However, if neither spouse was a United States spouse at any time during the period of the taxable year when both spouses were alive, the election is suspended for that year even if the surviving spouse subsequently acquires United States citizenship or residency. For the effect of the death of either spouse on the status of the election in subsequent taxable years, see paragraph (b)(2) of this section.

(4) *Time and manner of making an election.* (i) A husband and wife shall make the election under this section by attaching a statement to a joint return for the first taxable year for which the election is to be in effect. The election must be made before the expiration of the period prescribed by section 6511(a) (or section 6511(c) if the period is extended by agreement) for making a claim for credit or refund. If either or both spouses die after the close of the taxable year but before the joint return is filed, the election may be made by the executor, administrator, or other person charged with the property of the deceased spouse. If the election is made with a joint amended return, the amended return should be made on Form 1040 or 1040A, the word "Amended" should be written clearly on the front of the return, and an amended return also must be filed for each subsequent taxable year as to which a return previously has been filed by either spouse.

(ii) The statement must contain a declaration that the election is being made and that the requirements of paragraph (a)(1) of this section are met for the taxable year. The statement must also contain the name, address, and taxpayer identifying number of each spouse. If the election is being made on behalf of a deceased spouse, the statement must contain the name and address of the executor, administrator, or other person making the election on behalf of the deceased spouse. The statement must be signed by both persons making the election.

(b) *Termination of election*—(1) *Revocation.* (i) An election under this section shall terminate if either spouse revokes the election. An election that is revoked terminates as of the first taxable year for which the last day prescribed by section 6072(a) and 6081(a) for filing the return of tax has not yet occurred.

(ii) Revocation of the election is made by filing a statement of revocation in the following manner. If the spouse revoking the election is required to file a return under section 6012, the statement is filed by attaching it to the return for the first taxable year to which the revocation applies. If the spouse revoking the election is not required to file a return under section 6012, but files a claim for refund under section 6511, the statement is filed by attaching it to the claim for refund. If the spouse revoking the election is not required to file a return and does not file a claim for refund, the statement is filed by submitting it to the service center director with whom was filed the most recent joint return of the spouses. The revocation may, if the revoking spouse dies after the close of the first taxable year to which the revocation applies but before the return, claim for refund, or statement of revocation is filed, be made by the executor, administrator or other person charged with the property of the deceased spouse.

(iii) A revocation of the election is effective as of a particular taxable year if it is filed on or before the last day prescribed by section 6072(a) and 6081(a) for filing the return of tax for that taxable year. However, the revocation is not final until that last day.

(iv) The statement of revocation must contain a declaration that the election under this section is being revoked. The statement must also contain the name, address, and taxpayer identifying number of each spouse. If the revocation is being made on behalf of a deceased spouse, the statement must contain the name and address of the executor, administrator, or other person revoking the election on behalf of the deceased spouse. The statement must also include a list of the States, foreign countries, and possessions of the United States which have community property laws and in which—

(A) Each spouse is domiciled, or

(B) Real property is located from which either of the spouses receives income. The statement must be signed by the person revoking the election.

(2) *Death.* An election under this section shall terminate if either spouse dies. An election that terminates on account of death terminates as of the first taxable year of the surviving spouse following the taxable year in which the death occurred. However, if the surviving spouse is a citizen or resident of the United States who is entitled to the benefits of section 2, the election terminates as of the first taxable year following the last taxable year for which the surviving spouse is entitled to the benefits of section 2. If both spouses die within the same taxable year, the election terminates as of the first day after the close of the taxable year in which the deaths occurred.

(3) *Legal separation.* An election under this section terminates if the spouses legally separate under a decree of divorce or of separate maintenance. An election that terminates on account of legal separation terminates as of the close of the taxable year preceding the taxable year in which the separation occurs. The rules in § 1.6013-4(a) are relevant in determining whether two spouses are legally separated.

(4) *Inadequate records.* An election under this section may be terminated by the Commissioner if it is determined that either spouse has failed to keep adequate records. An election that is terminated on account of inadequate records terminates as of the close of the taxable year preceding the taxable year for which the Commissioner determines that the election should be terminated. Adequate records are the books, records, and other information reasonably necessary to ascertain the amount of liability for taxes under chapters 1, 5, and 24 of the Code of either spouse for the taxable year. Adequate records also includes the granting of access to the books and records.

(c) *Illustrations.* The application of this section is illustrated by the following examples. In each case the individual's taxable year is the calendar year and the spouses are not legally separated.

Example (1). W, a U.S. citizen for the entire taxable year 1979, is married to H, a nonresident alien individual. W and H may make the section 6013(g) election for 1979 by filing the statement of election with a joint return. If W and H make the election, income from sources within and without the United States received by W and H in 1979 and subsequent years must be included in gross income for each taxable year unless the election later is terminated or suspended. While W and H must file a joint return for 1979, joint or separate returns may be filed for subsequent years.

Example (2). H and W are husband and wife and are both nonresident alien individuals. In June 1980 H becomes a U.S. resident and remains a resident for the balance of the year. H and W may make the section 6013(g) election for 1980. If H and W make the election, income from sources within and without the United States received by H and W for the entire taxable year 1980 and subsequent years must be included in gross income for each taxable year, unless the election later is terminated or suspended.

Example (3). W, a U.S. resident on December 31, 1981, is married to H, a nonresident alien. W and H make the section 6013(g) election and file joint returns for 1981 and succeeding years. On January 10, 1987, W becomes a nonresident alien. H has remained a nonresident alien. W and H may file a joint return or separate returns for 1987. As neither W nor H is a U.S. resident at any time during 1988, their election is suspended for 1988. If W and H have U.S. source or foreign source income effectively connected with the conduct of a U.S. trade or business in 1988, they must file separate returns as nonresident aliens. W becomes a U.S. resident again on January 5, 1990. Their election no longer is in suspense. Income from sources within and without the United States received by W or H in the years their election is not suspended must be included in gross income for each taxable year.

Example (4). H, a U.S. citizen for the entire taxable year 1979, is married to W, who is not a U.S. citizen. While W believes that she is a U.S. resident, H and W make the section 6013(g) election for 1979 to cover the possibility that later it would be determined that she is a nonresident alien during 1979. The election for 1979 will not be considered evidence that W was a nonresident alien in prior years. Income from sources within and without the United States received by H and W in 1979 and subsequent years must be included in gross income for each taxable year, unless the election later is terminated or suspended.

§ 1.6013-7 Joint return for year in which nonresident alien becomes resident of the United States.

(a) *Election for special treatment*—(1) *In general.* Two individuals who are husband and wife at the close of a taxable year ending on or after December 31, 1975, may make an election under this section for that taxable year if one spouse is a citizen or resident of the United States on the last day of that taxable year and the other spouse is a nonresident alien at the beginning of that taxable year and a citizen or resident of the United States at the close of that taxable year. Two married individuals who are nonresident aliens at the beginning of a taxable year and who are U.S. citizens or residents on the last day of that taxable year qualify for the election. The effect of the election is that each spouse is treated as a resident of the United States for purposes of chapters 1, 5, and 24 and sections 6012, 6013, 6072, and 6091 of the Code for all of that taxable year. A husband and wife may not make an election if an election has previously been made under this section by either spouse.

(2) *Particular rules.* The rules in subdivisions (ii) through (v) of § 1.6013-6(a)(2) are applicable to this section.

(3) *Time and manner of making an election.* A husband and wife shall make the election under this section in accordance with the rules in § 1.6013-6(a)(4).

(b) *Section 6013(g) election in effect.* If an election under section 6013 (g) is in effect for a year subsequent to the first taxable year for which made and during that subsequent year the husband and wife meet the requirements of section 6013(h) and paragraph (a)(1) of this section, then the election under section 6013(g) shall apply to that subsequent taxable year. A separate election under section 6013(h) is not required for that subsequent taxable year.

Par. 12. Paragraph (c) of § 1.6072-1 is amended by inserting the phrase "(other than one treated as a resident under section 6013(g) or (h))" in the first sentence between the phrases "nonresident alien individual" and "and of a foreign trust".

Par. 13. Paragraph (a) of § 1.6073-1 is amended by adding two sentences at the end that read as follows:

§ 1.6073-1 Time and place for filing declarations of estimated tax by individuals.

(a) *Individuals other than farmers or fishermen.* * * * A special rule applies to nonresident aliens who do not have wages subject to withholding under chapter 24 of the Code and are not treated as residents under section 6013(g) or (h) of the Code. For taxable years beginning after December 31, 1976, these aliens are not required to file a declaration of estimated tax before June 15th.

* * * * *

Par. 14. Paragraph (d) of § 1.6091-3 is amended by deleting the period at the end, and inserting in lieu thereof the phrase "(other than one treated as a resident under section 6013(g) or (h)).".

Par. 15. Paragraph (b)(1)(ii) of § 1.6851-2 is amended as follows:

1. The phrase "(or treated as a resident under section 6013(g) or (h))" is inserted in the first sentence between the phrases "possession thereof" and "who intends to continue".

2. The phrase "(or treatment as a resident)" is inserted in the first sentence between the phrases "to continue such residence" and "shall be treated".

Par. 16. Paragraph (a)(2) of § 7.0 is amended to read as follows:

§ 7.0 Various elections under the Tax Reform Act of 1976.

(a) *Elections covered by temporary rules.* * * *

(2) SECOND CATEGORY

185(d) of Code	Amortization of railroad grading and tunnel bores	All taxable years beginning after December 31, 1974.
528(c)(1)(E) of Code	Certain homeowners associations	Any taxable year beginning after December 31, 1973.
1057 of Code	Transfer to foreign trusts etc.	Any transfer of property after October 2, 1975.

* * * * *

Par. 17. The first sentence of paragraph (b)(7) of § 31.3401(a)-1 is amended by inserting the phrase "(including, in regard to wages paid after February 28, 1979, an individual treated as a resident under section 6013(g) or (h))" between the phrases "citizen or resident" and "of the United States".

Par. 18. Paragraph (a) of § 31.3401 (a)(6)-1 is amended by adding a sentence at the end as follows:

§ 31.3401(a)(6)-1 Remuneration for services of nonresident alien individual paid after December 31, 1966.

(a) *In general.* * * * In regard to wages paid under this section after February 28, 1979, the term "nonresident alien individual" does not include a nonresident alien individual treated as a resident under section 6013(g) or (h).

* * * * *

Par. 19. Subdivision (i) of § 31.3402 (f)(1)-1(d)(4) is amended by inserting the phrase "(including, in regard to wages paid after February 28, 1979, an individual treated as a resident under section 6013(g) or (h))" between the phrases "United States" and ", Canada,".

Par. 20. The first sentence of § 31.3402(f)(6)-1 is amended by inserting the phrase "(other than, in regard to wages paid after February 28, 1979, a nonresident alien individual treated as a resident under section 6013(g) or (h))" between the phrases "nonresident alien individual" and "subject to withholding".

Par. 21. Section 301.6013-1 is amended by deleting the reference to § 1.6013-4 and inserting in its place a reference to § 1.6013-7.

Par. 22. Paragraph (g) of § 301.6109-1 is amended by adding a sentence at the end that reads as follows:

§ 301.6109-1 Identifying numbers.

* * * * *

(g) *Nonresident alien exclusion.* * * * The exclusion in this paragraph does not apply to nonresident aliens treated as residents under section 6013 (g) or (h).

* * * * *

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. § 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved January 22, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on January 30, 1980, 8:45 a.m., and published in the issue of the Federal Register for January 31, 1980, 45 F.R. 6924)

Section 4064.—Gas Guzzler Tax

26 CFR 138.4064-1: Gas guzzler tax.
(Also Section 4222; 138.4222-1.)

T.D. 7674

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 138.—TEMPORARY EXCISE TAX REGULATIONS UNDER THE ENERGY TAX ACT OF 1978

GAS GUZZLER TAX

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains Temporary Excise Tax Regulations relating to the gas guzzler tax, as provided by section 4064 of the Internal Revenue Code of 1954. Changes to the applicable tax law were made by the Energy Tax Act of 1978 [Pub. L. 95-618, 1978-3 (Vol. 2) 1, 6]. The regulations would provide manufacturers of automobiles with the guidance needed to comply with the new law. In addition, the rules contained in the temporary regulation set forth in this document also serve as a notice of proposed rulemaking by which the rules contained therein are proposed to be prescribed as final regulations.

DATES: These temporary regulations are effective with respect to 1980 and later model year automobiles. Written comments and requests for a public hearing must be delivered or mailed by April 8, 1980.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-205-78), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Eileen Murphy of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T (202-566-3297).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains temporary regulations under section 4064 of the Internal Revenue Code of 1954. The temporary regulations are necessary to conform the regulations to section 201 of the Energy Tax Act of 1978 (92 Stat. 3175).

The regulations promulgated in this documents are also proposed to be prescribed as final Excise Tax Regulations (26 CFR Part 48) under sections 4064 and 4222 of the Internal Revenue Code of 1954.

IN GENERAL

The Energy Tax Act of 1978 imposes on the sale by a manufacturer of an automobile a tax determined in accordance with tables provided under that Act. The tax is applicable to model types of 1980 and later model year automobiles which have a certain fuel economy level. The Act provides that a small manufacturer may apply to the Secretary for an alternate rate schedule by showing that it is not feasible for that manufacturer to meet the tax-free fuel economy level.

DEFINITIONS

The regulations define the following terms: sale, manufacturer, automobile, model year, model type, fuel economy, and fuel. The regulations define the term "sale" to include use or lease. Model year is defined as the manufacturer's annual production period (as determined by the Administrator of the Environmental Protection Agency) which includes January 1 of any particular calendar year. The term "model type" means a particular class of automobile, as determined by regulation by the Administrator of the Environmental Protection Agency. The term "fuel economy" means the average (weighted 55 percent urban cycle and 45 percent highway cycle) number of miles traveled by an automobile per gallon of fuel consumed. Fuel is defined as gasoline and diesel fuel. The definitions of automobile, model year, model type, and fuel economy conform generally to the definition of these terms in regulations promulgated by the Department of Transportation and the Environmental Protection Agency.

PROCEDURE FOR APPLYING FOR ALTERNATE RATE SCHEDULE

The regulations outline the procedure to be followed by a small manufacturer seeking an alternate rate schedule. Applications are to be sent to the Commissioner of Internal Revenue, Attention: Assistant Commissioner (Technical). The regulations prescribe the contents of the application. The regulations set forth the public policy considerations which will be taken into account by the Secretary in deciding whether to allow a manufacturer to use an alternate rate schedule. The regulations prescribe an alternate rate schedule that would be applicable to a qualifying small manufacturer.

WAIVER OF PROCEDURAL REQUIREMENTS OF TREASURY DIRECTIVE

There is need for expeditious adoption of the provisions contained in this document because of the need for immediate guidance to manufacturers to whom section 4064 applies in ascertaining whether they are liable for the tax imposed by that section. For this reason, Jerome Kurtz, Commissioner of Internal Revenue, has determined that the provisions of paragraphs 8 through 14 of the Treasury Department directive implementing Executive Order 12044 must be waived.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adoption of the final regulations proposed in this document, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

DRAFTING INFORMATION

The principal author of these regulations is Eileen Murphy of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style. In addition, personnel from the Departments of Energy and Transportation, and the Environmental Protection Agency, were consulted with respect to technical and policy issues arising under the Act.

Adoption of amendments to the regulations

Accordingly, the following new sections are adopted and inserted in Part 138, Temporary Excise Tax Regulations Under the Energy Tax Act of 1978 (26 CFR Part 138):

§ 138.4064-1 Gas guzzler tax.

(a) *General rule*—(1) *In general.* Section 4064 imposes on the sale by the manufacturer of an automobile a tax determined in accordance with the tables in section 4064(a)(1) through (7), and paragraph (a)(2) of this section. The tax is applicable to model types of 1980 and later model year automobiles which have a certain fuel economy level. Paragraph (b) of this section defines the following terms: sale, manufacturer, automobile, model year, model type, fuel economy, and fuel. Paragraph (c) contains rules relating to the determination of fuel economy. Paragraph (d) contains a special rule for certain small manufacturers.

(2) *Tables.* (i) In the case of a 1980 model year automobile:

If the fuel economy (miles per gallon) of the model type in which the automobile falls is:	The tax is:
At least 15	0
At least 14 but less than 15	$ 200
At least 13 but less than 14	300
Less than 13	550

(ii) In the case of a 1981 model year automobile:

If the fuel economy (miles per gallon) of the model type in which the automobile falls is:	The tax is:
At least 17	0
At least 16 but less than 17	$ 200
At least 15 but less than 16	350
At least 14 but less than 15	450
At least 13 but less than 14	550
Less than 13	650

(iii) In the case of a 1982 model year automobile:

If the fuel economy (miles per gallon) of the model type in which the automobile falls is:	The tax is:
At least 18.5	0
At least 17.5 but less than 18.5	$ 200
At least 16.5 but less than 17.5	350
At least 15.5 but less than 16.5	450
At least 14.5 but less than 15.5	600
At least 13.5 but less than 14.5	750
At least 12.5 but less than 13.5	950
Less than 12.5	1,200

(iv) In the case of a 1983 model year automobile:

If the fuel economy (miles per gallon) of the model type in which the automobile falls is:	The tax is:
At least 19	0
At least 18 but less than 19	$ 350
At least 17 but less than 18	500
At least 16 but less than 17	650
At least 15 but less than 16	800
At least 14 but less than 15	1,000
At least 13 but less than 14	1,250
Less than 13	1,550

(v) In the case of a 1984 model year automobile:

If the fuel economy (miles per gallon) of the model type in which the automobile falls is:	The tax is:
At least 19.5	0
At least 18.5 but less than 19.5	$ 450
At least 17.5 but less than 18.5	600
At least 16.5 but less than 17.5	750
At least 15.5 but less than 16.5	950
At least 14.5 but less than 15.5	1,150
At least 13.5 but less than 14.5	1,450
At least 12.5 but less than 13.5	1,750
Less than 12.5	2,150

(vi) In the case of a 1985 model year automobile:

If the fuel economy (miles per gallon) of the model type in which the automobile falls is:	The tax is:
At least 21	0
At least 20 but less than 21	$ 500
At least 19 but less than 20	600
At least 18 but less than 19	800
At least 17 but less than 18	1,000
At least 16 but less than 17	1,200
At least 15 but less than 16	1,500
At least 14 but less than 15	1,800
At least 13 but less than 14	2,200
Less than 13	2,650

(vii) In the case of a 1986 or later model year automobile:

If the fuel economy (miles per gallon) of the model type in which the automobile falls is:	The tax is:
At least 22.5	0
At least 21.5 but less than 22.5	$ 500
At least 20.5 but less than 21.5	650
At least 19.5 but less than 20.5	850
At least 18.5 but less than 19.5	1,050
At least 17.5 but less than 18.5	1,300
At least 16.5 but less than 17.5	1,500
At least 15.5 but less than 16.5	1,850
At least 14.5 but less than 15.5	2,250
At least 13.5 but less than 14.5	2,700
At least 12.5 but less than 13.5	3,200
Less than 12.5	3,850

(3) *Liability for tax.* The tax imposed by section 4064 is payable by the manufacturer making the sale.

(4) *Cross-reference.* In the case of an overpayment of tax imposed by this section, see section 6401 (relating to amounts treated as overpayments) and section 6416 (relating to certain taxes on sales and services).

(b) *Definitions*—(1) *Sale.* Sale includes the use (within the meaning of section 4218) or the first lease (within the meaning of section 4217(e)) of an automobile by the manufacturer.

(2) *Manufacturer.* The term "manufacturer" has the same meaning assigned to such term under § 48.0-2(a)(4). The term "manufacturer" includes a producer or importer. An importer is a person who imports an automobile whether or not in connection with a trade or business.

(3) *Automobile.* The term "automobile" means any four-wheeled vehicle, propelled by an engine powered by fuel, which is manufactured primarily for use on public streets, roads, and highways (except any vehicle op-

erated exclusively on a rail or rails), and which is rated at 6,000 pounds gross vehicle weight or less, and which requires no further manufacturing operations to perform its intended function, other than the addition of readily attachable components, such as mirrors or tire and rim assemblies, or minor finishing operations such as painting. For this purpose, gross vehicle weight means the value specified by the manufacturer as the maximum design loaded weight of a single vehicle. An automobile does not include a nonpassenger automobile as defined in regulations in effect on November 9, 1978 (49 CFR 523.5) which were prescribed by the Secretary of Transportation for section 501 of the Motor Vehicle Information and Cost Savings Act (15 U.S.C. 2001). In addition an automobile does not include the following: any vehicle sold for use and used primarily as an ambulance or combination ambulance-hearse; any vehicle sold for use and used by the United States or by a State or local government primarily for police or other law enforcement purposes or any vehicle sold for use and used primarily for firefighting purposes.

(4) *Model year.* The term "model year" means the manufacturer's annual production period (as determined by the Administrator of the Environmental Protection Agency) which includes January 1 of any particular calendar year. If the manufacturer has no annual production year, the model year is the calendar year.

(5) *Model type.* The term "model type" means a particular class of automobile, as determined by regulation in effect on November 9, 1978 (40 CFR 600.002.79(a)(19)) which were prescribed by the Administrator of the Environmental Protection Agency.

(6) *Fuel economy.* The term "fuel economy" means the average number of miles traveled by an automobile per gallon of fuel consumed. The fuel economy level for any model type is determined by the Environmental Protection Agency (as determined in accordance with the procedures provided in paragraph (c)). For this purpose, the fuel economy level is a combined (urban-highway weighted average) mileage figure estimated in connection with the determination of general label value (fuel economy information displayed on a sticker that is affixed to new automobiles) mandated under section 506 of the Motor Vehicle Information and Cost Savings Act (15 U.S.C. 2006) and regulations thereunder in effect on November 9, 1978 (40 CFR 600).

(7) *Fuel.* The term "fuel" means gasoline and diesel fuel.

(c) *Determination of fuel economy.* For purposes of this section, the fuel economy for any model type is determined in accordance with the testing and calculation procedures utilized by the Environmental Protection Agency Administrator for model year 1975 (weighted 55 percent urban cycle and 45 percent highway cycle) or procedures established by the Administrator which yield comparable results. The Environmental Protection Agency's determination of a model type's fuel economy is made at the time the general label fuel economy value is calculated. This determination is conclusive for purposes of this section.

(d) *Special rule for small manufacturers*—(1) *In general.* A small manufacturer (as defined in subparagraph (2)(i)) may apply for a determination that it is not feasible for that manufacturer to meet the tax-free fuel economy level for the model year, with respect to all automobiles produced by that manufacturer, or with respect to a particular model type. For this purpose, the Commissioner will make a determination of maximum feasible fuel economy level with respect to the automobiles which are the subject of the determination, but only after consultation with the Secretary of Energy, the Secretary of Transportation, and the Administrator of the Environmental Protection Agency (or their delegates) to obtain their views. A finding that it is not feasible for the manufacturer to meet the statutory tax-free fuel economy level will be made by the Internal Revenue Service if the maximum feasible fuel economy level of the automobiles which are the subject of the determination is lower than the statutory tax-free fuel economy level for these automobiles. If it is determined that it is not feasible for a small manufacturer to meet the tax-free fuel economy level, the Secretary has the discretion to grant to the manufacturer the alternate rate schedule prescribed in paragraph (d)(3)(iii) in lieu of the rate schedule prescribed in section 4064 (a)(1) through (7). The decision whether to grant the alternate rate schedule is based on the consideration set forth in paragraph (d)(3)(ii) of this section. If a small manufacturer for which an alternate rate schedule under this paragraph (d) is applicable sells an automobile to an importer, the alternate rate schedule applies to the sale by the importer of such automobile (if such automobile is of the model type or year to which such alternate schedule applies).

(2) *Definitions*—(i) *Small manufacturer.* A small manufacturer is any manufacturer who produced (whether or not in the United States) fewer than 10,000 automobiles in the second model year preceding the affected model year (the model year for which the determination under this paragraph is being made), and who can reasonably be expected to produce (whether or not in the United States) fewer than 10,000 automobiles in the affected model year.

(ii) *Manufacturer.* For purposes of this paragraph, the term "manufacturer" does not include a person who is solely an importer, but does include a producer of automobiles outside the United States who is also an importer.

(iii) *Members of a controlled group.* For the purposes of this paragraph (d), persons who are members of a controlled group of corporations (as defined in section 1563(a) of the Internal Revenue Code, except that "more than 50 percent" is substituted for "at least 80 percent" each place it appears in section 1563(a)) are treated as one manufacturer.

(3) *Basis for determination*—(i) *Maximum feasible fuel economy level.* For purposes of this paragraph, the maximum feasible fuel economy level is determined by taking into account the same factors used in determining the maximum feasible fuel economy level under section 502(e) of the Motor Vehicle Information and Cost Savings Act (as amended) and the

regulations thereunder in effect on November 9, 1978. (These regulations for small manufacturers are prescribed in 49 CFR 525 (1978).) In making this determination, the Commissioner will consult with the National Highway Traffic Safety Administration of the Department of Transportation.

(ii) *Decision to grant alternate rate schedule.* In deciding whether to grant an alternate rate schedule, the Secretary will consider whether the use (in the United States) of the automobile serves an important public policy (*e.g.*, providing public transportation or transportation for the handicapped) that overrides the Nation's need to conserve energy. The manufacturer has the burden of demonstrating that the public policy consideration involved overrides the Nation's need to conserve energy. The Commissioner, after consultation with the Secretary of Energy, the Secretary of Transportation, and the Administrator of the Environmental Protection Agency (or their delegates), will review the information submitted by the manufacturer and report findings and recommendations to the Secretary.

(iii) *Alternate rate schedule and tax.* If an alternate rate schedule is granted, the maximum feasible fuel economy level is considered the tax-free fuel economy level. Accordingly, a tax is imposed on automobiles sold which fail to meet that level. The applicable tax is determined by substituting the maximum feasible fuel economy level for the tax-free fuel economy level in the tax schedules set forth in section 4064(a), and by substituting for the miles per gallon amount prescribed in section 4064(a) an amount which is the tax-free level decreased by one mile per gallon increments, while keeping the same corresponding tax amount prescribed in section 4064 (a). This rule may be illustrated by the following example:

Example. Manufacturer X, a small manufacturer, applied for a determination that it is not feasible for X to meet the tax-free fuel economy level for a particular model type of X's 1982 model year automobiles. It was determined that the maximum feasible fuel economy level for that model type was 15 miles per gallon. The Secretary decided to grant X an alternate rate schedule. The alternate rate schedule for the model type would be as follows:

If the fuel economy of the automobile is:	The tax is:
At least 15	$ 0
At least 14 but not more than 15	200
At least 13 but not more than 14	350
At least 12 but not more than 13	450
At least 11 but not more than 12	600
At least 10 but not more than 11	750
At least 9 but not more than 10	950
Less than 9	1,200

Thus, if X's 1982 automobiles of that model year and type only attain 12 miles per gallon (because X fails to modify them to reach the maximum feasible fuel economy level before they are sold), the tax imposed upon the sale of each automobile is $450 (instead of the $1,200 tax (see the tax table set forth in section 4064(a)(2)) which would have been imposed had no alternate rate schedule been prescribed).

(4) *Duration of determination.* A determination under this paragraph does not apply to more than three model years.

(5) *Requirements for application.* Each application for a determination under this section must—

(i) Identify the model year or years, and particular model type or types for which a determination is requested;

(ii)(A) In the case of an application for model year 1980, be submitted not later than May 8, 1980;

(B) In the case of an application for model year 1981, be submitted not later than 9 months before the beginning of that model year or March 10, 1980, whichever is later;

(C) In the case of an application for model year 1982 or any subsequent model year, be submitted not later than 9 months before that model year;

(iii) Be submitted in three copies to: Commissioner of Internal Revenue, Attention: Assistant Commissioner (Technical), 1111 Constitution Avenue, N.W., Washington, D.C. 20224;

(iv) Be written in the English language;

(v) Set forth the full name, address, and title of the official responsible for preparing the application;

(vi) State whether the applicant is a member of a controlled group of corporations (as defined in paragraph (d)(2)(iii));

(vii) State the total number of automobiles manufactured (whether or not in the United States) by the applicant (or the controlled group of corporations in the case where the applicant is a member of the group) in the second model year immediately preceding each affected model year and the total number of automobiles likely to be manufactured in the affected model year;

(viii) Set forth the same information required by an application pursuant to section 502(e) of the Motor Vehicle Information and Cost Savings Act (as amended) and the regulations thereunder (see 49 C.F.R. 525 (1978)) (whether or not the applicant under this paragraph has also made an application pursuant to such Act); and

(ix) Set forth the reasons why an alternate rate schedule should be granted under paragraph (d)(3)(ii) of this section.

(6) *Update of application.* A manufacturer making an application under this section must update the application when a material change of circumstances occurs or material information not available at the time of applying becomes available. The manufacturer must also furnish any further information relevant to the application which may be required by the Internal Revenue Service.

(7) *Processing of applications.* If a manufacturer's application is found not to contain the information required by this paragraph, the applicant will be informed of the areas of insufficiency. The application will not receive further consideration until the required information is submitted. Each applicant will be informed in writing whether an application has been granted or denied.

§ 138.4222-1 Registration.

The registration procedure set forth in § 48.4222(a)-1 applies to tax-free sales on or after March 10, 1980 under section 4064(b)(1)(C) (relating to emergency vehicles). The manufacturer, intervening vendors (if any), and the vendee must be registered. See section 4064 and the regulations thereunder. The exceptions to the requirement for registration set forth in § 48.4222(b)-1 shall apply. Notwithstanding any provision in paragraph (a) of § 48.4222(b)-1, a State or local government is not required to register as provided in § 48.4222(a)-1 even though the purchased vehicle is not purchased directly from the manufacturer for its exclusive use.

There is need for the immediate guidance provided by the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved January 28, 1980.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on February 7, 1980, 8:45 a.m., and published in the issue of the Federal Register for February 8, 1980, 45 F.R. 8589)

Section 4222.—Registration

26 CFR 138.4222-1: Registration.

Registration requirements of manufacturers, intervening vendors and vendees for tax-free sales of gas guzzler automobiles. See T.D. 7674, page 22.

Section 6013.—Joint Returns of Income Tax by Husband and Wife

26 CFR 1.6013-6: Election to treat nonresident alien individual as resident of the United States.

Final regulations relating to the election by a nonresident alien to be treated as a resident and the treatment of community income if the election is not made. See T.D. 7670, page 14.

Section 7701.—Definitions

26 CFR 301.7701-2: Associations.
(Also Section 167; 1.167(h)-1.)

Trust treated as association; income beneficiaries' deductions. An example is provided of a business arrangement that is a trust under local law, but is classified as an association taxable as a corporation for federal tax purposes. The income beneficiaries of such an arrangement may not deduct any depreciation or amortization on any property held by the association.

Rev. Rul. 80-75

ISSUE

How will the trust arrangement described below be classified for federal tax purposes?

FACTS

A promoter established a trust that was funded by contributions from various individuals designated as income beneficiaries. Each individual contributed 100x dollars for an income interest in the trust, with the remainder interest passing to other persons designated by them. The trust agreement provides that the income of the trust is distributable to the income beneficiaries for a period of 12 years, at which time it will terminate and its remaining assets will be distributed to the remaindermen. No beneficiary has a power under local law to terminate the trust, nor will the death, insanity, bankruptcy, retirement, resignation or expulsion of any beneficiary cause the trust to be dissolved. The trustee has, in addition to other powers, the power to engage in business, and has continuing exclusive authority to make the management decisions necessary for the conduct of the trust business. The agreement further provides that the beneficiaries may not transfer, pledge or assign their beneficial interests in the trust. Under local law the beneficiaries are not personally liable for the debts of the trust.

The trustee used the contributed funds as a downpayment to purchase from the inventor a patent for exploitation by the trust in a business activity described in section 465(c) of the Internal Revenue Code. The balance of the stated purchase price for the patent was financed by giving a full-recourse note to the inventor, with the properties as security. The promoter and the trustee selected by the promoter represent that the trust qualifies as an ordinary trust under the provisions of subparts A, B, C, and D, (section 641 and following), part I, subchapter J, chapter 1 of the Code, and that the income beneficiaries are entitled to deduct, under section 167(h), any depreciation or amortization of the trust as if they were absolute owners of the properties held by the trust. The promoter further represents that the beneficiaries are not subject to the loss limiting rules of section 465 with respect to such depreciation.

LAW AND ANALYSIS

Section 7701(a)(3) of the Internal Revenue Code provides that the term "corporation" includes associations, joint-stock companies, and insurance companies.

In general, the term "trust" as used in the Internal Revenue Code refers to an arrangement created by a will or an inter vivos declaration whereby trustees take title to property for the purpose of protecting or conserving it for the beneficiaries under the ordinary rules applied in chancery or probate courts. See section 301.7701-4(a) of the Procedure and Administration Regulations.

There are other arrangements which while trusts under local law are not classified as trusts under the Internal Revenue Code because they are not arrangements to protect and conserve property for the beneficiaries. Rather, these trusts, which are often known as business or commercial trusts, are created by the beneficiaries as a device to carry on a profit-making business.

Section 301.7701-2(a)(1) of the regulations provides that an "association" is an organization whose characteristics require it to be classified for purposes of taxation as a corporation rather than as another type of organization such as a partnership or trust. An organization will be treated as an association if its corporate characteristics are such that the organization more nearly resembles a corporation than a partnership or trust. The regulations refer to six characteristics ordinarily found in a pure corporation that, taken together, distinguish it from other organizations. These are: (1) associates, (2) an objective to carry on business and divide the gains therefrom, (3) continuity of life, (4) centralization of management, (5) liability for corporate debts limited to corporate property, and (6) free transferability of interests. Section 301.7701-2 (a)(3) provides that an unincorporated organization will not be classified as an association unless such organization has more corporate characteristics than noncorporate characteristics. However, in determining whether an organization has more corporate characteristics than noncorporate characteristics, all characteristics common to both types of organizations shall not be considered.

Because centralization of management, continuity of life, free transferability of interests, and limited liability are generally common to trusts and corporations, the determination of whether a trust that has such characteristics is to be treated for tax purposes as a trust or as an association depends on whether there are associates and an objective to carry on business and divide the gains therefrom. This trust arrangement has associates and an objective to carry on business and divide the gains therefrom. Thus, under the regulations, it will be classified as an association for federal tax purposes. However, it should be noted that if, under the regulations, the arrangement could have been classified as a trust, it would have been a grantor trust pursuant to Rev. Rul. 78-175, 1978-1 C.B. 144, each grantor would have been treated as engaged in the section 465 activity of the trust and therefore subject to the loss limitations of that section.

HOLDING

The arrangement is classified as an association taxable as a corporation for federal tax purposes. Therefore, the income beneficiaries may not deduct any depreciation or amortization on any property held by the association.

Part III. Administrative, Procedural, and Miscellaneous

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER H, PART 601.—STATEMENT OF PROCEDURAL RULES

Miscellaneous Amendments

AGENCY: Internal Revenue Service, Treasury.

ACTION: Amendment of Statement of Procedural Rules.

SUMMARY: This document contains miscellaneous amendments to the Statement of Procedural Rules (SPR). The SPR sets forth the procedural rules of the Internal Revenue Service for all taxes administered by the Service as well as certain rules that apply to the Bureau of Alcohol, Tobacco and Firearms. These amendments make certain changes in the Service's procedure, eliminate discriminatory language, and bring certain provisions of the SPR up to date.

DATE: The amendments are effective upon publication.

FOR FURTHER INFORMATION CONTACT: Benedetta A. Kissel of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Ave., N.W., Washington, D.C. 20224, Attention: CC:LR:T (202-566-3458, not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains amendments to the SPR (26 CFR Part 601). These amendments do not meet the Treasury Department criteria for a significant regulation set forth in paragraph 8 of the Treasury Directive for improving government regulations, published in the Federal Register for November 8, 1978 (43 FR 52120). The amendments are issued under the authority contained in 5 U.S.C. §§ 301 and 552.

These amendments fall into several categories. A description of the most significant amendments in each category follows:

Conforming Amendments

Several amendments reflect the delegation of authority within the Bureau of Alcohol, Tobacco and Firearms. For example, the change in § 601.327(a) from Director, Alcohol, Tobacco and Firearms Division to Assistant Director (Regulatory Enforcement), Bureau of Alcohol, Tobacco and Firearms reflects the delegation of authority in ATF Order 1100.63B (43 FR 55305). Other amendments relating to the Bureau change nomenclature, addresses, and cross-references.

Several amendments conform the SPR to the procedures set forth in the Internal Revenue Code of 1954 for the assessment, collection, refund, and credit of excise taxes imposed by chapters 41 through 44 of the Code.

Several sections are changed to conform to the amendments made by section 1202 of the Tax Reform Act of 1976 (Pub. L. No. 94-455, 90 Stat. 1667) [1976-3 C.B. (Vol. 1) 1, 143], which revised section 6103 of the Code, relating to disclosure of returns and return information, and repealed section 6106 of the Code, relating to publicity of unemployment tax returns. Thus, § 601.702(d)(1) is revised to reflect the amendment to section 6103 deleting the provision that returns are open to inspection only upon order of the President and under rules and regulations approved by the President. Paragraphs (d)(2) and (4) of § 601.702, which relate to disclosure of information as to persons filing certain tax returns, are deleted to reflect the amendment of section 6103(f) and the repeal of section 6106.

Paragraphs (a)(1)(i), (a)(2), and (d)(3) of § 601.106, relating to Appeals functions, are amended to conform to Delegation Order 60 (Rev. 5) (1979-48 I.R.B. 20), Delegation Order No. 66 (Rev. 9) [1979-27 I.R.B. 18] (44 FR 33509), and Rev. Proc. 79-59 (1979-48 I.R.B. 21). The amendments relate to limitations upon Appeals authority and to the processing of cases docketed in the United States Tax Court.

Section 601.203(a)(1) is amended to conform to Delegation Order 11 (Rev. 11) [1979-43 I.R.B. 25] (44 FR 50128), which authorizes certain officials to accept or reject offers in compromise for specified categories of civil and criminal cases.

Amendments deleting out-of-date material

Sections 601.101(c) and 601.501(a) are amended by deleting references to the Economic Stabilization Program, which has been terminated.

Section 601.105(i) is amended by deleting reference to review by the National Office Examination Division of examined cases closed in the Office of International Operations. The National Office no longer performs that function.

Section 601.404, relating to miscellaneous excise taxes collected by sale of revenue stamps, is amended to reflect the repeal of some of these excise taxes.

Amendments clarifying the SPR

Section 601.105(k) is amended to provide further guidance with respect to the transfer of returns between districts for examination or the closing of a case. The amendment makes clear that the transfer of returns is not mandatory and that the effective administration of the tax laws will be considered in determining if returns will be transferred to another district.

Amendments reflecting changes in procedure

Section 601.106(a)(1)(ii), relating to Appeals procedures, is amended to reflect the Service's requirement that a written protest be submitted on all post-assessment penalty appeals.

Paragraph (b)(1) of § 601.502, relating to requirements for recognition to practice before the Revenue Service, is amended to reflect the requirement that taxpayer representatives present satisfactory identification before they appear on behalf of any taxpayer. Paragraph (b)(1)(iii) is amended to extend to enrolled agents the requirement of filing a written declaration of qualification and authorization.

Section 601.504(b)(1), relating to execution of a power of attorney or a tax information authorization, is amended to provide that a husband and wife can authorize separate representatives with respect to joint returns. A separate representative cannot, however, perform any act with respect to a joint return year that the spouse represented could not perform alone.

Section 601.506(b)(2), relating to delivery of refund checks in cases in litigation, is amended to provide a procedure for delivery of such checks in actions arising in the United States Tax Court. Under this procedure a check is delivered to the appropriate Internal Revenue Service District Counsel or, in certain cases, to the appropriate member of the National Office Trial Staff, for delivery to the taxpayer or to the counsel of record.

Amendments eliminating discriminatory language

Many sections of the SPR are to eliminate the exclusive use of masculine pronouns in referring to taxpayers, internal revenue agents, etc. For example, in § 601.103(c)(3) "he" is changed to "the taxpayer".

Miscellaneous amendments

Additional miscellaneous amendments are included, such as the correction of a clerical error, the change of a publication number, the addition of form numbers, and other amendments of a similar nature.

DRAFTING INFORMATION

The principal author of these amendments to the Statement of Procedural Rules is Benedetta A. Kissel of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service participated in developing the amendments, both on matters of substance and style.

Adoption of amendments to the Statement of Procedural Rules

Accordingly, 26 CFR Part 601 is amended as follows:

Paragraph 1. Section 601.101 is amended as follows:

1. Paragraph (b) is amended by deleting "Titles 26 and" from the eleventh sentence and inserting instead "Title".

2. Paragraph (c) is deleted.

3. Paragraph (d) is redesignated paragraph (c) and is amended by deleting "the terms 'Alcohol, Tobacco, and Firearms Division', 'assistant regional commissioner (alcohol, tobacco and firearms)', and 'chief special investigator (alcohol, tobacco and firearms)' shall be construed as meaning respectively 'Bureau of Alcohol, Tobacco and Firearms', 'regional director, Bureau of Alcohol, Tobacco and Firearms', and 'special agent-in-charge, Bureau of Alcohol, Tobacco and Firearms'." from the third sentence, by deleting "Also," and "used in Subpart C of this part," from the fourth sentence, by deleting "director" the first time it appears in the fourth and fifth sentences and inserting instead "regulatory administrator", by deleting "and their geographical compositions" from the last sentence, and by deleting "27 CFR 71.22(b)(3)(ii)" from the last sentence and inserting instead "Appendix A to Subpart C, 27 CFR Part 71".

Par 2. Paragraph (b)(1)(iv) of § 601.102 is amended by deleting "chapter 42" and inserting instead "chapters 41 through 44".

Par 3. Section 601.103 is amended as follows:

1. Paragraph (c)(2) is amended by deleting "gift, and excise" from the first sentence and inserting instead "and gift", by inserting "excise" between "and" and "taxes" in the first sentence, and by deleting "chapter 42" from the first sentence and inserting instead "chapters 41 through 44".

2. Paragraph (c)(3) is amended by deleting "He" from the fourth sentence and inserting instead "The taxpayer", and by deleting "he" from the seventh sentence and inserting instead "the taxpayer".

Par. 4. Section 601.104 is amended as follows:

1. Paragraph (a)(1) is amended by deleting "he himself" from the first sentence and by inserting instead "the taxpayer", by deleting "him" from the third sentence and by inserting instead "the taxpayer", and by deleting "his" from the ninth sentence and inserting instead "the Secretary's".

2. Paragraph (a)(3) is amended by deleting "or" the second time it appears in the first sentence and inserting instead "and", by inserting "or her" between "his" and "estimated tax" in the first sentence, and by deleting "$40" from the first sentence and inserting instead "$100".

3. Paragraph (b) is amended by inserting "or her" between "his" and "return" in the sixth sentence, and by deleting "and paying the unpaid balance of tax due with the return" from the sixth sentence and inserting instead "accompanied by payment of the full amount of the estimated unpaid tax liability".

4. Paragraph (c)(1) is amended by deleting "regional" from the first sentence and inserting instead "appropriate".

5. Paragraph (c)(2) is amended by inserting "chapters 41 through 44," between "estate," and "or" in the third sentence.

6. Paragraph (c)(4) is amended by deleting "regional" from the first and third sentences and inserting instead "appropriate".

Par. 5. Section 601.105 is amended as follows:

1. Paragraph (b)(1) is amended by deleting "examining officers" wherever it appears and inserting instead "examiners" and by deleting "examining officer" wherever it appears and inserting instead "examiner".

2. Paragraph (b)(2)(ii) is amended by deleting "examining officer" wherever it appears and inserting instead "examiner", by deleting "his" wherever it appears and inserting instead "the", by deleting "with him" from the sixth sentence, and by deleting "he" from the seventh sentence and inserting instead "the taxpayer".

3. Paragraph (b)(3) is amended by deleting "examining officer" from the second sentence and inserting instead "examiner".

4. Paragraph (b)(4) is amended by deleting "examining officer" wherever it appears and inserting instead "examiner", by deleting "his" from the second sentence and inserting instead "the", by deleting "him" from the third sentence and inserting instead "the taxpayer", by deleting "against him and paid by him" from the eighth sentence and inserting instead "against, and paid by, the taxpayer", by deleting the last word of the eighth sentence and inserting instead "the taxpayer", and by deleting "his" from the ninth sentence and inserting instead "the taxpayer from".

5. Paragraph (b)(5)(i)(*c*) is amended by deleting "he" from the first sentence.

6. Paragraph (b)(5)(iii)(*b*) is amended by deleting "examining officer" from the second sentence and inserting instead "examiner".

7. Paragraph (b)(5)(iii)(*g*) is amended by deleting "he" wherever it appears in the first sentence and inserting instead "the taxpayer" and by deleting "his" from the first sentence and inserting instead "the taxpayer's".

8. Paragraph (b)(5)(iii)(*h*) is amended by deleting "he" the first place it appears and inserting instead "the taxpayer", by deleting "his" and inserting instead "the", and by deleting "he desires such a conference" and inserting instead "such a conference is desired".

9. Paragraph (b)(5)(iv) is amended by deleting "examining officer" wherever it appears and inserting instead "examiner".

10. Paragraph (b)(5)(v)(*e*) is amended by deleting "his" the first place it appears and inserting instead "a taxpayer's", by deleting "his" the second place it appears and inserting instead "the", by deleting "Income Tax" and inserting instead ", Corporation Tax", and by deleting "Miscellaneous and Special Provisions Tax" and inserting instead "Individual Tax".

11. Paragraph (b)(5)(viii)(*d*) is amended by inserting "or she" between "he" and "may".

12. Paragraph (d)(1)is amended by deleting "examining officer" from the first sentence and inserting instead "examiner", by deleting "examining officer's" from the fifth sentence and inserting instead "examiner's", by deleting "he" the first place it appears in the sixth sentence and inserting instead "the taxpayer", by inserting "or she" in the sixth sentence between "he" and "indicate", by deleting "his" from the sixth sentence, by deleting "to him" from the seventh sentence, and by inserting "or she" in the seventh sentence between "he" and "disagrees".

13. Paragraph (i) is amended by deleting the second sentence.

14. Paragraph (k) is revised to read as follows:

§ 601.105 Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.

* * * * *

(k) *Transfer of returns between districts.* When a request is received to transfer returns to another district for examination or the closing of a case, the district director having jurisdiction may transfer the case, together with pertinent records, to the district director of such other district. The Service will determine the time and place of the examination. In determining whether a transfer should be made, circumstances such as the following will be considered:

(1) Change of the taxpayer's domicile, either before or during examination.

(2) Discovery that taxpayer's books and records are kept in another district.

(3) Change of domicile of an executor or administrator to another district before or during examination.

(4) The effective administration of the tax laws.

Par. 6. Section 601.106 is amended as follows:

1. Paragraph (a)(1)(i) is amended by deleting the fifth sentence and inserting instead a new sentence, reading as set forth below.

2. Paragraph (a)(1)(ii) is amended by adding after the last sentence a new sentence reading as set forth below.

3. Paragraph (a)(1)(iii)(*c*) is redesignated (a)(1)(iii)(*d*), paragraph a)(1)(iii)(*d*) is redesignated (a)(1)(iii)(*e*), and a new (a)(l)(iii)(*c*) is added to read as set forth below.

4. Paragraph (a)(2) is revised to read as set forth below.

5. Paragraph (a)(3) is amended by deleting "the Appellate Division" and inserting instead "Appeals".

6. Paragraph (a)(4) is amended by deleting "Appellate jurisdiction" and inserting instead "Appeals jurisdiction" and by deleting "Appellate Division" and inserting instead "Appeals official".

7. Paragraph (b) is amended by deleting "the *Appellate Division"* from the title and inserting instead *"Appeals"*, by deleting "Appellate" from the first sentence and inserting instead "Appeals", by inserting ", (c)(1) and (c)(2) of 601.105," in the first parenthetical of the first sentence between "§§ 601.103" and "and", by deleting "regional office of the Appellate Division" from the first sentence and inserting instead "Appeals organization", by deleting "Appellate Division of the region" from the fourth sentence and inserting instead "Appeals activity", by deleting "the Appellate Division" from the fifth sentence and inserting instead "Appeals", by deleting "Appellate Division" from the sixth sentence and inserting instead "Appeals", by deleting "his" from the seventh sentence and inserting instead "a", by deleting "the Appellate Division" from the seventh sentence and inserting instead "Appeals", and by deleting "the Appellate Division" from the ninth sentence and inserting instead "Appeals".

8. Paragraph (c) is amended by deleting *"the Appellate Division"* from the title and inserting instead *"Appeals"*, by deleting "the Appellate Division" from the first sentence and the first place it appears in the fifth sentence and inserting instead "Appeals", by deleting "he and the Appellate Division" from the fifth sentence and inserting instead "the Appeals", by inserting "and the district director" in the fifth sentence between "authority" and "deem", by deleting "Regional" from the last sentence and inserting in-

stead "District", and by inserting "or she" in the last sentence between "he" and "so".

9. Paragraph (d) is amended by deleting *"the Appellate Division"* from the title and inserting instead *"Appeals"*.

10. Paragraph (d)(1) is amended by deleting "Appellate Division" from the first sentence and inserting instead "Appeals office" and by deleting "the Appellate Division" from the second sentence and inserting instead "Appeals".

11. Paragraph (d)(2)(i) is amended by deleting "the Appellate Division of the region" from the first sentence and inserting instead "Appeals" and by deleting "he" from the first sentence and inserting instead "the taxpayer".

12. Paragraph (d)(2)(ii) is amended by revising the first sentence to read as set forth below, by deleting "Appellate Division" from the second sentence and inserting instead "Appeals office", by deleting "the Appellate Division" from the fourth sentence and inserting instead "Appeals", by deleting "service center director or returned to the district director" from the fifth sentence and inserting instead "appropriate function", by deleting "such" from the fifth sentence, and by deleting from the fifth sentence "the Appellate Division as may be appropriate, such as the preparation of a notice of adjustment, or the collection of any additional tax in excise and employment tax cases or of the 100-percent penalty" and inserting instead "Appeals".

13. Paragraph (d)(2)(iii) is amended by deleting "chapter 42" from the first sentence and inserting instead "chapters 41 through 44," by deleting "said" from the first sentence, and by inserting "(or portion thereof of divisible taxes)" in the first sentence between "tax" and "when".

14. Paragraph (d)(3)(i) is amended by deleting "the Appellate Division" from the first sentence and inserting instead "Appeals".

15. Paragraph (d)(3)(ii) is amended by deleting "the Appellate Division" wherever it appears and inserting instead "Appeals" and by deleting "regional" and inserting instead "appropriate district".

16. Paragraph (d)(3)(iii) is amended by deleting "Appellate Division" wherever it appears in the first sentence and inserting instead "Appeals office" and deleting "regional" from the first sentence and inserting instead "district".

17. Paragraphs (d)(3)(iii)(*a*) through (*f*) are revised to read as set forth below.

18. Paragraphs (d)(3)(iii)(*g*) and (*h*) are deleted.

19. Paragraph (d)(3)(iii)(*i*) is amended by redesignating it (d)(3)(iii)(*g*) and by deleting the last two sentences.

20. Paragraph (e)(1) is amended by deleting "A Regional Appellate Division" from the first sentence and inserting instead "An Appeals office", by deleting "his" from the first sentence and inserting instead "the taxpayer's", and by deleting "Appellate" from the last sentence and inserting "Appeals".

21. Paragraph (e)(2) is amended by deleting "A Regional Appellate Division" from the first sentence and inserting instead "An Appeals office", by deleting "his" from the first sentence and inserting instead "the petitioner's", and by deleting "Appellate" from the second sentence and inserting instead "Appeals".

22. Parargaph (e)(3) is amended by inserting "or she" between "he" and "may", by deleting "Appellate Division of the region" and inserting instead "Appeals office", and by inserting "or her" between "his" and "personal".

23. Paragraph (f) is amended by deleting "the Appellate Division" from the first sentence and the first place it appears in the second sentence and inserting instead "Appeals".

24. Paragraph (f)(1) is amended by deleting "Appellate Division" from the second sentence and inserting instead "Appeals", and by inserting "or her" in the second sentence between "his" and "conclusions" and in the third sentence between "his" and "duty".

25. Paragraph (f)(2) is revised to read as set forth below.

26. Paragraph (f)(3) is amended by deleting "Appellate Division conferee" from the first sentence and inserting instead "Appeals officer", by deleting "the Appellate Division" from the first sentence and inserting instead "Appeals", and by deleting "Appellate Division" from the second sentence and inserting instead "Appeals office".

27. Paragraph (f)(4) is amended by deleting "Appellate Division" wherever it appears and inserting instead "Appeals" and by inserting "or her" in the second sentence between "his" and "office".

28. Paragraph (f)(5) is amended by inserting "unagreed" in the first sentence between "an" and "income", by deleting "the Appellate Division" from the third and fourth sentences and inserting instead "Appeals", by deleting "Appellate Division" the first place it appears in the last sentence and inserting instead "Appeals Division", by deleting "Appellate Divisions" from the last sentence and inserting instead "Appeals office" and by deleting "Appellate Division" the second place it appears in the last sentence and inserting instead "Appeals".

29. Pargaraph (f)(6) is amended by deleting "the Appellate Division" wherever it appears and inserting instead "Appeals" and by inserting "or her" in the last sentence between "his" and "consideration".

30. Paragraph (f)(8) is revised to read as set forth below.

31. Paragraph (f)(9) is deleted.

32. Paragraph (f)(10) is redesignated (f)(9) and is amended by deleting *"Rule X"* from the heading and inserting instead *"Rule IX"*.

33. Paragraph (g)(1) is revised to read as set forth below.

34. Paragraphs (g)(2) and (g)(3) are amended by deleting "the Appellate Division" and inserting instead "Appeals".

35. Paragraph (h)(1) is amended by deleting "the Appellate Division" wherever it appears and inserting instead "Appeals" and by deleting "Assistant Regional Commissioner (Appellate)" from the last sentence and inserting instead "Regional Director of Appeals".

36. Paragraph (h)(2) is amended by deleting "the Appellate Division" from the first sentence and inserting instead "Appeals", by deleting "Assistant Regional Commissioner (Appellate") from the first sentence and inserting instead "Regional Director of Appeals", by deleting "Appellate Division" from the second sentence and inserting instead "Appeals", and by deleting "Appellate" from the last sentence and inserting instead "Appeals".

37. Paragraph (h)(3) is amended by deleting "the Appellate Division" wherever it appears and inserting instead "Appeals" and by deleting "Assistant Regional Commissioner (Appellate)" from the last sentence and inserting instead "Regional Director of Appeals".

38. Paragraph (h)(4) is amended by deleting "the Appellate Division" wherever it appears and inserting instead "Appeals".

§ 601.106 Appeals functions.

(a) *General.* (1)(i) * * * After the filing of a petition in the Tax Court the Appeals office will have exclusive settlement jurisdiction, subject to the provisions of subparagraph (2) of this paragraph, for a period of 4 months (but no later than the receipt of the trial calendar in regular cases and no later than 15 days before the calendar call in S cases), over cases docketed in the Tax Court. * * *

(ii) * * * A written protest is required on all postassessment penalty appeals.

(iii) * * *

(*c*) Penalties that are subject to an administratively granted preassessment appeal procedure such as that provided in § 1.6694-2(a)(1) because taxpayers are able to protest such penalties prior to assessment;

* * * * *

(2) The authority described in subparagraph (1) of this paragraph does not include the authority to:

(i) Negotiate or make a settlement in any case docketed in the Tax Court if the notice of deficiency, liability or other determination was issued by Appeals officials;

(ii) Negotiate or make a settlement in any docketed case if the notice of deficiency, liability or other determination was issued after appeals consideration of all petitioned issues by the Employee Plans/Exempt Organizations function;

(iii) Negotiate or make a settlement in any docketed case if the notice of deficiency, liability or final adverse determination letter was issued by a District Director and is based upon a National Office ruling or National Office technical advice in that case involving a qualification of an employee plan or tax exemption and/or foundation status of an organization (but only to the extent the case involves such issue);

(iv) Negotiate or make a settlement if the case was docketed under Code sections 6110, 7477, or 7478;

(v) Eliminate the ad valorem fraud penalty in any case in which the penalty was determined by the district office or service center office in connection with a tax year or period, or which is related to or affects such year or period, for which criminal prosecution against the taxpayer (or related taxpayer involving the same transaction) has been recommended to the Department of Justice for willful attempt to evade or defeat tax, or for willful failure to file a return, except upon the recommendation or concurrence of Counsel; or

(vi) Act in any case in which a recommendation for criminal prosecution is pending, except with the concurrence of Counsel.

* * * * *

(d) *Disposition and settlement of cases before Appeals.* * * *

(2) *Cases not docketed in the Tax Court.* * * *

(ii) If after consideration of the case by Appeals it is determined that there is a deficiency in income, profits, estate, gift tax, chapter 41, 42, 43, or 44 tax liability to which the taxpayer does not agree, a statutory notice of deficiency will be prepared and issued by Appeals. * * *

* * * * *

(3) *Cases docketed in the Tax Court.* * * *

(iii) * * *

(*a*) The Appeals office will have exclusive settlement jurisdiction for a period of 4 months over certain cases docketed in the Tax Court. The 4-month period will commence at the time Appeals receives the case from Counsel, which will be after the case is at issue. Appeals will arrange settlement conferences in such cases within 45 days of receipt of the case. In the event of a settlement, Appeals will prepare and forward to Counsel the necessary computations and any stipulation decisions secured. Counsel will prepare any needed settlement documents for execution by the parties and filing with the Tax Court. Appeals will also have authority to settle less than all the issues in the case and to refer the unsettled issues to Counsel for disposition. In the event of a partial settlement, Appeals will inform Counsel of the agreement of the petitioner(s) and Appeals may secure and forward to Counsel a stipulation covering the agreed issues. Counsel will, if necessary, prepare documents reflecting settlement of the agreed issues for execution by the parties and filing with the Tax Court at the appropriate time.

(*b*) At the end of the 4-month period, or before that time if Appeals determines the case is not susceptible of settlement, the case will be returned to Counsel. Thereafter, Counsel will have exclusive authority to dispose of the case. If, at the end of the 4-month period, there is substantial likelihood that a settlement of the entire case can be effected in a reasonable period of time, Counsel may extend Appeals setlement jurisdiction for a period not to exceed 60 days, but not beyond the date of the receipt of a trial calendar upon which the case appears. Extensions beyond the 60-day period or after the event indicated will be granted only with the personal approval of regional counsel and will be made only in those cases in which the probability of settlement of the case in its entirety by Appeals clearly outweighs the need to commence trial preparation.

(*c*) During the period of Appeals jurisdiction, Appeals will make available such files and information as may be necessary for Counsel to take any action required by the Court or which is in the best interest of the Government. When a case is referred by Counsel to Appeals, Counsel may indicate areas of needed factual development or areas of possible technical uncertainties. In referring a case to Counsel, Appeals will furnish its summary of the facts and the pertinent legal authorities.

(*d*) The Appeals office may specify that proposed Counsel settlements be referred back to Appeals for its views. Appeals may protest the proposed Counsel settlements. If Counsel disagrees with Appeals, the Regional Counsel will determine the disposition of the cases.

(*e*) If an offer is received at or about the time of trial in a case designated by the Appeals office for setlement consultation, Counsel will endeavor to have the case placed on a motions calendar to permit consultation with and review by Appeals in accordance with the foregoing procedures.

(*f*) For issues in docketed and nondocketed cases pending with Appeals which are related to issues in docketed cases over which Counsel has jurisdiction, no settlement offer will be accepted by either Appeals or Counsel unless both agree that the offer is acceptable. The protest procedure will be available to Appeals and regional counsel will have authority to resolve the issue with respect to both the Appeals and Counsel cases. If settlement of the docketed case requires approval by regional counsel or Chief Counsel, the final decision with respect to the issues under the jurisdiction of both Appeals and Counsel will be made by regional counsel or Chief Counsel. See Rev. Proc. 79-59 [1979-48 I.R.B. 21].

* * * * *

(f) *Conference and practice requirements.* * * *

(2) *Rule II.* Appeals will ordinarily give serious consideration to an offer to settle a tax controversy on a basis which fairly reflects the relative merits of the opposing views in light of the hazards which would exist if the case were litigated. However, no settlement will be made based upon nuisance value of the case to either party. If the taxpayer makes an unacceptable proposal of settlement under circumstances indicating a good-faith attempt to reach an agreed disposition of the case on a basis fair both to the Government and the taxpayer, the Appeals official generally should give an evaluation of the case in such a manner as to enable the taxpayer to ascertain the kind of settlement that would be recommended for acceptance. Appeals may defer action on or decline to settle some cases or issues (for example, issues on which action has been suspended nationwide) in order to achieve greater uniformity and enhance overall voluntary compliance with the tax laws.

* * * * *

(8) *Rule VIII.* In cases not docketed in the United States Tax Court on which a conference is being conducted by the Appeals office, the district counsel may be requested to attend and to give legal advice in the more difficult cases, or on matters of legal or litigating policy.

* * * * *

(g) *Limitation on the jurisdiction and function of Appeals*—(1) *Overpayment of more than $200,000.* If Appeals determines that there is an overpayment of income, war profits, excess profits, estate, or gift tax, or any tax imposed by chapters 41 through 44, including penalties and interest, in excess of $200,000, such determination will be considered by the Joint Committee on Taxation. See section 601.108.

* * * * *

Par. 7. Section 601.108 is amended as follows:

1. Paragraph (a) is amended by deleting "imposes with respect to private foundations or pension plans under chapter 42 or 43" from the first sentence and inserting instead "imposed by chapters 41 through 44".

2. Paragraph (b) is amended by deleting "the Appellate Division" from the first sentence and inserting instead "Appeals", and by revising the last sentence to read as set forth below.

§ 601.108 Review of overpayments exceeding $200,000.

* * * * *

(b) *Reports to Joint Committee.* * * * In cases in which a protest has been made, the report to the Joint Commitee is prepared by an Appeals officer; in cases in which a petition is docketed, either an Appeals officer or a Counsel attorney prepares the report, depending on the circumstances.

Par. 8. Section 601.109 is amended as follows:

1. Paragraph (a)(1) is amended by deleting "agricultural composition," from the sixth sentence, by deleting "sections 75," from the sixth sentence and inserting instead "section", and by deleting "section 75 or" from the seventh sentence.

2. Paragraph (d) is amended by deleting "75 (1)," from the third sentence and by inserting "or abandoned" in the last sentence between "exempt" and "property".

Par. 9. Section 601.201 is amended as follows:

1. Paragraph (a)(7) is amended by inserting after the fifth sentence a new reference to read as set forth below.

2. Paragraph (e)(2) is amended by inserting after the parenthetical reading "(Revenue Procedure 73-17 sets forth the information to be included in the request for a ruling under section 332, 334(b)(1), or 334(b)(2).)" a new reference, reading as set forth below.

3. Paragraph (o)(10)(iv) is amended by making the sentence beginning with "The steps described" flush material and revising it to read as set forth below.

4. Paragraph (o)(10)(v) is revised to read as set forth below.

7. A new paragraph (u) is added to read as set forth below.

§ 601.201 Rulings and determination letters.

(a) *General practice and definitions.* * * *

(7) * * * See, for example, Rev. Proc. 78-15, 1978-2 C.B. 488, and Rev. Proc. 78-16, 1978-2 C.B. 489. * * *

* * * * *

(e) *Instructions to taxpayers.* * * *

(2) * * * See Rev. Proc. 77-30, 1977-2 C.B. 539, Rev. Proc. 78-18,

1978-2 C.B. 491, relating to rules for the issuance of an advance ruling that a proposed sale of employer stock to a related qualified defined contribution plan of deferred compensation will be a sale of the stock rather than a distribution of property. * * *

* * * * *

(o) *Employees' trust or plans.* * * *

(10) *Exhaustion of administrative remedies.* * * *

(iv) * * * The step described in paragraph (o)(10)(i)(*c*) of this section will not be considered completed until the Internal Revenue Service has had a reasonable time to act upon the appeal. * * *

(v) The administrative remedy described in paragraph (o)(10)(i)(*c*) of this section will not be available to an applicant with respect to any issue on which technical advice from the National Office has been obtained.

* * * * *

(u) *Conditions for issuing rulings involving bonuses and advanced royalties of lessors under § 631(c) of IRC of 1954.*

(1) *In general.* Rev. Proc. 77-11, 1977-1 C.B. 568, provides that the tax liability of a lessor who received a bonus or an advance royalty is required to be recomputed for the taxable year or years in which such payment or payments were received if the right to mine coal or iron ore under the lease expires, terminates, or is abandoned before (with respect to bonuses) any coal or iron ore has been mined; or (with respect to advance royalties) the coal or iron ore that has been paid for in advance is mined. In such recomputation, the lessor is required to treat the bonus payment or payments or any portion of the advance royalty payment or payments attributable to unmined coal or iron ore, as ordinary income and not as received from the sale of coal or iron ore under section 631(c) of the Code.

(2) *Condition for issuing rulings.* Prior to issuing a ruling to lessors who request a ruling that they may treat bonuses or advance royalties received under a lease for coal or iron ore as received from a sale of coal or iron under section 631(c) of the Code, the Internal Revenue Service will require that the lessor enter a closing agreement in which the lessor agrees that—

(i) If the lease under which the lessor received a bonus or an advance royalty expires, terminates, or is abandoned before (with respect to a bonus) any coal or iron ore has been mined or (with respect to an advance royalty) the coal or iron ore that has been paid for in advance is mined, the tax liability of the lessor will be recomputed for the taxable year or years of receipt of (A) the bonus by treating the bonus payment or payments as ordinary income or (B) the advance royalty by treating any portion of the advance royalty payment or payments attributable to unmined coal or iron ore as ordinary income;

(ii) If the recomputation described in paragraph (u)(2)(i) of this section is required, the lessor will pay the additional amount, if any, of all federal income tax finally determined as due and payable by the lessor for the taxable year or years of the receipt of the bonus or advance royalty; and

(iii) If any of the described events has occurred, the lessor will notify the appropriate district director of such event in writing within 90 days of the close of the taxable year in which the lease expires, terminates, or is abandoned.

Par. 10. Section 601.203 is amended as follows:

1. Paragraph (a)(1) is amended by deleting the second and third sentences and inserting instead four sentences to read as set forth below and by deleting "Alcohol, Tobacco and Firearms Division" from the next-to-the-last sentence and inserting instead "Bureau of Alcohol, Tobacco and Firearms".

3. Paragraph (b) is amended by deleting "(Rev. 2-69)" from the first sentence.

4. Paragraph (c)(1) is amended by inserting "or she" in the fourth sentence between "he" and "will".

5. Paragraph (c)(1)(iii) is amended by deleting "(including in the case of narcotics, smoking opium, and marihuana taxes only those specific penalties which involve delinquency in registration or delinquency in payment)".

6. Paragraph (c)(2)(i)(*c*) is amended by deleting "(without regard to the class of tax involved)" and inserting instead "; in joint liability cases, where either taxpayer is deceased".

7. Paragraph (c)(2)(iv) is amended by inserting "or her" in the last sentence between "his" and "recommendation" and by deleting "his" the second place it appears in the last sentence and inserting instead "the".

8. Paragraph (c)(3) is amended by deleting "Appellate Division" from the second sentence and inserting instead "Appeals office".

§ 601.203 Offers in compromise.

(a) *General.* (1) * * * Certain functions of the Commissioner with respect to compromise of civil cases involving liability of $100,000 or more, based solely on doubt as to liability, have been delegated to regional commissioners and, for cases arising in the Office of International Operations, to the Assistant Commissioner (Compliance). The authority concerning liability of $100,000 or more based on doubt as to collectibility or doubt as to both collectibility and liability has been delegated to the Director, Collection Division and regional commissioners. The authority with respect to compromise of civil cases involving liability under $100,000, and of certain specific penalties has been delegated to district directors, assistant district directors, the Director of International Operations, the Assistant Director of International Operations, regional directors of Appeals, and chiefs and associate chiefs, Appeals offices. The authority concerning offers in compromise of penalties based solely on doubt as to liability, if the liability is less than $100,000, has also been delegated to service center directors and assistant service center directors. * * *

* * * * *

Par. 11. Section 601.301 is amended as follows:

1. Paragraph (c) is amended by revising the fifth sentence to read as set forth below and by deleting "this chapter" wherever it appears and inserting instead "Title 27 CFR".

2. Paragraph (c)(7) is further amended by inserting "Bureau of" in

the last sentence between "the" and "Alcohol" and by deleting from the last sentence "Division".

3. Paragraph (c)(18) is further amended by deleting "internal revenue" from the last sentence and inserting instead "ATF".

4. Paragraph (c)(21) is further amended by deleting "198" and inserting instead "18".

§ 601.301 Imposition of taxes, qualification requirements, and regulations.

* * * * *

(c) *Regulations.* * * * ATF publication 1322.1, which contains a listing of alcohol, tobacco and firearms public-use forms, may be obtained from the ATF Distribution Center, 3800 South Four Mile Run Drive, Arlington, Va. 22206. * * *

Par. 12. Section 601.304 is amended as follows:

1. All paragraphs of this section are amended by deleting "this chapter" wherever it appears and inserting "Title 27 CFR".

2. Paragraph (a) is further amended by deleting "director" from the last sentence and inserting instead "regulatory administrator".

Par. 13. Section 601.306 is amended by deleting "Alcohol, Tobacco, and Firearms Division" from the first and second sentences and inserting instead "Bureau of Alcohol, Tobacco and Firearms", by deleting "Internal Revenue Service," from the second sentence, and by deleting "20224" from the second sentence and inserting instead "20226".

Par. 14. Section 601.308 is amended by inserting "Bureau of" in the first sentence between "Director," and "Alcohol," and by deleting "Division" from the first sentence.

Par. 15. Section 601.309 is amended by deleting "before the Service,", by inserting "Bureau of" between "Director," and "Alcohol,", and by deleting "Division".

Par. 16. Section 601.311 is amended by deleting "this chapter" wherever it appears and inserting instead "Title 27 CFR".

Par. 17. Section 601.312 is amended by deleting "Internal Revenue Service" wherever it apears in paragraphs (a) and (b) and inserting instead "Bureau of Alcohol, Tobacco and Firearms".

Par. 18. Section 601.315 is amended by deleting "assistant regional commissioner (alcohol, tobacco, and firearms)" from the first sentence of paragraph (i) and inserting instead "regional regulatory administrator".

Par. 19. Section 601.318 is amended by deleting "assistant regional commissioners (alcohol, tobacco, and firearms)" from the second sentence and inserting instead "regional regulatory administrators in the Bureau of Alcohol, Tobacco and Firearms", by deleting "IRS Publication No. 480" from the third sentence and inserting instead "ATF Publication 1322.1", by deleting "purchase from the Superintendent of Documents, Government Printing Office, Washington, D.C. 20402" from the third sentence and inserting instead "obtained from the ATF Distribution Center, 3800 South Four Mile Run Dr., Arlington, Va. 22206", and by deleting "Internal Revenue Service" from the fourth sentence and inserting instead "Bureau of Alcohol, Tobacco and Firearms".

Par. 20. Sections 601.320 and 601.321 are amended by deleting "this chapter" wherever it appears and inserting instead "Title 27 CFR".

Par. 21. Section 601.321a is amended by deleting "180" wherever it appears and inserting instead "47" and by deleting "this chapter" wherever it appears and inserting instead "Title 27 CFR".

Par. 22. Sections 601.321b and 601.324 are amended by deleting "this chapter" wherever it apepars and inserting "Title 27 CFR".

Par. 23. Section 601.326 is amended by deleting "172" from the first sentence and inserting instead "72" and by deleting "this chapter" from the first sentence and inserting instead "Title 27 CFR".

Par. 24. Section 601.327 is amended as follows:

1. Paragraph (a) is amended by deleting "internal revenue" the second place it appears in the first sentence and inserting instead "ATF", by deleting ";" between "taxes" and "(2)" in the third sentence and inserting instead "and", by deleting from the third sentence "; and (3) liabilities arising under chapter 52 of the Code (cigars, cigarettes, and cigarette papers and tubes)", by deleting "Director, Alcohol, Tobacco and Firearms Division" from the fourth and ninth sentences and inserting instead "Assistant Director (Regulatory Enforcement), Bureau of Alcohol, Tobacco and Firearms", by inserting, "52," in the fourth sentence between "51" and "and", by deleting "Commissioner" from the fifth sentence and inserting instead "Director, Bureau of Alcohol, Tobacco and Firearms,", by deleting "Internal Revenue Service" from the sixth sentence and inserting instead "Bureau of Alcohol, Tobacco and Firearms", and by deleting "assistant regional commissioner" from the ninth sentence and inserting instead "regional regulatory administrator".

2. Paragraph (b) is amended by deleting "Director, Alcohol, Tobacco, and Firearms Division" from the second and fourth sentences and inserting instead "Assistant Director (Regulatory Enforcement) Bureau of Alcohol, Tobacco and Firearms", by deleting "internal revenue" from the third sentence and inserting instead "ATF", and by deleting "assistant regional commissioner" from the fourth sentence and inserting instead "regional regulatory administrator".

3. Paragraph (c) is amended by deleting "special agent in charge (alcohol, tobacco and firearms)" from the first sentence and inserting instead "regional administrative officer, Bureau of Alcohol, Tobacco and Firearms,", by deleting "Internal Revenue Service, including liabilities to forfeiture under the internal revenue laws pertaining to wagering" from the first sentence and inserting instead "Bureau of Alcohol, Tobacco and Firearms", by deleting "chief special investigator (alcohol, tobacco, and firearms)" from the second sentence and inserting instead "regional administrative officer, Bureau of Alcohol, Tobacco and Firearms" and by deleting the third sentence.

Par. 25. Section 601.401 is amended as follows:

1. Paragraph (a)(3) is amended by deleting "he may at his election"

from the tenth sentence and inserting instead "the employer may elect to", by deleting "he" from the last sentence and inserting instead "the employee", and by inserting "or her" in the last sentence between "his" and "income".

2. Paragraph (a)(5) is amended by inserting "*and trust companies*" in the heading between "*banks*" and "*in*".

3. Paragraph (a)(5)(i) is amended by deleting "his" from the last sentence and inserting instead "the employer's".

4. Paragraph (a)(5)(iv) is amended by inserting "or trust company" in each sentence after the words "authorized commercial bank".

5. Paragraph (a)(5)(v) is amended by inserting "or trust company" in the first sentence between "bank" and "authorized".

6. Paragraph (a)(6) is amended by deleting "he" from the first sentence and inserting instead "the employer".

7. Paragraph (b)(1) is amended by deleting "has in his employ" from the last sentence and inserting instead "employs" and by deleting "his" the last place it appears in the first sentence and inserting instead "the employer's".

8. Paragraph (c)(1) is amended by deleting "his" from the second and third sentences and inserting instead "the".

9. Paragraph (d)(1) is amended by deleting the footnote.

10. Paragraph (d)(3) is amended by deleting "he" from the first sentence and inserting instead "the employee".

Par. 26. Section 601.402 is amended as follows:

1. Paragraph (c)(2) is amended by deleting "him" from the first sentence and inserting instead "the taxpayer".

2. Paragraph (c)(3) is amended by deleting "his" from the fifth sentence and inserting instead "the taxpayer's", by deleting "his" from the seventh sentence and inserting instead "the purchaser's", and by deleting "he" from the seventh sentence and inserting instead "such purchaser".

3. Paragraph (d)(1)(ii) is amended by deleting "his" from the first sentence and inserting instead "the person's".

4. Paragraph (e)(1) is amended by deleting "his" from the fifth and sixth sentences and inserting instead "the".

5. Paragraph (e)(3) is amended by deleting "he" wherever it appears in the first sentence and inserting instead "the importer" and by deleting "his" from the first sentence.

Par. 27. Section 601.403 is amended by deleting "he is not required to file a return with respect to such taxes" from paragraph (d) and by inserting instead "a return is not required to be filed with respect to such taxes".

Par. 28. Section 601.404 is amended as follows:

1. Paragraph (a) is revised to read as set forth below.

2. Paragraphs (b) and (c) are deleted.

3. Paragraph (d) is redesignated paragraph (b).

4. Paragraph (e) is amended by redesignating it paragraph (c) and by deleting the first sentence.

5. Paragraph (f)(1) is deleted.

6. Paragraph (f)(2) is amended by deleting the first two sentences.

7. Paragraph (f)(3) is amended by deleting the first sentence and by deleting "Commodity and occupational" from the second sentence and inserting instead "Occupational" .

8. Paragraph (f)(4) is amended by deleting the second sentence.

9. Paragraph (f)(5) is amended by deleting "miscellaneous" from the first sentence and by deleting "revenue" from the first sentence and inserting instead "occupational tax".

10. Paragraph (f) is further amended by redesignating it paragraph (d) and by redesignating subparagraphs (2) as (1), (3) as (2), (4) as (3), and (5) as (4).

11. Paragraph (g) is amended by redesignating it paragraph (e).

12. Paragraphs (h), (i) and (j) are deleted.

13. Paragraph (k) is amended by redesignating it paragraph (f), by deleting "*special or*" from the heading, and by deleting "form 11 (relating to adulterated and process or renovated butter and filled cheese)," from the fourth sentence.

§ 601.404 Miscellaneous excise taxes collected by sale of revenue stamps.

(a) *General*. Excise taxes collected by sale of revenue stamps apply to wagering and to gaming devices. A brief description of these taxes is set forth in paragraph (b) of this section.

* * * * *

Par. 29. Section 601.501 is amended as follows:

1. Paragraph (a) is amended by deleting ", except economic stabilization matters" from the first sentence.

2. Paragraph (b)(3) is amended by deleting "his" from the first sentence and inserting instead "the taxpayer's".

Par. 30. Section 601.502 is amended as follows:

1. Paragraph (a) is amended by deleting "his" wherever it appears and inserting instead "the taxpayer's".

2. Paragraph (b)(1) is amended by inserting "presents satisfactory identification and" in the first sentence between "person" and "is" and by inserting "or she" in the second sentence between "he" and "meets".

3. Paragraphs (b)(1)(i) and (b)(1)(ii) are amended by inserting "or she" between "he" and "is" and between "he" and "acts".

4. Paragraph (b)(1)(iii) is revised to read as set forth below.

5. Paragraph (b)(1) is amended by deleting "his" from the last sentence and inserting instead "the".

6. Paragraph (b)(3) is amended by inserting "or her" in the last sentence between the words "his" and "employer" the first time they appear and by deleting "his" the second time it appears in the last sentence and inserting instead "the".

7. Paragraph (c)(1)(i) is amended by deleting "his" from the second sentence and inserting instead "the taxpayer's".

8. Paragraph (c)(1) is amended by deleting "him" from the last sentence and inserting instead "the taxpayer".

9. Paragraph (c)(2)(i) is amended by deleting "examining officer's" from the third sentence and inserting instead "examiner's", by deleting "his" from the third sentence and inserting instead "the taxpayer's", and by deleting the fourth sentence.

10. Paragraph (c)(2)(ii) is amended by deleting "he" and inserting instead "the representative".

11. Paragraph (c)(3)(i) is amended by deleting "his" from the second sentence and inserting instead "the taxpayer's".

12. Paragraph (c)(3)(ii) is amended by deleting "that he" and inserting instead "that he or she".

13. Paragraph (c)(3)(iii) is amended by inserting "or her" between "his" and "authority" in the second sentence.

14. Paragraph (c)(3)(iv) is deleted.

15. Paragraph (c)(5) is amended by inserting "or her" between "his" and "authority".

§ 601.502 Requirements for conference-recognition to practice and, in certain cases, power of attorney or tax information authorization.

* * * * *

(b) *Requirements to be met by taxpayer's representative in order to be recognized.*

(1) *Explanation of recognition to practice.* * * *

(iii) Any person currently enrolled as an agent pursuant to the requirements of Circular No. 230, and who is not currently under suspension or disbarment from practice before the Revenue Service, and who files with the Revenue Service a written declaration that he or she is so currently qualified and is authorized to represent the particular party on whose behalf he or she acts (hereinafter referred to in this subpart as an enrolled agent); and

* * * * *

Par. 31. Section 601.503 is amended as follows:

1. Paragraph (a) is amended by deleting "present himself" from the first sentence and inserting instead "appears", by inserting "or she" in the first sentence between "he" and "represents", by inserting "or she" in the first sentence between "he" and "acts", by deleting "or a" from the third sentence and inserting instead ", a", by inserting ", or an enrolled agent" in the third sentence between "accountant" and ", the", by deleting "and (ii)" from the third sentence and inserting instead ", (ii), and (iii)", and by deleting the last sentence.

2. Paragraph (b) is amended by inserting "(Form 2848 and Form 2848-D)" in the next-to-the-last sentence between "forms" and "are".

3. Paragraph (c) is amended by deleting "or certified public accountant" from the second sentence and inserting instead ", certified public accountant, or enrolled agent", by deleting "or (ii)" from the second sentence and inserting instead ", (ii), or (iii)", and by deleting the last sentence.

Par. 32. Section 601.504 is amended as follows:

1. Paragraph (a) is amended by deleting "his" from the third and fourth sentences and inserting instead "the taxpayer's" and by inserting "(Forms 2848 and 2848-D)" in the next-to-the-last sentence between "forms" and "are".

2. Paragraph (b)(1)(ii) is revised to read as set forth below.

3. Paragraph (b)(1)(iv) is amended by inserting "or she" between "he" and "has".

4. Paragraph (b)(2)(ii) is amended by inserting "or her" in the third and fourth sentences between "his" and "authority".

5. Paragraph (b)(2)(iii) is amended by inserting "or her" in the second sentence between "his" and "authority".

6. Paragraph (b)(2)(v) is amended by inserting "or her" in the last sentence between "his" and "appointment".

7. Paragraph (d)(2) is amended by inserting "or she" between "he" and "is".

8. Paragraph (e) is amended by inserting "or xerographic" in the first sentence between "photographic" and "processes" and by inserting "or she" in the last sentence between "he" and "has".

§ 601.504 Requirement for execution, attestation, acknowledgement or witnessing, and certification of copies of power of attorney and tax information authorization.

* * * * *

(b) *Execution of a power of attorney or a tax information authorization*—(1) *Ordinary cases.* * * *

(ii) *Husband and wife.* In the case of any taxable year for which a joint return was made by husband and wife, by both husband and wife if both are to be represented by the same representative, except that either spouse may sign for the other if such signature is duly authorized in writing by the other spouse. In the case of any taxable year for which a joint return was made by husband and wife, by either the husband or the wife if both are not represented by the same representative; however, the representative cannot perform any act with respect to a joint return year that the spouse represented cannot perform alone.

Par. 33. Section 601.505 is amended as follows:

1. Paragraph (b) is amended by revising the last sentence to read as set forth below.

2. Paragraph (c)(2)(iv) is amended by deleting "to act for him" from the first sentence, and also by deleting "he" from the second sentence and inserting instead "the taxpayer".

§ 601.505 Requirements for changing representation.

* * * * *

(b) *Cases where taxpayer may be contacted directly.* * * * Moreover, if the district director deems it advisable, he or she may refer the matter to the Director of Practice for possible disciplinary proceedings under section 10.23 of Department Circular No. 230.

Par. 34. Section 601.506 is amended as follows:

1. Paragraph (b)(1) is amended by inserting "or her" between "him" and "to" in the second sentence and by deleting the clause beginning with ": *Provided*".

2. Paragraph (b)(2) is amended by inserting at the end of the paragraph a sentence to read as set forth below.

§ 601.506 Notices to be given to recognized representatives; delivery of refund checks to recognized representatives.

* * * * *

(b) *Delivery of checks in payment of refunds.* * * *

(2) *Cases in litigation.* * * * In an action arising in the U.S. Tax Court,

the check will be sent to the appropriate Internal Revenue Service District Counsel, or member of the National Office Trial Staff where a case is tried in the National Office, for delivery to the taxpayer or the counsel of record in the court proceeding.

Par. 35. Section 601.507 is amended by deleting "or not he" wherever it appears in the third sentence and inserting instead "the representative" and by inserting "or her" in the third and fourth sentences between "his" and "own".

Par. 36. Section 601.509 is amended by deleting "the Appellate Division" from the last sentence and inserting instead "Appeals".

Par. 37. Sections 601.521, 601.522, 601.524, 601.526, and 601.527 are amended by deleting "Alcohol, Tobacco, and Firearms Division" wherever it appears and inserting instead "Bureau of Alcohol, Tobacco and Firearms".

Par. 38. Section 601.701 is amended as follows:

1. Paragraph (a) is amended by revising the first sentence to read as set forth below, and by inserting "(Freedom of Information Act)" in the first sentence of the flush material between "552" and "are".

2. Paragraph (b)(1)(ii) is amended by deleting "inforcement" and inserting instead "enforcement", by deleting "or" between "action", and "(C)", and by deleting ";" at the end and inserting instead ", or (D) use of parking facilities, regulation of lunch hours, statements of policy as to sick leave and the like;".

3. Paragraph (b)(1)(iii) is amended to read as set forth below.

4. Paragraph (b)(2) is deleted.

5. Paragraphs (b)(3) and (b)(4) are redesignated (b)(2) and (b)(3).

§ 601.701 Publicity of information.

(a) *General.* Section 552 of title 5 of the United States Code, as amended, prescribes rules regarding the publicizing of information by Federal agencies. * * *

(b) *Exemptions*—(1) *In general.* * * *

(iii) Specifically exempted from disclosure by statute (other than 5 U.S.C. 552b), provided that such statute (A) requires that the matters be withheld from the public in such a manner as to leave no discretion on the issue, or (B) establishes particular crietria for withholding or refers to particular types of matters to be withheld (e.g., I.R.C. sections 6103, 6110, and 4424); * * *

* * * * *

Par. 39. Section 601.702 is amended as follows:

1. Paragraph (b)(2) is amended by deleting "and 18 U.S.C. 1905" from the last sentence.

2. Paragraph (b)(3)(i) is amended by deleting "481" from the fourth sentence and inserting instead "676", and by revising the fifth sentence to read as set forth below.

3. Paragraph (b)(3)(ii) is amended by deleting from the address of the North Atlantic Region "90 Church Street" and inserting instead "120 Church Street, Room 805,".

4. Paragraph (d)(1) is revised to read as set forth below.

5. Paragraph (d)(2) is deleted.

6. Paragraph (d)(3) is amended by redesignating it paragraph (d)(2), by revising the first sentence to read as set forth below, and by deleting the last sentence.

7. Paragraph (d)(4) is deleted.

8. Paragraph (d)(5) is amended by redesignating it paragraph (d)(3), by deleting "for a 4-year period" from the first sentence, and by deleting "or of the Director of the Mid-Atlantic Regional Service Center" from the second sentence.

9. Paragraph (d)(6) is amended by redesignating it paragraph (d)(4) and by inserting ", and any letter or other document issued by the Internal Revenue Service with respect to such applications," in the first sentence between "501(a)" and "will".

10. Paragraph (d)(7) is amended by redesignating it paragraph (d)(5), by inserting "as well as copying" in the first sentence between "inspection" and "(i) in", and by deleting the second sentence and inserting instead a new sentence to read as set forth below.

11. Paragraphs (d)(8), (d)(9), (d)(10), and (d)(11) are redesignated (d)(6), (d)(7), (d)(8), and (d)(9), respectively.

12. Paragraph (f)(1) is amended by inserting "for time expended in" in the second sentence between "asserted," and "deleting".

§ 601.702 Publication and public inspection.

* * * * *

(b) *Public inspection and copying.* * * *

(3) *Public reading rooms*—(i) *In general.* * * * Fees will be charged for copying materials in the reading rooms as provided in paragraph (f) of this section. * * *

* * * * *

(d) *Rules for disclosure of certain specified matters*—(1) *Inspection of tax returns and return information.* The inspection of returns and return information is governed by the provisions of the internal revenue laws and regulations thereunder promulgated by the Secretary of the Treasury. See section 6103 and the regulations thereunder.

(2) *Record of seizure and sale of real estate.* Subject to the rules on disclosure set forth in section 6103, Record 21, "Record of seizure and sale of real estate", is open for public inspection in offices of district directors and copies are furnished upon application.

* * * * *

(5) *Accepted offers in compromise.* * * * After the 1-year period has expired, the documents will continue to be available upon request, although they may have been removed from the Freedom of Information Reading Room. * * *

* * * * *

These amendments to the Statement of Procedural Rules are issued under the authority contained in 5 U.S.C. §§ 301 and 552.

Jerome Kurtz,
Commissioner of
Internal Revenue.

A. R. Dickerson,
Director of the Bureau of
Alcohol, Tobacco and Firearms.

(Filed by the Office of the Federal Register on January 31, 1980; 8:45 a.m., and published in the issue of the Federal Register for February 1, 1980, 45 F.R. 7250)

Part IV. Items of General Interest

Changes in Deposit Requirements for Social Security and Withheld Income Taxes—Public Hearing

Announcement 80-33 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of public hearing on proposed regulations relating to the requirements with regard to depositing social security and withheld income taxes.

DATES: The public hearing will be held on April 16, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by April 8, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-10-79), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: George Bradley or Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under section 6302 of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Friday, February 8, 1980 (45 F.R. 8666).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of the comments to be presented at the hearing and the time they wish to devote to each subject by April 8, 1980. Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restriction, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive appearing in the Federal Register for Wednesday, November 8, 1978.

Errors in the Instructions for 1979 Form 4972, Special 10-Year Averaging Method, and 1979 Form 5544, Multiple Recipient Special 10-Year Averaging Method

Announcement 80-34

The instructions for Part I, Line 1, of the 1979 Form 4972 and for Part I, Line 2, of the 1979 Form 5544 contain errors. The reference to column f on Schedule D (Form 1040) should be to column g on Schedule D (Form 1040), and the reference to line 9 on Schedule D (Form 1041) should be to line 8 on Schedule D (Form 1041).

The following changes should be made to the Form 4972 Line-by-Line Instructions:

The second paragraph of Part I, Line 1 should read, "Otherwise, enter on Line 1 the capital gain from the payer's statement (Form 1099R, box 2) you received. If neither of the following paragraphs applies to you, also enter this amount on Schedule D (Form 1040), Part II, line 9, column g if you are filing Form 1040, and Schedule D (Form 1041), Part II, line 8, column f if you are filing Form 1041. Identify it as 'capital gain from lump-sum distribution.' "

The third sentence of the fourth paragraph should read, "If you are filing Schedule D for Form 1040, enter the product on Part II, line 9, column g, and identify it as 'capital gain from lump-sum distribution less exclusion.' " The following sentence should be added at the end of that paragraph, "If you are filing Schedule D of Form 1041, enter the product on Part II, line 8, column f, and identify it as 'capital gain from lump-sum distribution less exclusion.' "

The following changes should be made to the Form 5544 Line-by-Line Instructions:

The second paragraph of Part I, Line 2 should read, "Otherwise, enter on line 2 the capital gain from the payer's statement (Form 1099R, box 2) you received. If neither of the following paragraphs applies to you, also enter this amount on Schedule D (Form 1040), Part II, line 9, column g if you are filing Form 1040, and Schedule D (Form 1041), Part II, line 8, column f if you are filing Form 1041. Identify it as 'capital gain from lump-sum distribution.' "

The third sentence of the fourth paragraph should read, "If you are filing Schedule D for Form 1040, enter the product on Part II, line 9, column g, and identify it as 'capital gain from lump-sum distribution less exclusion.' " The following sentence should be added at the end of that paragraph. "If you are filing Schedule D for Form 1041, enter the product on Part II, line 8, column f, and identify it as 'capital gain from lump-sum distribution less exclusion.' "

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[1] Filed by the Office of the Federal Register on February 7, 1980, 8:45 a.m., and published in the issue of the Federal Register for February 8, 1980, 45 F.R. 8668.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants and Enrolled Agents from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following person has been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Albert J. Kendall	Wyncote, PA	Attorney	Four months effective January 7, 1980

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from further practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants or enrolled agents to practice before the Internal Revenue Service.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant or enrolled agent so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and hearing before the administrative law judge, the following person was disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
Roy W. Hunt	Redwood City, CA	Certified Public Accountant	January 14, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.401-2, 1.403(b)-1, 1.405-1, amended; 1.401-8A redesignated 1.401-8 and as redesignated amended; 1.401-8 redesignated 1.401(f)-1 and as redesignated amended; 1.401(a)-1, 1.401(a)-2, 1.401(a)-16, 1.415-1 through 1.415-10 added.	Limitations on benefits and contributions under qualified plans.	Jan. 24, 1980	Apr. 23, 1980
26 CFR 1.337 deleted; 1.337-6 amended.	Election to extend the 12-month period for certain corporate liquidations where there is an involuntary conversion.	Jan. 30, 1980	Mar. 31, 1980
26 CFR 5a.612-1 added; published as temporary regulations in T.D. 7669, page 11, this Bulletin.	Option to capitalize or deduct intangible drilling and development costs in the case of wells drilled for any geothermal deposit.	Jan 30, 1980	Mar. 31, 1980
26 CFR 138.4064-1, 138.4222-1 added; published as temporary regulations in T.D. 7674, page 22, this Bulletin.	Gas Guzzler Tax.	Feb. 8, 1980	Apr. 8, 1980
26 CFR 31.6302(c)-1.	Deposit requirements for social security and withheld income taxes.	Feb. 8, 1980	Apr. 8, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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______	1939–2	9.40
______	1940–1	5.55
______	1940–2	14.00
______	1941–1	*$6.95*
______	*1941–2*	*3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
______	*1944*(*)	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*2.65*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$10.10
______	1957–2	13.00
______	1958–1	9.60
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______	1959–1	15.00
______	1959–2	9.60
______	1960–1	9.00
______	1960–2	11.50
______	1961–1	14.00
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______	1964–1–2	11.00
______	1964–2	9.80
______	1965–1	10.70
______	1965–2	12.25
______	1966–1	9.25
______	1966–2	14.05
______	1967–1	10.00
______	1967–2	10.00
______	1968–1	14.00
______	1968–2	11.75
______	1969–1	7.50
______	1969–2	6.50
______	1969–3	$12.50
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______	1970–2	14.00
______	1971–1	10.55
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March 24, 1980
Bulletin No. 1980-12

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENT

Announcement 80-37, page 16.
A public hearing will be held on April 10, 1980, concerning proposed regulations relating to the discharge of liabilities on the sale or other disposition of property.

INCOME TAX

Rev. Rul. 80-76, page 6.
Stock transfer; stockholder to employee of corporation's subsidiary. A corporation's majority stockholder recognizes no gain or loss on a transfer of stock of the corporation to an employee of the corporation's subsidiary, but must allocate the basis in the transferred stock to the shares retained. The fair market value of the stock at the time of transfer is includible in the employee's gross income and is subject to income tax withholding. The subsidiary may deduct the amount includible in the employee's income, but does not recognize gain or loss on the transfer. Rev. Ruls. 69-368 and 69-369 obsoleted with respect to transfers occurring after June 30, 1969.

Rev. Rul. 80-77, page 8.
Charitable contributions. Situations are presented in which payments to the Red Cross, a volunteer fire department, the Girl Scouts, and a combined charity fund are charitable contributions under section 170 of the Code.

Rev. Rul. 80-78, page 8.
Earned income exclusion; contract employee of Trust Territory. For purposes of section 911 of the Code, both before and after its amendment by the Foreign Earned Income Act of 1978, and section 913, a U.S. citizen and contract employee of the Government of the Trust Territory of the Pacific Islands who is not a U.S. Civil Service employee is not considered paid by the U.S. or any agency thereof; Rev. Rul. 68-608 modified.

Rev. Rul. 80-79, page 9.
Consolidated returns; net operating loss and unused investment credit carryback; newly formed parent. A consolidated net operating loss and a consolidated unused investment credit that are attributable to a newly organized corporation, which became the parent of an affiliated group by acquiring the stock of two unrelated corporations, may not be carried back to the separate return years of the subsidiary member corporations.

T.D. 7671, page 7.
Amendments to the regulations under sections 84 and 2501 of the Code relate to the treatment of certain transfers of appreciated property to political organizations.

Announcement 80-35, page 16.
Form 1118, Computation of Foreign Tax Credit—Corporations, has been revised and is available at most Service district offices.

(Continued on page 4)

Finding Lists begin on page 21.
Announcement Relating to Decisions of the Tax Court on page 5.
Announcement of Disbarment and Suspensions begin on page 17.
Announcement of Notice of Proposed Rulemaking on page 19.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part includes rulings and decisions based on Subpart A, Tax Conventions and related Treasury Decisions and Revenue Rulings; Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of Revenue Rulings, Revenue Procedures, and other published items, and (3) topical Indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

ESTATE TAX

Rev. Rul. 80-81, page 12.

Refund of deceased employee's contribution to Civil Service Retirement System. A divorce court that has the power to decree a settlement of all marital rights ordered that if a federal employee died prior to retirement, the lump-sum refund of the employee's contribution to the U.S. Civil Service Retirement System, plus any interest accrued thereon, would be payable to the employee's former spouse. The employee died prior to retirement. The refund is includible in the employee's gross estate under section 2039 of the Code and is deductible under section 2053(a)(4).

GIFT TAX

Rev. Rul. 80-82, page 13.

Transfer of annuity payments; incident to agreement in contemplation of divorce. A retired federal employee, in contemplation of a divorce, entered into a written property settlement agreement providing that, after the divorce, the ex-spouse would receive one-half of the employee's annuity payments under the U.S. Civil Service Retirement System. Within two years thereafter, a divorce court that had no power to alter the agreement incorporated it into a divorce decree. The employee did not make a gift to the ex-spouse, because the transfer is deemed to be made for full and adequate consideration in money or money's worth under section 2516.

Rev. Rul. 80-83, page 14.

Unitrust remainder interest; donee's power; beneficial interest; presently ascertainable. A donor transferred shares of stock in a publicly held corporation to a qualified, pre-existing charitable remainder unitrust. The donor was both a director of the corporation and one of two cotrustees of the trust. The trust corpus consisted solely of that corporation's stock, which was subject to a right of "first refusal." The trustees, using independent judgment, consistently adopted the same price as the fair market value of the trust's stock. Because the donor is bound by a fiduciary duty as both a director and cotrustee, the donor's power to determine the stock's value is limited. Therefore, the value of the charitable beneficial interest is presently ascertainable, and the charitable deduction is allowable with respect to the remainder interest.

ESTATE AND GIFT TAXES

Rev. Rul. 80-80, page 10.

Valuation; actuarial tables; imminent death of transferee. The actuarial tables set forth in the regulations may be disregarded in valuing annuities, life estates, terms for years, remainders, and reversions for estate and gift tax purposes only if the individual is known to have been afflicted, at the time of transfer, with an incurable physical condition that is in such an advanced stage that death is clearly imminent; Rev. Rul. 66-307 clarified.

Announcement Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issues or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by Revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the Court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the Tax Court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Johnson, Frankie Lee (formerly Frankie Lee Yancey)	3047-77	72	37
Seaboard Coast Line Railroad Co.[1]	3771-71	72	855
Yancey, Richard R.	2453-77	72	37

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[1] Acquiescence relates to the fair market value approach in valuing reusable or relay rail and is limited to the deduction claimed for retirements and replacements for years ended prior to May 8, 1967, pursuant to Rev. Rul. 67-145, 1967-1 C.B. 54, and Rev. Proc. 68-46, 1968-2 C.B. 961.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 83.—Property Transferred in Connection with Performance of Services

26 CFR 1.83-6: Deduction by employer.
(Also Sections 162, 3402; 1.162-7, 31.3402 (a)-1.)

Stock transfer; stockholder to employee of corporation's subsidiary. A corporation's majority stockholder recognizes no gain or loss on a transfer of stock of the corporation to an employee of the corporation's subsidiary, but must allocate the basis in the transferred stock to the shares retained. The fair market value of the stock at the time of transfer is includible in the employee's gross income and is subject to income tax withholding. The subsidiary may deduct the amount includible in the employee's income, but does not recognize gain or loss on the transfer. Rev. Ruls. 69-368 and 69-369 obsoleted with respect to transfers occurring after June 30, 1969.

Rev. Rul. 80-76

ISSUE

What are the federal income tax consequences of a transfer of stock under the circumstances described below?

FACTS

On January 2, 1979, *A*, an individual who owned a majority of the outstanding shares of *P*, a domestic corporation, transferred 10 shares of *P* stock to *B*. *B* was a key employee of *S*, also a domestic corporation and controlled by *P* within the meaning of section 368(c) of the Internal Revenue Code. The fair market value of the 10 shares on the date of transfer was 75*x* dollars. *B*'s rights in the *P* stock were not subject to a substantial risk of forfeiture. The total compensation received by *B* in 1979, including the fair market value of the *P* stock, was reasonable compensation for services performed by *B* for *S*. Both *S* and *B* file federal income tax returns on a calendar year basis.

LAW

The applicable sections of the Code and the Income Tax Regulations are 83(a) and 1.83-1(a)(1), relating to the inclusion in gross income of the fair market value of property transferred in connection with the performance of services; 83(h) and 1.83-6, relating to the allowance of a deduction by the employer; and 3402 and 31.3402(a)-1, relating to the withholding of income tax at source on wages.

Section 83(a) of the Code provides that if, in connection with the performance of services, property is transferred to any person other than the person for whom the services are performed, the excess of (1) the fair market value of the property (determined without regard to any restriction other than a restriction which by its terms will never lapse) at the first time the rights of the person having the beneficial interest in the property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over (2) the amount (if any) paid for the property, is includible in the gross income of the person who performed the services in the first taxable year in which the rights of the person having the beneficial interest in the property are transferable or are not subject to a substantial risk of forfeiture, whichever is applicable.

Section 1.83-6(a)(1) of the regulations provides that, in the case of a transfer of property in connection with the performance of services, a reduction is allowable under section 162 or 212 of the Code, to the person for whom the services were performed. The amount of the deduction is equal to the amount includible as compensation in the gross income of the service provider, but only to the extent the amount meets the requirements of section 162 or 212 and the regulations thereunder.

Section 1.83-6(a)(2) of the regulations provides that, if the service provider is an employee of the person for whom services are performed, the deduction is allowed only if the employer deducts and withholds upon the amount in accordance with section 3402 of the Code.

HOLDINGS

(1) No gain or loss is recognized by *A* as a result of the transfer of the 10 shares of *P* stock; however, *A* must allocate *A*'s basis in the transferred stock to *A*'s remaining shares of *P* stock.

(2) The fair market value of the stock on January 2, 1979, 75*x* dollars, is includible in *B*'s gross income under section 83(a) of the Code for 1979 and is subject to the withholding of income tax at source on wages.

(3) Pursuant to section 83(h), *S* is allowed a deduction under section 162 of 75*x* dollars for 1979.

(4) Because section 83 applies to the transfer of the *P* stock to *B*, *S* does not recognize gain or loss on the transfer of the *P* stock.

The above principles would also apply had *B*'s rights in the *P* stock been subject to a substantial risk of forfeiture.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 69-369, 1969-2 C.B. 27, which holds that the fair market value of stock transferred to a corporation by its majority shareholder pursuant to a prearranged plan for distribution by the corporation to certain of its employees is includible in the gross incomes of the employees under section 61 of the Code, but is not deductible by the corporation under section 162, is obsoleted with respect to transfers occurring after June 30, 1969, the effective date of section 83.

Rev. Rul. 69-368, 1969-2 C.B. 27, which holds that the fair market value of stock contributed to a corporation by its majority shareholder, not under a prearranged plan, and subsequently distributed by the corporation to its employees is includible in the gross incomes of the employees under section 61 of the Code and is deductible by the corporation under section 162, is also obsoleted with respect to transfers occurring after June 30, 1969.

Section 84.—Transfer of Appreciated Property to Political Organization

26 CFR 1.84-1: Transfer of appreciated property to political organizations.
(Also Section 2501; 25.2501-1.)

T.D. 7671

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; SUBCHAPTER B, PART 25.—GIFT TAX; GIFTS MADE AFTER DECEMBER 31, 1954

Transfer of appreciated property to political organizations.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the treatment of certain transfers of appreciated property to political organizations. Changes to the applicable tax laws were made by the Act of January 3, 1975 [Pub. L. 93-625, 1975-1 C.B. 510]. The regulations provide the public with the guidance needed to comply with the statutory changes.

DATE: The regulations are effective with respect to transfers of appreciated property to political organizations made after May 7, 1974.

FOR FURTHER INFORMATION CONTACT: Susan K. Thompson of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constituiton Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202/566-3294).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On July 30, 1979, the Federal Register published amendments to the Income Tax Regulations (26 CFR Part 1) under section 84 of the Internal Revenue Code of 1954, and to the Gift Tax Regulations (26 CFR Part 25) under section 2501 of the Internal Revenue Code of 1954 (44 FR 44553). These amendments were proposed to conform the regulations to sections 13 and 14 of the Act of January 3, 1975 (88 Stat. 2120). No comments were received with respect to the proposed amendments, and no public hearing was requested or held. The proposed amendments are adopted by this Treasury decision without change.

NEW RULES

The regulations adopted by this Treasury decision contain new rules applicable to transfers of appreciated property to political organizations after May 7, 1974. These transfers are governed by section 84, added to the Code in 1975.

In general, section 84 treats certain transfers of appreciated property to political organizations as sales for purposes of the income tax. The term "political organization" is defined in section 527(e)(1). The term "transfer" is defined under the new rules as any assignment, conveyance or delivery of property other than a bona fide sale for an adequate and full consideration in money or money's worth.

The transferor is taxed on the difference between the fair market value and the adjusted basis of the property. In determining the amount of gain recognized by the transferor, the income tax rules relating to a sale of property apply. Because of the recognition of gain by the transferor at the time the property is contributed, the political organization is not permitted to "tack" the holding period of the donor to its holding period for purposes of determining its own holding period. Rather, under the new rules, the holding period of the political organization begins on the day after it acquires the property.

The new rules conform the regulations to the exemption from gift tax of money or other property transferred to a political organization. At the same time, the rules emphasize that the gift tax continues to apply to transfers to organizations other than political organizations.

The final regulations adopted by this Treasury decision impose no new reporting or recordkeeping requirements. Evaluation of the effectiveness of these regulations after issuance will be based upon comments received from offices within Treasury and the Internal Revenue Service, other governmental agencies, and the public.

DRAFTING INFORMATION

The principal author of these regulations is Susan K. Thompson of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Parts 1 and 25 are amended as follows:

Paragraph 1. The following new section is inserted immediately following section 1.83-8:

§ 1.84-1 Transfer of appreciated property to political organizations.

(a) *Transfer defined.* A transfer after May 7, 1974, of property to a political organization (as defined in section 527(e)(1), and including a newsletter fund to the extent provided under section 527(g)) is treated as a sale of the property to the political organization if the fair market value of the property exceeds its adjusted basis. The transferor is treated as having realized an amount equal to the fair market value of the property on the date of the transfer. For purposes of this section, a transfer is any assignment, conveyance, or delivery of property other than a bona fide sale for an adequate and full consideration in money or money's worth, whether the transfer is in trust or otherwise, whether the transfer is direct or indirect and whether the property is real or personal, tangible or intangible. Thus, for example, a sale at less than fair market value (other than an ordinary trade discount), or a receipt of property by a political organization under an agency agreement entitling the organization to sell the property and retain all or a portion of the proceeds of the sale, is a transfer within the meaning of this section. The term "transfer" also includes an illegal contribution of property.

(b) *Amount realized.* A transferor to whom this section applies realizes an amount equal to the fair market value of the property on the date of the transfer. For purposes of this section, the definition of fair market value set forth in § 1.170A-1(c)(2) and (3) is incorporated by reference.

(c) *Amount recognized.* A transferor to whom this section applies is treated as having sold the property to the political organization on the date of the transfer. Therefore, the rules of chapter 1 of subtitle A (relating to income tax) apply to the gain realized under this section as if this gain were an amount realized upon the sale of the property. These rules include those of section 55 and section 56 (relating to minimum tax for tax preference), section 306 (relating to disposition of certain stock), section 1201 (relating to the alternative tax on certain capital gains), section 1245 (relating to gain from dispositions of certain depreciable property), and section 1250 (relating to gain from dispositions of certain depreciable realty).

(d) *Holding period.* The holding period of property transferred to a political organization to which this section applies begins on the day after the date of acquisition of the property by the political organization.

Par. 2. Section 25.2501 is deleted.

Par. 3. Section 25.2501-1 is amended by adding at the end of paragraph (a) a new subparagraph (5) to read as follows:

§ 25.2501-1 Imposition of tax.

(a) *In general.* * * *

(5) The general rule of this paragraph (a) shall not apply to a transfer after May 7, 1974, of money or other property to a political organization for the use of that organization. However, this exception to the general rule applies solely to a transfer to a political organization as defined in section 527(e)(1) and including a newsletter fund to the extent provided under section 527(g). The general rule governs a transfer of property to an organization other than a political organization as so defined.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved January 22, 1980.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on February 5, 1980, 8:45 a.m., and published in the issue of the Federal Register for February 6, 1980, 45 F.R. 8003)

Section 162.—Trade or Business Expenses

26 CFR 1.162-7: Compensation for personal services.

Applicability of section 83 of the Code to the transfer of a corporation's stock from a shareholder of the corporation to an employee of the corporation's wholly owned subsidiary. See Rev. Rul. 80-76, page 6.

Section 170.—Charitable, Etc., Contributions and Gifts

26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance of deduction.

Charitable contributions. Situations are presented in which payments to the Red Cross, a volunteer fire department, the Girl Scouts, and a combined charity fund are charitable contributions under section 170 of the Code.

Rev. Rul. 80-77

ISSUE

Is a charitable contribution deduction allowable under section 170 of the Internal Revenue Code under the circumstances described below?

FACTS

Situation 1: A tornado destroys several homes in a town. The local chapter of the American National Red Cross provides food and temporary shelter to a taxpayer whose home was destroyed. The taxpayer, motivated by gratitude, makes a contribution of $5x$ dollars to the local chapter of the American National Red Cross.

Situation 2: A taxpayer owns a home in an area served by a volunteer fire department. No state or local taxes are used to support the fire department. The taxpayer makes a contribution of $5x$ dollars to the volunteer fire department's annual fund drive.

Situation 3: The taxpayer's daughter is a member of a local unit of the Girl Scouts of America. The taxpayer makes a contribution of $5x$ dollars to the Girl Scouts of America.

Situation 4: The taxpayer has a dependent parent who is a resident of a home for the elderly which is a member organization of a combined charity fund. The taxpayer makes an unrestricted contribution of $5x$ dollars to the combined charity fund that distributes the contributions to the member organizations according to a formula.

HOLDING

In each of the four situations, the taxpayer is allowed a charitable contribution deduction under section 170 of the Code, subject to the percentage limitations of section 170(b)(1).

Section 911.—Income Earned by Individuals in Certain Camps

26 CFR 1.911-2: Earned income from sources without the United States attributable to services performed after 1962. (*Also Section 913.*)

Earned income exclusion; contract employee of Trust Territory. For purposes of section 911 of the Code, both before and after its amendment by the Foreign Earned Income Act of 1978, and section 913, a U.S. citizen and contract employee of the Government of the Trust Territory of the Pacific Islands who is not a U.S. Civil Service employee is not considered paid by the U.S. or any agency thereof; Rev. Rul. 68-608 modified.

Rev. Rul. 80-78

ISSUE

Is a taxpayer, a U.S. citizen and contract employee of the Government of the Trust Territory of the Pacific

Islands (GTTPI), entitled to exclude from gross income under section 911 (a) of the Internal Revenue Code the salary paid by the GTTPI?

LAW AND ANALYSIS

Section 911 of the Code provides, in part, for the exclusion from gross income of earned income from sources without the United States (except amounts paid by the United States or any agency thereof) in the case of a United States citizen who is a bona fide resident of a foreign country for an uninterrupted period that includes an entire taxable year, or is physically present in a foreign country or countries during at least 510 full days of a period of 18 consecutive months.

For taxable years beginning after December 31, 1977 (or December 31, 1978, if a timely election is filed), the section 911 exclusion is further limited by section 202 of the Foreign Earned Income Act of 1978, Pub. L. 95-615, 1978-2 C.B. 415, to individuals who, because of their employment, reside in a camp located in a hardship area. A new section 913, added by section 203 of that Act and effective for taxable years beginning after December 31, 1977, provides a deduction for certain expenses of an individual living abroad, but not in excess of the individual's earned income. Section 913(j) provides that the term "earned income" does not include amounts paid by the United States or any agency thereof.

Rev. Rul. 68-608, 1968-2 C.B. 309, holds that in view of the control exercised by the Secretary of the Interior, or the Secretary's representatives over the GTTPI, United States citizens employed by that government are "paid by the United States or any agency thereof" for purposes of section 911 of the Code, and thus are not entitled to exclude from gross income under section 911 of the salary paid by the GTTPI whether they are United States Civil Service employees or contract employees who are outside the Civil Service system. Accord *Groves v. United States,* 533 F.2d 1376 (5th Cir. 1976), *aff'g,* Civil No. 74-15 (N.D. Fla., Nov. 21, 1974), *cert denied,* 429 U.S. 1000 (1977), which reaches a similar nonexcludable result for salary paid to contract employees of GTTPI.

In *McComish v. Commissioner,* 580 F.2d 1323 (9th Cir. 1978), *rev'g,* 64 T.C. 909 (1975), the Ninth Circuit considered the same issue for tax year 1968. In that decision, however, the court held that a U.S. citizen who was a contract employee of the GTTPI could exclude from gross income under section 911(a) of the Code the salary paid by the GTTPI because of the "severely limited" United States control over GTTPI, and the fact that the taxpayer was neither a U.S. government employee nor a person receiving the benefits accorded such an employee.

The Internal Revenue Service will follow *McComish* only to the extent of its holding that contract employees of the GTTPI are not paid by an agency of the United States. It remains the position of the Service that the exception in section 911(a) applies to any U.S. citizen, regardless of whether such citizen is a Civil Service or contract employee, who is paid by the United States or any agency thereof. See, *Erlandson v. Commissioner*, 277 F.2d 70 (9th Cir. 1960), in which the court stated at page 72 that "amounts paid by the United States or an agency thereof are excepted from the benefits of section 911(a)(2) whether or not the recipient is an employee of the United States"; and *Donaldson v. Commissioner,* 51 T.C. 830 (1969), in which the court examined the degree of control exercised by the United States over the operations of the paying entity in determining that it was an agency of the United States.

HOLDING

On the basis of the *result* reached under section 911 of the Code by the Ninth Circuit in *McComish,* taxpayer, a U.S. citizen and contract employee of the GTTPI, may exclude from gross income under section 911(a) of the Code the salary paid by the GTTPI for all open tax years. Section 911 as amended by Pub. L. 95-615, and section 913 as added by that Act, will be similarly interpreted.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 68-608, 1968-2 C.B. 309, is modified with respect to U.S. citizens who are contract employees of the GTTPI. This modification is not applicable to U.S. citizens, employed by the GTTPI, who are U.S. Civil Service employees.

Section 913.—Deduction for Certain Expenses of Living Abroad

Whether taxpayer, a U.S. citizen and contract employee of the Government of the Trust Territory of the Pacific Islands (GTTPI), may exclude from gross income under section 911(a) of the Internal Revenue Code the salary paid by the GTTPI. See Rev. Rul. 80-78, page 8.

Section 1502.—Consolidated Return Regulations

26 CFR 1.1502-79: Separate return years.

Consolidated returns; net operating loss and unused investment credit carryback; newly formed parent. A consolidated net operating loss and a consolidated unused investment credit that are attributable to a newly organized corporation, which became the parent of an affiliated group by acquiring the stock of two unrelated corporations, may not be carried back to the separate return years of the subsidiary member corporations.

Rev. Rul. 80-79

ISSUE

May a consolidated net operating loss and a consolidated unused investment credit that are attributable to a newly-organized corporation which became the parent of an affiliated group by acquiring the stock of two other unrelated corporations be carried back to the separate return years of the subsidiary members of the group?

FACTS

Corp *P* was incorporated by separate unrelated interests in April 1976 for the purpose of acquiring ownership of *X* and *Y,* two unrelated corporations which had filed separate returns since their own formation several years ago. Immediately after incorporation, *P* acquired all of the stock of *X* and *Y,* thus becoming the parent corporation of an affiliated group.

For taxable years ending December 31, 1976, and December 31, 1977, *P* and its subsidiaries *X* and *Y* filed consolidated federal income tax returns. In both years the consolidated group experienced net operating losses all of which were attributable to *P*. These losses included interest charges incurred in acquiring the stock of *X* and *Y* as well as other operating losses. *P* also made investment in those years that qualified for the investment tax credit.

LAW AND ANALYSIS

Section 1502 of the Internal Revenue Code grants the Secretary authority to issue such regulations as are deemed necessary in the case of consolidated returns. Section 1.1502-79 (a)(1)(i) of the Income Tax Regulations provides that if a consolidated net operating loss can be carried under the principles of section 172(b) of the Code and 1.1502-21(b) of the regulations to a separate return year of a corporation (or could have been so carried if such were in existence) which was a member in the year in which such loss arose, then the portion of such consolidated net operating loss attributable to such corporation shall be apportioned to such corporation and shall be a net operating loss carryover or carryback to such separate return year. Under section 1.1502-79(a)(2), however, the portion of a consolidated net operating loss attributable to a member shall not be apportioned to a prior separate return year for which such member was not in existence and shall be included in the consolidated net operating loss carrybacks to the equivalent consolidated return year of the group (which may be a separate return year if the equivalent year is a separate return year), provided that such member was a member of the group immediately after its organization.

Section 1.1502-79(c) of the regulations provides that if a consolidated unused investment credit can be carried under the principles of section 46 (b) of the Code and section 1.1502-3 (b) to a separate return year of a corporation (or could have been so carried if such corporation were in existence) that was a member of the group in the year in which such unused credit arose, then the portion of such consolidated unused credit attributable to such corporation shall be apportioned to that corporation under the principles of section 1.1502-79(a) (1) and (2) and shall be an investment credit carryover or carryback to such separate return year.

Rev. Rul. 74-610, 1974-2 C.B. 288, holds that a consolidated net operating loss attributable to a new subsidiary wholly owned by another subsidiary which formerly owned the assets and operations that generated the loss may be carried back to the other subsidiary's separate return for a year in which the new wholly-owned subsidiary was not in existence but may not be carried back to the common parent's separate return for that year. The rationale is that if the new subsidiary had not been formed by the other subsidiary, the loss sustained by the new subsidiary would have been sustained by the other subsidiary and could have been carried back to the latter's separate return years.

In Rev. Rul. 74-610, the group member allowed the net operating loss carryback was the corporation that formed the loss corporation because that corporation would have incurred the loss had the loss corporation not been formed. In this revenue ruling, the loss sustained by *P* was not attributable to any assets or operations of *X* or *Y*. *P* was formed not by those corporations but by separate unrelated interests. Therefore, the loss of *P* would not have been incurred by *X* or *Y* if *P* had not been organized, and thus the loss may not be carried back to the separate return years of *X* and *Y* under the rationale of Rev. Rul. 74-610. The same reasoning applies to disallow the unused investment credit carryback attributable to *P* to the separate returns years of *X* and *Y*.

HOLDING

The consolidated net operating loss and consolidated unused investment credit attributable to *P* may not be carried back to the separate return years of *X* and *Y*.

Section 2013.—Credit for Tax on Prior Transfers

26 CFR 20.2013-4: Valuation of property transferred.

Whether actuarial tables must be used in order to value the interest of a life beneficiary, in view of the individual's physical condition. See Rev. Rul. 80-80, below.

Section 2031.—Definition of Gross Estate

26 CFR 20.2031-10: Valuation of annuities, life estates, terms for years, remainders, and reversions for estates of decedents dying after December 31, 1970.
(Also Sections 2013, 2037, 2042, 2055, 2512, and 2522; 20.2013-4, 20.2037-1, 20.2042-1, 20.2055-2, 25.2512-9, 25.2522 (c)-3.)

Valuation; actuarial tables; imminent death of transferee. The actuarial tables set forth in the regulations may be disregarded in valuing annuities, life estates, terms for years, remainders, and reversions for estate and gift tax purposes only if the individual is known to have been afflicted, at the time of transfer, with an incurable physical condition that is in such an advanced stage that death is clearly imminent; Rev. Rul. 66-307 clarified.

Rev. Rul. 80-80

ISSUE

Under what circumstances will the physical condition of an individual justify departure from using the actuarial tables to value property interests for federal estate and gift tax purposes?

LAW AND ANALYSIS

The methods and actuarial tables (based on Table LN) that are to be used in valuing annuities, life estates, terms for years, remainders, and reversions are set forth in section 20.2031-10 of the Estate Tax Regulations, for estates of decedents dying after December 31, 1970, and in section 25.2512-9 of the Gift Tax Regulations for gifts made after December 31, 1970.

The actuarial tables in the regulations are provided as an administrative necessity, and their general use has been readily approved by the courts. *See Ithaca Trust Company v.*

United States, 279 U.S. 151 (1929); *Simpson v. United States,* 252 U.S. 547 (1920); *McMurtry v. Commissioner,* 203 F. 2d 659 (1st Cir. 1953).

The actuarial tables are not based on data that exclusively involve persons of "good" or "normal" health. They reflect the incidence of death by disease and illness as well as by accident. The actuarial tables are properly applicable to the vast majority of individual life interests, even though the health of a particular individual is obviously better or worse than that of the "average" person of the same age and sex. Occasionally, however, the actual facts of an individual's condition are so exceptional as to justify departure from the actuarial tables.

Rev. Rul. 66-307, 1966-2 C.B. 429, dealing with the value of a transferred property interest for purposes of section 2013 of the Internal Revenue Code, concludes that if it is known on the valuation date that the life tenant is afflicted with a fatal and incurable disease in its advanced stages and cannot survive for more than a brief period of time, the value of the life or remainder interest should be determined by reference to such known facts.

In *Continental Illinois National Bank and Trust Company v. United States,* 504 F. 2d 586 (7th Cir. 1974), the court analyzed the requirement in Rev. Rul. 66-307 that survival by only a "brief" period must be expected, if the actuarial tables are to be properly avoided. The court rejected the argument that the word "brief" means *relatively* brief when compared to the life expectancy predicted by the tables. Instead, the word "brief" was interpreted as being an *absolute* term. The actuarial tables were consequently held to be applicable for purposes of section 2013 of the Code, because the medical experts failed to testify that the transferee's death was "imminent" at the date of death of the transferor.

The cases cited in Rev. Rul. 66-307 were primarily concerned with the maximum period of actual life expectancy. All but one of those cases dealt with persons who were expected to survive by less than one year. The cases decided since Rev. Rul. 66-307 was issued place more emphasis on the immediacy of the individual's death rather than on the maximum period of expected survival. *See Miami Beach First National Bank v. United States,* 443 F. 2d 116 (5th Cir. 1971); *Mercantile-Safe Deposit and Trust Company v. United States,* 368 F. Supp. 743 (D. Md. 1974); and especially *Continental Illinois,* discussed above. These later cases, by focusing on whether the death of the subject individual is "imminent," differ from the cases relied on in Rev. Rul. 66-307.

The Service agrees that the expected death of the individual must be "imminent" in *absolute* terms rather than in relative terms. Comparison of each subject individual's actual life expectancy to the life expectancy derived from the tables, in order to depart from the tables where the actual life expectancy is "relatively" shorter, would involve the same case-by-case analysis of each individual's physical condition that the tables are designed to avoid.

In view of recent case law, the resulting principle is as follows: the current actuarial tables in the regulations shall be applied if valuation of an individual's life interest is required for purposes of the federal estate or gift taxes unless the individual is known to have been afflicted, at the time of transfer, with an incurable physical condition that is in such an advanced stage that death is clearly imminent. Death is not clearly imminent if there is a reasonable possibility of survival for more than a very brief period. For example, death is not clearly imminent if the individual may survive for a year or more and if such a possibility is not so remote as to be negligible. If the evidence indicates that the decedent will survive for less than a year, no inference should be drawn that death will be regarded as clearly imminent, because this question depends on all the facts and circumstances.

The above principle is applicable to every situation that involves valuation of an interest that is dependent upon the life of one or more individuals for federal estate or gift tax purposes, including valuation with respect to deductions allowable under section 2055 or section 2522 of the Code, with the exception of determinations involving a decedent's own life expectancy under sections 2037 and 2042(2). The Service adheres to the conclusion, stated in Rev. Rul. 66-307, that the actuarial tables must be applied in *every* case where a decedent's reversionary interest must be valued under sections 2042 (2) or 2037 of the Code. *See* the discussion in *Estate of Roy v. Commissioner,* 54 T.C. 1317 (1970), which declined to follow *Hall v. United States,* 353 F. 2d 500 (7th Cir. 1965). *See also Estate of Allen v. United States,* 558 F. 2d 14 (Ct. Cl. 1977).

The above principle will govern cases involving application of section 2013 of the Code unless a final determination of the federal estate tax liability of the *transferor's* estate has been made under circumstances that required valuation, by whatever method, of the life interest received by the transferee. If such a valuation was required, then the value of the property transferred, for the purposes of the credit allowable to the transferee's estate, shall be the value determined previously for the transferor's estate. *See* section 2013(d) of the Code.

HOLDING

The actuarial tables in the regulations may be disregarded only if the individual is known to have been afflicted, at the time of transfer, with an incurable physical condition that is in such an advanced stage that death is clearly imminent.

EFFECT ON OTHER REVENUE RULINGS

Revenue Ruling 66-307 is clarified.

Section 2037.—Transfers Taking Effect at Death

26 CFR 20.2037-1: Transfers taking effect at death.

Whether actuarial tables must be used in order to value the interest of a life beneficiary, in view of the individual's physical condition. See Rev. Rul. 80-80, page 10.

Section 2039.—Annuities

26 CFR 20.2039-2: Annuities under "qualified plans" and section 403(b) annuity contracts.

Whether a refund of a deceased employee's contribution to the United States Civil Service Retirement System, plus interest thereon, is includible in the employee's gross estate under section 2039 of the Code, if the refund is paid by the Civil Service Commission directly to the employee's former spouse pursuant to a divorce decree. See Rev. Rul. 80-81, this page.

Section 2042.—Proceeds of Life Insurance

26 CFR 20.2042-1: Proceeds of life insurance.

Whether actuarial tables must be used in order to value the interest of a life beneficiary, in view of the individual's physical condition. See Rev. Rul. 80-80, page 10.

Section 2043.—Transfers for Insufficient Consideration

26 CFR 20.2043-1: Transfers for insufficient consideration.

Whether a retired federal employee made a gift of the portion of the United States Civil Service Retirement annuity that is to be paid by the Civil Service Commission to the spouse pursuant to an agreement executed in contemplation of divorce. See Rev. Rul. 80-82, page 13.

Section 2053.—Expenses, Indebtedness, and Taxes

26 CFR 20.2053-7: Deduction for unpaid mortgages.
(Also Section 2039; 20.2039-2.)

Refund of deceased employee's contribution to Civil Service Retirement System. A divorce court that has the power to decree a settlement of all marital rights ordered that if a federal employee died prior to retirement, the lump-sum refund of the employee's contribution to the U.S. Civil Service Retirement System, plus any interest accrued thereon, would be payable to the employee's former spouse. The employee died prior to retirement. The refund is includible in the employee's gross estate under section 2039 of the Code and is deductible under section 2053(a)(4).

Rev. Rul. 80-81

ISSUES

1. Is the refund of a deceased employee's contribution to the United States Civil Service Retirement System, plus interest thereon, includible in the employee's gross estate under section 2039 of the Internal Revenue Code, if the refund is paid by the Civil Service Commission directly to the employee's former spouse pursuant to a divorce decree?

2. Is the amount of the refund payable to the former spouse deductible under section 2053(a)(4) of the Code, if the divorce court has the power to decree a settlement of all marital rights?

FACTS

In 1978, *D* and *A* entered into a written agreement in contemplation of their obtaining a divorce. The agreement provides that, upon *D*'s retirement, *A* would receive one-half of the annuity payments that would otherwise be payable to *D* as a retired federal employee under the United States Civil Service Retirement System. The agreement also provides that, if *D* died prior to retirement, the lump-sum refund of *D*'s contribution to the system plus interest accrued thereon would be payable to *A*.

In March 1979, *D* and *A* were divorced by a court in State *X*. The court incorporated the settlement agreement into the divorce decree. Under the laws of State *X*, a divorce court has the power to decree a settlement of all marital property rights.

D died in July 1979, prior to retirement.

LAW AND ANALYSIS

Section 2039(a) of the Code provides for the inclusion in the gross estate of the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent under any form of contract or agreement, if, under such contract or agreement, the decedent possessed for life the right to receive such annuity or other payment either alone or in conjunction with another. Section 2039(b) provides that the amount includible is the portion of the annuity or other payment attributable to the decedent's contribution to the purchase price and that contributions made by the decedent's employer are considered to be contributed by the decedent. Section 2039(c) provides that contributions by an employer under an employee's trust meeting the requirements of section 401(a) are not considered as having been made by the decedent.

The United States Civil Service Retirement System is treated as an employees' trust which has been held to meet the requirements of section 401(a) of the Code. Rev. Rul. 56-1, 1956-1 C.B. 444, holds that if an individual who is covered by the Civil Service Retirement System dies before retirement, the amount includible in the gross estate under section 2039, because of the annuity payable to the surviving spouse or other beneficiary, is the amount of the decedent's contribution to the system plus the interest accrued thereon.

Section 2053(a)(4) of the Code allows a deduction for the amount of an unpaid mortgage or other indebtedness with respect to property, if the full value of the decedent's interest in the property is included in the gross estate without diminution by the amount of the mortgage or indebtedness.

In Rev. Rul. 76-113, 1976-1 C.B. 276, the decedent was divorced by a court with the power to decree a settlement of all marital property rights. Under the terms of the divorce decree, the decedent was required to maintain certain life insurance policies until death and to name the spouse as beneficiary of the policies. The ruling holds that since the insurance proceeds are includible in the decedent's gross estate under section 2042 of the Code, the obligation to pay the proceeds to the former spouse pursuant to the divorce decree is an indebtedness against property included in the value of the gross estate and is deductible under section 2053(a)(4).

Subsection (j) of 5 U.S.C. section 8345, added by Pub. L. No. 95-366, 92 Stat. 600 (1978), authorizes the Civil Service Commission to make payments, which would otherwise be payable to a retired federal employee, to another person if and to the extent expressly provided for in the terms of any court decree of, or any court order or court-approved property settlement incident to, divorce, annulment or legal separation. Section 8345(j)(3) defines a court as any court of any state or the District of Columbia.

In the present situation, the value of *D*'s contribution to the Civil Service Retirement System plus interest accrued thereon is includible in *D*'s gross estate under section 2039 of the Code because *D*, immediately before death, possessed the right to receive an annuity upon retirement. The refund of *D*'s contribution plus interest is payable by the Civil Service Commission directly to the former spouse because of a divorce decree by a court having the power to decree a settlement of all marital property rights. Therefore, a deduction for the amount of the refund is allowable under section 2053(a)(4) of the Code.

HOLDINGS

1. The refund of *D*'s contribution to the United States Civil Service Retirement System, plus the interest accrued thereon, is includible in the gross estate under section 2039 of the Code, even though the refund is paid to *D*'s former spouse pursuant to the terms of a divorce decree.

2. Because the refund is payable to *D*'s former spouse pursuant to a divorce decree issued by a court having the power to decree a settlement of all marital property rights, the amount of the refund is deductible under section 2053(a)(4) of the Code.

Section 2055.—Transfers for Public, Charitable and Religious Uses

26 CFR 20.2055-2: Transfers not exclusively for charitable purposes.

Whether actuarial tables must be used in order to value the interest of a life beneficiary, in view of the individual's physical condition. See Rev. Rul. 80-80, page 10.

Section 2501.—Imposition of Tax [Gift Tax]

26 CFR 25.2501-1: Imposition of tax.

Transfer of appreciated property to political organizations. See T.D. 7671, page 7.

Section 2512.—Valuation of Gifts

26 CFR 25.2512-8: Transfers for insufficient consideration.

Whether a retired federal employee made a gift of the portion of the United States Civil Service Retirement annuity that is to be paid by the Civil Service Commission to the spouse pursuant to an agreement executed in contemplation of divorce. See Rev. Rul 80-82, this page.

26 CFR 25.2512-9: Valuation of annuities, life estates, terms for years, remainders, and reversions transferred after December 31, 1970.

Whether actuarial tables must be used in order to value the interest of a life beneficiary, in view of the individual's physical condition. See Rev. Rul. 80-80, page 10.

Section 2516.—Certain Property Settlements

26 CFR 25.2516-1: Certain property settlements.
(Also Sections 2043, 2512; 20.2043-1, 25.2512-8.)

Transfer of annuity payments; incident to agreement in contemplation of divorce. A retired federal employee, in contemplation of a divorce, entered into a written property settlement agreement providing that, after the divorce, the ex-spouse would receive one-half of the employee's annuity payments under the U.S. Civil Service Retirement System. Within two years thereafter, a divorce court that had no power to alter the agreement incorporated it into a divorce decree. The employee did not make a gift to the ex-spouse, because the transfer is deemed to be made for full and adequate consideration in money or money's worth under section 2516.

Rev. Rul. 80-82

ISSUE

Has a retired federal employee made a gift of the portion of the United States Civil Service Retirement annuity that is to be paid by the Civil Service Commission to the spouse pursuant to an agreement executed in contemplation of a divorce, under the circumstances described below?

FACTS

G, a retired federal employee, is receiving annuity payments under the United States Civil Service Retirement System. In May 1979, *G* and *A*, *G*'s spouse, entered into a written property settlement agreement in contemplation of their obtaining a divorce. The agreement provides, in part, that after the divorce becomes final, *A* will receive one-half of *G*'s annuity payments. In August 1979, *G* and *A* were divorced by the final decree of a court in State *X*. Under the laws of State *X*, the divorce court had no power to alter the settlement agreement, but it did incorporate the settlement agreement into the divorce decree. Thereafter, upon application to the Civil Service Commission, *A* began to receive one-half of *G*'s annuity payments.

LAW AND ANALYSIS

Section 2511 of the Internal Revenue Code states that the federal gift tax is applicable whether a gift is in trust or otherwise, whether direct or indirect, and whether the transferred property is real or personal, tangible or intangible.

Section 2512(b) of the Code provides that if property is transferred for less than an adequate and full consideration in money or money's worth, then the amount of the gift is the amount by which the value of the transferred property exceeds the value of the consideration received.

Section 2043(b) of the Code, an estate tax provision, requires that a relinquishment of dower or curtesy, or of a statutory estate created in lieu thereof, or "of other marital rights" in the decedent's estate, shall not be considered to any extent a consideration in money or money's worth. This provision was held applicable to the definition of "consideration in money or money's worth" for gift tax purposes, as well as for estate tax purposes, by the Supreme Court in *Merrill v. Fahs*, 324 U.S. 308 (1945), 1945 C.B. 418. *See also* section 25.2512-8 of the Gift Tax Regulations.

Therefore, the release by a spouse of marital property rights cannot serve as consideration in money or money's worth for gift tax purposes. However, the release of the right to support constitutes consideration in money or money's worth. *See* Rev. Rul. 68-379, 1968-2 C.B. 414.

Section 2516 of the Code provides that if a married couple executes a written agreement with respect to their "marital and property rights" and if a divorce is obtained within two years thereafter, all transfers made under the agreement to the donor's spouse in settlement of the spouse's marital or property rights shall be deemed, for gift tax purposes, to be made for full and adequate consideration in money or money's worth.

Subsection (j) of 5 U.S.C. section 8345, added by Pub. L. No. 95-366, 92 Stat. 600 (1978), authorizes the Civil Service Commission to make payments, which would otherwise be payable to a retired federal employee, to another person if and to the extent expressly provided for in the terms of any court decree of, or any court order or court-approved property settlement incident to, divorce, annulment or legal separation. Section 8345(j)(3) defines a court as any court of any state or the District of Columbia.

In the present situation, *G* and *A* were divorced within two years after executing the property settlement agreement. The payments of one-half of *G*'s annuity to *A* by the Civil Service Commission are deemed to be made for full and adequate consideration in money or money's worth under section 2516 of the Code. Therefore, the payments to *A* are exempt from gift tax.

If *G* and *A* had not obtained a divorce within two years after executing the property settlement agreement, *G* would have made a gift to *A* to the extent that the present value of the payments to be made to *A* under the agreement exceeds the present value of the support rights relinquished by *A*. See Situation 1 in Rev. Rul. 77-314, 1977-2 C.B. 349.

HOLDING

G has not made a gift to *A* of the portion of *G*'s Civil Service Retirement annuity that is payable to *A* pursuant to a property settlement agreement executed within two years prior to divorce, because the transfer is deemed to be made for full and adequate consideration in money or money's worth under section 2516 of the Code.

Section 2522.—Charitable and Similar Gifts

26 CFR 25.2522(c)-3: Transfer not exclusively for charitable, etc., purposes in the case of gifts made after July 31, 1969.

Unitrust remainder interest; donee's power; beneficial interest; presently ascertainable. A donor transferred shares of stock in a publicly held corporation to a qualified, pre-existing charitable remainder unitrust. The donor was both a director of the corporation and one of two cotrustees of the trust. The trust corpus consisted solely of that corporation's stock, which was subject to a right of "first refusal." The trustees, using independent judgement, consistently adopted the same price as the fair market value of the trust's stock. Because the donor is bound by a fiduciary duty as both a director and cotrustee, the donor's power to determine the stock's value is limited. Therefore, the value of the charitable beneficial interest is presently ascertainable, and the charitable deduction is allowable with respect to the remainder interest.

Rev. Rul. 80-83

ISSUE

Is a charitable deduction allowable under section 2522 of the Internal Revenue Code, under the circumstances described below?

FACTS

During 1977, a donor transferred additional shares of *M* Corporation stock to a pre-existing charitable remainder unitrust that meets the requirements of section 664 of the Code, as amended by the Tax Reform Act of 1969, Pub. L. 91-172, 1969-3 C.B. 10. The donor, who was one of fourteen directors of *M* Corporation, a publicly held corporation, was named as one of two cotrustees. Trust corpus consists solely of *M* Corporation stock. The trust provides that an amount equal to six percent of the net fair market value of the corpus, as determined annually by the trustees, is to be paid annually to the donor's child for life. At the child's death, the remaining trust property is to be paid to organizations described in sections 170(c), 2055(a), and 2522(a) of the Code.

Under the certificate of incorporation, the sale of *M* Corporation stock is subject to a right of "first refusal" that requires any stockholder desiring to sell *M* Corporation stock to first offer the shares to the corporation at the same price and terms as offered to any other buyer. Additionally, the Board of Directors of the corporation periodically establishes a price at which it will buy a limited number of its shares. The trustees of the trust, using independent judgement, have consistently adopted the price established by *M* Corporation as the fair market value of its stock.

LAW AND ANALYSIS

Section 2522 of the Code provides that, in computing taxable gifts for the calendar quarter, there shall be allowed as a deduction the amount of all gifts made during such quarter to or for the use of charitable organizations or trusts.

Under section 25.2522(c)-3 of the Gift Tax Regulations, certain conditions are applicable with respect to transfers that are not exclusively for charitable purposes. Section 25.2522(c)-3 reads, in part:

> (a) *Remainders and similar interests.* If a trust is created or property is transferred for both a charitable and a private purpose, deduction may be taken of the value of the charitable beneficial interest only insofar as that interest is presently ascertainable, and hence severable from the noncharitable interest.

While the donor in this case acts both as a cotrustee and a director in determining the value of the stock, the donor is bound by a fiduciary duty in each capacity to exercise independent judgment on behalf of the trust beneficiaries and corporation, respectively. The donor does not have the freedom to control circumstances affecting the value of the corpus during the term of the unitrust. Therefore, the donor's power, as a cotrustee and a director, to determine the value of the charitable beneficial interest is ascertainable within the meaning of section 25.2522(c)-3 of the regulations.

The value determined by the donor, acting as a cotrustee and a director, does not bind the Internal Revenue Service for the purpose of determining the amount of the charitable deduction either initially or at the time of a subsequent transfer of stock. Similarly, the Service is not bound by the trustee's determination for purposes of the annual valuation required to determine the payment to the noncharitable beneficiary. See section 1.664-2(a)(1)(iii), Income Tax Regulations.

HOLDING

The value of the charitable beneficial interest is presently ascertainable as that term is used in section 25.2522(c)-3 of the regulations. Accordingly, the charitable deduction is allowable under section 2522 of the Code, with respect to the remainder interest.

26 CFR 25.2522(c)-3: Transfers not exclusively for charitable, etc., purposes in the case of gifts made after July 31, 1969.

Whether actuarial tables must be used in order to value the interest of a life beneficiary, in view of the individual's physical condition. See Rev. Rul. 80-80, page 10.

Section 3402.—Income Tax Collected at Source

26 CFR 31.3402(a)-1: Requirement of withholding.

Applicability of section 83 of the Code to the transfer of a corporation's stock from a shareholder of the corporation to an employee of the corporation's wholly owned subsidiary. See Rev. Rul. 80-76, page 6.

Part IV. Items of General Interest

Form 1118, Computation of Foreign Tax Credit—Corporations, Revised

Announcement 80-35

Form 1118, Computation of Foreign Tax Credit—Corporations, and the Instructions for Form 1118 have recently been revised. The major change is the elimination of the separate limitation for income from U.S. possessions. The revised Form 1118 has a January 1980 revision date and is available in most Service district offices.

Discharge of Liabilities on the Sale or Other Disposition of Property—Public Hearing

Announcement 80-37 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to the computation under section 1001 of the Internal Revenue Code of 1954 of the amount realized on the sale or other disposition of encumbered property.

DATES: The public hearing will be held on April 10, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by March 31, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-52-79), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles G. Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under section 1001 of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Friday, December 28, 1979, at page 76815 (44 FR 76815).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of the comments to be presented at the hearing and the time they wish to devote to each subject by March 31, 1980.

Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive appearing in the Federal Register for Wednesday, November 8, 1978.

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[1] Filed by the Office of the Federal Register on March 7, 1980, 8:45 a.m., and published in the same issue of the Federal Register for March 10, 1980, 45 F.R. 15188.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants and Enrolled Agents from Practice before the Internal Revenue Service

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants or enrolled agents to practice before the Internal Revenue Service.

Attorneys, certified public accounts and enrolled agents are prohibited in any Internal Revenue Service matters from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant or enrolled agent so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and hearing before the administrative law judge, the following person was disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
Roy W. Hunt	Redwood City, CA	Certified Public Accountant	January 14, 1980

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the instituton or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation at attorney, certified public account or enrolled agent, and the date or period of suspenison. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following persons have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
John E. Bishop	Greenville, SC	Attorney	Indefinite effective October 24, 1979
Raymond A. Carr	Roanoke, VA	Certified Public Accountant	Indefinite effective February 11, 1980
Philip R. Hedrick	Charlotte, NC	Attorney	One Year effective February 22, 1980

Name	Address	Designation	Term of Suspension
Edward J. Loughery	Succasunna, NJ	Enrolled Agent	Indefinite effective February 1, 1980
C. Rex Olson	Phoenix, AZ	Certified Public Accountant	Four months effective February 15, 1980
Julian S.H. Weiner	Beverly Hills, CA	Certified Public Accountant	Indefinite effective August 23, 1979
W. Frank Wolfenbarger	Irving, TX	Certified Public Accountant	Indefinite effective January 1, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.401-2, 1.403(b)-1, 1.405-1, amended; 1.401-8A redesignated 1.401-8 and as redesignated amended; 1.401-8 redesignated 1.401(f)-1 and as redesignated amended; 1.401(a)-1, 1.401(a)-2, 1.401(a)-16, 1.415-1 through 1.415-10 added.	Limitations on benefits and contributions under qualified plans.	Jan. 24, 1980	Apr. 23, 1980
26 CFR 1.337 deleted; 1.337-6 amended.	Election to extend the 12-month period for certain corporate liquidations where there is an involuntary conversion.	Jan. 30, 1980	Mar. 31, 1980
26 CFR 5a.612-1 added; published as temporary regulations in T.D. 7669, page 11, 1980-11 I.R.B.	Option to capitalize or deduct intangible drilling and development costs in the case of wells drilled for any geothermal deposit.	Jan. 30, 1980	Mar. 31, 1980
26 CFR 138.4064-1, 138.4222-1 added; published as temporary regulations in T.D. 7674, page 22, 1980-11 I.R.B.	Gas Guzzler Tax.	Feb. 8, 1980	Apr. 8, 1980
26 CFR 31.6302(c)-1 amended.	Deposit requirements for social security and withheld income taxes.	Feb. 8, 1980	Apr. 8, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified,* above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1, dated January 7, 1980.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1 I.R.B., dated January 7, 1980.

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______	1928–2	9.50
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______	1937–2	7.70
______	*1938–1*	*4.05*
______	*1938–2*	*3.50*
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______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
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______	1945(*)	9.40
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______	1946–2	5.20
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______	1948–2	7.50
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______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*2.65*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$10.10
______	1957–2	13.00
______	1958–1	9.60
______	1958–2	13.00
______	1958–3	15.00
______	1959–1	15.00
______	1959–2	9.60
______	1960–1	9.00
______	1960–2	11.50
______	1961–1	14.00
______	1961–2	10.00
______	1962–1	6.20
______	1962–2	7.15
______	1962–3	15.00
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Italics indicate paperbound editions. When stocks on these publications have been depleted, all reprints will be issued in casebound editions. All others are casebound.

(*) Printed in one volume.

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March 31, 1980
Bulletin No. 1980-13

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENTS

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A public hearing will be held on April 22, 1980, concerning proposed regulations relating to the election to treat outdoor advertising displays as real property.

Announcement 80-49, page 37.
A public hearing will be held on April 24, 1980, concerning proposed regulations relating to the targeted jobs tax credit.

INCOME TAX

Rev. Rul. 80-84, page 5.
Firefighters' and police officers' beneficiaries; Los Angeles. Benefits received by beneficiaries of deceased members of the Los Angeles fire or police departments under Los Angeles, California, Charter Art. XVII, section 183, are excludable from gross income under section 104(a)(1) of the Code if the recipient can establish either (1) that the benefits are received under the service-connected death provision, or (2) that the benefits are received under the retirement provision and that the employee on account of whose death the benefits are paid was retired under the service-connected disability provisions of the Charter at the time of that employee's death.

Rev. Rul. 80-85, page 6.
Depreciation; rehabilitation expenditures; low income rental housing. Rev. Rul. 76-439, which holds that because a partnership did not obtain the sworn and notarized income certification required by section 1.167(k)-3(b)(4) of the regulations in existence at that time, it does not qualify to compute the depreciation deduction of rehabilitation expenditures under section 167(k) of the Code, is revoked.

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Temporary regulations under section 6411 of the Code relate to the application for a tentative refund under a claim of right adjustment.

T.D. 7673, page 7.
Amendments to the regulations under sections 936 and 1502 of the Code concern elections relating to the Puerto Rico and possession tax credit.

EXEMPT ORGANIZATIONS

Rev. Rul. 80-86, page 6.
Electric cooperative; sale of excess fuel. An electric cooperative's sale of excess fuel at cost in the year of purchase is not income for purposes of determining compliance with the 85 percent member-income requirement of section 501(c)(12) of the Code.

EMPLOYMENT TAXES

Page 9.
Railroad retirement; rate determination; quarterly. The Railroad Retirement Board has determined

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Finding Lists begin on page 41.
Announcement of Disbarment and Suspensions begin on page 38.
Announcement of Notice of Proposed Rulemaking on page 40.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part includes rulings and decisions based on Subpart A, Tax Conventions and related Treasury Decisions and Revenue Rulings; Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

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(Continued from page 1)

EMPLOYMENT TAXES—Cont'd

that the rate of tax imposed by section 3221(c) of the Code shall be twelve and one-half cents for the quarter beginning April 1, 1980.

SELF-EMPLOYMENT TAX

Rev. Rul. 80-87, page 8.

Honorary corporate director. Payments received by an honorary director of a corporation who has served as an active director for a period of 20 years and who is no longer required to perform any services for the corporation are includible in net earnings from self-employment.

EXCISE TAXES

Rev. Rul. 80-88, page 9.

Exemptions; church conducting several activities. A discussion is presented of exemptions from excise taxes on fuel, oil, tires, and parts used on buses operated by a tax-exempt church in connection with (1) regularly scheduled Sunday school classes, (2) a regularly staffed kindergarten, (3) a music education program, and (4) recreational programs.

Rev. Rul. 80-89, page 10.

Exemptions; United Nations Secretariat. The exemptions from the federal excise taxes referred to in Rev. Rul. 73-198 apply to the Secretary-General of the United Nations, Under Secretaries-General, Assistant Secretaries-General of the United Nations, and officials of equivalent rank who possess diplomatic privileges and immunities. However, the exemptions do not apply to members of the United Nations Secretariat. Rev. Rul. 73-198 amplified.

Rev. Rul. 80-90, page 11.

Cranes installed on trucks; job-site operations. The tax imposed by section 4061 does not apply to sales of certain mast and boom type cranes having lifting capacity of 5,000 or 6,000 pounds that are mounted on small trucks and designed for job-site operations rather than for typical loading or unloading duties.

Rev. Proc. 80-9, page 20.

Resale of taxable articles; first retail sale of light-duty truck; registration. Guidelines are provided whereby manufacturers of automotive parts or accessories and purchasers of such articles may register to sell and purchase taxable articles tax free for resale with the first retail sales of light-duty trucks.

ADMINISTRATIVE

Ct. D. 1999, page 15.

Summons; handwriting exemplar. The Service may require individuals to appear and provide handwriting exemplars under the summons authority conferred by section 7602 of the Code. *Euge*, Supreme Court of the United States.

Rev. Proc. 80-10, page 20.

Reproduction of Forms W-2, W-2P, and W-3. Specifications are set forth under which substitutes for Forms W-2, W-2P, and W-3 may be privately printed without prior approval of the Service. Proposed substitutes not conforming to these specifications must be submitted to the Commissioner for consideration. Rev. Proc. 79-21 superseded.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 104.—Compensation for Injuries or Sickness

26 CFR 1.104-1: Compensation for injuries or sickness.

Firefighters' and police officers' beneficiaries; Los Angeles. Benefits received by beneficiaries of deceased members of the Los Angeles fire or police departments under Los Angeles, California, Charter Art. XVII, section 183, are excludable from gross income under section 104(a)(1) of the Code if the recipient can establish either (1) that the benefits are received under the service-connected death provision, or (2) that the benefits are received under the retirement provision and that the employee on account of whose death the benefits are paid was retired under the service-connected disability provisions of the Charter at the time of that employee's death.

Rev. Rul. 80-84

ISSUE

Are amounts received under Los Angeles, California, Charter Art. XVII, section 183 by beneficiaries of deceased members of the Los Angeles fire and police departments excludable from gross income under section 104 (a)(1) of the Internal Revenue Code?

FACTS

Los Angeles, California, Charter Art. XVII, section 183 states:

> Whenever any member of the Fire or Police Department shall die as a result of any injury received during the performance of his duty, or from sickness caused by the discharge of such duty, or after retirement, or while eligible to retirement from such department on account of years of service, then an annual pension shall be paid in equal monthly installments to his widow or child or children, or dependent parent or parents, in an amount equal to one-half (½) of the average monthly rate of salary assigned to the ranks or positions held by such member during the three years immediately preceding the time of his death or the date of his retirement from active duty in such department. . . .

Charter section 182 states:

> Whenever any member of the Fire or Police Department shall become so physically or mentally disabled by reason of bodily injuries received in, or by reason of sickness caused by the discharge of the duties of such person in such department as to render necessary his retirement from active service, such member shall be retired and, during his lifetime (if the disability or sickness does not sooner cease) shall be paid . . . a pension. . . .

The Charter section 182 pension is computed by a formula that does not refer to age or years of service and the benefits are provided to a class that is restricted to employees with service-incurred disabilities. These benefits are therefore payments for those disabilities. Thus, Charter section 182 is a statute in the nature of a workmen's compensation act. See Rev. Rul. 72-44, 1972-1 C.B. 31.

LAW AND ANALYSIS

Section 104(a)(1) of the Code provides that gross income does not include amounts received under workmen's compensation acts as compensation for personal injuries or sickness.

Section 1.104-1(b) of the Income Tax Regulations provides that section 104(a)(1) of the Code excludes from gross income amounts received by an employee under a workmen's compensation act or under a statute in the nature of a workmen's compensation act that provides compensation to employees for personal injuries or sickness incurred in the course of employment. Section 104(a)(1) also applies to compensation that is paid under a workmen's compensation act to the survivor or survivors of a deceased employee. Section 104(a)(1) does not apply to a retirement pension or annuity to the extent that it is determined by reference to the employee's age or length of service even though the employee's retirement is occasioned by occupational injury or sickness.

A statute authorizing benefits for employees' survivors may qualify as a statute in the nature of a workmen's compensation act if it requires as a prerequisite to payment a determination that the cause of the employee's death was service-related. See *Riley v. United States,* 156 F. Supp. 751 (Ct. Cl. 1957); Rev. Rul. 72-291, 1972-1 C.B. 36. The Charter section 183 provisions authorizing benefits to survivors of members dying from service-connected injury or sickness (the service-connected death provisions) require such a determination as a prerequisite to payment. Thus, the benefits are in the nature of workmen's compensation. Accordingly, if a taxpayer can establish that the taxpayer's Charter section 183 benefits are received under the service-connected death provisions, those benefits will qualify for exclusion under section 104(a)(1) of the Code. The fact that such a taxpayer could also have qualified for the same benefits under another provision of section 183 will not prevent the section 104(a)(1) exclusion from applying. See *Neill v. Commissioner,* 17 T.C. 1015 (1951), *acq.,* 1952-1 C.B. 3; Rev. Rul. 74-582, 1974-2 C.B. 34.

Benefits paid to employees' survivors may also qualify as paid under a statute in the nature of a workmen's compensation act if those benefits are part of the compensation for service-related injury or illness and thus are a mere continuation of employees' lifetime section 104(a)(1) benefits. If a Los Angeles fireman or policeman suffers a service-related injury or illness necessitating the employee's retirement, the compensation for that injury or illness is two-fold—1) because of that injury, the employee may retire under Charter section 182 and receive lifetime benefits under that section, and 2) because that injury qualifies the employee for retirement, the employee's survivors qualify for Charter section 183 benefits under the provision of Charter section 183 authorizing survivors' benefits whenever any member dies after retirement (the retirement provision). Benefits paid under this provision to survivors of employees who were retired under section 182 at the time of death are thus part of the compensation for the employee's service-related injury or illness. These benefits therefore are treated as a continuation of the employee's lifetime section 104(a)(1) benefits.

HOLDING

Charter section 183 benefits are excludable from gross income under section 104(a)(1) of the Code if the recipient can establish either 1) that the benefits are received under the service-connected death provisions, or 2) that the benefits are received under the retirement provision and that the employee on account of whose death the benefits are paid was retired under Charter section 182 at the time of that employee's death.

Section 167.—Depreciation

26 CFR 1.167(k)-3: Definitions.

Depreciation; rehabilitation expenditures; low income rental housing. Rev. Rul. 76-439, which holds that because a partnership did not obtain the sworn and notarized income certification required by section 1.167(k)-3(b)(4) of the regulations in existence at that time, it does not qualify to compute the depreciation deduction of rehabilitation expenditures under section 167(k) of the Code, is revoked.

Rev. Rul. 80-85

Rev. Rul. 76-439, 1976-2 C.B. 50, holds that because a partnership did not obtain the sworn and notarized income certifications required by section 1.167(k)-3(b)(4) of the Income Tax Regulations in existence at that time, it does not qualify to compute the depreciation deduction of the rehabilitation expenditures under section 167(k) of the Internal Revenue Code. The taxpayer submitted Federal Housing Administration's Form 1705, "Total Family Income Certification" in lieu of the sworn notarized certification.

The amendment to section 1.167(k)-3(b)(5) of the regulations by T.D. 7642, 1979-43 I.R.B. 8, makes Rev. Rul. 76-439 obsolete with respect to property attributable to expenditures paid or incurred after July 24, 1969. The Federal Housing Administration's Form 1705 is an acceptable form under section 1.167(k)-3(b)(5) as amended.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 76-439 is revoked.

Section 501.—Exemption from Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(c)(12)-1: Local benevolent life insurance associations, mutual irrigation and telephone companies, and like organizations.

Electric cooperative; sale of excess fuel. An electric cooperative's sale of excess fuel at cost in the year of purchase is not income for purposes of determining compliance with the 85 percent member-income requirement of section 501(c)(12) of the Code.

Rev. Rul. 80-86

ISSUE

Will an organization exempt from federal income tax under section 501(c)(12) of the Internal Revenue Code jeopardize its exempt status in the taxable year in which it engages in the transaction described below?

FACTS

The organization's primary purpose is to generate and transmit electricity to its members on a cooperative basis. Its gross receipts from the sale of electricity to members usually represent the organization's only receipts.

In the process of producing electricity the organization regularly uses large quantities of natural gas as fuel to operate its generators. In order to guarantee itself an adequate supply of natural gas in the event of a fuel shortage, the organization entered into a contract with a commercial gas supplier to purchase approximately 500*x* dollars worth of natural gas during the taxable year. However, the organization estimates that in ordinary operations, assuming no fuel shortage occurs, it will only use approximately 200*x* dollars of the gas it contracted to purchase. Therefore, the organization entered into a second contract with a commercial pipeline company whereby the pipeline company would buy any excess gas at cost. The pipeline company is not a member of the organization and purchases no electricity from it.

In the taxable year under consideration no fuel shortage occurred and the organization only used 200*x* dollars worth of the gas it originally estimated. Consequently, pursuant to its contract with the pipeline company, it sold the excess natural gas at cost receiving approximately 300*x* in gross receipts from the sale.

LAW AND ANALYSIS

Section 501(c)(12) of the Code provides for the exemption from federal income tax of benevolent life insurance associations of a purely local character, mutual ditch or irrigation companies, mutual or cooperative telephone companies, or like organizations; but only if 85 percent or more of the income consists of amounts collected from members for the sole purpose of meeting losses and expenses.

Rev. Rul. 65-99, 1965-1 C.B. 242, holds, in part, that the 85 percent income requirement of section 501(c)(12) of the Code is applied on the basis of annual accounting periods.

The question presented is to what extent, if any, the gross receipts from the sale of the natural gas to the pipeline company should be taken into consideration in determining whether 85 percent or more of the organization's income consists of amounts collected from members for the sole purpose of meeting losses and expenses, in the taxable year in question. The answer to this question depends upon the meaning of the term "income" as used in section 501(c)(12) of the Code. Though the term is not specifically defined in that section, or in the Income Tax Regulations thereunder, there is precedent as to its meaning for purposes of the 85 percent member income requirement.

Rev. Rul. 74-362, 1974-2 C.B. 170, states, in part, that compliance with the 85 percent member-income requirement by an organization that is exempt under section 501(c)(12) of the Code is based on "gross income." Thus, for purposes of determining whether 85 percent or more of its income is collected by the organization from members for the sole purpose of meeting losses or expenses, the term "income" means "gross income."

Gross income is generally considered to represent an intermediate figure between gross receipts and net income. There are two categories of adjustments from gross receipts that must be taken into consideration in arriving at gross income. These are: 1) trade discounts, allowances on goods sold and refunds on returned goods, and 2) cost of goods sold. In the case of an organization selling merchandise, the cost of goods sold generally is the more significant figure in determining gross income.

While the Code does not specifically allow the deduction for cost of goods sold, section 1.61-3(a) of the Income Tax Regulations provides that in a manufacturing, merchandising, or mining business, "gross income" means total sales less cost of goods sold. Similarly, in the case of the sale of merchandise by an organization exempt under section 501(c)(12) of the Code, the cost of goods sold should be subtracted from gross receipts in determining whether 85 percent or more of its income has been collected from members for the sole purpose of meeting losses and expenses. This principle applies to both the sale of merchandise in the ordinary course of business, and to the incidental sale of excess supplies or fuel.

Rev. Rul. 68-620, 1968-2 C.B. 199, holds, in part, that gas is generally considered to be inventoriable merchandise. See also Rev. Rul. 78-352, 1978-2 C.B. 168. Consequently, even though the sales of gas by this organization is merely ancillary to its primary purpose of providing electricity to its members, the cost of the gas sold should be taken into consideration in determining the amount of gross income derived from the sale.

HOLDING

Since the organization is selling the excess gas at cost, there would be no gross income derived from its sale. Thus, in a year in which the organization's only income is from the sale of electricity to its members and from the sale of its excess gas at a price equal to its cost, the organization's only income for purposes of determining compliance with the 85 percent member-income requirement would be that derived from the sale of electricity to its members. Accordingly, the transaction would not adversely affect the exempt status of the organization under section 501(c)(12) of the Code in the taxable year in which the transaction takes place.

Section 936.—Puerto Rico and Possession Tax Credit

26 CFR 1.936-1: Elections.

T.D. 7673

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Elections relating to the Puerto Rico and possession tax credit

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations prescribing rules for making and revoking elections relating to the Puerto Rico and possession tax credit which was enacted by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1].

DATE: The regulations apply for taxable years beginning after December 31, 1975.

FOR FURTHER INFORMATION CONTACT: Daniel Horowitz of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (LR-139-78), 202-566-3289, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On May 9, 1979, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) relating to the making and revoking of elections under section 936(e) of the Internal Revenue Code of 1954 (44 FR 27180). These amendments were proposed to conform the regulations to section 1051(b) of the Tax Reform Act of 1976 (90 Stat. 1643). No comments disagreeing with these amendments and no requests for a public hearing were received. Accordingly, these amendments are adopted by this Treasury decision. In addition, the Treasury decision resolves a question that has arisen as to whether, if a corporation is a member of an affiliated group (as defined in section 1504(a)), the section 936(e) election is made by the corporation itself or by the common parent under § 1.1502-77(a).

EXPLANATION OF PROVISIONS

Section 1051(b) of the Tax Reform Act of 1976 added section 936 to the Code. A domestic corporation which elects the application of section 936 may qualify for the Puerto Rico and possession tax credit. Section 936(e) provides that the election shall be made at such time and in such manner as the Secretary may by regulations prescribe. The election shall apply for the first taxable year for which it is made and for which the conditions of section 936(a)(1)(A) and (B), as in effect prior to the enactment of the Revenue Act of 1978 [1978-3 C.B. (Vol. 1) 1], are satisfied. It shall continue to apply for at least the 9 immediately following taxable years unless the Secretary grants consent for earlier revocation. Temporary regulations § 7.0(c)(5) now provides that the election be made by filing Form 5712 within 90 days after the beginning of the first taxable year for which the election is made.

The amendments to the Income Tax Regulations provide that a corporation shall make the election by filing Form 5712 on or before the later of the two following dates. The first date is the date on which such corporation is required to file its Federal income tax return for the first taxable year for which the election is made. The second date is April 8, 1980. In addition, any corporation to which an election applies on February 8, 1980 is granted the consent of the Secretary to revoke the election for the first taxable year to which the election applied.

Existing § 1.1502-77(a) provides that the common parent of an affiliated group shall be the sole agent for each subsidiary in the group for all matters relating to tax liability other than the exceptions therein specified.

However, section 936(a) is drafted in terms of the electing corporation itself making the election. To eliminate this ambiguity, § 1.1502-77(a) is amended to add the section 936 election to the specified exceptions to its general rule.

The amendments to the Income Tax Regulations do not meet the Treasury Department criteria for a significant regulation because they are essentially procedural.

DRAFTING INFORMATION

The principal author of this regulation is Daniel Horowitz of the Legislation and Regulations Division of the Office of Chef Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended as follows:

Paragraph 1. Section 7.0(c)(5) is deleted and § 7.0(c)(6) is redesignated as § 7.0(c)(5).

Par. 2. Section 1.936-1 is added to read as set forth below.

§ 1.936-1 Elections.

(a) *Making an election.* A domestic corporation shall make an election under section 936(e), for any taxable year beginning after December 31, 1975, by filing Form 5712 on or before the later of—

(1) The date on which such corporation is required, pursuant to sections 6072(b) and 6081, to file its Federal income tax return for the first taxable year for which the election is made; or

(2) April 8, 1980.

Form 5712 shall be filed with the Internal Revenue Service Center, 11601 Roosevelt Boulevard, Philadelphia, Pennsylvania 19155 (Philadelphia Center).

(b) *Revoking an election.* Any corporation to which an election under section 936(e) applies on February 8, 1980 is hereby granted the consent of the Secretary to revoke that election for the first taxable year to which the election applied. (The corporation may make a new election under § 1.936-1(a) for any subsequent taxable year.) The corporation shall make this revocation by sending to the Philadelphia Center a written statement of revocation on or before April 8, 1980.

Par. 3. Section 1.1502-77(a) is amended by inserting in the first sentence thereof "the making of an election under section 936(e)," after "paragraph (a)(1) of § 1.1502-75," and before "the making of an election to be treated as a DISC".

This Treasury decision is issued under the authority contained in sections 7805 and 936(e) of the Internal Revenue Code of 1954 (68A Stat. 917 and 90 Stat. 1644; 26 U.S.C. 7805 and 936(e)).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved January 29, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on February 7, 1980, 8:45 a.m., and published in the issue of the Federal Register for February 8, 1980, 45 F.R. 8588)

Section 1402.—Definitions [Tax on Self-Employment Income]

26 CFR 1.1402(a)-1: Definition of net earnings from self-employment.

Honorary corporate director. Payments received by an honorary director of a corporation who has served as an active director for a period of 20 years and who is no longer required to perform any services for the corporation are includible in net earnings from self-employment.

Rev. Rul. 80-87

ISSUE

Are payments to honorary directors of a corporation who are not required to perform services for the corporation includible in net earnings for self-employment under section 1402(a) of the Internal Revenue Code?

FACTS

The corporation appoints individuals who have served as directors for a period of 20 years to the position of honorary director. Honorary directors are not required to attend any directors' meetings and do not have voting powers. The corporation pays the honorary directors a fee whether or not they attend the meetings.

LAW AND ANALYSIS

Section 1402(a) of the Code provides that the term "net earnings from self-employment" means an individual's gross income from, less the allowable income tax deductions attributable to, a trade or business.

Rev. Rul. 72-86, 1972-1 C.B. 273, holds that the fees received by the director of a corporation for performing services on its board of directors are income from a trade or business and are includible in computing net earnings from self-employment.

Section 1.1402(a)-1(c) of the Income Tax Regulations provides that gross income from a trade or business includes gross income received or accrued in the taxable year of the individual even though such income may be attributable in whole or in part to services rendered in a prior taxable year as to which the individual was not subject to the tax on self-employment income.

Rev. Rul. 68-498, 1968-2 C.B. 377, holds that royalties received by an author from previously published books are includible in computing net earnings from self-employment under section 1402(a) of the Code.

In addition, Rev. Rul. 54-312, 1954-2 C.B. 327, holds that renewal commissions paid to life insurance agents who perform no services at the time they receive their commissions, and who may be retired, are includible in determining net earnings from self-employment at the time paid, since they are based on services rendered at the time of sale of the policies.

In the instant case, the payments to the honorary directors, who do not attend meetings or perform any services as directors, are attributable to their prior services within the meaning of section 1.1402(a)-1(c) of the regulations.

HOLDING

The payments to the honorary directors are includible in net earnings from self-employment under section 1402(a) of the Code.

Section 3221.—Rate of Tax [Railroad Retirement Tax Act]

RAILROAD RETIREMENT BOARD

Determination of Quarterly Rate of Excise Tax for Railroad Retirement Supplemental Annuity Program

In accordance with directions in Section 3221(c) of the Railroad Retirement Tax Act (26 U.S.C. 3221 (c)), the Railroad Retirement Board has determined that the excise tax imposed by such Section 3221(c) on every employer, with respect to having individuals in his employ, for each work-hour for which compensation is paid by such employer for services rendered to him during the quarter beginning April 1, 1980, shall be at the rate of 12½ cents.

In accordance with directions in Section 15(a) of the Railroad Retirement Act of 1974, the Railroad Retirement Board has determined that for the quarter beginning April 1, 1980, 20.3 percent of the taxes collected under Sections 3211(b) and 3221(c) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Account and 79.7 percent of the taxes collected under Section 3211 (b) and 3221(c) plus one hundred percent of the taxes collected under Section 3221(d) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Supplemental Account.

By Authority of the Board.

Dated: February 21, 1980.

R. F. Butler,
Secretary of the Board.

(Filed by the Office of the Federal Register on February 27, 1980, 8:45 a.m., and published in the issue of the Federal Register for February 28, 1980, 45 F.R. 13242)

Section 4041.—Imposition of Tax [Special Fuels]

26 CFR 48.4041-1: Tax on diesel fuel and special motor fuel.

Whether retailers excise tax applies to special fuels sold to members of the United Nations Secretariat. See Rev. Rul. 80-89, page 10.

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26 CFR 48.4041-13: Tax-free retail sales to certain nonprofit educational organizations. (Also Sections 4063, 4221, 6421, 6424, 6427; 48.4221-6.)

Exemptions; church conducting several activities. A discussion is presented of exemptions from excise taxes on fuel, oil, tires, and parts used on buses operated by a tax-exempt church in connection with (1) regularly scheduled Sunday school classes, (2) a regularly staffed kindergarten, (3) a music education program, and (4) recreational programs.

Rev. Rul. 80-88

ISSUE

May taxable fuels and articles be sold exempt from the manufacturers and retailers excise taxes to a church for use in the activities described below?

FACTS

A church operates the following activities:

(1) Regularly scheduled Sunday school classes for all age groups in the congregation. Classes are taught by a volunteer faculty at the church classroom facility and at various other class locations, including a junvenile detention center and a nursing home.

(2) A regularly staffed kindergarten, using the standard curriculum of the local board of education.

(3) A music education program conducted by the music ministry and employing three professional instructors in music education, two full-time and one part-time. The program encompasses age groups from first graders through adults who meet regularly at the church for instruction. Both vocal and instrumental theory are included in the program and some classes are held at other locations, such as music camps and clinics. This program is much more extensive than the regular church choir program. Many persons, however, participate in both activities.

(4) Recreational programs that include skating, swimming, a baseball league, and picnics. The recreational programs are open to all members of the church.

The church purchases buses that it uses to provide transportation in connection with the various activities described above. The buses are also used for choir trips and to transport church members to retreats. In operating the buses, the church purchases fuel, oil, tires, and parts.

The church is exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3).

LAW AND REGULATIONS

The applicable sections of the Internal Revenue Code and Manufacturers and Retailers Excise Tax Regulations are sections 4041(g)(4), 4063 (a)(6), 4221(a)(5), 4221(d)(7), 4221(e)(5), 4221(e)(6), 6421(b)(1) (B), 6424(a)(2), 6427(b)(1)(B), 48.4041-13, and 48.4221-6.

Under sections 4063(a)(6) and 4221(e)(6) of the Code, as amended by the Energy Tax Act of 1978, Pub. L. No. 95-618 (1978), 1978-3 C.B. Vol. 2, effective December 1, 1978, buses and bus parts or accessories are exempt from the manufacturers excise tax.

Under sections 4041(g)(4) and 4221(a)(5) of the Code, exemptions from the retailers and manufacturers excise taxes are provided for fuels and articles sold to a nonprofit educational organization for its exclusive use. Under section 4221(d)(5) and sections 48.4041-13 and 48.422-6 of the regulations, the term "nonprofit educational organization" includes a school operated as an activity of an organization described in section 501(c)(3) which is exempt from income tax under section 501(a), provided the primary function of such school is the presentation of formal instruction and provided such school normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

Under section 4221(e)(5) of the Code, as amended by the Energy Tax Act, effective December 1, 1978, the manufacturers excise tax on tires does not apply in the case of tires or inner tubes for tires sold for use by the purchaser on or in connection with a qualified bus. Under section 4221(d)(7) a "qualified bus" includes a school bus that is defined as any automobile bus substantially all the use of which is in transporting students and employees of schools. In Senate Report No. 95-529, Pub. Law 95-618, 1978-3 (Vol. 2) C.B. 248, the Committee indicates that in reference to a school bus, the term "substantially all" means at least 85 percent. The term "school" is defined by section 4221(d)(7)(C) as an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are carried on.

Under sections 6421(b)(1)(B) and 6427(b)(1)(B) of the Code, as amended by the Energy Tax Act, effective December 1, 1978, if gasoline and other fuels are used in an automobile bus while engaged in the transportation of students and employees of schools (as defined in section 4221(d)(7)(C)), the ultimate purchaser of the fuels is entitled to a payment by the Secretary equivalent to the excise tax on such fuels.

Under section 6424(a)(2) of the Code, as amended by the Energy Tax Act, effective December 1, 1978, if lubricating oil (other than cutting oil and oil that has previously been used) is used in a qualified bus (as defined in section 4221(d)(7)), the ultimate purchaser of the lubricating oil is entitled to a payment by the Secretary equivalent to the manufacturers excise tax on such lubricating oil.

ANALYSIS AND HOLDINGS

In determining whether certain activities conducted by an income tax-exempt organization qualify as a school for purposes of the excise tax exemptions for nonprofit educational organizations, each activity must qualify on its own, rather than all activities being considered on a cumulative basis. Thus, each activity must meet the statute and regulation requirements of faculty, curriculum, and student body. In addition, taxable fuels and articles purchased by the organization must be for the exclusive use of the qualifying school activities. See, for example, Rev. Rul. 75-314, 1975-2 C.B. 442, and Rev. Rul. 74-234, 1974-1 C.B. 316, which illustrate how the nonprofit educational exemption from certain excise taxes applies where a religious organization conducts an exempt school activity.

In this case, the Sunday school described in (1), the kindergarten described in (2), and the music education program described in (3) meet the school activity requirements of the statute and regulations in that their primary function is the presentation of formal instruction and that they maintain a regular faculty and curriculum and normally have a regularly enrolled body of students in attendance at the place where their educational activities are regularly carried on. The recreational programs described in (4), the regular church choir program, and the church retreats do not meet such requirements, and thus do not qualify as school activities. Moreover, they are not merely incidental to the qualifying school activities since they are available to the entire church congregation. See Rev. Rul. 68-342, 1968-1 C.B. 484.

Accordingly, the nonprofit educational exemptions provided by sections 4041(g)(4) and 4221(a)(5) of the Code apply to taxable fuels and articles sold to the organization for exclusive use in activities (1), (2), and (3), but the exemptions do not apply to fuels and articles sold for use in activity (4) or for use in the retreats and choir program.

Under section 4221(e)(5) of the Code, effective December 1, 1978, however, tires and tubes may be purchased tax free by the organization for use on a bus if substantially all the use of the bus (at least 85 percent) is in providing transportation in connection with activities (1), (2), and (3), thus meeting the definition of a qualified bus under section 4221(d)(7) even if the bus is used for some nonexempt activities. Further, if lubricating oil purchased by the organization is used in a qualified bus, under section 6424(a)(2), the organization will be entitled as the ultimate purchaser to a payment equivalent to the manufacturers tax imposed on lubricating oil.

In addition, where gasoline and other fuels are purchased by the organization tax paid because the organization does not qualify for the nonprofit educational exemption under section 4221(a)(5) of the Code, any portion of such fuels used in an automobile bus while transporting students and employees in connection with school activities (1), (2), or (3) will entitle the organization to a credit or refund under sections 6421(b)(1)(B) and 6427(b)(1)(B), effective December 1, 1978, with respect to the excise tax on such portion of the fuels.

Section 4061.—Imposition of Tax [Motor Vehicles]

26 CFR 48.4061(a)-1: Imposition of tax; exclusion for light-duty trucks, etc.
(Also Sections 4041, 4071, 4081, 4091, 4161, 4181, 4251, 4371, 4481; 48.4041-1, 48.4071-1, 48.4081-1, 48.4091-1, 48.4161(a)-1, 48.4181-1, 49.4251-1, 46.4371-2, 41.4481-1.)

Exemptions; United Nations Secretariat. The exemptions from the federal excise taxes referred to in Rev. Rul. 73-198 apply to the Secretaries-General of the United Nations, Under Secretaries-General, Assistant Secretaries-General of the United Nations, and officials of equivalent rank who possess diplomatic privileges and immunities. However, the exemptions do not apply to members of the United Nations Secretariat. Rev. Rul. 73-198 amplified.

Rev. Rul. 80-89

ISSUE

Are members of the United Nations Secretariat exempt from the federal excise taxes?

FACTS

Members of the United Nations Secretariat are employed and paid by the United Nations. The Secretary-General, Under Secretaries-General, Assistant Secretaries-General, and officials of equivalent rank, their spouses, and their minor children, have the privileges and immunities, exemptions and facilities accorded to diplomatic envoys in accordance with international law.

LAW AND ANALYSIS

Rev. Rul. 73-198, 1973-1 C.B. 425, relates to the exemptions from Federal excise taxes with respect to foreign diplomatic and consular officers, and other nondiplomatic officers, agencies and commissions of foreign governments. The revenue ruling concludes that exemptions from certain excise taxes are extended to officers of missions to the United Nations serving in a representative capacity and to family members living with such officers.

Rev. Rul. 75-203, 1975-1 C.B. 336, states that observers to the United Nations are not officers of missions to that organization, nor do they come within the exempt category of nondiplomatic officers, agencies and commissions of foreign governments, since the United Nations observers are not in this country to conduct working relationships with American individuals or organizations on behalf of their home governments. Accordingly, the exemptions from the Federal excise taxes referred to in Rev. Rul. 73-198 do not apply to permanent observers to the United Nations.

Members of the United Nations Secretariat are not officers of missions to that organization, nor do they come within the exempt category of nondiplomatic officers, agencies and commissions of foreign governments, because the members of the Secretariat are not in this country to conduct working relationships with American individuals or organizations on behalf of their home governments.

HOLDING

The exemptions from the federal excise taxes referred to in Rev. Rul. 73-198 do not apply to members of the United Nations Secretariat. However, the exemptions from the federal excise taxes referred to in Rev. Rul. 73-198 apply to the Secretary-General of the United Nations, Under Secretaries-General, Assistant Secretaries-General of the United Nations, and officials of equivalent rank who possess diplomatic privileges and immunities.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 73-198 is amplified.

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26 CFR 48.4061(b)-2: Definition of parts or accessories.

Cranes installed on trucks; job-site operations. The tax imposed by section 4061 does not apply to sales of certain mast and boom type cranes having lifting capacity of 5,000 or 6,000 pounds that are mounted on small trucks and designed for job-site operations rather than for typical loading or unloading duties.

Rev. Rul. 80-90

ISSUE

Does the manufacturers excise tax on automotive parts or accessories apply to sales of certain cranes designed to be mounted on trucks?

FACTS

The cranes are of the mast and boom type, and are normally mounted on small trucks in the right rear corner of the body to perform lifting operations at field locations and job-sites. The cranes have lifting capacities of 5,000 or 6,000 pounds, and are available with fixed boom lengths from 9 to 20 feet. They are driven by a truck or carrier battery which provides 30 to 80 minutes of operation. Further, they have a winch speed from 2 to 30 feet per minute, a rotation speed of ½ to 1 revolution per minute, and an elevation speed from 2 to 25 feet per minute. Some of the cranes have equipment to eliminate any "creep" in the hold positions and other equipment to prevent operation of more than one function at a time. The cranes have current selling prices of $4,000 to $7,000.

The lifting capacity of the cranes enables them to lift articles which are too heavy to be transported by the trucks on which the cranes are mounted. In addition, the available load space within the truck body prevents placing such articles on the truck.

LAW AND ANALYSIS

Section 4061(b)(1) of the Internal Revenue Code imposes a manufacturers excise tax on the sale of automotive parts or accesories.

Section 48.4061(b)-2(a) of the Manufacturers and Retailers Excise Tax Regulations provides that the term "parts or accessories" includes (1) any article the primary use of which is to improve, repair, replace, or serve as a component part of an automobile truck chassis or body, (2) any article designed to be attached to or used in connection with such chassis or body to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such chassis or body, whether or not essential to its operation or use.

Section 48.4061(b)-2(a) of the regulations provides further that an article is not a taxable part or accessory even though it is designed to be attached to the vehicle or to be primarily used with it if the article is the load being transported and the primary function of the article is to serve a purpose unrelated to the vehicle as such. On the other hand, an article such as loading or unloading equipment designed to be attached to or to be primarily used with a truck is a taxable part or accessory inasmuch as it contributes to the load-carrying function of the truck.

Rev. Rul. 75-88, 1975-1 C.B. 341, sets forth an administrative test to assist in determining the taxability of cranes of the mast and boom type. In applying this test, it will be presumed that cranes of such type that (1) measure 25 feet or less is extended horizontal reach, from the center line of the mast, without readily removable extensions, and (2) can be mounted on trucks for use in loading or unloading such trucks, are articles that are designed and primarily used for loading and unloading such trucks. Therefore, the tax imposed by section 4061 (b)(1) of the Code would apply to such cranes. However, the presumption established by this test is rebuttable if it can be established that such determination is inconsistent with section 48.4061(b)-2(a) of the regulations.

Rev. Rul. 79-192, 1979-1 C.B. 340, concluded that an article is a part or accessory under section 48.4061(b)-2(a) of the regulations only if it contributes as much or more to the highway transportation function than to the non-transportation function. In other words, an item which contributes primarily to the non-highway transportation function of the vehicle is not taxable.

The cranes in question measure less than 25 feet in extended horizontal reach and can be mounted on trucks for use in loading or unloading the trucks. Thus, the cranes meet (1) and (2) of the test set forth in Rev. Rul. 75-88 and are presumed to be taxable.

However, such determination is inconsistent with section 48.4061(b)-2(a) of the regulations because the cranes are primarily designed for job-site operations rather than as typical loading and unloading cranes. Loading and unloading cranes for small trucks typically have lifting capacities of 1,000 to 2,000 pounds; articulating, folding or extendable booms; a hydraulic pump power source which permits an indefinite work cycle; faster winch speeds of 60 to 120 feet per minute; faster rotation speeds of 2 to 3 revolutions per minute; faster elevation speeds of 30 to 50 feet per minute; and current selling prices as low as $600 to $700.

HOLDING

The presumption of taxability established under Rev. Rul. 75-88 is rebutted with respect to these cranes. Accordingly, the tax imposed by section 4061(b)(1) of the Code on automotive parts or accessories does not apply to sales of the described cranes.

Section 4063.—Exemptions

Buses used by a church for various activities; automobile bus bodies and chassis no longer subject to manufacturers excise tax on and after December 1, 1978. See Rev. Rul. 80-88, page 9.

Guidelines provided whereby manufacturers of automotive parts or accessories and purchasers thereof may register to sell and purchase taxable articles tax-free for resale with light-duty trucks. See Rev. Proc. 80-9, page 20.

Section 4071.—Imposition of Tax [Tires and Tubes]

26 CFR 48.4071-1: Imposition and rates of tax.

Whether manufacturers excise tax applies to articles sold to members of the United Nations Secretariat. See Rev. Rul. 80-89, page 10.

Section 4081.—Imposition of Tax [Gasoline]

26 CFR 48.4081-1: Imposition and rates of tax.

Whether manufacturers excise tax applies to articles sold to members of the United Nations Secretariat. See Rev. Rul. 80-89, page 10.

Section 4091.—Imposition of Tax [Lubricating Oil]

26 CFR 48.4091-1: Tax on lubricating oils.

Whether manufacturers excise tax applies to articles sold to members of the United Nations Secretariat. See Rev. Rul. 80-89, page 10.

Section 4161.—Imposition of Tax [Sporting Goods]

26 CFR 48.4161(a)-1: Imposition and rate of tax; fishing equipment.

Whether manufacturers excise tax applies to articles sold to members of the United Nations Secretariat. See Rev. Rul. 80-89, page 10.

Section 4181.—Imposition of Tax [Firearms]

26 CFR 48.4181-1: Imposition and rates of tax.

Whether manufacturers excise tax applies to articles sold to members of the United Nations Secretariat. See Rev. Rul. 80-89, page 10.

Section 4221.—Certain Tax-Free Sales

26 CFR 48.4221-6: Tax-free sales of articles to nonprofit educational organizations.

Whether manufacturers excise tax exemption for nonprofit educational organizations applies to fuels and articles sold to a church for use with buses that provide transportation in connection with various activities. Also, applicability of exemption for bus parts or accessories and tires sold for use in a "qualified bus." See Rev. Rul. 80-88, page 9.

Section 4251.—Imposition of Tax [Communications]

26 CFR 49.4251-1: Imposition of tax.

Whether federal communications excise tax applies to amounts paid for communications services or facilities furnished to members of the United Nations Secretariat. See Rev. Rul. 80-89, page 10.

Section 4371.—Imposition of Tax [Policies Issued by Foreign Insurers]

26 CFR 46.4371-2: Imposition of tax on policies issued by foreign insurers; scope of tax.

Whether the tax on policies issued by foreign insurers applies to members of the United Nations Secretariat. See Rev. Rul. 80-89, page 10.

Section 4481.—Imposition of Tax [Tax on Use of Certain Vehicles]

26 CFR 41.4481-1: Imposition of tax.

Whether the highway use tax applies to vehicles registered in the name of members of the United Nations Secretariat. See Rev. Rul. 80-89, page 10.

Section 6011.—General Requirement of Return, Statement or List

Printing of substitutes for Form W-2, Wage and Tax Statement; Form W-2P, Statement for Recipients of Periodic Annuities, Pensions, Retired Pay or IRA Payments; and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 80-10, page 20.

Section 6041.—Information at Source

26 CFR 1.6041-1: Return of information as to payments of $600 or more.

Printing of substitutes for Form W-2, Wage and Tax Statement; Form W-2P, Statement for Recipients of Periodic Annuities, Pensions, Retired Pay or IRA Payments; and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 80-10, page 20.

Section 6047.—Information Relating to Certain Trusts and Annuity and Bond Purchase Plans

26 CFR 1.6047-1: Information to be furnished with regard to employee retirement plan covering an owner-employee.

Printing of substitutes for Form W-2, Wage and Tax Statement; Form W-2P, Statement for Recipients of Periodic Annuities, Pensions, Retired Pay or IRA Payments; and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 80-10, page 20.

Section 6051.—Receipts for Employees

26 CFR 31.6051-1: Statements for employees.

Printing of substitutes for Form W-2, Wage and Tax Statement; Form W-2P, Statement for Recipients of Periodic Annuities, Pensions, Retired Pay or IRA Payments; and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 80-10, page 20.

26 CFR 31.6051-2: Information returns on Form W-3 and Social Security Administration copies of Forms W-2.

Printing of substitutes for Form W-2, Wage and Tax Statement; Form W-2P, Statement for Recipients of Periodic Annuities, Pensions, Retired Pay or IRA Payments; and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 80-10, page 20.

Section 6071.—Time for Filing Returns and Other Documents

26 CFR 31.6071(a)-1: Time for filing returns and other documents.

Printing of substitutes for Form W-2, Wage and Tax Statement; Form W-2P, Statement for Recipients of Periodic Annuities, Pensions, Retired Pay or IRA Payments; and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 80-10, page 20.

Section 6081.—Extension of Time for Filing Returns

26 CFR 31.6081(a)-1: Extensions of time for filing returns and other documents.

Printing of substitutes for Form W-2, Wage and Tax Statement; Form W-2P, Statement for Recipients of Periodic Annuities, Pensions, Retired Pay or IRA Payments; and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 80-10, page 20.

Section 6091.—Place for Filing Returns or Other Documents

Printing of substitutes for Form W-2, Wage and Tax Statement; Form W-2P, Statement for Recipients of Periodic Annuities, Pensions, Retired Pay or IRA Payments; and Form W-3, Transmittal of Income and Tax Statements. See Rev. Proc. 80-10, page 20.

Section 6411.—Tentative Carryback and Refund Adjustments

26 CFR 5.6411-1: Tentative refund under claim of right adjustment.

T.D. 7672

TITLE 26.—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER A, PART 5.—TEMPORARY INCOME TAX REGULATIONS UNDER THE REVENUE ACT OF 1978

Tentative Refund Under Claim of Right Adjustment

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains a temporary regulation that prescribes the rules for applying for a tentative refund under a claim of right adjustment. Changes to the applicable tax law were made by the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1].

DATE: The regulation applies to applications for tentative refund filed after November 5, 1978.

FOR FURTHER INFORMATION CONTACT: Richard L. Mull of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention CC:LR:T (202-566-3458, not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains a temporary regulating to applications for a tentative refund ("quick" refund) under a claim of right adjustment. The temporary regulation prescribes the method of applying for the "quick" refund and indicates the information that must be contained in the application.

Section 6411(d) of the Code (as added by section 504 of the Revenue Act of 1978) establishes a "quick" refund procedure for an overpayment of tax under section 1341(b)(1). The procedure is similar to that available under section 6411(a) for tentative carryback adjustments. Under new section 6411(d), the Internal Revenue Service must review an application, determine the amount of the overpayment, and apply, credit, or refund the overpayment to the taxpayer within 90 days after the application is filed (or, if later, within 90 days after the last day of the month in which the tax return for the year the overpayment occurs must be filed, including extensions).

Taxpayers are not required to use the "quick" refund procedure but may continue to use the normal procedure under section 6402 for obtaining a refund or credit of an amount treated as an overpayment under section 1341 (b)(1). For refunds not required to be reported to the Joint Committee on Taxation, refunds under the normal procedure will be as effective as under the "quick" refund procedure.

The temporary regulation prescribes the method of applying for the "quick" refund. For corporations, the application must be filed on Form 1139. For other taxpayers, the application must be filed on Form 1045. Special rules apply for applications filed before February 7, 1980. The regulation also indicates the time and place for filing.

The application must contain certain information necessary to make the computation under section 1341(b) (1). The application is not a claim for credit or refund in determining whether a claim was filed timely under section 6511.

DRAFTING INFORMATION

The principal author of this regulation is Richard L. Mull of the Legislation and Regulations Division of the office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

WAIVER OF CERTAIN PROCEDURAL REQUIREMENTS

A determination has been made by Jerome Kurtz, Commissioner of Internal Revenue, that there is need for immediate guidance to enable taxpayers to file applications for tentative refunds under a claim of right adjustment. This is because section 6411(d) is effective for applications filed after November 5, 1978, and because the application must be made in the manner prescribed by regulations. Because of the immediate need for this regulation, compliance with the procedural requirements of paragraph 8 through 14 of the final Treasury directive (43 FR 52120), relating to improving regulations, would be impracticable and, therefore, these requirements have not been followed.

Adoption of regulation

Accordingly, 26 CFR Part 5 is amended by adding a new section 5.6411-1, to read as follows:

§ 5.6411-1 Tentative refund under claim of right adjustment.

(a) *Effective date.* This section applies to applications for tentative refunds filed after November 5, 1978, under section 6411(d).

(b) *In general.* Section 6411(d) allows taxpayers to apply for a tentative refund of amounts treated under section 1341(b)(1) as an overpayment of tax under a claim of right adjustment. This section contains rules for filing an application for this tentative refund. The computation of amounts treated as an overpayment must be made in accordance with section 1341 and the regulations under that section.

(c) *Method of applying for tentative refund*—(1) *In general.* For a corporation, the application is made by filing Form 1139. For taxpayers other than corporations, the application is made by filing Form 1045. The application must be made by filing those forms even if the taxpayer is not applying for a tentative carryback adjustment under section 6411(a). If the taxpayer files the form to apply for the section 6411(d) tentative refund only, it may disregard those lines on the form used to compute the section 6411(a) carryback adjustment. If the taxpayer has a carryback of a net operating loss, credit, or capital loss for the taxable year (determined without the deduction described in section 1341(a)(2)) and applies for both the section 6411(a) tentative carryback adjustment and the section 6411(d) tentative refund, an ordering rule applies. The taxpayer must take into account any adjustments made in applying for the tentative carryback adjustment under section 6411(a) before determining the amount of the overpayment for which an application under section 6411(d) is being made. The taxpayer must attach to the form a separate schedule containing the information required under paragraph (d) of this section.

(2) *Applications made before February 7, 1980.* Applications made before February 7, 1980 that are made under penalties of perjury will be considered meeting the requirements of this section if made by filing a separate statement whether or not it is attached to Form 1139 or 1045. This application, however, must contain the information required under paragraph (d) of this section (other than paragraph (d)(2)).

(d) *Information required*—(1) *In general.* The application must contain (i) the taxpayer's name, address, and identification number and (ii) the information set forth in paragraph (d)(2) and (3) of this section, determined in accordance with section 1341 and the regulations under that section. For example, the decrease in tax under paragraph (d)(3)(iii) of this section is determined under § 1.1341-1(d)(4).

(2) *Computation under section 1341(a)(4).* The application must contain the following information related to the computation under section 1341(a)(4):

(i) The amount of income restored by the taxpayer to another during the taxable year and the amount of the corresponding deduction described in section 1341(a)(2);

(ii) The tax for the taxable year computed with the deduction described in section 1341(a)(2); and

(iii) The tax for each prior taxable year (determined before adjustment under section 1341) to which any net operating loss described in section 1341(b)(4)(A) must be carried and the decrease in tax for each of those years that results from the carryback of that loss.

(3) *Computation under section 1341(a)(5).* The application must contain the following information related to the computation under section 1341(a)(5):

(i) The tax for the taxable year without the deduction described in section 1341(a)(2);

(ii) The tax for each prior taxable year (determined before adjustment under section 1341) for which a decrease in tax is computed under section 1341(a)(5)(B);

(iii) The decrease in tax for each prior taxable year computed under section 1341(a)(5)(B), including any decrease resulting from a net operating loss or capital loss described in section 1341(b)(4)(B); and

(iv) The amount treated as an overpayment of tax under section 1341(b)(1).

(e) *Time and place for filing.* The application must be filed no earlier than the date of filing the return for the taxable year of restoration and no later than the date 12 months from the last day of that taxable year. The application must be filed with the Internal Revenue Service Center (or other office) where the taxpayer filed its return for the taxable year of restoration.

(f) *Not a claim for credit or refund.* An application for tentative refund under section 6411(d) is not a claim for credit or refund. The principles of paragraph (b)(2) of § 1.6411-1 apply in determining the effect of an application for a tentative refund. For example, the filing of an application for tentative refund under section 6411(d) is not a claim for credit or refund in determining whether a claim for credit or refund was timely filed.

There is need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in sections

6411(d)(1) and 7805 of the Internal Revenue Code of 1954 (92 Stat. 2880; 26 U.S.C. 6411(d)), (68A Stat. 917; 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved January 24, 1980.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on February 6, 1980, 8:45 a.m., and published in the issue of the Federal Register for February 7, 1980, 45 F.R. 8295)

Section 6421.—Gasoline Used for Certain Nonhighway Purposes or by Local Transit Systems

Applicability of the exemption for gasoline used in school buses to gasoline used by a church in buses that provide transportation in connection with various activities. See Rev. Rul. 80-88, page 9.

Section 6424.—Lubricating Oil Used for Certain Nontaxable Purposes

Whether the exemption for lubricating oil used in a "qualified bus" applies to lubricating oil used by a church in buses that provide transportation in connection with various activities. See Rev. Rul. 80-88, page 9.

Section 6427.—Fuels Not Used for Taxable Purposes

Applicability of the exemption for special fuels used in school buses to fuels used by a church in buses that provide transportation in connection with various activities. See Rev. Rul. 80-88, page 9.

Section 7602.—Examination of Books and Witnesses

26 CFR 301.7602-1: Examination of books and witnesses.

Ct. D. 1999

SUPREME COURT
OF THE
UNITED STATES
No. 78-1453

United States et al., Petitioners,
v. Harvey F. Euge

[444 U.S.]

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

[February 20, 1980]

Syllabus

No. 78-1453. Argued November 26, 1979—Decided February 20, 1980

Section 7602 of the Internal Revenue Code of 1954 authorizes the Internal Revenue Service to summon individuals to "appear," and "to produce such books, papers, records, or other data, and to give testimony," as may be relevant to a tax investigation. During an investigation of respondent's income tax liability, in an effort to determine whether deposits in certain bank accounts not registered in respondent's name represented income attributable to him, an IRS agent issued a summons requiring respondent to appear and execute handwriting exemplars of the various signatures appearing on the bank signature cards. When respondent refused to comply with the summons, the United States brought suit to enforce it. The District Court held that the summons should be enforced, but the Court of Appeals reversed, holding that the summons authority under § 7602 does not authorize the IRS to compel the execution of handwriting exemplars.

Held: The IRS is empowered to compel handwriting exemplars under its summons authority conferred by § 7602.

(a) While § 7602's language may not be explicit in authorizing handwriting exemplars, the duty to appear and give testimony has traditionally encompassed a duty to provide some forms of nontestimonial, physical evidence, including handwriting exemplars. By imposing an obligation to produce documents as well as to appear and give testimony, § 7602's language suggests an intention to codify a broad testimonial obligation, including an obligation to provide some physical evidence relevant and material to a tax investigation. From this authority to compel the production of some physical evidence, it can properly be concluded that the authority extends to the execution of handwriting exemplars, one variety of physical evidence.

(b) This Court has consistently construed congressional intent to require that if the claimed summons authority is necessary for the effective performance of congressionally imposed responsibilities to enforce the Internal Revenue Code, that authority should be upheld absent express statutory prohibition or substantial countervailing congressional policies.

(c) The authority claimed here is necessary for the effective exercise of the IRS's enforcement responsibilities. Handwriting exemplars are often an important evidentiary component in establishing tax liability, the use of such exemplars being an effective method for determining whether a particular name is an alias of a taxpayer.

(d) Moreover, the authority claimed here is entirely consistent with the statutory language and is not in derogation of any countervailing policies or any constitutional rights, compulsion of handwriting exemplars being neither a search or seizure subject to Fourth Amendment protections nor testimonial evidence protected by the Fifth Amendment privilege against self-incrimination.

587 F. 2d 25, reversed.

Rehnquist, J., delivered the opinion of the Court, in which Burger, C. J., and Stewart, White, Blackmun, and Powell, JJ., joined. Brennan, J., filed a dissenting opinion, in which Marshall and Stevens, JJ., joined. Marshall, J., filed a dissenting opinion.

Mr. Justice Rehnquist delivered the opinion of the Court.

The United States sued in the District Court seeking enforcement of an Internal Revenue Service summons requiring respondent to appear and provide handwriting exemplars. Enforcement was denied by the Court of Appeals for the Eighth Circuit, *United States v. Euge,* 587 F.2d 25 (CA8 1978) (en banc), and we granted certiorari.[1] We now hold that Congress has empowered the IRS to compel handwriting exemplars under its summons authority conferred by 26 U.S.C. § 7602.

I

The facts are not in dispute. In October 1977, an agent in the Intelligence Division of the Internal Revenue Service was assigned to investigate respondent's income tax liability for the years 1973 through 1976. Respondent had not filed any tax returns for those years. The Service sought to employ the "bank deposits method" of reconstructing respondent's income for those years as a means of calculating his tax liability. Under this method of proof, the sums deposited in the taxpayer's bank accounts are scrutinized to determine whether they represent taxable income.

During the course of the investigation, the agent found only two bank accounts registered in respondent's name. Twenty other bank accounts were discovered, however, which the agent had reason to believe were being maintained by respondent under aliases to conceal taxable income. The statements for these accounts were sent to post office boxes held in respondent's name; the signature cards for the accounts listed addresses of properties owned by respondent; and the agent had documented frequent transfers of funds between the accounts.

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[1] The Fourth Circuit reached a contrary result in *United States v. Rosinsky,* 547 F. 2d 249 (CA4 1977). The Sixth Circuit decided this issue in accord with the Eighth Circuit. *United States v. Brown,* 536 F. 2d 117 (CA6 1976).

In an effort to determine whether the sums deposited in these accounts represented income attributable to respondent, the agent issued a summons on October 7, 1977, requiring respondent to appear and execute handwriting exemplars of the various signatures appearing on the bank signature cards. Respondent declined to comply with the summons.

The United States commenced this action under 26 U.S.C. § 7604(a). The District Court held that the summons should be enforced, ordering respondent to provide 10 handwriting exemplars of eight different signatures. The Court of Appeals reversed, ruling that the summons authority vested in the Internal Revenue Service under 26 U.S.C. § 7602 does not authorize the IRS to compel the execution of handwriting exemplars.[2]

II

The structure and history of the statutory authority of the Internal Revenue Service to summon witnesses to produce evidence necessary for tax investigations has been repeatedly reviewed by this Court in recent years. See *Reisman* v. *Caplin,* 375 U.S. 440 (1964) [1964-1 C.B. (Part 1) 517]; *United States* v. *Powell,* 379 U.S. 48 (1964) [1965-1 C.B. 547]; *Donaldson* v. *United States,* 400 U.S. 517 (1971) [1971-1 C.B. 416]; *United States* v. *Bisceglia,* 420 U.S. 141 (1975) [1975-1 C.B. 379]; *Fisher* v. *United States,* 425 U.S. 391 (1976) [1976-1 C.B. 411]; *United States* v. *LaSalle National Bank,* 437 U.S. 298 (1978) [1978-2 C.B. 336]. Under § 7602, the Secretary of the Treasury, and therefore the IRS as his designate,[3] is authorized to summon individuals to "appear before the Secretary . . . and to produce such books, papers, records, or other data, and to give testimony, under oath, as may be relevant or material to such inquiry. . . ."[4] The question presented here is whether this power to compel a witness to "appear," to produce "other data," and to "give testimony," includes the power to compel the execution of handwriting exemplars. We conclude that it does, for several reasons. While the language may not be explicit in its authorization of handwriting exemplars, the duty to appear and give testimony, a duty imposed by § 7602, has traditionally encompassed a duty to provide some forms of non-testimonial, physical evidence, including handwriting exemplars. Further, this Court has consistently construed congressional intent to require that if the summons authority claimed is necessary for the effective performance of congressionally imposed responsibilities to enforce the tax code, that authority should be upheld absent express statutory prohibition or substantial countervailing policies. The authority claimed here is necessary for the effective exercise of the Service's enforcement responsibilities; it is entirely consistent with the statutory language; and it is not in derogation of any constitutional rights or countervailing policies enunciated by Congress.

A

Through § 7602, Congress has imposed a duty on persons possessing information "relevant or material" to an investigation of federal tax liability to produce that information at the request of the Secretary or his delegate. That duty to provide relevant information expressly obligates the person summoned to produce documentary evidence and to "appear" and "give testimony." Imposition of such an evidentiary obligation is, of course, not a novel innovation attributable to § 7602. The common law has been the source of a comparable evidentiary obligation for centuries. In determining the scope of the obligation Congress intended to impose by use of this language, we have previously analogized, as an interpretive guide, to the common-law duties attaching to the issuance of a testimonial summons. See *United States* v. *Bisceglia,* 420 U.S. 141, 147-148 (1975); *United States* v. *Powell,* 379 U.S. 48, 57 (1964). Congress, through legislation, may expand or contract the duty imposed,[5] but absent some contrary expression, there is a wealth of history helpful in defining the duties imposed by the issuance of a summons.

The scope of the "testimonial"[6] or evidentiary duty imposed by common law or statute has traditionally been interpreted as an expansive duty limited principally by relevance and privilege. As this Court described the contours of the duty in *United States* v. *Bryan,* 339 U.S. 323, 331 (1950): "[P]ersons summoned as witnesses by competent authority have certain minimum duties and obligations which are necessary concessions to the public interest in the orderly operation of legislative and judicial machinery. . . . We have often iterated the importance of this public duty, which every person within the jurisdiction of the Government is bound to perform when properly summoned." While the Court recognized that certain exemptions would be upheld, the "primary assumption" was that a summoned party must "give what testimony one is capable of giving" absent an exemption "grounded in a substantial individual interest which has been found, through centuries of experience, to outweigh the public interest in the search for truth." *Ibid.*

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[2] The precise reasons for the Court's holding are not clear. In the opinion, the Court suggests that the statute does not authorize the IRS to compel a taxpayer to create evidence "out of thin air." 587 F. 2d, at 27, n. 3. The opinion also states, however, that it adopts the views expressed in the dissenting opinion in *United States* v. *Campbell,* 525 F. 2d 604 (CA8 1975). The principal reason forwarded in that decision for declining to construe § 7602 to authorize production of handwriting exemplars was the conclusion that such an order would constitute a seizure in violation of the Fourth Amendment. Neither rationale supports the conclusion reached by the Court of Appeals.

[3] Responsibility for administration and enforcement of the revenue laws is vested in the Secretary of the Treasury. 26 U. S. C. § 7801(a). The Internal Revenue Service, however, is organized to carry out those responsibilities for the Secretary. See *Donaldson* v. *United States, supra,* 400 U. S., at 534; 35 Fed. Reg. 2417 *et seq.* (1970). For the purposes of this opinion, we refer to the authority and responsibilities of the Secretary and the Service interchangeably.

[4] "SEC. 7602. Examination of Books and Witnesses.

"For the purpose of ascertaining the correctness of any return, making a return where none has been made, determining the liability of any person for any internal revenue tax or the liability at law or in equity of any transferee or fiduciary of any person in respect of any internal revenue tax, or collecting any such liability, the Secretary or his delegate is authorized—

"(1) To examine any books, papers, records, or other data which may be relevant or material to such inquiry;

"(2) To summon the person liable for tax or required to perform the act, or any officer or employee of such person, or any person having possession, custody, or care of books of account containing entries relating to the business of the person liable for tax or required to perform the act, or any other person the Secretary may deem proper, to appear before the Secretary or his delegate at a time and place named in the summons and to produce such books, papers, records, or other data, and to give such testimony, under oath, as may be relevant or material to such inquiry; and

"(3) To take such testimony of the person concerned, under oath, as may be relevant or material to such inquiry."

[5] Legislative efforts to *expand* the scope of the testimonial obligation would, of course, be limited by the applicable constitutional guarantees.

[6] The word "testimony" has been used loosely in this context to refer to physical and documentary, as well as oral, evidence. See 8 Wigmore on Evidence § 2194, at 76 (McNaughton Rev. 1961).

One application of this broad duty to provide relevant evidence has been the recognition, since early times, of an obligation to provide certain forms of nontestimonial physical evidence.[7] In *Holt* v. *United States,* 218 U.S. 245, 252-253 (1910) (Holmes, J.) the Court found that the common-law evidentiary duty permitted the compulsion of various forms of physical evidence. In *Schmerber* v. *California,* 384 U.S. 757, 764 (1966), this Court observed that traditionally witnesses could be compelled, in both state and federal courts, to submit to "fingerprinting, photographing, or measurements, to write or speak for identification, to appear in court, to stand, to assume a stance, to walk, or to make a particular gesture." See also *United States* v. *Wade,* 388 U.S. 218 (1967). In *Gilbert* v. *California,* 388 U.S. 263, 266-267 (1967), handwriting was held, "like the body itself" to be an "identifying physical characteristic," subject to production. In *United States* v. *Dionisio,* 410 U.S. 1 (1973), and *United States* v. *Mara,* 410 U.S. 19 (1973), this Court again confirmed that handwriting is in the nature of physical evidence which can be compelled by a grand jury in the exercise of its subpoena power. See also *United States* v. *Mullaney,* 32 Fed. 370 (CC Mo. 1887).

This broad duty to provide most relevant, nonprivileged evidence has not been considered to exist only in the common law. The Court has recognized that by statute "Congress may provide for the performance of this duty." *Blackmer* v. *United States,* 284 U.S. 421, 438 (1932). By imposing an obligation to produce documents as well as to appear and give testimony, we believe the language of § 7602 suggests an intention to codify a broad testimonial obligation, including an obligation to provide some physical evidence relevant and material to a tax investigation, subject to the traditional privileges and limitations. This conclusion seems inherent in the imposition of an obligation to "appear," since an obligation to appear necessarily entails an obligation to display physical features to the summoning authority. Congress thereby authorized the Service to compel the production of some physical evidence and it is certainly possible to conclude that this authorization extended to the execution of handwriting exemplars, one variety of relevant physical evidence. This construction of the language conforms with the historical notions of the testimonial duty attaching to the issuance of a summons.[8]

B

Congress certainly could have narrowed the common-law testimonial duty in enacting § 7602 and thus we do not rely solely on the common-law meaning of the statutory language. Section 7602 does not, by its terms, compel the production of handwriting exemplars, and therefore, a narrower interpretation of the duty imposed is not precluded by the actual language of the statute. A narrower interpretation *is* precluded, however, by the precedents of this Court construing that statute. As early as 1911, this Court established the benchmarks for interpreting the authority of the Internal Revenue Service to enforce tax obligations in holding that, "the administration of this statute may well be taken to embrace all appropriate measures for its enforcement, [unless] there is . . . substantial reason for assigning to the phrase[s] . . . a narrower interpretation." *United States* v. *Chamberlin,* 219 U.S. 250, 265 (1911). This precise mode of construction has consistently been applied by this Court in construing the breadth of the summons authority Congress intended to confer in § 7602. In *United States* v. *Powell,* 379 U.S. 48 (1964), the Court declined to construe § 7605(b), prohibiting the Secretary from conducting "unnecessary examinations," to require probable cause for the issuance of a § 7602 summons. The Court found that "although a more stringent interpretation is possible, one which would require some showing of cause for suspecting fraud, we reject such an interpretation because it might seriously hamper the Commissioner in carrying out investigations he thinks warranted. . . ." *Id.,* at 53-54. In *Donaldson* v. *United States,* 400 U.S. 517 (1917), the Court refused to hold that the summons authority could not be used whenever there was a potential that the civil investigation might later lead to criminal prosecution. In construing the scope of the summons authority, the Court emphasized that it refused to draw the line in a manner that would "stultify enforcement of federal law." *Id.,* at 536. Finally, in *United States* v. *Bisceglia,* 420 U.S. 141 (1975), the Court upheld the Service's authority to issue a John Doe summons to a bank in order to discover the identity of an individual unknown to the Service. The Court reasoned that absent that construction, "no meaningful investigation of such events could be conducted" and thus "settled principles of statutory interpretation require that we avoid such a result absent unambiguous directions from Congress." *Id.,* at 150. There is thus a formidable line of precedent construing congressional intent to uphold the claimed enforcement authority of the Service if such authority is necessary for the effective enforcement of the revenue laws and is not undercut by contrary legislative purposes.[9]

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[7] Wigmore has identified the testimonial duty as including an obligation "to disclose for the purpose of justice all that is in his control which can serve the ascertainment of the truth, [and] this duty includes not only mental impressions preserved in his brain and the documents preserved in his hands, but also the corporal facts existing on his body." 8 Wigmore on Evidence § 2194, at 76 (McNaughton Rev. 1961).

[8] As indicated elsewhere, we do not suggest that the evidentiary obligation codified in § 7602 in all respects conforms to the common law. We rely on the analogy only as one interpretive *guide.*

Applying these principles, we conclude that Congress empowered the Service to seek, and obliged the witness to provide handwriting exemplars relevant to the investigation. First, there is no question that handwriting exemplars will often be an important evidentiary component in establishing tax liability. The statutory framework, as reviewed in the numerous precedents recited, *supra,* imposes on the Secretary of Treasury, and the IRS as his designate, a broad duty to enforce the tax laws. 26 U.S.C. § 7601(a). Congress has legislated that the Secretary is "required to make the inquiries, determinations, and assessments of all taxes . . . imposed by this title. . . ." 26 U.S.C. § 6201(a). Under § 6301 the Secretary "shall collect taxes imposed by the Internal Revenue laws." In order to fulfill these duties, the Service will often need to determine whether a particular name is an alias of a taxpayer. One effective method for resolving that issue is through the use of handwriting exemplars.[10] As we recognized in *Bisceglia,* the IRS does have a need for investigative devices which assist them in ascertaining the identity of tax evaders. In *Bisceglia,* we held, in language relevant to this case, that:

> "[I]f criminal activity is afoot the persons involved may well have used aliases or taken other measures to cover their tracks. Thus, if the Internal Revenue Service is unable to issue a summons to determine the identity of such persons, the broad inquiry authorized by § 7601 will be frustrated in this class of cases. Settled principles of statutory interpretation require that we avoid such a result absent unambiguous directions from Congress." 420 U.S., at 150.

There is certainly nothing in the statutory language,[11] or in the legislative history,[12] precluding the interpretation asserted by the Service. Nor is there any constitutional privilege of the taxpayer or other parties that is violated by this construction. Compulsion of handwriting exemplars is neither a search or seizure subject to Fourth Amendment protections, *United States* v. *Mara, supra,* nor testimonial evidence protected by the Fifth Amendment privilege against self-incrimination. *Gilbert* v. *California,* 388 U.S. 263 (1967). The compulsion of handwriting exemplars has been the subject of far less protection than the compulsion of testimony and documents.[13] Since Congress has explicitly established an obligation to provide the more protected forms of evidence, it would seem curious had it chosen not to impose an obligation to produce a form of evidence tradition has found it less important to protect.[14]

As we have emphasized in other cases dealing with § 7602 proceedings, the summoned party is entitled to challenge the issuance of the summons in an adversary proceeding in federal court prior to enforcement, and may assert appropriate defenses. See *Bisceglia, supra,* 420 U.S., at 151. The Service must also establish compliance with the good-faith requirements recognized by this Court, *United States* v. *LaSalle National Bank,* 437 U.S. 298, 318 (1978), and with the requirement of § 7605(b) that "no taxpayer shall be subjected to unnecessary examination or investigations. . . ." These protections are quite sufficient to lead us to refuse to strain to imply additional ones from the neutral language Congress has used in § 7602.

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[9] Congressional intent to provide the Secretary with broad latitude to adopt enforcement techniques helpful in the performance of his tax collection and assessment responsibilities is expressed throughout the Act. In § 6302, for example, Congress has conferred the Secretary with discretion to devise methods of tax collection not specifically provided by statute:

"Whether or not the method of collecting any tax imposed . . . is specifically provided for by this title, any such tax may . . . be collected by . . . other reasonable devices or methods as may be necessary or helpful in securing a complete and proper collection of the tax."

[10] The United States suggests there are numerous uses of handwriting exemplars helpful to the Service. Not only are they useful in identifying the holder of a bank account, but they are also said to be useful for identifying persons who file multiple tax returns under false names claiming income tax refunds, purchase of money orders under false names, and forgery of joint returns to take advantage of lower joint rates.

[11] Respondent argues that the language of § 7602 suggests that it only requires the production of documents already in existence. Since handwriting exemplars must be created by the witness, it is argued that the statute is inapplicable. First, we do not view the exhibition of physical characteristics to be equivalent to the creation of documentary evidence. See *United States* v. *Dionisio,* 410 U. S. 1, 6 (1973). Further, the statute obviously contemplates the transformation of some evidence not formerly tangible, since it obligates the summoned individual to provide testimony. The testimony, of course, creates evidence not previously in existence. We see no difference between the nature of the evidence created when the witness is ordered to talk and that created when he is ordered to write.

We express no opinion on the scope of the Service's authority to otherwise order the witness to generate previously nonexistent documentation under § 7602. The Service in fact has expressly disclaimed any intention to order the creation of documents. The Internal Revenue Manual § 4022.64(4) (1977) provides that an administrative summons:

"should not require the witness to do anything other than to appear on a given date to give testimony and to bring with him/her existing books, papers, and records. A witness cannot be required to prepare or create documents."

The section states, however, that "[t]he giving of exemplars, for example, handwriting exemplars, at an appearance pursuant to a summons is not 'creating a document.' "

[12] The legislative history is simply unilluminating. The only conclusion which that history supports is that Congress did not intend to change the expanse of the § 7602 summons authority by its amendments in 1954. H. R. Rep. No. 1337, 83d Cong., 2d Sess. (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. (1954). Since there are no pre-1954 interpretations of the statute precluding the issuance of handwriting exemplars, the legislative history sheds no light on the construction intended by Congress.

[13] *Gilbert* v. *California,* 388 U. S. 262 (1967), demonstrates the minimal level of protection afforded handwriting exemplars, and the reasons why such protection is unnecessary. The Court found that production of the exemplars was not subject to the Fifth Amendment privilege, and that their creation did not represent a critical stage requiring counsel. The Court found only a "minimal risk that the absence of counsel might derogate from [a] right to a fair trial." *Id.,* at 267. The Court concluded that, "If for some reason, an unrepresentative exemplar is taken, this can be brought out and corrected through the adversary process of trial since the accused can make an unlimited number of additional exemplars for analysis and comparison by government and defense handwriting experts." *Ibid.*

[14] *Palmer* v. *United States,* 530 F. 2d 787 (CA8 1976), similarly construed 28 U. S. C. § 1826(a). That statute authorizes the imposition of contempt on witnesses who refuse to "testify or provide other information." The statute does not explicitly authorize contempt sanctions for refusal to execute handwriting exemplars. The Court found that the legislative history indicated that Congress had intended, through the use of the language employed in the statute, to "codify present civil contempt practice." Since that practice had included the power to punish a witness for refusing to create a handwriting exemplar, the Court reasoned that Congress must have thought this phrasing adequate to cover production of handwriting samples.

We accordingly reverse the judgment of the Court of Appeals refusing enforcement of the summons.

Reversed.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.402: Sales taxes collected by return.
(Also Part I, Section 4063.)

Rev. Proc. 80-9

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide guidelines whereby manufacturers of automotive parts or accessories and purchasers of such articles may register to sell and purchase taxable articles tax free for resale with the first retail sales of light-duty trucks.

SEC. 2. BACKGROUND

Under section 4063(e) of the Internal Revenue Code, the tax on automotive parts or accessories imposed by section 4061(b) does not apply to the sale by the manufacturer, producer, or importer of any article that is to be resold by the purchaser on or in connection with the first retail sale of a light-duty truck, as described in section 4061(a)(2), or that is to be resold by the purchaser to a second purchaser for resale by such second purchaser on or in connection with the first retail sale of a light-duty truck. Section 4063(e) was added by the Revenue Act of 1978, Pub. L. 95-600 (1978), 1978-3 C.B. (Vol. 1) 158, effective December 1, 1978.

Section 4221(c) of the Code provides that, in the case of any article sold free of tax under section 4063(e), if the manufacturer in good faith accepts a certification by the purchaser that the article will be used in accordance with the applicable provisions of law, no tax shall thereafter be imposed under chapter 32 of the code in respect of such sale by such manufacturer. Section 4222(a) provides that section 421 shall not apply with respect to the sale of any article unless the manufacturer, the first purchaser, and the second purchaser (if any) are all registered under this section and that registration shall be made at such time, in such manner and form, and subject to such terms and conditions, as the Secretary or the Secretary's delegate may by regulations prescribe.

Under section 4222(d) of the Code, the provisions of section 4222 regarding registration may be extended to, and made applicable with respect to, the exemption under section 4063(e) to the extent provided by regulations prescribed by the Secretary.

SEC. 3. PROCEDURE

.01 No regulations have yet been prescribed that would make the registration provisions of section 4222 of the Code applicable to section 4063(e). Consequently, registration is not yet required in order to make tax-free sales and purchases under section 4063(e). However, manufacturers and purchasers may register to sell or purchase parts or accessories tax free for resale with the first retail sales of light-duty trucks.

.02 A seller and purchaser may register by filing a Form 637 with the District Director of Internal Revenue for the district in which the principal place of business of the applicant is located (or if there is no principal place of business in the United States, with the Director of International Operations, Internal Revenue Service, Washington, D.C. 20225). The person who receives a validated Certificate of Registry (Validated Form 637) is considered to be registered for purposes of selling or purchasing taxable parts or accessories tax free for resale on or in connection with the first retail sales of light-duty trucks. A purchaser who is registered should furnish to the seller, as evidence in support of each tax-free sale, information that the articles are being purchased for the exempt purpose and should include the registration number of the purchaser. The information should be in writing and may be noted on the purchase order or other document furnished by the purchaser to the seller in connection with the sale.

.03 If, however, the seller and the purchaser do not register for purposes of the exemption under section 4063(e), then for each sale of taxable parts or accessories, the purchaser must furnish an exemption certificate to the seller as evidence that the articles are being purchased for resale on or in connection with the first retail sales of light-duty trucks.

SEC. 4. EFFECTIVE DATE

This revenue procedure is effective on and after December 1, 1978.

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26 CFR 601.602: Forms and instructions.
(Also Part I, Sections 6011, 6041, 6047, 6051, 6071, 6081, 6091; 1.6041-1, 1.6047-1, 31.6051-1, 31.6051-2, 31.6071(a)-1, 31.6081(a)-1.)

Rev. Proc. 80-10

SECTION 1. PURPOSE

.01 The purpose of this Revenue Procedure is to state the requirements of the Internal Revenue Service (IRS) and the Social Security Administration (SSA) relating to substitutes for Form W-2, Wage and Tax Statement, Form W-2P, Statement for Recipients of Periodic Annuities, Pensions, Retired Pay or IRA Payments, and Form W-3, Transmittal of Income and Tax Statements (hereinafter referred to as Forms W-2, W-2P, and W-3). The IRS provides two Form W-2 sets, a six part and a four part. The official Form W-2P is provided as a six part set. The official Form W-3 is provided as a two part set.

.02 Rev. Proc. 79-21, 1979-15 I.R.B. 31, was amended and supplemented by Announcement 79-98, 1979-27 I.R.B. 21. The text of Announcement 79-98 was reflected in Rev. Proc. 79-21, when printed in the 1979-1 C.B. at page 541.

SEC. 2. GENERAL RULES FOR FILING FORMS W-2 AND W-2P

.01 *Employers and payers* (hereafter and where applicable collectively referred to as payers) with computer capability are encouraged to use magnetic media for filing Forms W-2 (Copy A) and W-2P (Copy A) with the SSA. Requests for additional information concerning magnetic media filing should be directed to either the Regional IRS Magnetic Media Coordinator or to the Regional SSA Magnetic Media Coordinator. Since many states and localities accept Forms W-2 and W-2P on magnetic media, savings may be obtained if a similar medium is used for filing with both the SSA and state or local agencies. Magnetic media users can design their own statements to give to employees, pensioners, annuitants, recipients of retired pay, recipients of IRA (Individual Retirement Account) payments, and recipients of disability income (hereafter and where applicable collectively referred to as payees). Statements designed by payers *must* comply with the requirements of Section 5 below.

.02 The following Technical Information Bulletins (TIB) contain the specifications and procedures for filing Forms W-2 (Copy A) and W-2P (Copy A) data on magnetic media directly with SSA:

1 TIB-4a—Magnetic Tape Reporting, "Submitting Wage and Tax Data to Federal and State Agencies" Form W-2 (Copy A);

2 TIB-4b—Magnetic Tape Reporting, "Submitting Annuity, Pension, Retired Pay or IRA Payments to the Federal Government on Magnetic Tape" Form W-2P (Copy A);

3 TIB-4c—Diskette and Disk Cartridge Reporting, "Submitting Wage and Tax Data to the Federal Government on Diskette and Disk Cartridge" Form W-2 (Copy A); and

4 TIB-3—Magnetic Tape Reporting for State and Local Employing Entities, Form W-2 (Copy A).

Copies of these publications are available at any IRS Service Center; IRS District Office; and SSA, (Reports Preparation Section, P.O. Box 2317, Baltimore, Maryland 21203); or by contacting the Regional SSA Magnetic Media Coordinator.

.03 Payers not using magnetic media must file Copy A of Form W-2 or Copy A of Form W-2P with SSA on either an official form or a privately printed substitute paper form meeting the specifications shown below.

.04 Payers using magnetic media are cautioned to obtain the most recent Technical Information Bulletins and supplements due to possible changes in the specifications and procedures.

Sec. 3. General Rules for Filing Form W-3

.01 Employers and payers (hereafter and where applicable collectively referred to as payers) required to file Forms W-2 or W-2P *must* transmit Forms W-2 or W-2P with Form W-3.

.02 Form W-3 must be the same width (i.e., 7 inches, 7.5 inches, or 8 inches) as the Forms W-2 or W-2P filed.

.03 Payers using magnetic media must transmit magnetic media Forms W-2 or W-2P with Form 4804, Annual Summary and Transmittal of Income, Tax, and Information Statements on Magnetic Media, or a facsimile thereof. SSA will provide Form 4804 to all approved magnetic media filers.

Sec. 4. Paper Substitutes for Forms W-2 (Copy A), W-2P (Copy A), and W-3

.01 Paper substitutes conforming to the specifications contained in this revenue procedure may be privately printed without the prior approval of the IRS. Proposed substitutes not conforming totally to these specifications *must* be submitted by letter to the Commissioner of the IRS, Attention: TX:R:I, 1111 Constitution Ave., N.W., Washington, D.C. 20224, for consideration. These requests should contain an explanation of the specific need for the deviations and the number of Forms W-2, W-2P, and/or W-3 to be printed.

.02 Forms W-2, W-2P, and W-3 are subject to annual review and possible change. Payers are cautioned against overstocking supplies of privately printed substitutes.

.03 Copies of the official form for the reporting year may be obtained from any IRS office. The IRS provides only cut sheet sets with no carbon interleaves for Forms W-2, W-2P, and W-3.

.04 Substitute Forms W-2, W-2P, and W-3 transmitted to the SSA should generally contain only data provided to payees and summary data as requested by the form's instructions.

.05 Substitute Forms W-2, W-2P, and W-3 may be redesigned as to the spacing for state and local tax data *as long* as the vertical and horizontal spacing for all federal payment and data boxes are in compliance with the specifications contained herein.

.06 The sizes for the ballot boxes on all Forms W-2 (Copy A), W-2P (Copy A), and W-3 are as follows:

1 For Forms W-2, ballot boxes must be 8-point boxes;

2 For Forms W-2P, ballot boxes must be 8-point boxes; and

3 For Forms W-2, ballot boxes must be 8-point boxes.

NOTE: More than 50% of the applicable ballot box must be covered by an "X."

Sec. 5. Requirements for Substitute Forms Furnished to Payees (Copies B, C, and 2 of the Official Six Part Set of Forms W-2 and W-2P)

.01 All payers, including those filing Copy A using magnetic media, must furnish payees with at least two statements. The dimensions of these copies may be expanded from the dimensions of the official form to allow space for conveying additional information such as withholding from pay for health insurance, union dues, bonds, charity, etc. This may permit the payer to eliminate other statements or notices which would otherwise be furnished to payees. The maximum allowable dimensions are:

1 depth should be no more than 5 inches; and

2 width no more than 8 inches.

.02 The paper for all copies should be white. The substitute Copy B (or its equal), that payees are instructed to attach to their federal income tax return, must be at least 24-pound paper (basis 17 x 22-1000), while the other copies furnished the payee should be at least 18-pound paper (basis 17 x 22-1000).

.03 Chemical transfer paper is *permitted* only if the following standards are met:

1 All copies must be clearly legible;

2 All copies must be able to be photocopied; and

3 Fading must not be of such a degree as to preclude legibility and the ability to photocopy.

In general, black chemical transfer inks are preferred; other colors are permitted only if the above standards are met. "Spot carbons" are *not permitted.*

.04 Interleaved carbon must meet the requirements specified in .03 above.

NOTE: Chemical transfer paper is permitted for additional payee copies.

.05 Substitute forms for payees need contain only the payment boxes and captions that are applicable (in any desired sequence). Other boxes contained on the official form may be omitted, except that in all cases the payee name, address and social security number must be present. Payment boxes and captions that are applicable must be clearly identified, using where possible the same wording as on the official form. If the form contains additional data (e.g., savings bonds withholding, retirement withholding, payroll savings, etc.), there should be a special highlighting of the areas pertaining to (1) Federal income tax withheld, (2) Wages, tips, and other compensation, and (3) Advance EIC payment.

.06 For substitute forms for payees (Copies B, C, and 2 of Forms W-2 and Copies B, C, and 2 of Forms W-2P), the following reqiurements must be met:

1 All copies of Forms W-2 and W-2P *must* contain the form title. For Form W-2, the title is "Form W-2 Wage and Tax Statement." For Form W-2P, the title is "Form W-2P Statement for Recipients of Periodic Annuities, Pensions, Retired Pay, or IRA Payments." Note: The title "Form W-2" or "Form W-2P" does not appear on Copy 2.

2 If the substitute forms are *not labelled* as to the disposition of the copies, then written notification must be provided to each payee as specified below:

(a) The first copy of the form must be filed with the employee's (or recipient's) federal tax return.

(b) The second copy of the form is for the employee's (or recipient's) records.

(c) If applicable, the third copy of the form must be filed with the employee's state, city, or local income tax return.

3 If the substitute forms are *labelled*, then the forms must contain the applicable description:

(a) "Copy B, to be filed with employee's Federal tax return," "Copy C, for employee's records," and the designation "Form W-2 Department of the Treasury—Internal Revenue Service," or

(b) "Copy B, file with recipient's Federal tax return," "Copy C, for recipient's records," and the designation "Form W-2P Department of the Treasury—Internal Revenue Service."

(c) The form number and reference to the Department of the Treasury—Internal Revenue Service should be omitted from other copies provided in the set.

4 Such substitutes are acceptable and payees should be advised that substitute wage and tax statements are acceptable for filing with their federal income tax returns.

Sec. 6. Requirements for Substitute "Privately Printed" Forms W-2 (Copy A), Forms W-2P (Copy A), and Forms W-3 That Payers Submit to the SSA

.01 Payers may file privately printed substitute Form W-2 and W-2P with the SSA (hereafter referred to as a substitute Copy A). Payers may file privately printed substitute Forms W-3 with the SSA (hereafter referred to as a substitute W-3). The substitute form must be an exact replica of the official repro-proof with respect to layout and contents. Chemical transfer paper and "spot carbons" are *not permitted* for Copy A or for Form W-3 filed with SSA. The dimensions of a substitute form may differ as far as width (see Section 6.05 below) and the printing of the Government Printing Office (GPO) symbol must be deleted (see Section 6.12 below). The specifications and allowable tolerances for the Copy A of substitute Forms W-2 and W-2P are provided in Exhibits A, B, C, E, F, G, and H respectively. The specifications and allowable tolerances for Forms W-3 are provided in Exhibits D, I, and J.

NOTE: *Printers of Forms W-2 or W-2P that are wider than 7 inches must provide Forms W-3 that are of the same width as the Forms W-2 or W-2P (i.e., 7½" width Forms W-3 with 7½" width Forms W-2 and W-2P; 8" width Forms W-3 with 8" width Forms W-2 and W-2P).*

.02 *Color and quality of paper.*

1 Paper for Copy A and for Form W-3, (cut sheets and continuous pin-feed forms) to be filed with SSA, as specified by JCP 0-25, dated November 29, 1978, must be: White 100% bleached chemical wood, optical character recognition (OCR) bond produced in accordance with the following specifications:

NOTE: Reclaimed fiber in any percentage is permitted, provided the requirements of this standard are met.

1 Acidity: pH value, average, not less than	4.5
	Bond
2 Basis Weight 17 x 22	
1000 cut sheets	40
Metric equivalent—g/m^2	75
A tolerance of ±5 pct. shall be allowed.	
3 Stiffness: Average, each direction, not less than—milligrams	50
4 Tearing strength: Average, each direction, not less than—grams	40
5 Opacity: Average, not less than—percent	82
6 Thickness: Average—inch—0.0038 Metric equivalent—mm—0.097	
A tolerance of ±0.0005 inch (0.0127 mm) shall be allowed. Paper shall not vary more than 0.0004 inch (0.0102 mm) from one edge to the other.	
7 Porosity: Average, not less than—seconds	10
8 Finish (smoothness): Average, each side—seconds	20-55
For information only, the Sheffield equivalent—units	170-100
9 Dirt: Average, each side, not to exceed—parts per million	8

.03 All printing will be in red OCR dropout ink, as specified below, except for the '22222', '55555', or '33333' at the top of the form and the descriptive information at the bottom (see Exhibits K, L, M and N) which will be printed in nonreflective black ink. All other printing will be in red OCR dropout ink with or comparable to the specifications below. The screened area of any substitute form (Copy A of Forms W-2 and W-2P, and the Form W-3 that is sent to SSA) should generally correspond to that present on the official form. Vertical rules require screening of .05 inches on each side of an inside rule. Horizontal screening should follow the standard format and allow for typewriter spacing. All screened areas are to be printed in the red OCR dropout ink. The numbered captions are printed as a solid with no screened background. (See Exhibits) Printing in red OCR dropout ink other than those listed below must be cleared by contacting: Manager of Media Support, Recognition Equipment, Inc., P.O. Box 222307, Dallas, Texas 75222; telephone number 214-438-8611, extension 1416. The red OCR dropout ink specifications already approved by Recognition Equipment, Inc., are:

Ink Manufacturer	*Red Ink Identification No.*
Gans Ink Co.	CS-310
General Printing Inks Div. (Sun Chemical Corp.)	SS-40B
Ink Masters, Inc. (Chicago)	B-6056
Inmont Canada, Ltd.	4T-39605
Lorilleux Lefranc	U-17410
Sinclair & Valentine (U.S.)	J-24893
Toyo Ink Company	OMR-57

.04 *Typography.* Type must be substantially identical in size and shape with corresponding type on the official form. NOTE: The form identifying number must be in OCR A font.

1 On Copy A of Forms W-2 and W-2P and for Form W-3, all the perimeter rules must be 1-point (0.014 inch), while all other rules must be one-half point (0.007 inch).

2 Vertical rules must be parallel to the left edge of the document; horizontal rules parallel to the top edge.

.05 *Dimension.* Three official Forms W-2, W-2P (Copy A) or one official Form W-3 are contained on a single page which is 7 inches wide (exclusive of any snap-stubs) by 11 inches deep.

The width of privately printed substitute pages must be 7 inches, 7½ inches, or 8 inches exclusive of any left or right snap-stubs, or pin-feed holes, although adherence to the size of the official page is preferred. If a 7 inch form is produced, the image must be an exact copy of the official repro-proof. If the width of the substitute page is increased, the width of specified fields on the substitute page must be increased in accordance with Exhibits E, F, G, H, I, and J. The top margin must be ⅓ inch and be free of all printing; the right margin must be ¼ inch plus or minus .0313 inch and must be free of all printing. For Forms W-2, the combination width of Box 1, "Control number", and the box containing the Form Identifying Number must always be 2.2 inches. For Forms W-2P and W-3, the combination width of Box 1, "Control Number", and the box containing the Form Identifying Number must always be 2.15 inches.

1 When the width of Copy A is increased to 8 inches, exclusive of any left or right snap-stubs or pin-feed holes, the form identifying number must be shown as 222 for Form W-2, 555 for Form W-2P, or 333 for Form W-3. This number tells the scan equipment used by SSA which information document it is reading, the width size and the position of individual data fields (see Exhibits E, G, and I).

2 When the width of Copy A is increased to 7½ inches, exclusive of any left or right snap-stubs or pin-feed holes, the form identifying number must be shown as 2222 for Form W-2, 5555 for Form W-2P, or 3333 for Form W-3. This number tells the scan equipment used by the SSA which information document it is reading, the width size and the position of individual data fields (see Exhibits F, H, and J).

.06 The depth of the individual image on a page (for Forms W-2 and W-2P) must be the same (3⅔ inches) as that of the official repro-proof. The depth of the Form W-3 on a page must be 3.37 inches.

.07 The words *"Do Not Cut or Separate Forms on This Page" must* be printed in red OCR dropout ink between the three Forms W-2 or W-2P (Copy A) (see Exhibits A, B, and C) and *must* also be present on 7½-inch- and 8-inch-wide substitute Forms W-2 or W-2P. Perforations are required on all copies (except Copy A) to enable the separation of individual forms.

.08 The words *"Please return this entire page" must* be printed on all Forms W-3 (see Exhibit D) whether Forms W-3 are 7 inches wide, 7½ inches wide, or 8 inches wide.

.09 *Privately printed continuous substitute Forms W-2 and W-2P (Copy A) must be perforated at each 11" (3-on) page depth. No perforations are allowed between the 3⅔" forms on a single copy page of Copy A.*

NOTE: Perforations are required between all the other individual copies (Copy 1, B, C, 2, and D) included in the set.

.10 The back of a substitute Copy A must be free of all printing.

.11 *Carbonized. "Chemical transfer paper"* and *"spot carbons"* are *not permitted* for Copy A of Forms W-2 or W-2P or for Form W-3. Interleaved carbon must be of good quality to assure legibility of information on all parts to preclude smudging, and should be black (see Section 5.04).

.12 *Printer's symbol.* The GPO symbol must not be placed on substitute Copy A of Forms W-2 and W-2P. In the place of the GPO symbol, the employer identification number (EIN) of the forms printer must be printed in the bottom margin on the face of each individual sheet of Copy A. In addition, the EIN of the forms printer *must be printed on the face* of the Form W-3 which is filed with SSA.

.13 All printers of substitute or privately printed Forms W-2, W-2P, or W-3 are requested to provide 3 copies of each version of each form to SSA, P.O. Box 2317, Baltimore, Maryland 21235. Paper substitutes conforming to the specifications contained in this procedure may be sent to SSA directly. Paper substitutes requiring IRS consideration and approval should be sent to SSA *only* after IRS approval has been granted.

Sec. 1. Additional Instructions

.01 *Arrangement of assembly.* Except as provided below, if magnetic media is not used for filing with SSA, the substitute copies of Forms W-2 and W-2P assembly should be arranged in the same order as the official Forms W-2 and W-2P. Copy A first, followed sequentially by perforated sets (Copies 1, B, C, 2, and D). The substitute form to be filed with SSA by the payer must carry the designation Copy A.

1 *Copy D for employer or payer.* It is not required that privately printed substitute forms contain a copy to be retained by payers although payers must be prepared to verify or duplicate this information if it is requested by the IRS or SSA.

2 *Additional copies.* Except as provided in the arrangement of the official assemblies, additional copies which may be prepared by payers shall not be placed ahead of the copy "For employee's records," Copy C (Forms W-2) or "For Recipient's Records," Copy C (Form W-2P). Instructions similar to those contained on the back of Copy C of the official form should be provided to each employee (recipient). For Form W-2, the social security (FICA) rates applicable for the current tax year must:

(a) appear either on the front or the back of the copy (Copy C) retained by the employee; or

(b) be communicated to the employee via a separate statement. The IRS recommends that the other text on the back of the official form Copy C be provided to the employee.

.02 All privately printed Forms W-2 and W-2P (Copy A) must have the tax year printed on the bottom face of each, using identical type to that of the official format.

.03 The substitute Copy B (or its equal), which the payee is instructed to attach to his/her federal income tax return, *must* be at least 24-pound paper (basis 17 x 22-1000), while the other copies furnished the payee should be at least 18-pound paper (basis 17 x 22-1000).

.04 The OCR bond Form W-3 that is filed with SSA *must* have *no* printing on the reverse side.

.05 *Instructions for Form W-3.* Instructions similar to those provided as part of the official form *must* be provided as part of any substitute Form W-3.

.06 All privately printed Forms W-3 *must* have the tax year printed on the bottom face of each Form W-3, using identical type to that of the official format.

.07 The copy of the substitute Form W-3 which contains the instructions and is to be retained by the employer should be at least 18-pound paper (basis 17 x 22-1000).

Sec. 8. Instructions for Payers

.01 Only originals or ribbon copies of Copy A of Forms W-2 and W-2P and of Form W-3 may be filed. Carbon copies and photocopies are *not* acceptable.

.02 The Service requests the cooperation of the payers in typing or machine printing whenever possible and in providing good quality data entries on the forms, i.e., using black ribbon, inserting data in the middle of blocks, well separated from other printing and guidelines, and taking any other measures that will guarantee clear, sharp images. However, payers are not required to acquire equipment solely for the purpose of preparing these forms.

.03 The employer identification number (EIN) may be entered anywhere in Box 2 along with the Payer's name and address on Copy A of Forms W-2 and W-2P. (If this is done, the EIN need not be entered in Box 3 of either Form W-2 or W-2P.) For Forms W-3, the EIN must be entered where prescribed by the Form W-3 Instructions.

.04 The payer's name, address and EIN may be preprinted.

.05 *State agencies.* The amounts of wages paid and employee contributions withheld under a state-federal agreement, entered into pursuant to Section 218 of the Social Security Act, may be shown in the space on Form W-2 for Federal Insurance Contribution Act Wages and Employee Tax. In such cases, the identification number assigned by the Social Security Administration to the state (prefixed by 69) should be shown in the employer name and address area block on Form W-2. This "69" number may be preprinted. For Form W-3, the identification number must be entered where prescribed by the Form W-3 Instructions.

.06 The optional employer's state number may be preprinted in the employer's (payer's) name, address, and ZIP code box. If this is done, Box 4 of Forms W-2 and W-2P need not be completed, so long as the applicable state taxing authority does not object.

.07 The preparation and filing instructions for Forms W-2 and W-2P are contained in the 1980 Instructions for Forms W-2 and W-2P. The preparation and filing instructions for Form W-3 are contained as part of the 1980 Form W-3 snap set assembly.

.08 To avoid confusion and questions by payees, payers are encouraged to delete the following items from copies of Forms W-2 and W-2P provided to payees:

1 Form identifying number (e.g., 22222, 55555);

2 The words "subtotal" and "void" and their boxes;

3 Any other captions or box number that would *not* be of any informational use to payees.

.09 Payers are encouraged to use IRS-supplied labels for affixing to all Forms W-3 filed with SSA.

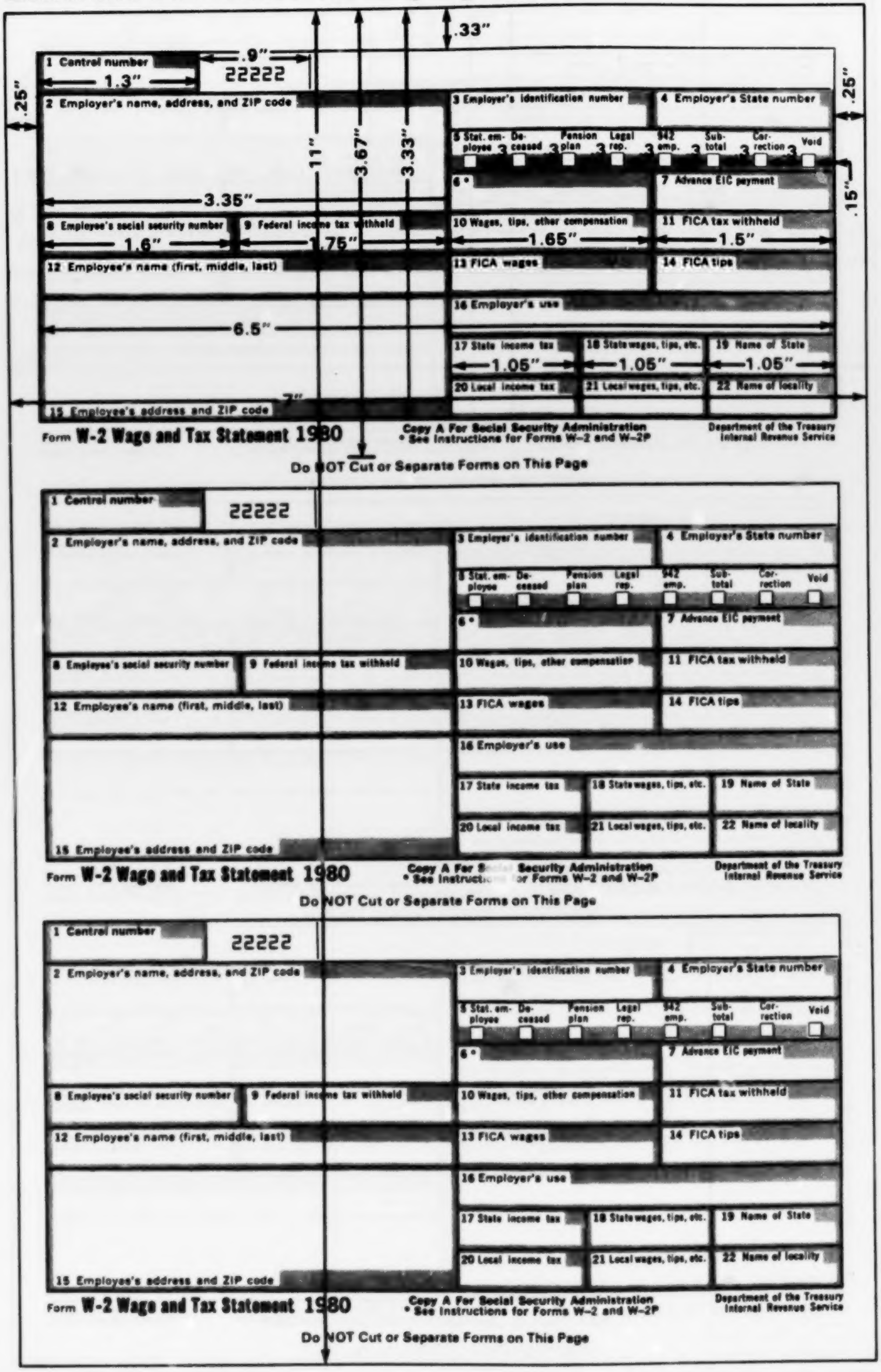
Sec. 9. Reproduction Proofs

Order blanks for reproduction proofs are mailed annually to requesters of record, and on request to other users. Reproduction copies of Forms W-2 (Copy A), W-2P (Copy A), and W-3 (Page 1) consist of two parts each. Part 1 is line art, i.e., type and ink. Part 2 is a black solid which should be photographically screened by the user to allow a 10%-20% dot pattern when printed in red OCR dropout ink. In some cases where the production method requires the use of something other than a standard dot pattern, the printed value of part 2 must still be 10%-20%. Printers and others wishing to obtain reproduction proofs may send their requests to the Commissioner of IRS, Attention: RM:FM:P, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. A charge of $1 per page will be made for each reproduction proof regardless of page size. Invoices will be mailed after orders have been filled.

Sec. 10. Effect on Other Documents

Rev. Proc. 79-21, 1979-1 C.B. 541, is superseded.

Exhibit A Form W-2 (6 part)



1 Control number	22222
2 Employer's name, address, and ZIP code	3 Employer's identification number 4 Employer's State number
	5 Stat. employee ☐ Deceased ☐ Pension plan ☐ Legal rep. ☐ 942 emp. ☐ Subtotal ☐ Correction ☐ Void ☐
	6 * 7 Advance EIC payment
8 Employee's social security number 9 Federal income tax withheld	10 Wages, tips, other compensation 11 FICA tax withheld
12 Employee's name (first, middle, last)	13 FICA wages 14 FICA tips
	16 Employer's use
	17 State income tax 18 State wages, tips, etc. 19 Name of State
15 Employee's address and ZIP code	20 Local income tax 21 Local wages, tips, etc. 22 Name of locality

Form **W-2 Wage and Tax Statement 1980**

Copy A For Social Security Administration
* See Instructions for Forms W-2 and W-2P

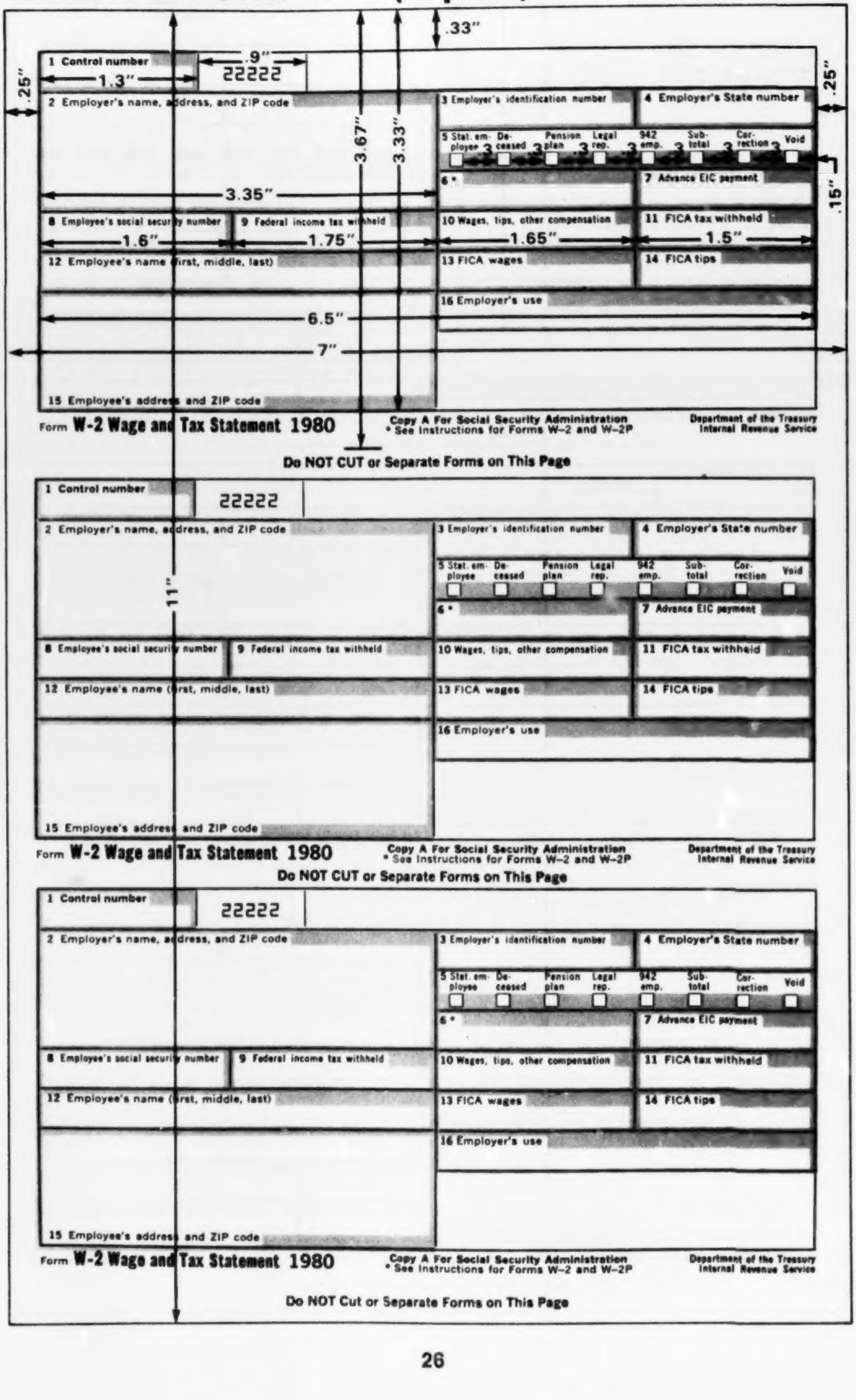
Department of the Treasury
Internal Revenue Service

Do NOT Cut or Separate Forms on This Page

1 Control number 22222
2 Employer's name, address, and ZIP code
3 Employer's identification number
4 Employer's State number
5 Stat. employee ☐ Deceased ☐ Pension plan ☐ Legal rep. ☐ 942 emp. ☐ Subtotal ☐ Correction ☐ Void ☐
6 *
7 Advance EIC payment
8 Employee's social security number
9 Federal income tax withheld
10 Wages, tips, other compensation
11 FICA tax withheld
12 Employee's name (first, middle, last)
13 FICA wages
14 FICA tips
16 Employer's use
17 State income tax
18 State wages, tips, etc.
19 Name of State
20 Local income tax
21 Local wages, tips, etc.
22 Name of locality
15 Employee's address and ZIP code
Form W-2 Wage and Tax Statement 1980
Copy A For Social Security Administration
* See Instructions for Forms W-2 and W-2P
Department of the Treasury
Internal Revenue Service
Do NOT Cut or Separate Forms on This Page

1 Control number 22222
2 Employer's name, address, and ZIP code
3 Employer's identification number
4 Employer's State number
5 Stat. employee ☐ Deceased ☐ Pension plan ☐ Legal rep. ☐ 942 emp. ☐ Subtotal ☐ Correction ☐ Void ☐
6 *
7 Advance EIC payment
8 Employee's social security number
9 Federal income tax withheld
10 Wages, tips, other compensation
11 FICA tax withheld
12 Employee's name (first, middle, last)
13 FICA wages
14 FICA tips
16 Employer's use
17 State income tax
18 State wages, tips, etc.
19 Name of State
20 Local income tax
21 Local wages, tips, etc.
22 Name of locality
15 Employee's address and ZIP code
Form W-2 Wage and Tax Statement 1980
Copy A For Social Security Administration
* See Instructions for Forms W-2 and W-2P
Department of the Treasury
Internal Revenue Service
Do NOT Cut or Separate Forms on This Page

Exhibit B Form W-2 (4 part)



1 Control number
22222
2 Employer's name, address, and ZIP code
3 Employer's identification number
4 Employer's State number
5 Stat. employee ☐ Deceased ☐ Pension plan ☐ Legal rep. ☐ 942 emp. ☐ Subtotal ☐ Correction ☐ Void ☐
6 *
7 Advance EIC payment
8 Employee's social security number
9 Federal income tax withheld
10 Wages, tips, other compensation
11 FICA tax withheld
12 Employee's name (first, middle, last)
13 FICA wages
14 FICA tips
16 Employer's use
15 Employee's address and ZIP code

Form **W-2 Wage and Tax Statement 1980**
Copy A For Social Security Administration
* See Instructions for Forms W-2 and W-2P
Department of the Treasury
Internal Revenue Service

Do NOT CUT or Separate Forms on This Page

1 Control number
22222
2 Employer's name, address, and ZIP code
3 Employer's identification number
4 Employer's State number
5 Stat. employee ☐ Deceased ☐ Pension plan ☐ Legal rep. ☐ 942 emp. ☐ Subtotal ☐ Correction ☐ Void ☐
6 *
7 Advance EIC payment
8 Employee's social security number
9 Federal income tax withheld
10 Wages, tips, other compensation
11 FICA tax withheld
12 Employee's name (first, middle, last)
13 FICA wages
14 FICA tips
16 Employer's use
15 Employee's address and ZIP code

Form **W-2 Wage and Tax Statement 1980**
Copy A For Social Security Administration
* See Instructions for Forms W-2 and W-2P
Department of the Treasury
Internal Revenue Service

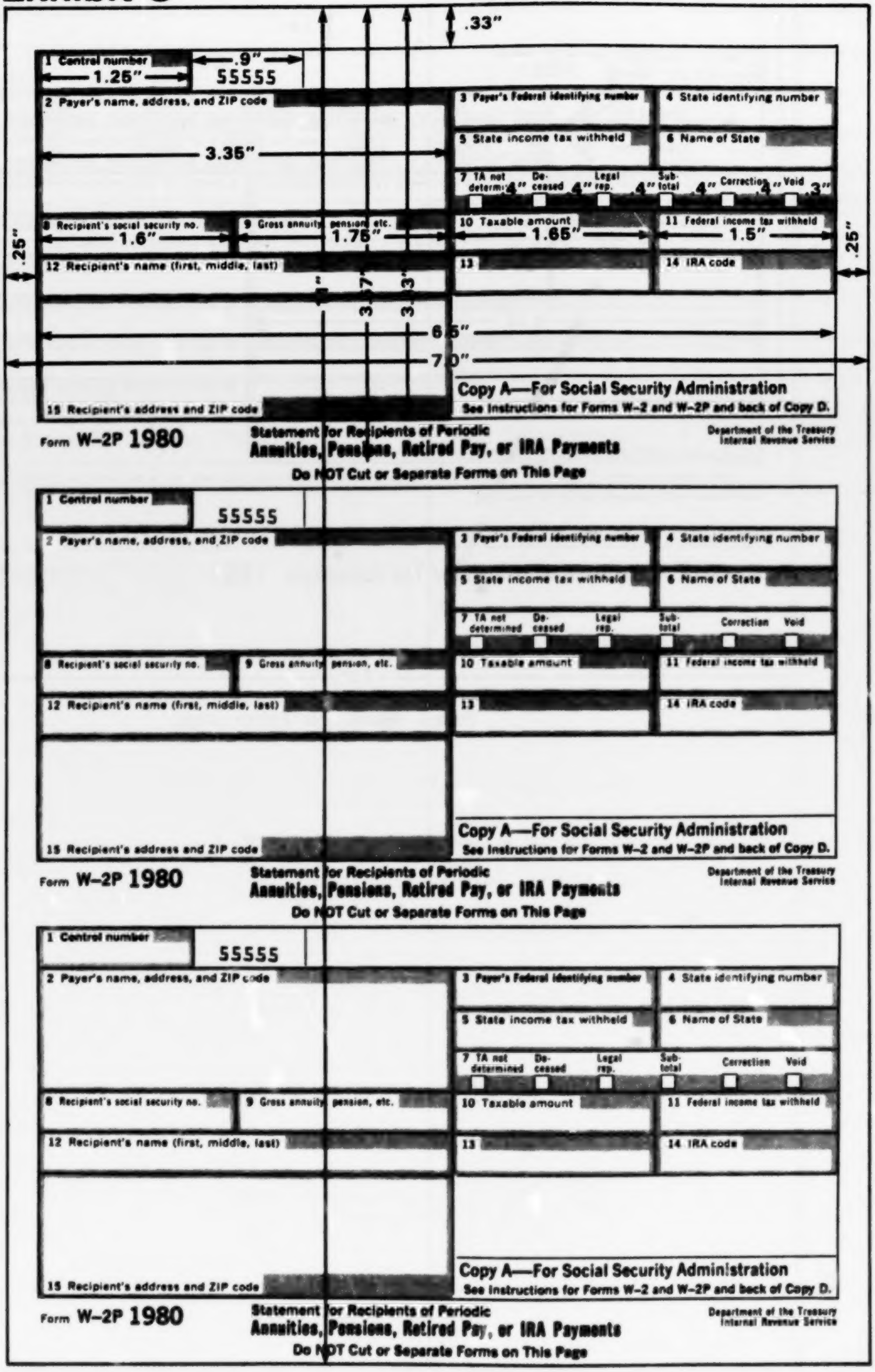
Do NOT CUT or Separate Forms on This Page

1 Control number
22222
2 Employer's name, address, and ZIP code
3 Employer's identification number
4 Employer's State number
5 Stat. employee ☐ Deceased ☐ Pension plan ☐ Legal rep. ☐ 942 emp. ☐ Subtotal ☐ Correction ☐ Void ☐
6 *
7 Advance EIC payment
8 Employee's social security number
9 Federal income tax withheld
10 Wages, tips, other compensation
11 FICA tax withheld
12 Employee's name (first, middle, last)
13 FICA wages
14 FICA tips
16 Employer's use
15 Employee's address and ZIP code

Form **W-2 Wage and Tax Statement 1980**
Copy A For Social Security Administration
* See Instructions for Forms W-2 and W-2P
Department of the Treasury
Internal Revenue Service

Do NOT Cut or Separate Forms on This Page

Exhibit C



1 Control number

55555

2 Payer's name, address, and ZIP code

3 Payer's Federal identifying number

4 State identifying number

5 State income tax withheld

6 Name of State

7 TA not determined ☐ De-ceased ☐ Legal rep. ☐ Sub-total ☐ Correction ☐ Void ☐

8 Recipient's social security no.

9 Gross annuity, pension, etc.

10 Taxable amount

11 Federal income tax withheld

12 Recipient's name (first, middle, last)

13

14 IRA code

15 Recipient's address and ZIP code

Copy A—For Social Security Administration

See Instructions for Forms W-2 and W-2P and back of Copy D.

Form **W-2P 1980** **Statement for Recipients of Periodic Annuities, Pensions, Retired Pay, or IRA Payments**

Department of the Treasury
Internal Revenue Service

Do NOT Cut or Separate Forms on This Page

1 Control number

55555

2 Payer's name, address, and ZIP code

3 Payer's Federal identifying number

4 State identifying number

5 State income tax withheld

6 Name of State

7 TA not determined ☐ De-ceased ☐ Legal rep. ☐ Sub-total ☐ Correction ☐ Void ☐

8 Recipient's social security no.

9 Gross annuity, pension, etc.

10 Taxable amount

11 Federal income tax withheld

12 Recipient's name (first, middle, last)

13

14 IRA code

15 Recipient's address and ZIP code

Copy A—For Social Security Administration

See Instructions for Forms W-2 and W-2P and back of Copy D.

Form W-2P 1980 Statement for Recipients of Periodic Annuities, Pensions, Retired Pay, or IRA Payments

Department of the Treasury
Internal Revenue Service

Do NOT Cut or Separate Forms on This Page

1 Control number

55555

2 Payer's name, address, and ZIP code

3 Payer's Federal identifying number

4 State identifying number

5 State income tax withheld

6 Name of State

7 TA not determined ☐ De-ceased ☐ Legal rep. ☐ Sub-total ☐ Correction ☐ Void ☐

8 Recipient's social security no.

9 Gross annuity, pension, etc.

10 Taxable amount

11 Federal income tax withheld

12 Recipient's name (first, middle, last)

13

14 IRA code

15 Recipient's address and ZIP code

Copy A—For Social Security Administration

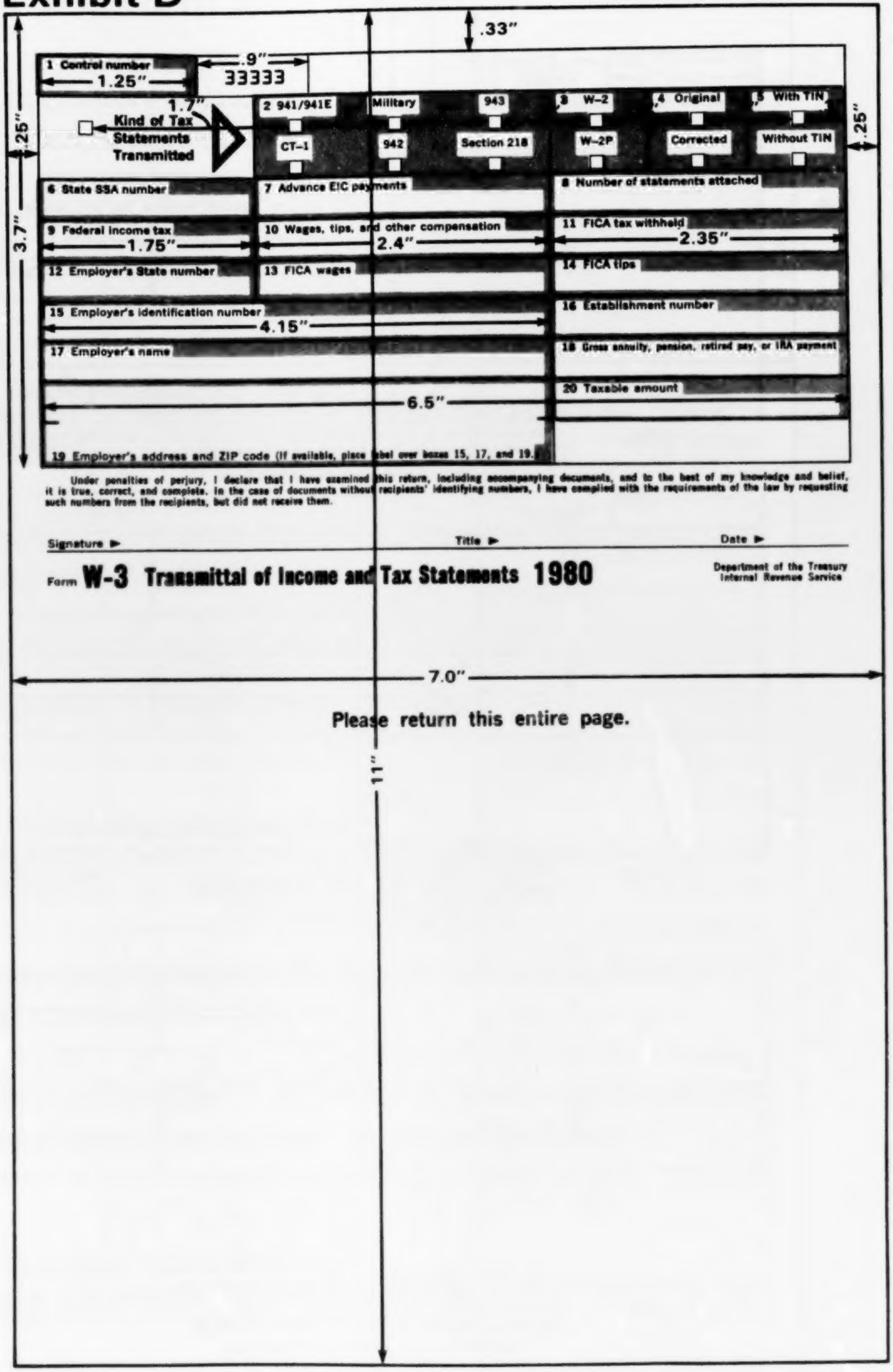
See Instructions for Forms W-2 and W-2P and back of Copy D.

Form W-2P 1980 Statement for Recipients of Periodic Annuities, Pensions, Retired Pay, or IRA Payments

Department of the Treasury
Internal Revenue Service

Do NOT Cut or Separate Forms on This Page

Exhibit D



1 Control number
33333

Kind of Tax Statements Transmitted ☐

2 941/941E ☐ | Military ☐ | 943 ☐ | 3 W-2 ☐ | 4 Original ☐ | 5 With TIN ☐

CT-1 ☐ | 942 ☐ | Section 218 ☐ | W-2P ☐ | Corrected ☐ | Without TIN ☐

6 State SSA number

7 Advance EIC payments

8 Number of statements attached

9 Federal income tax

10 Wages, tips, and other compensation

11 FICA tax withheld

12 Employer's State number

13 FICA wages

14 FICA tips

15 Employer's identification number

16 Establishment number

17 Employer's name

18 Gross annuity, pension, retired pay, or IRA payment

20 Taxable amount

19 Employer's address and ZIP code (If available, place label over boxes 15, 17, and 19.)

Under penalties of perjury, I declare that I have examined this return, including accompanying documents, and to the best of my knowledge and belief, it is true, correct, and complete. In the case of documents without recipients' identifying numbers, I have complied with the requirements of the law by requesting such numbers from the recipients, but did not receive them.

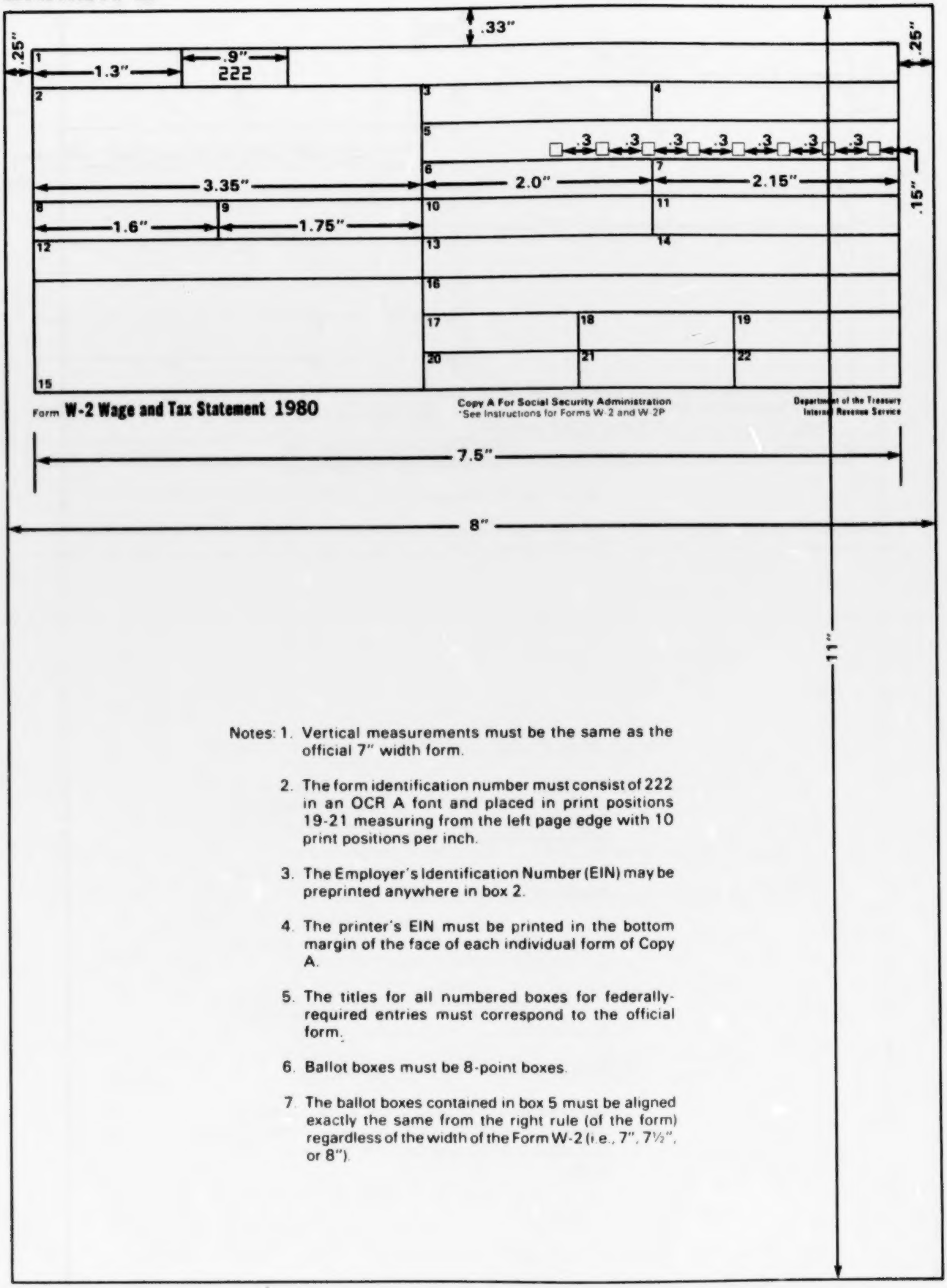
Signature ► Title ► Date ►

Form **W-3** **Transmittal of Income and Tax Statements 1980**

Department of the Treasury
Internal Revenue Service

Please return this entire page.

Exhibit E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22
15
Form W-2 Wage and Tax Statement 1980
Copy A For Social Security Administration
*See Instructions for Forms W-2 and W-2P
Department of the Treasury
Internal Revenue Service
7.5"
8"
11"

Notes: 1. Vertical measurements must be the same as the official 7" width form.

2. The form identification number must consist of 222 in an OCR A font and placed in print positions 19-21 measuring from the left page edge with 10 print positions per inch.

3. The Employer's Identification Number (EIN) may be preprinted anywhere in box 2.

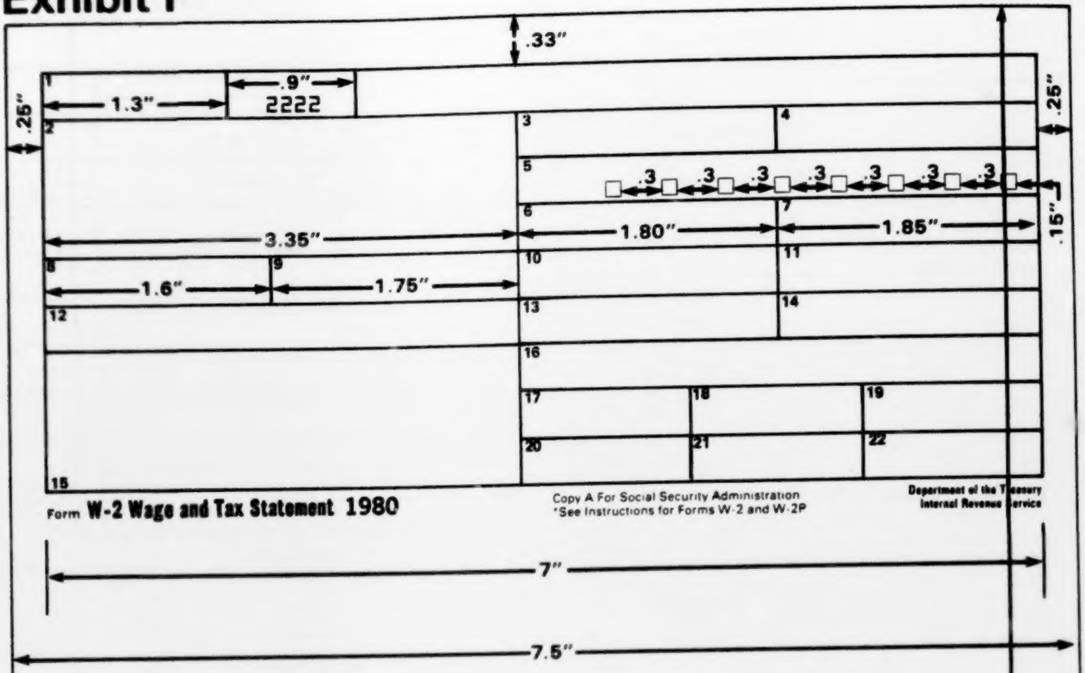
4. The printer's EIN must be printed in the bottom margin of the face of each individual form of Copy A.

5. The titles for all numbered boxes for federally-required entries must correspond to the official form.

6. Ballot boxes must be 8-point boxes.

7. The ballot boxes contained in box 5 must be aligned exactly the same from the right rule (of the form) regardless of the width of the Form W-2 (i.e., 7", 7½", or 8").

Exhibit F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Form W-2 Wage and Tax Statement 1980
Copy A For Social Security Administration
*See Instructions for Forms W-2 and W-2P
Department of the Treasury
Internal Revenue Service
7"
7.5"
11"

Notes: 1. Vertical measurements must be the same as the official 7" width form.

2. The form identification number must consist of 2222 in an OCR A font and placed in print positions 19-22 measuring from the left page edge with 10 print positions per inch.

3. The Employer's Identification Number (EIN) may be preprinted anywhere in box 2.

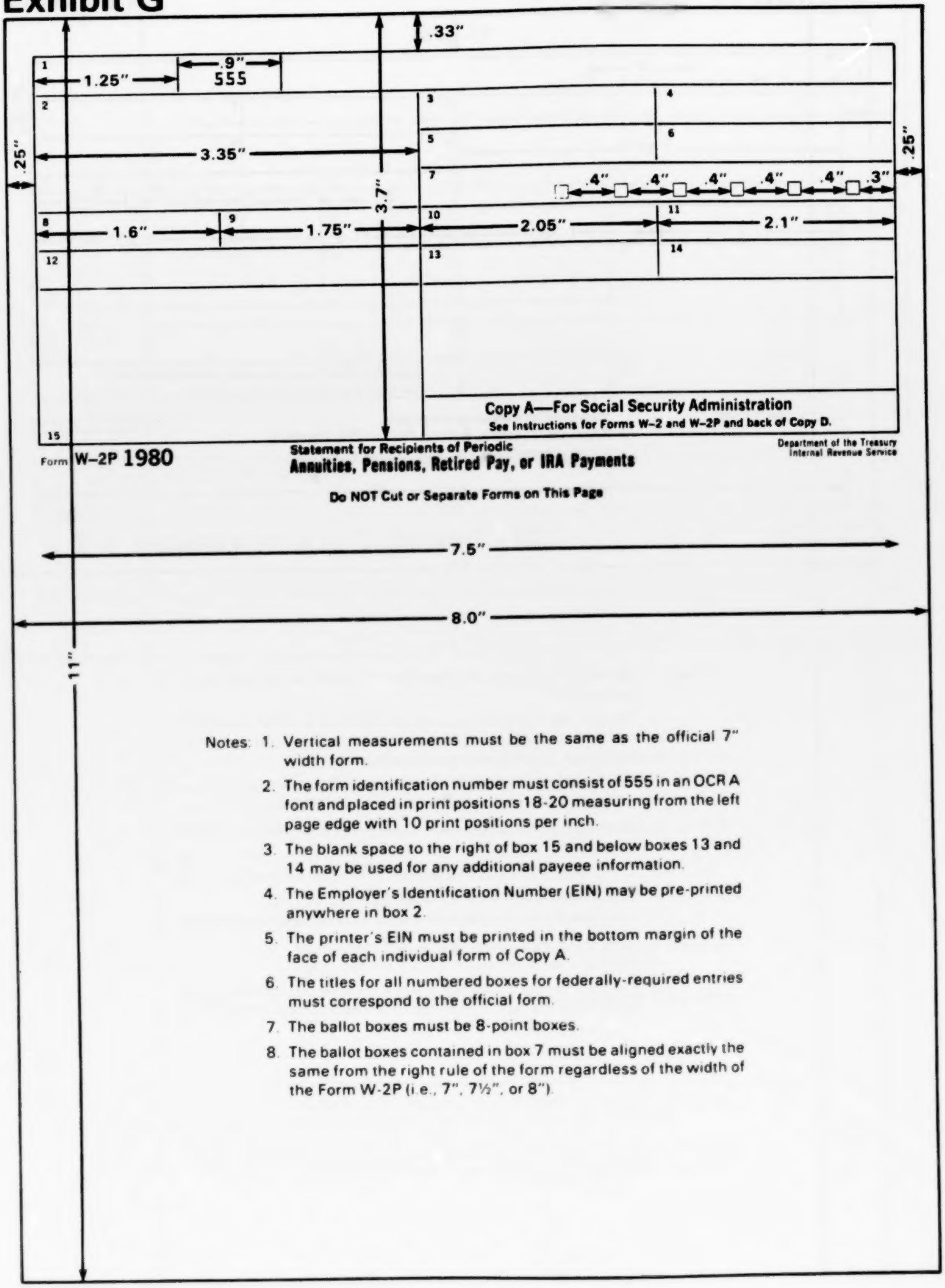
4. The printer's EIN must be printed in the bottom margin of the face of each individual form of Copy A.

5. The titles for all numbered boxes for federally-required entries must correspond to the official form.

6. Ballot boxes must be 8-point boxes.

7. The ballot boxes contained in box 5 must be aligned exactly the same from the right rule of the form regardless of the width of the Form W-2 (i.e., 7", 7½", or 8").

Exhibit G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2.05"
11
2.1"
12
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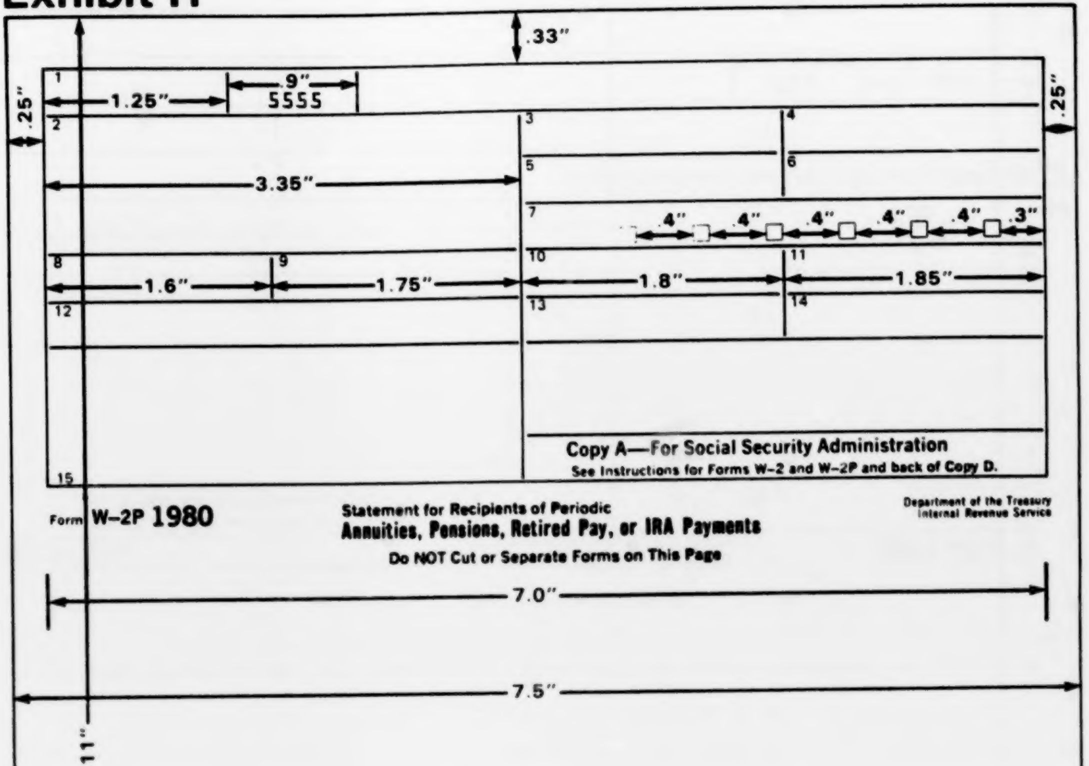
14
Copy A—For Social Security Administration
See Instructions for Forms W-2 and W-2P and back of Copy D.
15
Form W-2P 1980
Statement for Recipients of Periodic
Annuities, Pensions, Retired Pay, or IRA Payments
Department of the Treasury
Internal Revenue Service
Do NOT Cut or Separate Forms on This Page
7.5"
8.0"
11"

Notes:
1. Vertical measurements must be the same as the official 7" width form.
2. The form identification number must consist of 555 in an OCR A font and placed in print positions 18-20 measuring from the left page edge with 10 print positions per inch.
3. The blank space to the right of box 15 and below boxes 13 and 14 may be used for any additional payeee information.
4. The Employer's Identification Number (EIN) may be pre-printed anywhere in box 2.
5. The printer's EIN must be printed in the bottom margin of the face of each individual form of Copy A.
6. The titles for all numbered boxes for federally-required entries must correspond to the official form.
7. The ballot boxes must be 8-point boxes.
8. The ballot boxes contained in box 7 must be aligned exactly the same from the right rule of the form regardless of the width of the Form W-2P (i.e., 7", 7½", or 8").

Exhibit H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1.85"
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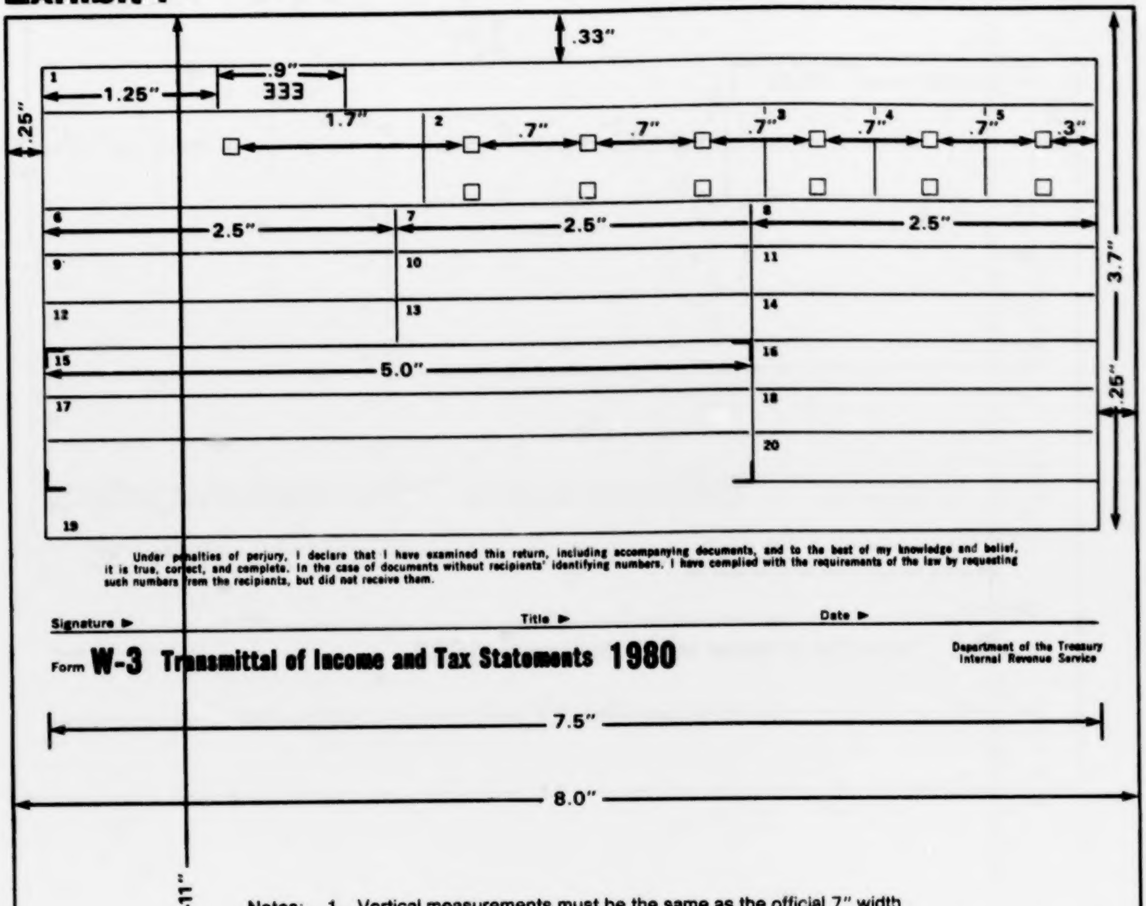
Copy A—For Social Security Administration
See Instructions for Forms W-2 and W-2P and back of Copy D.
Form W-2P 1980
Statement for Recipients of Periodic
Annuities, Pensions, Retired Pay, or IRA Payments
Do NOT Cut or Separate Forms on This Page
Department of the Treasury
Internal Revenue Service
7.0"
7.5"
11"

Notes:
1. Vertical measurements must be the same as the official 7" width form.
2. The form identification number must consist of 5555 in an OCR A font and placed in print positions 18-21 measuring from the left page edge with 10 print positions per inch.
3. The blank space to the right of box 15 and below boxes 13 and 14 may be used for any additional payeee information.
4. The Employer's Identification Number (EIN) may be pre-printed anywhere in box 2.
5. The printer's EIN must be printed in the bottom margin of the face of each individual form of Copy A.
6. The titles for all numbered boxes for federally-required entries must correspond to the official form.
7. The ballot boxes must be 8-point boxes.
8. The ballot boxes contained in box 7 must be aligned exactly the same from the right rule of the form regardless of the width of the Form W-2P (i.e., 7", 7½", or 8").

Exhibit I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333
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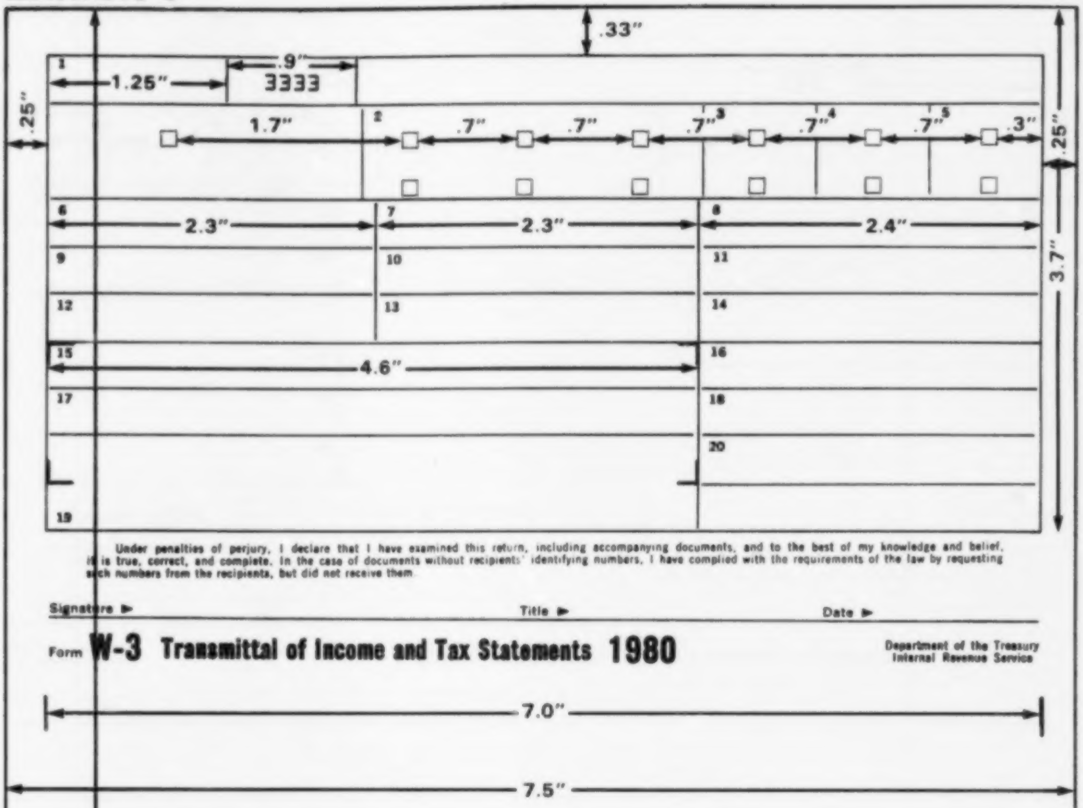
19
3.7"
.25"
Signature ►
Title ►
Date ►
Form W-3 Transmittal of Income and Tax Statements 1980
Department of the Treasury
Internal Revenue Service
7.5"
8.0"
11"

Under penalties of perjury, I declare that I have examined this return, including accompanying documents, and to the best of my knowledge and belief, it is true, correct, and complete. In the case of documents without recipients' identifying numbers, I have complied with the requirements of the law by requesting such numbers from the recipients, but did not receive them.

Notes:

1. Vertical measurements must be the same as the official 7" width form except the mark sense squares (i.e., ballot boxes) in Boxes 2-5 may be moved down to conform to a six line per inch spacing.
2. The Form Identification number must consist of 333 in an OCR A font and placed in print positions 18-20 measuring from the left page edge with 10 print positions per inch.
3. The Employer's Identification Number (EIN) may be preprinted (in OCR A font) in box 15.
4. The printer's EIN must be printed centered below the "signature" line.
5. The titles for all numbered boxes must correspond to the official form.
6. The ballot boxes must be 8-point boxes.
7. The ballot boxes contained in boxes 2, 3, 4, and 5 must be aligned exactly the same from the right rule of the form regardless of the width of the Form W-3 (i.e., 7", 7½", or 8").
8. The words "Please return this entire page" must appear on any substitute Form W-3 in the same position as on the official form.

Exhibit J



Under penalties of perjury, I declare that I have examined this return, including accompanying documents, and to the best of my knowledge and belief, it is true, correct, and complete. In the case of documents without recipients' identifying numbers, I have complied with the requirements of the law by requesting such numbers from the recipients, but did not receive them.

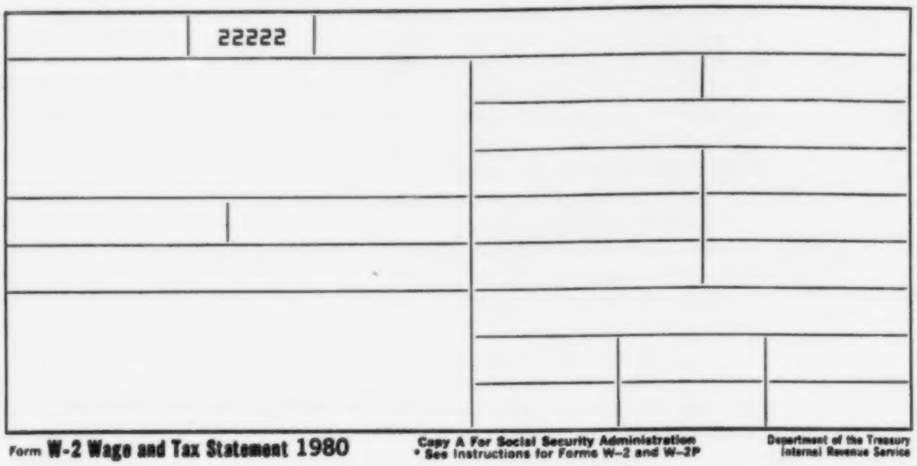
Form **W-3** **Transmittal of Income and Tax Statements 1980**

Department of the Treasury
Internal Revenue Service

Notes:

1. Vertical measurements must be the same as the official 7" width form except the mark sense squares (i.e., ballot boxes) in Boxes 2-5 may be moved down to conform to a six line per inch spacing.
2. The form identification number must consist of 3333 in an OCR A font and placed in print positions 18-21 measuring from the left page edge with 10 print positions per inch.
3. The Employer's Identification Number (EIN) may be preprinted (in OCR A font) in box 15.
4. The printer's EIN must be printed centered below the "signature" line.
5. The titles for all numbered boxes must correspond to the official form.
6. The ballot boxes must be 8-point boxes.
7. The ballot boxes contained in boxes 2, 3, 4, and 5 must be aligned exactly the same from the right rule of the form regardless of the width of the Form W-3 (i.e., 7", 7½", or 8").
8. The words "Please return this entire page" must appear on any substitute Form W-3 in the same position as on the official form

Exhibit K - 6 part W-2



22222

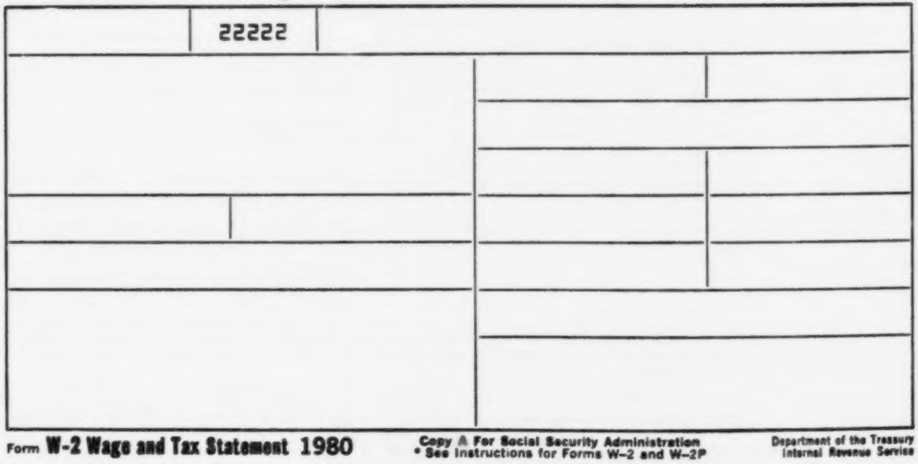
Form **W-2 Wage and Tax Statement 1980**

Copy A For Social Security Administration
* See Instructions for Forms W–2 and W–2P

Department of the Treasury
Internal Revenue Service

Note: Exhibits K and L are shown with the descriptive information that must be printed in nonreflective blank ink. All other printing will be in red OCR dropout ink.

Exhibit L - 4 part W-2



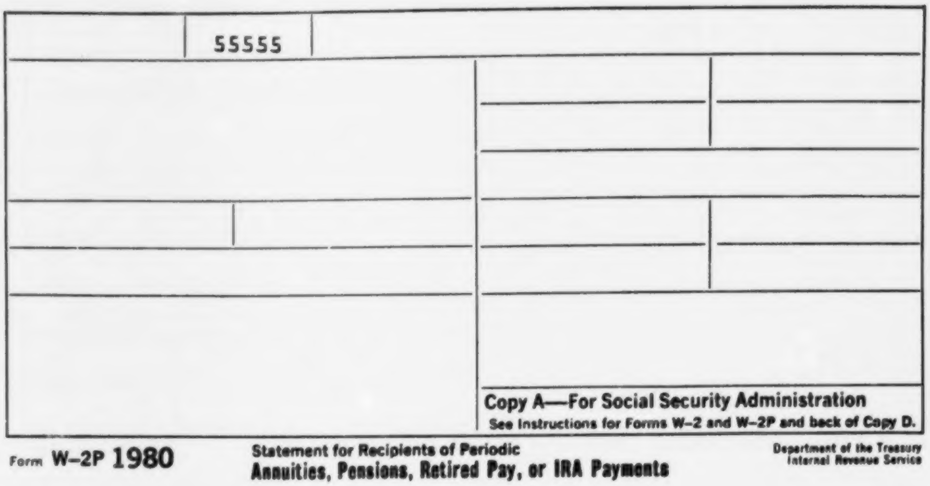
22222

Form **W-2 Wage and Tax Statement 1980**

Copy A For Social Security Administration
* See Instructions for Forms W–2 and W–2P

Department of the Treasury
Internal Revenue Service

Exhibit M - W-2P



55555

Copy A—For Social Security Administration

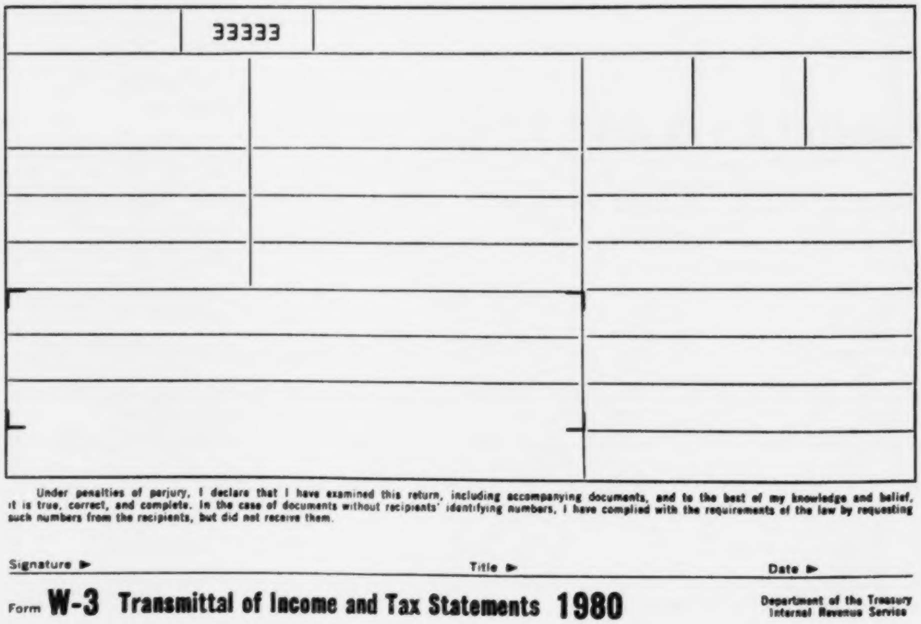
See Instructions for Forms W-2 and W-2P and back of Copy D.

Form **W-2P 1980** Statement for Recipients of Periodic **Annuities, Pensions, Retired Pay, or IRA Payments**

Department of the Treasury
Internal Revenue Service

Note: Exhibits M and N are shown with the descriptive information that must be printed in nonreflective blank ink. All other printing will be in red OCR dropout ink.

Exhibit N - W-3



33333

Under penalties of perjury, I declare that I have examined this return, including accompanying documents, and to the best of my knowledge and belief, it is true, correct, and complete. In the case of documents without recipients' identifying numbers, I have complied with the requirements of the law by requesting such numbers from the recipients, but did not receive them.

Signature ► Title ► Date ►

Form **W-3 Transmittal of Income and Tax Statements 1980**

Department of the Treasury
Internal Revenue Service

Part IV. Items of General Interest

Election to Treat Outdoor Advertising Displays as Real Property—Public Hearing

Announcement 80-48 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to the involuntary conversion of real property. The proposed regulations provide rules regarding the making of an election to that property that constitutes certain outdoor advertising displays as real property for income tax purposes.

DATES: The public hearing will be held on April 22, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by April 8, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-268-76), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under section 1033 of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Tuesday, December 11, 1979, at page 71429 (44 FR 71429).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of the comments to be presented at the hearing and the time they wish to devote to each subject by April 8, 1980.

Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive appearing in the Federal Register for Wednesday, November 8, 1978.

Targeted Jobs Tax Credit—Public Hearing

Announcement 80-49 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to the credit for employment of individuals qualifying as members of a targeted group.

DATES: The public hearing will be held on April 24, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by April 10, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-199-76), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under sections 44B, 51, 52, 53, 280C and 381 of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Friday, December 28, 1979, at page 76817 (44 FR 76817).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of the comments to be presented at the hearing and the time they wish to devote to each subject by April 10, 1980.

Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenut Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive appearing in the Federal Register for Wednesday, November 8, 1978.

---

[1] Filed by the Office of the Federal Register on March 13, 1980, 8:45 a.m., and published in the issue of the Federal Register for March 14, 1980, 45 F.R. 16500.

[1] Filed by the Office of the Federal Register on March 13, 1980, 8:45 a.m., and published in the issue of the Federal Register for March 14, 1980, 45 F.R. 16500.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants and Enrolled Agents from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the instituton or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation at attorney, certified public account or enrolled agent, and the date or period of suspenison. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following persons have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
John E. Bishop	Greenville, SC	Attorney	Indefinite effective October 24, 1979
Raymond A. Carr	Roanoke, VA	Certified Public Accountant	Indefinite effective February 11, 1980
Philip R. Hedrick	Charlotte, NC	Attorney	One Year effective February 22, 1980
Edward J. Loughery	Succasunna, NJ	Enrolled Agent	Indefinite effective February 1, 1980
C. Rex Olson	Phoenix, AZ	Certified Public Accountant	Four months effective February 15, 1980
Julian S.H. Weiner	Beverly Hills, CA	Certified Public Accountant	Indefinite effective August 23, 1979
W. Frank Wolfenbarger	Irving, TX	Certified Public Accountant	Indefinite effective January 1, 1980

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants or enrolled agents to practice before the Internal Revenue Service.

Attorneys, certified public accounts and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify such disbarred or suspended

practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant or enrolled agent so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing, the following individual was disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
John J. McBurney	College Park, MD	Attorney	October 22, 1979

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.401-2, 1.403(b)-1, 1.405-1, amended; 1.401-8A redesignated 1.401-8 and as redesignated amended; 1.401-8 redesignated 1.401(f)-1 and as redesignated amended; 1.401(a)-1, 1.401(a)-2, 1.401(a)-16, 1.415-1 through 1.415-10 added.	Limitations on benefits and contributions under qualified plans.	Jan. 24, 1980	Apr. 23, 1980
26 CFR 138.4064-1, 138.4222-1 added; published as temporary regulations in T.D. 7674, 1980-11 I.R.B.	Gas Guzzler Tax.	Feb. 8, 1980	Apr. 8, 1980
26 CFR 31.6302(c)-1 amended.	Deposit requirements for social security and withheld income taxes.	Feb. 8, 1980	Apr. 8, 1980
26 CFR 1.861-8, 1.882-4, amended.	Allowance of deductions to foreign corporations doing business in the U.S.	Feb. 27, 1980	Apr. 28, 1980

Numerical Finding List[1]

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1, dated January 7, 1980.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1 I.R.B., dated January 7, 1980.

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_____	*1936–2*	*3.90*
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_____	1937–2	7.70
_____	*1938–1*	*4.05*
_____	*1938–2*	*3.50*
_____	1939–1–1	8.25
_____	1939–1–2	10.90
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_____	1958–1	9.60
_____	1958–2	13.00
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_____	1959–1	15.00
_____	1959–2	9.60
_____	1960–1	9.00
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_____	1966–1	9.25
_____	1966–2	14.05
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_____	1967–2	10.00
_____	1968–1	14.00
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contin

9258

Internal Revenue
bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-91, page 6.
Arbitrage bonds; advance refunding issue; unreasonable investment fees. Unreasonable fees or unreasonably allocated fees paid by an issuer of advance refunding bonds in an escrow restructuring transaction may not be taken into account in determining whether the arbitrage yield restrictions of section 103(c) of the Code are met.

Rev. Rul. 80-92, page 7.
Arbitrage bonds; advance refunding issue; acquired obligations; excess cost. Amounts in excess of fair market value paid for acquired obligations from the proceeds of advance refunding bonds may not be taken into account in determining whether the arbitrage yield restrictions of section 103(c) of the Code are met.

Rev. Rul. 80-93, page 9.
Depreciation; land preparation costs; electric and gas distribution systems. Amounts paid by the developer of a mobile home park to a public utility for underground electric and gas distribution systems are capital expenditures that are included in the developer's cost basis of the land. Examples illustrate which land preparation costs may be depreciated by the developer and which must be included in the basis of the land.

Rev. Rul. 80-94, page 10.
Social security taxes; Federal Republic of Germany. No deduction or credit is allowable under section 164(a) or section 901(b) of the Code for social security taxes paid or accrued to the Federal Republic of Germany on or after December 1, 1979.

Rev. Rul. 80-96, page 22.
FHLMC participation certificates. Certain procedures of the Federal Home Loan Mortgage Corporation (FHLMC) will not alter the tax consequences resulting from the purchase of mortgage participation certificates by FHLMC followed by the formation of pools and a subsequent issuance of participation sales certificates by FHLMC to other organizations; Rev. Rul. 71-399, as amplified by Rev. Ruls. 72-376, 74-221, and 74-300, is further amplified.

Rev. Proc. 80-12, page 28.
Election; revocation; Puerto Rico and possession tax credit. The amendment of section 901(g) of the Code by the Revenue Act of 1978 eliminates the need for the revocation procedure contained in Rev. Proc. 78-32 relating to an election to receive the Puerto Rico and possession tax credit under section 936; Rev. Proc. 78-32 revoked.

Announcement 80-36, page 30.
A correction is made to Rev. Rul. 80-28, which illustrates application of the penalty imposed by section 6694(a) of the Code to an income tax return preparer's failure to report a taxpayer's minimum tax liability.

Announcement 80-38, page 30.
Form 5309, Application for Determination of

(Continued on page 4)

Finding Lists begin on page 36.
Announcement of Disbarments and Suspensions begins on page 33.
Announcement of Notice of Proposed Rulemaking on page 35.
Quarterly Index for January, February and March begins on page 38.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part includes rulings and decisions based on Subpart A, Tax Conventions and related Treasury Decisions and Revenue Rulings; Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of Revenue Rulings, Revenue Procedures, and other published items, and (3) topical Indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

Employee Stock Ownership Plan, has been revised and is available at Service offices.

EXEMPT ORGANIZATIONS

Rev. Rul. 80-97, page 16.
Qualifying distribution; private foundation; exempt cemetery company. An unrestricted contribution made by a private foundation to an exempt cemetery company that is not described in section 170(c)(2)(B) of the Code is not a qualifying distribution within the meaning of section 4942 (g) and is a taxable expenditure within the meaning of section 4945(d)(5).

Announcement 80-39, page 30.
A listing is given of organizations now classified as private foundations.

ESTATE AND GIFT TAXES

T.D. 7687, page 11.
Temporary regulations are adopted relating to the election under section 2040(d) of the Code to treat an interest in certain joint tenancies created before January 1, 1977 as a qualified joint interest.

EXCISE TAXES

Rev. Rul. 80-95, page 15.
Foreign insurer; indemnity bond vs. insurance policy. A domestic corporation that maintains disability plans covering its U.S. citizen or resident employees and former employees entered into a contract with a foreign insurer that is neither doing business nor authorized to do business in the U.S. In return for an actuarially computed annual payment, the insurer, which is not a party to the plans, indemnifies the corporation for all required plan payments. It incurs no liability to the employees or former employees and is responsible for neither plan performance failures nor the application or disposition of money paid to the corporation under the contract. The insurer has the right to audit claims against the plans and to protest what it feels are improper payments. The contract is a policy taxable under section 4371(2) of the Code.

TAX CONVENTIONS

Rev. Rul. 80-98, page 25.
NIH Visiting Fellows Program. Amounts received from the National Institutes of Health under the Visiting Fellows Program by residents of the following countries are exempt from federal income tax under the respective countries' tax conventions with the U.S.: Belgium, Finland, France, Iceland, Japan, the Netherlands, Norway, Poland, Romania, and Trinidad and Tobago. Rev. Rul. 76-567 amplified.

ADMINISTRATIVE

Rev. Proc. 80-11, page 28.
Reporting dividends on restricted stock; employee compensation. A procedure is set forth for reporting dividends on restricted stock that is not substantially vested within the meaning of section 83 of the Code when such dividends are reflected on both Forms 1099-DIV and W-2.

T.D. 7675, page 21.
Amendments to the regulations under section 7701 of the Code relate to the definition of income tax return preparer.

T.D. 7676, page 18.
Amendments to the regulations relate to allowable disclosure or use of tax return information by tax return preparers under section 7216 of the Code.

T.D. 7677, page 16.
Amendments to the temporary regulations under section 6103 of the Code relate to the disclosure of certain return information to and by officers and employees of the Department of Commerce, Bureau of the Census, for certain statistical purposes and related activities.

Del. Order 66 (Rev. 10), page 27.
Appeals; settlements in protested cases. Authority is delegated to Appeals Team Chiefs to represent the Commissioner in certain protested cases. All authorized persons are delegated authority to determine whether elections made by estates meet the conditions specified in sections 6166 and 6166A of the Code; Del. Order 66 (Rev. 9) superseded.

Announcement 80-40, page 32.
Form 1090, Statement of Income, and Profit and

(Continued on page 5)

Highlights of this Issue—Continued

(Continued from page 4)

ADMINISTRATIVE—Cont'd

Loss Accounts, has been revised and will be available on or about April 1.

Announcement 80-41, page 32.
Installment payments that involve capital gains on sales occurring before November 1, 1978, and that are received after October 31, 1978, are included in the phrase "transactions entered into" found on the 1979 Schedule D, Capital Gains and Losses.

Announcement 80-42, page 32.
Publication 1026, Supplemental Report, Statistics of Income—1968 and 1972, International Income and Taxes, U.S. Corporations and Their Controlled Foreign Corporations, may be purchased from the Superintendent of Documents, Washington, D.C.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-1: Gross income.

Whether savings and loan association recognizes ordinary income or loss upon sale of an undivided interest in mortgage loans sold to the Federal Home Loan Mortgage Corporation. See Rev. Rul. 80-96, page 22.

26 CFR 1.61-7: Interest.

Whether interest on obligations of a political subdivision is exempt from tax. See Rev. Rul. 80-91, this page.

26 CFR 1.61-7: Interest.

Whether interest on obligations of a political subdivision is exempt from tax. See Rev. Rul. 80-92, page 7.

Section 83.—Property Transferred in Connection with Performance of Service

26 CFR 1.83-1: Property transferred in connection with the performance of services.

Manner in which dividends with respect to stock transferred to an employee in connection with the performance of services will be reported to the Internal Revenue Service, where the stock has not become substantially vested in the employee. See Rev. Proc. 80-11, page 28.

Section 103.—Interest on Certain Governmental Obligations

26 CFR 1.103-13: Arbitrage bonds.
(Also Section 61; 1.61-7.)

Arbitrage bonds; advance refunding issue; unreasonable investment fees. Unreasonable fees or unreasonably allocated fees paid by an issuer of advance refunding bonds in an escrow restructuring transaction may not be taken into account in determining whether the arbitrage yield restrictions of section 103(c) of the Code are met.

Rev. Rul. 80-91 [1]

ISSUE

Will an authority that is a political subdivision of a state comply with the arbitrage yield restrictions of section 103(c) of the Internal Revenue Code with respect to an issue of its obligations in the situation described below?

FACTS

Authority *P* is a political subdivision of the state of *O* that was created by *O* to construct, finance and operate college dormitories in *O*. On January 2, 1974, *P* issued bonds that were used to construct dormitories.

On January 7, 1976, *P* issued advance refunding bonds to refund the 1974 bonds. Proceeds of the refunding bonds were to be held in escrow until 1984. The yield on the refunding bonds was 7 percent, as computed under section 1.103-13(c) of the proposed Income Tax Regulations published in the Federal Register of May 3, 1973 (38 F.R. 10944). A major portion of the proceeds of the refunding bonds were invested in United States Treasury obligations—State and Local Government Series (SLGS), at a restricted yield that was not materially higher than the yield on the advance refunding bonds. Amounts representing a minor portion of the proceeds of the advance refunding bonds were invested at an unrestricted yield of 9 percent. At the time of issuance *P* executed a certification in accordance with the provisions of section 1.103-13(a)(2)(ii) of the proposed regulations published in the Federal Register of May 3, 1973 (38 F.R. 10944).

On January 2, 1980, *P* redeemed a portion of the SLGS constituting the major portion of the escrow investment and redeemed all of the SLGS constituting the minor portion of the escrow investment and reinvested them in a new series of SLGS. *P* allocated 52 percent of the reinvested SLGS to the major portion and 48 percent to the minor portion. The reason *P* entered into this escrow restructuring transaction was to invest the minor portion at a rate higher than 9 percent. *P* paid $225,000 in "costs" to financial advisors and counsel in connection with the escrow restructuring. A reasonable fee for such services was $100,000.

Although *P* entered into the transaction for the purpose of increasing the yield on its minor portion investments, *P* allocated 47 percent of the "costs" of the transaction to the major portion investments, which are subject to restrictions on yield, and 53 percent to the minor portion investments, which are not subject to restrictions on yield. Thus, *P* took into account 47 percent of its "costs" for the escrow restructuring transaction ($105,750) in computing the yield on the major portion of the SLGS subject to yield restrictions.

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include interest on the obligations of a state or a political subdivision of a state.

Section 103(c)(1) of the Code provides that, with certain minor exceptions, the interest on any arbitrage bond will not be excludable from gross income.

Section 103(c)(2) of the Code provides that the term "arbitrage bond" means any obligation that is issued as part of an issue all or a major portion (more than 15 percent) of the proceeds of which are reasonably expected to be used directly or indirectly (A) to acquire securities or obligations that may be reasonably expected at the time of issuance of such issue, to produce a yield over the term of the issue that is materially higher than the yield on obligations of such issue, or (B) to replace funds that were used directly or indirectly to acquire securities or obligations described in section 103(c)(2)(A).

T.D. 7627 (44 F.R. 32657), 1979-28 I.R.B. 5, which adopted the final arbitrage bond regulations, provides that, for governmental obligations issued on or before the effective date of the final regulations (May 31, 1979), the proposed income tax regulations, as amended, under section 103(c) of the Code shall apply.

Section 1.103-13(a)(2)(i) of the proposed regulations published in the Federal Register of May 3, 1973 (38 F.R. 10944), applicable to the advance refunding bonds, provides, in part, that under section 103(c)(2) of the Code the determination whether an obligation is an arbitrage bond depends upon the issuer's reasonable expectations, as of the date of issue, regarding the amount and use of the proceeds of the issue. The reasonable expectations regarding the amount and use of the proceeds of a governmental obligation may be established by the certification described in section 1.103-13(a)(2)(ii).

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[1] Also released as News Release IR-80-32, dated March 19, 1980.

Example (1) of section 1.103-13(a)(2)(v) of the final regulations illustrates the effect of a no-arbitrage certification. In this example, city *A* issues bonds to construct a water treatment facility and in the certification *A* includes a statement that 85 percent of the receipts from the sale of the bonds will be used for construction costs within three years of the date of issue of the bonds. Subsequently, construction of the water treatment facility was determined by the Environmental Protection Agency to have certain adverse effects. As a result, 85 percent of the receipts from the sale of the bonds will not be expended for project costs within three years of the date of issue of the bonds. The example concludes that the certification is conclusive as to the issuer's reasonable expectations that 85 percent of the receipts will be expended for construction costs within three years of the date of issue of the bonds.

Section 1.103-13(c)(1) of the proposed regulations published in the Federal Register of May 3, 1973 (38 F.R. 10944), provides that an amount equal to the sum of the administrative costs of issuing, carrying, and repaying an issue of governmental obligations shall be treated as a discount on the selling price of such issue. An amount equal to the sum of the administrative costs to be incurred in purchasing, carrying, and selling or redeeming a class of acquired obligations shall be treated as a premium on the purchase price of such acquired obligations.

Section 1.103-13(b)(5) of the proposed regulations published in the Federal Register of December 3, 1975 (40 F.R. 56448), applicable to the advance refunding bonds, provides, in the case of a refunding issue, that prior to the date on which the last obligation of the prior issue is discharged, the yield produced by acquired obligations allocated to the proceeds (other than transferred proceeds) of the refunding issue is materially higher than the yield produced by such issue if the yield of such acquired obligations exceeds the yield of such issue.

P allocated 47 percent of the "costs" of the escrow restructuring to the 52 percent of the SLGS that were reinvested as a major portion. In addition, *P* allocated 53 percent of the "costs" of the escrow restructuring to the 48 percent of the SLGS that were reinvested as a minor portion. Because the underlying motive and real purpose of the escrow restructuring was to increase the yield on the securities in the minor portion, the allocation of 47 percent of the administrative costs to the major portion is unreasonable. As a result, the excessive amounts may not be taken into account in computing the yield on the major portion investments. Thus, the yield on the SLGS allocated to the major portion exceeds 7 percent.

The result would be the same even if it were reasonable to allocate 47 percent of the administrative costs of the escrow restructuring to the major portion because the "costs" paid by *P* in excess of reasonable administrative costs may not be taken into account in computing the yield on the major portion investments.

The "reasonable expectations" test contained in section 103(c) of the Code and the certification procedure contained in section 1.103-13(a)(2) of the proposed and the final regulations both provide a high degree of certainty by generally assuring that the bonds will not be arbitrage bonds in the event of occurrences that are beyond the control of the issuer. Compare example (1) of section 1.103-13(a)(2)(v) of the final regulations which concerns the reasonable expectations of an issuer with respect to a matter it did not reasonably expect to occur and was beyond its control. However, neither the reasonable expectations test nor the certification procedure provides protection in this particular case where the issuer has *taken deliberate and intentional* actions to produce arbitrage.

HOLDING

P has failed to comply with the arbitrage yield restrictions of section 1.103-13(b)(5) of the proposed regulations. The no-arbitrage certification made by *P* will not prevent the advance refunding bonds from being arbitrage bonds. Therefore, the advance refunding bonds issued by *P* are arbitrage bonds within the meaning of section 103(c)(2) of the Code and the interest on the bonds is not excludable from the gross income of the bondholders under section 103(a)(1).

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26 CFR 1.103-13: Arbitrage bonds.
(Also Sections 61, 1012; 1.61-7, 1.1012-1.)

Arbitrage bonds; advance refunding issue; acquired obligations; excess cost. Amounts in excess of fair market value paid for acquired obligations from the proceeds of advance refunding bonds may not be taken into account in determining whether the arbitrage yield restrictions of section 103(c) of the Code are met.

Rev. Rul. 80-92 [1]

ISSUE

Will an authority that is a political subdivision of a state comply with the arbitrage yield restrictions of section 103(c) of the Internal Revenue Code with respect to an issue of its obligations in the situation described below?

FACTS

Authority *Q* is a school district that is a political subdivision of the state of *R*. On January 2, 1976, *Q* issued its advance refunding bonds to refund construction bonds that were issued by *Q* in 1975. The refunding bonds have a yield of 8 percent.

A major portion of the proceeds of the advance refunding bonds were immediately invested in United States Treasury obligations—State and Local Government Series (SLGS) at a restricted yield of 8 percent. Amounts representing a minor portion of the proceeds of the advance refunding bonds were immediately invested in

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[1] Also released as News Release IR-80-32, dated March 19, 1980.

SLGS at an unrestricted yield of 9 percent. On January 2, 1980, *Q* redeemed the SLGS that it had purchased in 1976. *Q* used the proceeds of the redemption to purchase United States Treasury bonds with an interest rate of 8 percent from *S*, an unrelated third person.

At par value the Treasury bonds have a yield of 8 percent. However, *Q* acquired the Treasury bonds at a time when their fair market value was below par. At fair market value, the yield on the Treasury bonds is 13 percent. Although *Q* knew the fair market value of the bonds, *Q* purchased a portion of the Treasury bonds at par. *Q* allocated the purchases at par to the major portion and computed the yield on those Treasury bonds by taking into account as the purchase price the par value of the Treasury bonds.

Q allocated all of the costs of the purchase of the Treasury bonds to the minor portion of the escrow for the advance refunding bonds. At the time of the issuance of the advance refunding bonds *Q* executed a no-arbitrage certification in accordance with the provisions of section 1.103-13(a)(2)(ii) of the proposed Income Tax Regulations published in the Federal Register of May 3, 1973 (38 F.R. 10944).

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include interest on the obligations of a state or a political subdivision of a state.

Section 103(c)(1) of the Code provides that, with certain minor exceptions, the interest on any arbitrage bond will not be excludable from gross income.

Section 103(c)(2) of the Code provides that the term "arbitrage bond" means any obligation that is issued as part of an issue all or a major portion (more than 15 percent) of the proceeds of which are reasonably expected to be used directly or indirectly (A) to acquire securities or obligations that may be reasonably expected at the time of issuance of such issue, to produce a yield over the term of the issue that is materially higher than the yield on obligations of such issue, or (B) to replace funds that were used directly or indirectly to acquire securities or obligations described in section 103(c)(2)(A).

Section 1012 of the Code provides that the basis of property is the cost.

T.D. 7627 (44 F.R. 32657), 1979-28 I.R.B. 5, which adopted the final arbitrage bond regulations, provides that, for governmental obligations issued on or before the effective date of the final regulations (May 31, 1979), the proposed income tax regulations, as amended, under section 103(c) of the Code shall apply.

Section 1.103-13(a)(2)(i) of the proposed regulations published in the Federal Register of May 3, 1973 (38 F.R. 10944), applicable to the advance refunding bonds, provides, in part, that under section 103(c)(2) of the Code the determination whether an obligation is an arbitrage bond depends upon the issuer's reasonable expectations, as of the date of issue, regarding the amount and use of the proceeds of the issue. The reasonable expectations regarding the amount and use of the proceeds of a governmental obligation may be established by the certification described in section 1.103-13(a)(2)(ii).

Example (1) of section 1.103-13(a)(2)(v) of the final regulations illustrates the effect of a no-arbitrage certification. In this example, city *A* issues bonds to construct a water treatment facility and in the certification *A* includes a statement that 85 percent of the receipts from the sale of the bonds will be used for construction costs within three years of the date of issue of the bonds. Subsequently, construction of the water treatment facility was determined by the Environmental Protection Agency to have certain adverse effects. As a result, 85 percent of the receipts from the sale of the bonds will not be expended for project costs within three years of the date of issue of the bonds. The example concludes that the certification is conclusive as to the issuer's reasonable expectations that 85 percent of the receipts will be expended for construction costs within three years of the date of issue of the bonds.

Section 1.103-13(b)(5) of the proposed regulations published in the Federal Register of December 3, 1975 (40 F.R. 56448), applicable to the advance refunding bonds, provides, in the case of a refunding issue, that prior to the date on which the last obligation of the prior issue is discharged, the yield produced by acquired obligations allocated to the proceeds (other than transferred proceeds) of the refunding issue is materially higher than the yield produced by such issue if the yield of such acquired obligations exceeds the yield of such issue.

The question in cases concerning the purchase of property at above fair market value is whether the price paid in excess of the market value is for a purpose other than the acquisition of the property. In such cases it is incumbent upon the taxpayer to show that the amount paid is for no purpose other than the acquisition of the property. See ***Majestic Securities Corp. v. Commissioner,*** 42 B.T.A. 698 (1940), ***aff'd,*** 120 F.2d 12 (8th Cir. 1941) and ***New Hampshire Fire Insurance Co. v. Commissioner,*** 2 T.C. 708 (1943).

In this case, *Q* knowingly paid in excess of fair market value for part of the Treasury bonds. Therefore, *Q* must show that such excess was paid only for the acquisition of the Treasury bonds.

If *Q* paid fair market value for the Treasury bonds, the yield on the Treasury bonds would have exceeded the yield on the issue of *Q*'s obligations by more than the amount permitted by section 1.103-13(b)(5) of the proposed regulations. Thus, the amounts that *Q* paid to *S* in excess of the fair market value of the Treasury bonds were amounts paid in an attempt to reduce yield on the acquired obligations and are not part of the purchase price of the obligations.

Therefore, in this case, the cost to *Q* of the Treasury bonds under section 1012 of the Code is their fair market value and not the stated cost of par value. The fact that the purchase price of the Treasury bonds to *Q* is the fair market value means that the yield on the Treasury bonds exceeds 8 percent.

The "reasonable expectations" test contained in section 103(c) of the Code and the certification procedure contained in section 1.103-13(a)(2) of the proposed and the final regulations both provide a high degree of certainty by generally assuring that the bonds will not be arbitrage bonds in the event of occurrences that are beyond the control of the issuer. Compare example (1) of section 1.103-13 (a) (2) (v) of the final regulations which concerns the reasonable expectations of an issuer with respect to a matter it did not reasonably expect to occur and was beyond its control. However, neither the reasonable expectations test nor the certification procedure provides protection in this particular case where the issuer has taken deliberate and intentional actions to produce arbitrage.

HOLDING

Q has failed to comply with the arbitrage yield restrictions of section 1.103-13(b) (5) of the proposed regulations. The no-arbitrage certification made by *Q* will not prevent the advance refunding bonds from being arbitrage bonds. Thus, the advance refunding bonds issued by *Q* are arbitrage bonds within the meaning of section 103(c) (2) of the Code and the interest on the bonds is not excludable from the gross income of the bondholders under section 103(a) (1).

Section 162.—Trade or Business Expenses

26 CFR 1.162-1: Business expenses.

Whether guarantee and management fees associated with the sale of participation sales certificates sold by Federal Home Loan Mortgage Corporation are deductible as business expenses. See Rev. Rul. 80-96, page 22.

Section 164.—Taxes

26 CFR 1.164-1: Deduction for taxes.

Whether a deduction is allowable for social security taxes paid or accrued to the Federal Republic of Germany on or after December 1, 1979. See Rev. Rul. 80-94, page 10.

Section 167.—Depreciation

26 CFR 1.167(a)-2: Tangible property.
(Also Section 263; 1.263(a)-1.)

Depreciation; land preparation costs; electric and gas distribution systems. Amounts paid by the developer of a mobile home park to a public utility for underground electric and gas distribution systems are capital expenditures that are included in the developer's cost basis of the land. Examples illustrate which land preparation costs may be depreciated by the developer and which must be included in the basis of the land.

Rev. Rul. 80-93

ISSUE

Is a depreciation deduction allowable for costs paid to a public utility company to assist in construction of an electrical distribution system and for land preparation costs that are incurred in connection with the development of a mobile home park?

FACTS

The taxpayer owns and operates a mobile home park in which it rents sites to tenants on a monthly basis. The taxpayer constructed asphalt roadways, concrete sidewalks, laundry facilities, storm sewers, and assets at each individual site that include a concrete driveway, patio, and mobile home supports.

The major part of the taxpayer's land preparation costs was incurred in the clearing, grubbing, cutting, filling, and rough grading necessary to bring the land to a suitable grade. Additional land preparation costs were incurred in the digging and the rough and finish grading necessary to construction of the roadways, sidewalks, driveways, patios, and mobile home supports. Land preparation costs do not include the cost of construction of the depreciable roadways, sidewalks, driveways, patios, and mobile home supports. Replacement of the roadways, sidewalks, driveways, patios and mobile home supports will not require additional digging or grading.

Other land preparation costs were incurred in the excavation and backfilling necessary to construction of the laundry facilities and the storm sewer system. Replacement of the underground components of these facilities owned by the taxpayer will require excavation and backfilling.

At the taxpayer's request, a public utility company installed an underground electrical distribution system instead of a less expensive system aboveground. The taxpayer contracted to pay the additional cost and to assist the utility company in the cost of a natural gas distribution system. The utility company will retain full ownership, provide all necessary maintenance, and replace the systems as necessary.

LAW AND ANALYSIS

Section 167(a) of the Internal Revenue Code provides that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business.

Section 1.167(a)-2 of the Income Tax Regulations provides that the depreciation allowance applies only to that part of tangible property subject to wear and tear, to decay or decline from natural causes, to exhaustion, and to obsolescence, but not to land apart from the improvements or physical development added to it.

Section 263(a) (1) of the Code provides that no deduction shall be allowed for any amount paid out for permanent improvements or betterments made to increase the value of any property or estate.

Costs for land preparation such as site clearing, grubbing, cutting, filling, and rough grading are one time only expenditures. Such work will not be affected by replacement of the components of the mobile home park. Similarly, the digging and rough and finish grading associated with construction of the roadways, sidewalks, and the assets at the individual home sites have a useful life that extends beyond the life of those assets since the work will not have to be repeated when the assets are replaced. On the other hand, the excavation and backfilling required for installation of the laundry facilities and the storm sewer system are so closely associated with those assets that replacement of the assets will require the physical destruction of that land preparation. *See* Rev. Rul. 74-265, 1974-1 C.B. 56, and Rev. Rul. 72-96, 1972-1 C.B. 67.

The amounts paid to the utility company for the installation of the underground electrical distribution system and the natural gas distribution system are expenditures that increase the value of the land. They are nonrecurring because the utility company will repair and replace the systems as necessary.

HOLDING

Land preparation costs, such as those for necessary clearing, grubbing, cutting, filling, and rough and finish grading (generally or with respect to individual assets), that will be unaffected by replacement of the components of the mobile home park and therefore will not be replaced contemporaneously therewith are nonrecurring general land improvement costs. These one time land preparation costs are considered inextricably associated with the land and, as such, are to be added to the taxpayer's cost basis in the land and are not depreciable.

Those land preparation costs that are so closely associated with assets such as the storm sewers and laundry facilities that they will be retired, abandoned, or replaced contemporaneously with those assets are to be capitalized and depreciated over the estimated useful lives of the assets with which they are associated.

The amounts paid to the utility for the underground electrical system and the gas distribution system are nonrecurring costs for betterments that increase the value of the land. As such, these amounts are capital expenditures within the meaning of section 263(a) of the Code that are includible in the taxpayer's cost basis of the land and are not depreciable.

Section 170.—Charitable, Etc., Contributions and Gifts

26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance of deduction.

Whether a contribution to a cemetery company exempt from federal income tax under section 501(c)(13) of the Code, made by an organization that is a private foundation under section 509(a), is an amount paid to accomplish one or more of the purposes described in section 170(c)(2)(B). See Rev. Rul. 80-97, page 16.

Section 263.—Capital Expenditures

26 CFR 1.263(a)-1: Capital expenditures; in general.

Whether a depreciation deduction is allowable for (1) costs paid to a public utility company to assist in construction of an electrical distribution system and for (2) land preparation costs that are incurred in connection with the development of a mobile home park. See Rev. Rul. 80-93, page 9.

Section 451.—General Rule for Taxable Year of Inclusion

26 CFR 1.451-1: General rule for taxable year of inclusion.

Time for inclusion in income of mortgage interest and other items of income with respect to holders of participation sales certificates that were sold by the Federal Home Loan Mortgage Corporation. See Rev. Rul. 80-96, page 22.

Section 501.—Exemption from Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(a)-1: Exemption from taxation.

Effect of purchase of participation sales certificates sold by the Federal Home Loan Mortgage Corporation on tax-exempt status of employees pension or profit-sharing trust. See Rev. Rul. 80-96, page 22.

Section 593.—Reserve for Losses on Loans

26 CFR 1.593-11: Qualifying real property loan and non-qualifying loan defined.

Whether participation sales certificates in mortgage pool guaranteed by Federal Home Loan Mortgage Corporation and held by a savings and loan association within the meaning of section 7701(a)(19) of the Code represents qualifying real property loans. See Rev. Rul. 80-96, page 22.

Section 671.—Trust Income, Deductions, and Credits Attributable to Grantors and Others as Substantial Owners

26 CFR 1.671-1: Grantors and others treated as substantial owners, scope.

Whether holders of participation sales certificates sold by the Federal Home Loan Mortgage Association are treated as owners of the trust under Subpart E of Subchapter J of the Code. See Rev. Rul. 80-96, page 22.

Section 894.—Income Affected by Treaty

26 CFR 1.894-1: Income affected by treaty.

Whether amounts received from the National Institutes of Health under the Visiting Fellows Program by residents of Japan and certain other countries are exempt from federal income tax. See Rev. Rul. 80-98, page 25.

Section 901.—Taxes of Foreign Countries and of Possessions of the United States

26 CFR 1.901-1: Allowance of credit for taxes.
(Also Section 164; 1.164-1.)

Social security taxes; Federal Republic of Germany. No deduction or credit is allowable under section 164(a) or section 901(b) of the Code for social security taxes paid or accrued to the Federal Republic of Germany on or after December 1, 1979.

Rev. Rul. 80-94

ISSUE

Is a deduction or a credit allowable under section 164(a) or section 901(b) of the Internal Revenue Code for social security taxes paid or accrued to the Federal Republic of Germany on or after December 1, 1979?

FACTS AND LAW

On December 1, 1979, pursuant to section 233(a) of the Social Security Act, 42 U.S.C. section 433 (1979), the United States entered into an agreement with the Federal Republic of Germany establishing a totalization arrangement between the United States social security system and the German social security system for the purpose of establishing an individual's entitlement to and the amount of benefits on the basis of such individual's period of coverage under both systems.

Section 317(b)(4) of the Social Security Amendments of 1977, Pub. L. 95-216, 1978-1 C.B. 462, 467, provides that, notwithstanding any other provision of law, social security taxes paid by any individual to a foreign country shall not be deductible by, or creditable against the income tax of, any such individual where an agreement pursuant to section 233 of the Social Security Act has been entered into between such foreign country and the United States.

HOLDING

Neither a deduction nor a credit is allowable under section 164(a) or section 901(b) of the Code for social security taxes paid or accrued to the Federal Republic of Germany on or after December 1, 1979.

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26 CFR 1.901-1: Allowance of credit for taxes.

Revocation of Rev. Proc. 78-32, relating to the revocation of an election to receive the Puerto Rico and possession tax credit made under section 936 of the Code. See Rev. Proc. 80-12, page 28.

Section 936.—Puerto Rico and Possession Tax Credit

26 CFR 7.936-1: Qualified possession source investment income.

Revocation of Rev. Proc. 78-32, relating to the revocation of an election to receive the Puerto Rico and possession tax credit made under section 936 of the Code. See Rev. Proc. 80-12, page 28.

Section 1012.—Basis of Property —Cost

26 CFR 1.1012-1: Basis of property.

Whether the cost of acquired obligations is the fair market value or stated cost. See Rev. Rul. 80-92, page 7.

Section 1232.—Bonds and Other Evidences of Indebtedness

26 CFR 1.1232-1: Bonds and other evidences of indebtedness; scope of section.

Extent to which participation sales certificates sold by the Federal Home Loan Mortgage Corporation may be subject to section 1232 of the Code. See Rev. Rul. 80-96, page 22.

Section 2040.—Joint Interests

26 CFR 23.1: Election and eligibility to treat interests in property held jointly on December 31, 1976, as qualified joint interests.

T.D. 7687

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART 23.—TEMPORARY ESTATE TAX REGULATIONS UNDER THE REVENUE ACT OF 1978

Procedure for election to treat an interest in certain joint tenancies as a qualified joint interest

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides temporary regulations for a husband and wife who elect to treat their interest in certain jointly held property as a "qualified joint interest" for Federal estate tax purposes. The regulations reflect changes made in the applicable tax law by the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1] and provide instructions on the manner and effect of making the election.

DATE: The regulations apply to certain property held jointly on December 31, 1976.

FOR FURTHER INFORMATION CONTACT: Stephen J. Small of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3287 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains temporary regulations providing instructions for taxpayers who elect to treat as a qualified joint interest their interest in property placed in joint tenancy before January 1, 1977. The election is available under section 2040(d) of the Internal Revenue Code of 1954, as added by section 702(k) of the Revenue Act of 1978 (Pub. L. 95-600, 92 Stat. 2932).

The temporary regulations provided by this document will remain in effect through December 31, 1981.

PROVISIONS OF THE REGULATIONS

In general, on the death of a joint tenant, the entire value of property owned in joint tenancy is included in the decedent's gross estate except for the portion of the value of the property attributable to the consideration furnished by the survivor. Section 2040(b) of the Code, added by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1], provides that in the case of a "qualified joint interest" created after December 31, 1976, only one half of the value of the property will be included in the gross estate of the first joint tenant to die.

Under section 2040(d) of the Code, added by the Revenue Act of 1978, a husband and wife may elect to treat an interest in certain property placed in joint tenancy before January 1, 1977 as a "qualified joint interest" without going through a formal severance and re-creation of the joint tenancy. This election must be made for a calendar quarter ending on or before December 31, 1979.

The regulation provides that the spouse who furnished more than one-half of the consideration for the property must make the election by including the amount of the gift in a timely filed gift tax return and by paying any gift tax due as a result. The regulation provides deadlines for filing the return as well as a formula for computing the amount of the gift.

The regulation also provides that in the case of real property an election under section 2040 will have the same effect as a post-1976 election under section 2515, and that in the case of personal property, an election under section 2040 will have the same effect as the creation of a post-1976 joint interest under section 2515A. Therefore, once the election is made to treat an interest in property as a qualified joint interest, additions to the value of the property made by one spouse must be included in any gift tax returns required to be filed for any taxable period in which total gifts to the donee spouse exceed the $3,000 annual exclusion. For these purposes, additions in value include mortgage payments on indebtedness secured by the property as well as improvements made to the property.

WAIVER OF CERTAIN PROCEDURAL REQUIREMENTS OF TREASURY DIRECTIVE

A determination has been made by Jerome Kurtz, Commissioner of Internal Revenue, that there is an immediate need for regulations under section 2040(d) because the election thereunder will not be available after the due date (including extensions thereof) for Federal gift tax returns for the last quarter of 1979. Compliance with the procedural requirements of paragraphs 8 through 14 of the Treasury directive relating to improved regulations (43 FR 52120) would therefore be impractical and, accordingly, the requirements have been waived.

DRAFTING INFORMATION

The principal author of this regulation was Stephen J. Small of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both in matters of substance and style.

Adoption of amendments to the regulations:

Accordingly, the following temporary regulations are adopted and inserted in new Part 23, Temporary Estate Tax Regulations under the Revenue Act of 1978 (26 CFR Part 23):

§ 23.1 Election and eligibility to treat interests in property held jointly on December 31, 1976, as qualified joint interests.

(a) *Election as a qualified joint interest*—(1) *In general.* If a taxpayer has elected to have an interest in property held jointly by a husband and wife on December 31, 1976, treated as a "qualified joint interest," the effect, from the deemed date of such election, shall be

(i) in the case of real property, as if an election under section 2515, as applicable to post-1976 transfers, had been made, and

(ii) in the case of personal property, as if a post-1976 joint interest described in section 2515A had been created.

For estate tax purposes, one-half of the value of the property is includible in the estate of the first joint tenant to die; and, for gift tax purposes, any subsequent additions to the value of a joint tenancy in real property must be treated as transfers at the time the additions occur.

(2) *Eligibility.* Any husband and wife who before January 1, 1977, created an interest in property as joint tenants with right of survivorship or as tenants by the entirety and who continue to hold such interest may elect to treat their interest as a qualified joint interest if:

(i) Such joint interest was created by either spouse, or both (for rules involving the creation of a joint tenancy by husband and wife, see § 25.2515-1 (b)) and

(ii) In the case of a joint tenancy with right of survivorship, only the husband and the wife are joint tenants.

An interest in property received as an into vivos or testamentary gift by husband and wife as joint tenants or tenants by the entirety is not an interest created by either spouse. See paragraph (c)(1)(ii) of § 25.2515-1.

(3) *Time and manner of making election.*

In order to elect under this section, the spouse who furnished more than one-half of the consideration for the property must include the amount of the gift in a timely filed Federal gift tax return for any calendar quarter in 1977, 1978 or 1979, pay any gift tax due as a result, and attach to the gift tax return a statement of consent. The statement of consent must be signed by the donee spouse and must indicate that the donee spouse consents to the election to treat the interest as a qualified joint interest as of the date of the deemed making of the gift. The election and gift are deemed made on the last day of the calendar quarter for which the return is filed. See section 6075(b) for the time for filing the gift tax return and section 6081 for extensions of time for filing the return. The return required by this section must be filed even though the amount involved does not exceed the exclusion provided by section 2503(b). No election may be made under this section after the death of the donor.

(b) *Determination of amount of gift*—(1) *Amount of gift.* Except as provided in subparagraph (5), the amount of any gift is one-half of the amount which bears the same ratio to the excess of the value of the property on the date of the deemed making of the gift over the value of such property on the date of the creation of the joint interest, as

(i) the excess of the consideration furnished by the donor over the consideration furnished by the donor's spouse, bears to

(ii) the total consideration furnished by both spouses. Under no circumstances can the amount of the gift be less than zero.

(2) *Value of the property.* For purposes of subparagraph (1), the value of the property on the date of the creation of the interest shall be the fair market value of the property on that date minus the amount of any original acquisition indebtedness. The value of the property on the date of the deemed making of the gift shall be the fair market value of the property on that date reduced by any outstanding indebtedness that is secured by the property.

(3) *Consideration furnished.* For purposes of subparagraph (1), the consideration furnished by each spouse shall be the total of the consideration furnished by that spouse at or prior to the time of the creation of the interest plus any subsequent payments by that spouse of mortgage principal on the original acquisition indebtedness. See paragraph (c)(1) of § 25.2515-1 for a discussion of what constitutes consideration and the value thereof. The phrase "original acquisition indebtedness" means indebtedness incurred (and secured by the property) upon the original acquisition of the property by either or both spouses and any refinancing of the original acquisition indebtedness to the extent of the unamortized balance of such original acquisition indebtedness. Repayments of mortgage principal on any such subsequent indebtedness shall be deemed to be reductions of the original acquisition indebtedness until the total principal amount of the original acquisiton indebtedness has been paid. Payments by either spouse that are a further reduction of any such subsequent indebtedness or are a reduction

of other indebtedness secured by the property shall not be included as consideration furnished under this section.

(4) *Subsequent payments.* In order to elect under this section, a taxpayer must be able to substantiate the amount and origin of the consideration furnished at the time of the creation of the interest. Any subsequent payments of mortgage principal the amount and origin of which cannot be substantiated will be deemed to be furnished in the same proportion as the consideration furnished at the time of the creation of the interest. Where a payment reducing the acquisition indebtedness is attributable to the income from the property the payment shall be deemed to have been made by each spouse in the same proportion that each spouse's prior consideration bears to the total consideration furnished to that time.

(5) *Creation that was not treated as a gift.* For purposes of subparagraph (2), the value of the property on the date of the creation of the joint interest shall be treated as zero, if—

(i) in the case of real property, the creation was not treated as a gift under section 2515, or

(ii) in the case of personal property, the transfer was required to be included on a gift tax return when created but was not so included, and the period of limitations on assessment under section 6501 has expired with respect to such gift.

(c) *Substantial improvements*—(1) *In general.* A substantial improvement of any property shall, for purposes of this section, be treated as the creation of a separate joint interest. An election under this section to treat an interest in underlying property as a qualified joint interest shall operate to treat any substantial improvement on such property made prior to January 1, 1977, as a separate qualified joint interest. An improvement shall be deemed to be a substantial improvement if—

(i) the cost of the improvement exceeded $10,000, or

(ii) the initial value of the improvement increased the fair market value of the property immediately before the improvement by more than 10 percent.

(2) *Value of the improvement.* The initial value of a substantial improvement shall be equal to the fair market value of the property immediately after the improvement less the fair market value of the property immediately before the improvement. In the absence of appraisals immediately before and immediately after the improvement, the cost of the improvement will be acceptable as proof of its initial value. For purposes of computing the amount of gift of both the substantial improvement and the original property, the ratio represented by the initial value of the substantial improvement over the fair market value of the property immediately after the improvement shall remain constant. (For an illustration of a substantial improvement for which consideration was furnished as a result of refinancing the original property, see example 6 of this section.)

(3) *Absence of consideration.* If the creation of the joint interest was not treated as a gift under section 2515 and if all of the consideration for a substantial improvement is furnished by increasing the amount of indebtedness secured by the property, such consideration shall be deemed to be furnished in the same proportion as the total consideration furnished by both spouses for the property to that time as determined under § 23.1(b).

(d) *Severance and re-creation of joint interest.* If, before January 1, 1977, a husband and wife had a joint interest in property with right of survivorship, and after December 31, 1976, (but prior to January 1, 1980) they sever and re-create the joint interest in such property (or in property the basis of which in whole or in part reflects the basis of such property), treatment as a qualified joint interest will be available only if the requirements of paragraphs (a) and (b) are met. If a timely gift tax return was filed as a result of such severance and re-creation but the amount of the gift was improperly computed or the required consent was not attached, treatment of the interest as a qualified joint interest from the date of the original filing will be permitted, if the gift tax return is corrected by the donor so that it is in compliance with the requirements of this section and any resulting deficiency (with interest) is paid.

(e) *Examples.* This section may be illustrated by the following examples.

Example 1. In 1962, Mr. A paid $20,000, the full amount of the down payment for a house having a fair market value of $65,000. Mr. and Mrs. A took title as joint tenants with right of survivorship and assumed a mortgage for $45,000. No gift tax return was filed. Over the years, Mr. A made all the mortgage payments with his own funds. Principal payments totaled $41,000. Mr. and Mrs. A would like to have their interest in the house treated as a qualified joint interest for Federal estate tax purposes. On December 31, 1979, the fair market value of the house is $117,000, and the balance due on the mortgage is $4,000.

Mr. and Mrs. A make the election by timely filing a gift tax return on April 15, 1980, along with the statement of consent. The amount of the gift is computed as follows:

The amount of the gift is ½ of x in the formula

$$\frac{x}{V_1 - V_2} = \frac{D.C. - S.C.}{D.C. + S.C.}$$

where V_1 is the value of the property on the date of the deemed making of the gift; V_2 is the value of the property on the date of the creation of the interest (which is deemed to be zero if the creation of the joint interest was not treated as a gift at that time); D.C. is the consideration furnished by the donor; and S.C. is the consideration by the donor's spouse.

Here, the value of the property on the date of the creation of the interest, for purposes of this section, is 0 and the value of the property at the date of the gift is $113,000 ($117,000 − $4,000). Accordingly, the formula becomes

$$\frac{x}{(\$117{,}000 - \$4{,}000) - 0} = \frac{[\$20{,}000 + \$41{,}000] - 0}{[\$20{,}000 + \$41{,}000] + 0}$$

$$x = \$113{,}000$$

$$\text{gift} = \$\ 56{,}500$$

Example 2. Assume the same facts as in example 1, except that Mr. A contributed $15,000 of the down payment and Mrs. A contributed $5,000. The amount of the gift is now $47,238, computed in the following manner:

$$\frac{x}{(\$117{,}000 - \$4{,}000) - 0} = \frac{[\$15{,}000 + \$41{,}000] - \$5{,}000}{[\$15{,}000 + \$41{,}000] + \$5{,}000}$$

$$\frac{x}{\$113{,}000} = \frac{\$51{,}000}{\$61{,}000}$$

$$x = \$94{,}476$$

$$\text{gift} = \$47{,}238$$

Example 3. Assume the same facts as in example 1, except that from 1962 to 1970 Mr. A made all the mortgage payments ($10,000) with his own funds and from 1970 through 1979 Mrs. A contributed half of each mortgage payment ($31,000 ÷ 2 = $15,500). Mr. A's contribution to the mortgage, then, has been $25,500, and Mrs. A's contribution has been $15,500.

The amount of the gift is now $27,787, computed in the following manner:

$$\frac{x}{(\$117{,}000 - \$4{,}000) - 0} = \frac{[\$20{,}000 + \$25{,}500] - \$15{,}500}{[\$20{,}000 + \$25{,}000] + \$15{,}500}$$

$$\frac{x}{\$113{,}000} = \frac{\$30{,}000}{\$61{,}000}$$

$$x = \$55{,}574$$

$$\text{gift} = \$27{,}787$$

Example 4. Assume the same facts as in example 1, except that in 1965, when the house was worth $70,000, Mr. A had a garage built on the property for $6,000. Mr. A paid the entire $6,000 and filed a gift tax return for the gift he made at that time. Since the garage neither cost $10,000 nor increased the value of the property immediately before the improvement by more than 10 percent, the garage is not considered to be a substantial improvement.

For purposes of § 23.1(b), even though a gift tax return was filed in 1965 with respect to the $6,000, the creation of the interest in 1962 was not treated as a gift and the value of the property on that date (V_2 in the formula) is treated as zero.

Example 5. In 1968, Mr. and Mrs. B purchased a farm for $50,000, and took title jointly. The farm included farmland, a home, and a barn. Mr. B made the full $10,000 down payment. In 1974, when the property was worth $100,000 and the balance on the mortgage was $30,000, Mr. B arranged to refinance his mortgage, increasing it to $80,000. He invested the additional $50,000 he received in securities. Mr. B has made all the principal payments on the mortgage since the purchase (a total of $18,000). At no time has Mr. B filed a gift tax return.

On December 31, 1979, the fair market value of the entire property is $150,000 and the balance on the new mortgage is $72,000. Mr. and Mrs. B elect at that time to have their interest in the property treated as a qualified joint interest. The amount of the gift is computed as follows:

$$\frac{x}{(\$150{,}000 - \$72{,}000) - 0} = \frac{[\$10{,}000 + \$18{,}000] - 0}{[\$10{,}000 + \$18{,}000] + 0}$$

$$\frac{x}{\$78{,}000} = \frac{\$28{,}000}{\$28{,}000}$$

$$\text{gift} = \$39{,}000$$

Example 6. Assume the same facts as in example 4, except that with the additional $50,000 he received, Mr. B added another barn on his property costing $20,000 and invested the balance in securities. Immediately after the construction of the barn, the fair market value of the entire property was $120,000, and today the fair market value of the entire property is $180,000.

The second barn was a substantial improvement because it increased the fair market value of the property immediately before the improvement by 20 percent. Under paragraph (c)(2) of this section the fair market value of the barn today is deemed to be $30,000 (1/6 × $180,000). Further, under paragraph (c)(3) of this section, when all the consideration for the substantial improvement is attributable to increasing the amount of the indebtedness secured by the property, the consideration for the substantial improvement is deemed to be furnished in the same proportion as the total consideration furnished by both spouses for the property to that time, as determined under § 23.1(b).

To compute the amount of each gift it is necessary to separate the original property from the substantial improvement for purposes of determining the amount of the consideration furnished for each. Mr. A furnished $10,000 at the time of the creation of the joint interest and $10,000 (in mortgage payments) between 1968 and 1974. After 1974, since the substantial improvement represented 1/6 of the fair market value of the entire property, 5/6 of the mortgage payments from 1974 to 1978 are attributable to the underlying property (5/6 of $8,000) and 1/6 of the mortgage payments are attributable to the substantial improvement (1/6 of $8,000). The same allocation is necessary for the indebtedness. If Mrs. A had made any of the mortgage payments at any time, appropriate adjustments would have to be made. Under these facts, for the original property the formula becomes

$$\frac{x}{[5/6\ (\$180{,}000) - 5/6\ (\$72{,}000)] - 0} = \frac{[\$10{,}000 + \$10{,}000 + 5/6\ (\$8{,}000)] - 0}{[\$10{,}000 + \$10{,}000 + 5/6\ (\$8{,}000)] + 0}$$

$$\frac{x}{\$90{,}000} = \frac{\$26{,}667}{\$26{,}667}$$

$$\text{gift} = \$45{,}000$$

For the second barn, the formula becomes

$$\frac{x}{[1/6\ (\$180{,}000) - 1/6\ (\$72{,}000)] - 0} = \frac{[\$20{,}000 + 1/6\ (\$8{,}000)] - 0}{[\$20{,}000 + 1/6\ (\$8{,}000)] + 0}$$

$$\frac{x}{\$18{,}000} = \frac{\$21{,}334}{\$21{,}334}$$

$$\text{gift} = \$9{,}000$$

Example 7. Mr. and Mrs. C purchased a home for $150,000 in 1970, with Mr. C contributing all the consideration and Mr. and Mrs. C taking title as joint tenants. In 1977, Mr. and Mrs. C severed the joint tenancy and re-created it in order to treat the property as a qualified joint interest under section 2040(b) of the Code. No gift tax return was filed at either time. Under paragraph (d) above, treatment as a qualified joint interest is available only if the requirements of paragraphs (a) and (b) are met. If Mr. and Mrs. C still want to treat their interest in the property as a qualified joint interest, he must timely file a gift tax return and pay any tax due based on the value of the property on the last day of the reporting period in which the election is made.

Example 8. Assume the same facts as in example 7, except that Mr. C filed a gift tax return in 1977. Under paragraph (d) above, for certain joint interests in property created after December 31, 1976, and prior to January 1, 1980, treatment as a qualified joint interest is available only if the requirements of paragraphs (a) and (b) are met. If, for example, Mr. C failed to compute the amount of the gift in accordance with the formula in paragraph (b) or failed to attach a statement of consent, treatment of the interest as a qualified joint interest from the date of the original filing will be permitted only if a corrected gift tax return is filed that is in compliance with the requirements of this section.

Example 9. In 1960, Mr. and Mrs. D purchased a home for $24,000. Mr. D made the down payment of $5,000, and they took title jointly. In 1974, when the balance on the mortgage was $1,000 and the house was worth $65,000, Mr. and Mrs. D refinanced their mortgage, increasing it to $50,000. Today the house is worth $85,000 and the balance on the new mortgage is $46,000. Mr. D has made all the mortgage payments and has not at any time filed a gift tax return.

If Mr. and Mrs. D elect to have their interest treated as a qualified joint interest, the consideration furnished by Mr. D, in addition to the amount of the down payment, will be limited to the amount of the original acquisition indebtedness ($19,000) under § 23.1(b).

Example 10. In 1970, Mr. and Mrs. E purchased a home for $25,000. In 1977, when the home was worth $80,000, Mr. and Mrs. E added a new wing, with a bedroom, bathroom, and family room. The addition cost $20,000 and is a substantial improvement. No gift tax return was filed at any time.

Mr. and Mrs. E may elect to treat their original interest in the home as a qualified joint interest by complying with the requirements of this section. However, since the substantial improvement was a separate interest and was not created before January 1, 1977, it is not eligible for the special election provided under this section. Treatment of their interest in the substantial improvement as a qualified joint interest is available only by severing and re-creating the interest.

(f) *Effective date.* This section is effective for elections made for calendar quarters beginning after December 31, 1976, and before January 1, 1980.

This Treasury decision adds temporary regulations to enable taxpayers to comply with the new law on the election to treat an interest in property as a qualified joint interest. Because the election will be available only through 1979, it is impractical to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved March 7, 1980.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on March 19, 1980, 8:45 a.m., and published in the issue of the Federal Register for March 20, 1980, 45 F.R. 17983)

Section 4371.—Imposition of Tax [Miscellaneous Excise Taxes]

26 CFR 46.4371-2: Imposition of tax on policies issued by foreign insurers; scope of tax.
(Also Section 4372.)

Foreign insurer; indemnity bond vs. insurance policy. A domestic corporation that maintains disability plans covering its U.S. citizen or resident employees and former employees entered into a contract with a foreign insurer that is neither doing business nor authorized to do business in the U.S. In return for an actuarially computed annual payment, the insurer, which is not a party to the plans, indemnifies the corporation for all required plan payments. It incurs no liability to the employees or former employees and is responsible for neither plan performance failures nor the application or disposition of money paid to the corporation under the contract. The insurer has the right to audit claims against the plans and to protest what it feels are improper payments. The contract is a policy taxable under section 4371(2) of the Code.

Rev. Rul. 80-95

ISSUE

Whether the agreement described below, between a domestic corporation and a foreign insurer, is taxable either as an indemnity bond under section 4371(1) of the Internal Revenue Code at the rate of four cents on each dollar, or as a policy of life, sickness or accident insurance under section 4371(2) at the rate of one cent on each dollar.

FACTS

X, a domestic corporation, maintains long-term disability plans under which it is required to make payments to its United States citizen or resident employees and former employees. *X* entered into a contract with *Y*, a foreign insurer that is neither authorized to do business nor doing business in the United States. Under the contract, *Y* agrees to indemnify *X* for all payments *X* is obligated to make to its employees and former employees under the disability plans. In consideration, *Y* receives from *X* an annual payment that is actuarially computed on the basis of a disability table.

Y is not a party to any of *X*'s employee disability plans and incurs no liability to any individual employee or former employee claiming a disability payment under one of the plans. Further, *Y* is not responsible for any failure of *X* to perform its duties under the disability plans, nor is *Y* responsible for the application or disposition by *X* of any money received from *Y* under their contract. The settlement and payment of disability claims is handled entirely by *X*. Under its contract with *X*, *Y* does have the right to audit claims made against a disability plan, and to protest when it feels *X* has improperly made a payment under a plan.

LAW AND ANALYSIS

Section 4372(c) of the Code defines "indemnity bond" as any instrument by whatever name called whereby an obligation of the nature of an indemnity, fidelity or surety bond is made, continued, or renewed. The term includes any bond for indemnifying any person who shall have become bound or engaged as surety, and any bond for the due execution or performance of any contract, obligation, or requirement, or the duties of any office or position, and to account for money received by virtue thereof, where a premium is charged for the execution of such bond.

Section 4372(e) defines "policy of life, sickness, or accident insurance, or annuity contract" as any policy or other instrument by whatever name called whereby a contract is made, continued, or renewed with respect to life or hazards to the person of a citi- or resident of the United States.

The contract between *X* and *Y* is an agreement wherein *Y*'s liability to *X* is contingent upon one of *X*'s employees or former employees becoming disabled. The contract between *X* and *Y* is not an indemnity bond subject to the tax imposed by section 4371(1) of the Code. However, the question remains whether the contract is a policy of life, sickness or accident insurance taxable under section 4371(2).

Although the independent and separate nature of the disability plans means that *X*'s employees or former employees are not parties to the contract between *X* and *Y*, this lack of privity is not necessarily determinative as to the nature of that contract.

The character of the risk covered by the contract is "with respect to the life or hazards of the person" as that phrase is used in section 4372(e) of the Code, because (1) the premium is actuarially computed on the basis of a disability table, (2) the contract is directly related to *X*'s disability plans (because the sole basis for a claim by *X* under its contract with *Y* is a prior payment by *X* to an employee or former employee under a disability plan), and (3) *Y* has the right to audit and protest the payments by *X* under the disability plans.

Because *Y* is obliged to indemnify *X* for losses sustained by *X* under the disability plans, the risk assumed by *Y* under the contract is the same as the risk borne by *X* under the disability plans. The fact that *X* has passed its risk to *Y* does not change the nature of the risk. The arrangement is similar to one of reinsurance in which the primary insurer transfers some or all of the risk it has assumed to a second insurance company. Thus the risk insured against under the contract is the risk of injury to employees or former employees of *X*. Therefore, the contract is a policy of "sickness or accident insurance" within the meaning of section 4372(e) of the Code.

HOLDING

The contract between *X* and *Y* is taxable at the rate of one cent on each dollar under section 4371(2) of the Code.

Section 4372.—Definitions [Policies Issued by Foreign Insurers]

Whether a certain insurance agreement between a domestic corporation and its foreign affiliate regarding the domestic corporation's employees is taxable under section 4371(1) or section 4371(2) of the Code. See Rev. Rul. 80-95, page 15.

Section 4942.—Taxes on Failure to Distribute Income

26 CFR 53.4942(a)-3: Qualifying distributions defined.
(Also Sections 170, 4945; 1.170A-1, 53.4945-1.)

Qualifying distribution; private foundation; exempt cemetery company. An unrestricted contribution made by a private foundation to an exempt cemetery company that is not described in section 170(c)(2)(B) of the Code is not a qualifying distribution within the meaning of section 4942(g) and is a taxable expenditure within the meaning of section 4945(d)(5).

Rev. Rul. 80-97

ISSUE AND FACTS

Is an unrestricted contribution to a cemetery company exempt from federal income tax under section 501(c)(13) of the Internal Revenue Code but not described in section 170(c)(2)(B), made by an organization that is a private foundation under section 509(a), a taxable expenditure within the meaning of section 4945(d)(5) or a qualifying distribution within the meaning of section 4942(g)?

LAW AND ANALYSIS

Section 4942(g) of the Code provides in part that the term "qualifying distribution" means any amount paid to accomplish one or more of the purposes described in section 170(c)(2)(B).

Section 4945(d)(5) of the Code provides that the term "taxable expenditure" means any amount paid or incurred by a private foundation for any purpose other than one specified in section 170(c)(2)(B).

Section 170(c)(2)(B) of the Code describes an organization that is organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or to foster national or international amateur sports competition, or for the prevention of cruelty to children or animals.

Section 501(c)(13) of the Code provides for the exemption from federal income tax of cemetery companies owned and operated exclusively for the benefit of their members or which are not operated for profit.

Section 170(c)(5) of the Code provides that the term "charitable contribution" includes a contribution or gift or for the use of a cemetery owned and operated exclusively for the benefit of its members, if such company is not operated for profit.

Although a cemetery company exempt under section 501(c)(13) of the Code is an organization to which contributions are deductible under section 170(c)(5), it is not an organization organized and operated exclusively for the purposes described in section 170(c)(2)(B).

HOLDING

Since the private foundation's contribution to the cemetery company is not an amount paid to accomplish one or more of the purposes described in section 170(c)(2)(B) of the Code, the contribution is a taxable expenditure within the meaning of section 4945(d)(5) and is not a qualifying distribution within the meaning of section 4942(g).

Compare section 53.4947-1(b)(2)(vii) of the Foundation Excise Tax Regulations which provides an exception to this rule for certain trusts described in section 4947(a)(1) of the Code that are devoted to section 170(c)(5) purposes together with section 170(c)(2)(B) purposes. Payments under the terms of the governing instrument of such a trust to an organization described in section 170(c)(5) are not considered a violation of section 4945(d)(5) and are considered qualifying distributions under section 4942.

Section 4945.—Taxes on Taxable Expenditures

26 CFR 53.4945-1: Taxes on taxable expenditures.

Whether a contribution to a cemetery company exempt from federal income tax under section 501(c)(13) of the Code, made by an organization that is a private foundation under section 509(a), is a qualifying distribution within the meaning of section 4945(g) and if it is not, whether it is a taxable expenditure within the meaning of section 4945(d)(5). See Rev. Rul. 80-97, this page.

Section 6042.—Returns Regarding Payments of Dividends and Corporate Earnings and Profits

26 CFR 1.6042-2: Returns of information as to dividends paid in calendar years after 1962.

Manner in which dividends with respect to stock transferred to an employee in connection with the performance of services will be reported to the Internal Revenue Service, where the stock has not become substantially vested in the employee. See Rev. Proc. 80-11, page 28.

Section 6051.—Receipts for Employees

26 CFR 31.6051-1: Statement for employees.

Manner in which dividends with respect to stock transferred to an employee in connection with the performance of services will be reported to the Internal Revenue Service, where the stock has not become substantially vested on the employee. See Rev. Proc. 80-11, page 28.

Section 6103.—Confidentiality and Disclosure of Returns and Return Information

26 CFR 404.6103(j)(1)-1: Disclosure of return information to officers and employees of the Department of Commerce for certain statistical purposes and related activities.

T.D. 7677

TITLE 26.—INTERNAL REVENUE.—CHAPTER 61, SUB-

CHAPTER B, PART 404.—TEMPORARY REGULATIONS ON PROCEDURE AND ADMINISTRATION UNDER THE TAX REFORM ACT OF 1976

Disclosure of return information to and by officers and employees of the Department of Commerce for certain statistical purposes and related activities.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains amendments to the temporary regulations relating to the disclosure of certain return information to and by officers and employees of the Department of Commerce for certain statistical purposes and related activities. These amendments are intended to clarify the existing regulations and expand them in one minor respect. They affect all disclosures to and by the Bureau of the Census.

DATE: The regulations apply to disclosures of return information after December 31, 1976.

FOR FURTHER INFORMATION CONTACT: David E. Dickinson of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3218).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains amendments to the temporary regulations relating to disclosure of return information to and by the Bureau of the Census under section 6103(j)(1) of the Internal Revenue Code of 1954, as added by section 1202 of the Tax Reform Act of 1976 (Pub. L. 94-455, 90 Stat. 1688) [1976-3 C.B. (Vol. 1) 1, 143].

DISCLOSURE OF RETURN INFORMATION ONLY FOR CERTAIN STATISTICAL ACTIVITIES CARRIED OUT BY BUREAU OF THE CENSUS

The Bureau of the Census conducts statistical and related activities under Title 13 of the United States Code. Its basic functions prescribed by statute are carried out under chapter 5 of Title 13. Under chapter 1, however, the Bureau is authorized to make, upon request, special statistical compilations and surveys on a cost reimbursement basis for other Federal agencies, State and local governments, or any other public or private person or agency. Section 6103(j)(1) of the Internal Revenue Code, and § 404.6103(j)(1)-1(b) of present temporary regulations, require the Internal Revenue Service to disclose return information to the Bureau for the purpose of structuring censuses and conducting related statistical activities authorized by law. Read literally, these disclosure provisions would apply to the disclosure of return information by the Service to the Bureau for purposes of carrying out statistical activities under chapter 1, as well as chapter 5, of Title 13.

The legislative history of section 6103(j)(1) of the Code indicates that, despite the language of section 6103(j)(1), Congress, in enacting that provision, was concerned with preserving the ability of the Bureau properly to carry out its functions under chapter 5 of Title 13 and not with statistical studies performed on a contractual basis under chapter 1. Accordingly, these proposed amendments of § 404.6103(j)(1)-1(b) would restrict the use of return information by the Bureau to censuses and related statistical activities conducted or prepared under the authority of chapter 5 of Title 13.

DISCLOSURE OF TAXPAYER NAME INFORMATION TO THE BUREAU OF THE CENSUS FOR PURPOSES OF CARRYING OUT A CHAPTER 5 ACTIVITY

Under § 404.6103(j)(1)-1(b)(1) of present temporary regulations, the Bureau of the Census is authorized to use certain described return information for described censuses, statistical programs, and program evaluation. These regulations provide, however, that the taxpayer's name can be used only where necessary to evaluate the completeness of census coverage, *i.e.*, census undercount. It has since developed, however, that the Bureau needs the authority to use taxpayer names for other statistical activities carried out under chapter 5 of Title 13. For example, if the Bureau were denied the use of taxpayers' names, its ability to conduct samples necessary to these chapter 5 activities would be impaired. Section 404.6103(j)(1)-1(b)(1) of present temporary regulations would, therefore, be amended to delete the restriction on the Bureau's use of taxpayers' names in conducting an activity under the authority of chapter 5.

DISCLOSURE OF EARNED INCOME CREDIT INFORMATION

In order to improve its estimates of per capita income for all geographic areas included in the general revenue sharing program, the Bureau of the Census needs access to the amount by which the earned income credit claimed on individual returns exceeds Federal income tax liability. Accordingly, a new subdivision (xiv) is added to § 404.6103(j)(1)-1(b)(1) to authorize the Service to disclose this information.

WAIVER OF PROCEDURAL REQUIREMENT OF TREASURY DIRECTING

There is need for expeditious adoption of the regulations contained in this document in order to prevent impairment of the present ability of the Bureau of the Census satisfactorily to conduct and prepare intercensal estimates, statistics programs, censuses and related program evaluation authorized by chapter 5 of Title 13, United States Code. For this reason, Jerome Kurtz, Commissioner of Internal Revenue, has determined that the provisions of paragraphs 8 through 14 of the Treasury Directive implementing Executive Order 12044 must be waived.

DRAFTING INFORMATION

The principal author of this regulation was David E. Dickinson of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations:

In order to amend the temporary regulation on Procedure and Administration (26 CFR Part 404) to allow for certain additional disclosures to and by the Bureau of the Census, § 404.6103(j)(1)-1(b) of such regulations is amended as follows:

Paragraph 1. Paragraph (b)(1) is amended to read as follows:

§ 404.6103(j)(1)-1 Disclosures of return information to officers and employees of the Department of Commerce for certain statistical purposes and related activities.

* * * * *

(b) *Disclosure of return information to officers and employees of the Bureau of the Census.* (1) Officers or employees of the Internal Revenue Service will disclose the following return information reflected on returns of an individual taxpayer to officers and employees of the Bureau of the Census for purposes of, but only to the extent necessary in, conducting and preparing, as authorized by chapter 5 of Title 13, United States Code, intercensal estimates of population and per capita income for all geographic areas included in the general revenue sharing program and demographic statistics programs, censuses and related program evaluation:

(i) Taxpayer identity information (as defined in section 6103(b)(6)), validity code with respect to the taxpayer identifying number (as described in section 6109), and taxpayer identifying number of spouse, if reported;

(ii) District office and service center codes;

(iii) Marital status;

(iv) Numbers and classifications of reported exemptions;

(v) Adjusted gross income;

(vi) Wage and salary income;

(vii) Dividend income;

(viii) Interest income;

(ix) Gross rent and royalty income;

(x) Entity code;

(xi) Residence information from the revenue sharing question;

(xii) Code indicators for Form 1040; Schedules C, D, E, F, and SE;

(xiii) Julian date relative to filing; and

(xiv) Amount by which the earned income credit exceeds Federal income tax liability.

Par. 2. Paragraph (b)(2) is amended by deleting "for purposes of conducting, as authorized by law," and inserting in lieu thereof "for purposes of, but only to the extent necessary in, conducting and preparing, as authorized by chapter 5 of Title 13, United States Code,".

Par. 3. Paragraphs (b)(3) and (4) are amended by deleting "for purposes of conducting and preparing, as authorized by law," and inserting in lieu thereof "for purposes of, but only to the extent necessary in, conducting and preparing, as authorized by chapter 5 of Title 13, United States Code,".

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in sections 6103(j)(1) and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1678, 68A Stat. 917; 26 U.S.C. 7805 and 6103(j)(1)).

JEROME KURTZ,
Commissioner of Internal Revenue.

Approved February 6, 1980.

DONALD C. LUBICK,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on February 21, 1980; 8:45 a.m., and published in the issue of the Federal Register for February 22, 1980, 45 F.R. 11802)

Section 7216.—Disclosure or Use of Information by Preparers of Returns

26 CFR 301.7216-2: Disclosure or use without formal consent of the taxpayer.

T.D. 7676

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Allowable disclosure or use of tax return information under section 7216.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Adoption of final regulations.

SUMMARY: This document provides final Regulations on Procedure and Administration relating to allowable disclosure or use of tax return information by tax return preparers under section 7216 of the Internal Revenue Code of 1954. These regulations provide necessary guidance to tax return preparers for compliance with the law.

DATE: These regulations are effective on January 1, 1972.

FOR FURTHER INFORMATION CONTACT: Catherine Kelly Bouknight of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3289, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On December 12, 1974, the Federal Register published proposed amendments to the Regulations on Procedure and Administration (26 CFR Part 301) under section 7216 of the Internal Revenue Code of 1954 (39 FR 43312). The amendments in the appendix to the notice of proposed rulemaking expand and augment the list of disclosures or uses of tax return information which can be made without violating section 7216(a) and

§ 301.7216-1. There was no request for a public hearing, and none was held.

After consideration of all comments regarding the proposed amendments, this Treasury decision adopts the amendments, as set forth in full below, to the Regulations on Procedure and Administration. Section § 301.7216-2 (n), as proposed, has been revised to make clear that a disclosure made in a bona fide though erroneous belief that a crime has been committed is excepted from section 7216(a) and § 301.7216-1.

In addition, a further notice of proposed rulemaking is being published contemporaneously with this Treasury decision. This further notice contains two proposed amendments to certain regulations under section 7216, which regulations are the subject of this Treasury decision.

EXPLANATION OF PROVISIONS

Section 7216(a) of the Code provides that, as a general rule, any tax return preparer who discloses or uses any tax return information other than for the specific purpose of preparing, or assisting in the preparation of, any tax return of the taxpayer by or for whom the information was made available to a tax return preparer shall be guilty of a misdemeanor. Section 7612(b)(3) provides that subsection (a) shall not apply to a disclosure or use of information which is permitted by regulations.

These amendments to § 301.7216-2 expand the list of disclosures or uses of tax return information to which the criminal sanction of section 7216(a) does not apply. The propriety of such disclosures or uses under ethical rules of conduct governing the practice of law or accountancy is beyond the scope of the proposed amendments.

Paragraph (c) of § 301.7216-2 is expanded to permit disclosure pursuant to an administrative order, demand, summons, or subpoena issued by any Federal regulatory agency.

Paragraph (e) of § 301-7216-2 expands allowable disclosure and use of tax return information by attorneys and accountants preparing tax returns. An attorney or accountant can use such information, or disclose it to another person in his firm who may use it, to render other legal or accounting services for the taxpayer, or, with the taxpayer's express or implied consent, make the information available to third parties. An attorney or accountant can take tax return information into account and act upon it, or disclose it to another person in his firm to take it into account and act upon it, while performing legal or accounting services for a client other than the taxpayer, where such information is or may be relevant to the services for such other client and its consideration by those performing the services is necessary to perform those services properly, but disclosure or use under this provision is limited to members or employees of the firm, unless such disclosure to an outsider is specifically excepted by another provision of § 301.7216-2 or § 301.7216-3.

Paragraph (n) of § 301.7216-2 permits disclosure of tax return information to Federal or State officials to inform them of activities which may constitute, or may have constituted, a violation of Federal or State criminal laws.

COMMENTS

A number of commenters requested clarification in § 301.7216-2(e) of the scope of a term used in the existing regulations, "lawfully engaged in the practice of law or accountancy." The suggestion was made that disclosure by employees of law or accounting firms who are not themselves lawyers or accountants but who receive tax return information should expressly be excepted from section 7216(a). The reason that lawyers and accountants are excepted from the criminal sanctions of section 7216 is because they are bound by codes of professional conduct and legal strictures that do not apply to nonprofessional employees. Moreover, paragraph (e), by expressly permitting attorneys and accountants to disclose tax return information to employees of their firms, so that such employees may make specified use of such information, by implication permits these employees to disclose such information to an attorney or accountant of the firm.

Another suggestion was to limit "lawfully engaged" to include only those licensed or registered with local authorities or, alternatively, to include only those admitted to practice before the Internal Revenue Service. This phrase as now used is intended to include only those licensed or registered locally and it is not considered necessary to state this expressly. Expanding the term to include tax return preparers admitted to Internal Revenue Service practice would except from section 7216 persons frequently not bound by professional canons of ethics or local laws, in violation of the rationale of the attorney/accountant exception.

Commenters also criticized another phrase in existing paragraph (e) as overly broad and vague. This paragraph provides that an accountant (and proposed paragraph (e) that an attorney as well) may make disclosure to third parties with the "implied consent" of the taxpayer. The term "implied consent" has been construed with adequate specificity in other areas of law and has sufficiently precise meaning to be commonly understood. This Treasury decision is not intended to alter these phrases, "lawfully engaged in the practice of law or accountancy" and "implied consent", as used in existing § 301.7216-2(e).

Other suggestions concerned the similar treatment of atorneys and accountants. A suggestion was made that the two professions should not be treated identically. While the attorney-client privilege has no exact counterpart in the accounting profession in most States, nonetheless State-licensed accountants are subject to sufficient professional discipline and legal restraint to be excepted with State-licensed attorneys from the sanctions of section 7216(a) and § 301.7216-1. Another proposal was that attorneys and State-licensed accountants should be completely excepted from the criminal provisions of section 7216(a) since professional ethics and State regulation insure "the highest standard of professional conduct." It is believed that this Treasury decision will not unduly hamper the conduct of these professionals and that they should not be completely excepted.

It was suggested that the proposed limit on disclosure pursuant to an administrative order, summons or subpoena in being limited to orders, etc., issued by a *regulatory* agency would probably exclude Internal Revenue Service orders, as well as other nonregulatory agency orders. This proposal has been taken into account in new proposed regulations under § 301.7216-2 contained in the notice of proposed rulemaking published contemporaneously with this Treasury decision. New proposed paragraph (c) would broaden the types of administrative bodies whose orders for disclosure of tax return information will be excepted from the criminal sanction of section 7216(a).

One criticism made was that the proposed rules could easily be construed as mandating unethical conduct by permitting disclosure by tax return preparers notwithstanding confidential relationships and constitutional rights. Code section 7216 and regulations issued thereunder do not mandate but rather decriminalize certain disclosures and uses. The propriety of such action under other laws or under ethical rules of conduct governing the practice of law or accountancy is beyond the scope of the amendments.

With regard to proposed paragraph (n) of § 301.7216-2, concern was expressed that this paragraph might be construed to impose an affirmative duty to disclose the commission of a crime. It is again emphasized that these proposed amendments are merely exceptions to a criminal provision and are not intended to authorize conduct forbidden elsewhere.

Commenters also suggested with respect to paragraph (n) that disclosure made in the bona fide though mistaken belief that a crime has been committed should be excepted. Language has been added to this paragraph to clarify that such good faith disclosure in fact comes under the protection of paragraph (n).

Finally, it was observed that paragraph (n) on disclosure to Federal and State officials omits disclosure to local officials, although disclosure pursuant to the order of a local court is permissible under § 301.7216-2(c). This matter is a subject of the new proposed regulations under § 301.7216-2 contained in the notice of proposed rulemaking published contemporaneously with this Treasury decision.

DRAFTING INFORMATION

The principal author of these regulations is Catherine Kelly Bouknight of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 301 is amended by revising § 301.7216-2(c) and (e) and by adding a new paragraph (n) thereto, to read as follows:

§ 301.7216-2 Disclosure or use without formal consent of the taxpayer.

* * * * *

(c) *Disclosure pursuant to an order of a court or of a Federal regulatory agency.* The provisions of section 7216 (a) and § 301.7216-1 do not apply to any disclosure of tax return information if such disclosure is made pursuant to any one of the following documents:

(1) The order of any court of record, Federal, State, or local, or

(2) An administrative order, demand, summons, or subpoena issued by any Federal regulatory agency in the performance of its duties.

Information must be clearly identified in the document in order to be disclosed under this paragraph (c).

* * * * *

(e) *Certain disclosure by attorneys and accountants.* The provisions of section 7216(a) and § 301.7216-1 do not apply to any disclosure of tax return information permitted by this paragraph (e).

(1) A tax return preparer who is lawfully engaged in the practice of law or accountancy and prepares a tax return for a taxpayer may use the tax return information of the taxpayer, or disclose such information to another employee or member of the preparer's law or accounting firm who may use it, to render other legal or accounting services to or for such taxpayer. Thus, for example, a lawyer who prepares a tax return for a taxpayer may use the tax return information of the taxpayer for, or in connection with, rendering legal services, such as estate planning or administration, or preparation of trial briefs or trust instruments, for the taxpayer or the estate of the taxpayer; or if another member of the same firm renders the other legal services for the taxpayer, the lawyer who prepared the tax return may disclose the tax return information to that other member for use in rendering those services for the taxpayer. In further illustration, an accountant who prepares a tax return for a taxpayer may use the tax return information, or disclose it to another member of the firm for use, for, or in connection with, the preparation of books of account, working papers, or accounting statements or reports to or for the taxpayer. Further, in the normal course of rendering such legal or accounting services to or for the taxpayer, the attorney or accountant may, with the express or implied consent of the taxpayer, make such tax return information available to third parties, such as stockholders, management, suppliers, or lenders.

(2) A tax return preparer who is lawfully engaged in the practice of law or accountancy and prepares a tax return for a taxpayer may (i) take such tax return information into account, and may act upon it, in the course of performing legal or accounting services for a client other than the taxpayer or (ii) disclose such information to another employee or member of the preparer's law or accounting firm to enable that other employee or member to take the information into account, and act upon it, in the course of performing legal or accounting services for a client other than the taxpayer, when such information is or may be relevant to the subject matter of such legal or accounting services for the other client

and its consideration by those performing the services is necessary for the proper performance by them of such services. In no event, however, may such tax return information be disclosed to a person who is not an employee or member of the law or accounting firm unless such disclosure is exempt from the application of section 7216(a) and § 301.7216-1 by reason of another provision, other than this paragraph, of § 301.7216-2 or § 301.7216-3.

(3) The application of this paragraph may be illustrated by the following examples:

* * * * *

Example (*1*). A, a member of an accounting firm, renders an opinion on a financial statement of M Corporation that is part of a registration statement filed with the Securities and Exchange Commission. After the filing of such registration statement, but before its effective date, B, a member of the same accounting firm, prepares an income tax return for N Corporation. In the course of preparing such income tax return, B discovers that N does business with M and concludes that information he is given by N should be considered by A to determine whether the financial statement reported on by A contains an untrue statement of material fact or omitted to state a material fact required to keep the statement from being misleading. B discloses to A the tax return information of N for this purpose. A determines that there is an omission of material fact and that an amended statement should be filed. A so advises M and the Securities and Exchange Commission. A explains that the omission was revealed as a result of confidential information which came to A's attention after the statement was filed, but A does not disclose the identity of the taxpayer or the tax return information itself. Section 7216(a) and § 301.7216-1 do not apply to the foregoing disclosure of N's tax return information by B to A and the use of such information by A in advising M and the Securities and Exchange Commission of the necessity for filing an amended statement. Section 7216(a) and § 301.7216-1 would apply to a disclosure of N's tax return information to M or to the Securities and Exchange Commission unless such disclosure is exempt from the application of section 7216(a) and § 301.7216-1 by reason of another provision of either § 301.7216-2 or § 301.7216-3.

Example (*2*). A, a member of an accounting firm, is conducting an audit of M Corporation, and B, a member of the same accounting firm, prepares an income tax return for D, an officer of M. In the course of preparing such return, B obtains information from D indicating that D, pursuant to an arrangement with a supplier doing business with M, has been receiving from the supplier, a percentage of the amounts which the supplier invoices to M. B discloses this information to A who, acting upon it, searches in the course of the audit for indications of such a kickback scheme. As a result, A discovers information from audit sources which also, but independently, indicates the existence of such a scheme. Without revealing the tax return information A has received from B, A brings to the attention of officers of M the audit information indicating the existence of the kickback scheme. Section 7216(a) and § 301.7216-1 do not apply to the foregoing disclosure of D's tax return information by B to A, the use by A of such information in the course of the audit, and the disclosure by A to M of the audit information indicating the existence of the kickback scheme. See also § 301.7216-2(*j*). Section 7216(a) and § 301.7216-1 would apply to a disclosure to M, or to any other person not an employee or member of the accounting firm, of D's tax return information furnished to B.

* * * * *

(n) *Disclosure to report the commission of a crime.* The provisions of section 7216(a) and § 301.7216-1 do not apply to the disclosure of any tax return information to the proper Federal or State official in order, and to the extent necessary, to inform the official of activities which may constitute, or may have constituted, a violation of Federal or State criminal laws. In addition, such a disclosure made in the bona fide but mistaken belief that the activities constituted a violation of criminal law is not subject to section 7216(a) and § 301.7216-1.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved February 8, 1980.

Donald C. Lubick,
Secretary of
the Treasury

(Filed by the Office of the Federal Register on February 20, 1980; 8:45 a.m., and published in the issue of the Federal Register for February 21, 1980, 45 F.R. 11470)

Section 7701.—Definitions

26 CFR 301.7701-2: Associations, including organizations labeled "corporations."

Whether a certain arrangement whereby savings and loan associations and other investors acquire participation sales certificates issued by the Federal Home Loan Mortgage Corporation is considered an association taxable as a corporation. See Rev. Rul. 80-96, page 22.

26 CFR 301.7701-15: Income tax return preparer.

T.D. 7675

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Definition of income tax return preparer.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulation.

SUMMARY: This document provides a final regulation excluding certain persons from the definition of income tax return preparer. This regulation amends existing regulations as a result of changes to the applicable law made by the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1] and also the need for clarification of existing law. This regulation affects certain persons who assist others in completing their Federal income tax returns and provides guidance needed to comply with law.

DATE: The regulation applies with respect to documents prepared after December 31, 1976.

FOR FURTHER INFORMATION CONTACT: Mark L. Yecies of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (202-566-3464, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains an amendment to the Regulations on Procedure and Administration (26 CFR Part 301) under section 7701(a)(36) of the Internal Revenue Code of 1954, relating to the definition of income tax return preparer.

Section 163 of the Revenue Act of 1978 authorizes the Secretary of the Treasury, through the Internal Revenue Service, to enter into agreements with nonprofit agencies or organizations pursuant to which the Service will provide training and technical assistance enabling volunteers of these institutions to assist the elderly in completing their Federal income tax returns. In addition to this Tax Counseling for the Elderly program, the Internal Revenue Service has established a Volunteer Income Tax Assistance (VITA) program, which provides assistance to individual taxpayers in completing their Federal income tax returns through the use of Service-trained volunteers.

Section 1203 of the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1] established duties for income tax return preparers and provided penalties for the breach of those duties. On November 23, 1977, the Federal Register published regulations to implement most of the provisions of section 1203 (42 FR 59961). Those regulations included a provision, § 301.7701-15, relating to the definition of income tax return preparer found in section 7701(a)(36) of the Code. Only preparers as so defined in the Code and regulations are subject to the duties and penalties imposed by section 1203.

In enacting these preparer measures in the Tax Reform Act of 1976 Congress sought to subject persons preparing returns for a fee to a specific set of requirements. However, Congress did not intend those requirements to apply to persons merely assisting others to complete their returns in a nonprofit, noncommercial setting such as volunteers under the Tax Counseling for the Elderly and the VITA programs. Assistance under these programs is provided to taxpayers free of charge. In addition, volunteers under the VITA program receive no amounts from any source in participating in the program, while volunteers under the Tax Counseling for the Elderly program may receive only reimbursement of expenses from the Internal Revenue Service through the sponsoring organizations. Further, section 163(c)(2) of the Revenue Act of 1978 in general exempts these reimbursed amounts from income and social security taxes.

Accordingly, this document amends § 301.7701-15 to make clear that volunteers under the VITA and Tax Counseling for the Elderly programs are not considered income tax return preparers for purposes of section 1203 of the Tax Reform Act of 1976. Similarly, this regulation makes clear that organizations sponsoring or administering these programs are not considered preparers with respect to such sponsorship or administration.

This regulation does not meet the Treasury criteria for a significant regulation under paragraph 8 of the final Treasury directive for improving government regulations appearing in the Federal Register for Wednesday, November 8, 1978 (43 FR 52120).

DRAFTING INFORMATION

The principal author of this regulation is Mark L. Yecies of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendment to the regulations

Accordingly, 26 CFR Part 301 is amended by adding to § 301.7701-15 a new paragraph (a)(7) reading as follows:

§ 301.7701-15 Income tax return preparer.

(a) *In general.* * * *

(7) The following persons are not income tax return preparers:

(i) Any individual who provides tax assistance under a Volunteer Income Tax Assistance (VITA) program established by the Internal Revnue Service;

(ii) Any organization sponsoring or administering a Volunteer Income Tax Assistance (VITA) program established by the Internal Revenue Service, but only with respect to that sponsorship or administration;

(iii) Any individual who provides tax counseling for the elderly under a program established pursuant to section 163 of the Revenue Act of 1978; and

(iv) Any organization sponsoring or administering a program to provide tax counseling for the elderly established pursuant to section 163 of the Revenue Act of 1978, but only with respect to that sponsorship or administration.

* * * * *

There is need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved February 5, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on February 20, 1980; 8:45 a.m., and published in the issue of the Federal Register for February 21, 1980, 45 F.R. 11468)

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26 CFR 301.7701-13A: Post 1969 domestic building and loan associations.
(Also 301.7701-2.)
(Also Sections 61, 162, 451, 501, 593, 671, 1232; 1.61-1, 1.162-1, 1.451-1, 1.501(a)-1, 1.593-11, 1.671-1, 1-1232-1.)

FHLMC participation certificates. Certain procedures of the Federal Home Loan Mortgage Corporation (FHLMC) will not alter the tax consequences resulting from the purchase of mortgage participation certificates by FHLMC followed by the formation of pools and a subsequent issuance of participation sales certificates by FHLMC to other organizations; Rev. Rul. 71-399, as amplified by Rev. Ruls. 72-376, 74-221, and 74-300, is further amplified.

Rev. Rul. 80-96

ISSUE

Do the holdings of Rev. Rul. 71-399, 1971-2 C.B. 433, as amplified by

Rev. Rul. 72-376, 1972-2 C.B. 647; Rev. Rul. 74-221, 1974-1 C.B. 365; and Rev. Rul. 74-300, 1974-1 C.B. 169, involving the purchase by the Federal Home Loan Mortgage Corporation (FHLMC) of mortgage loans and interests therein from savings and loan associations and other eligible sellers and the sale of participation sales certificates to investors including other savings and loan associations, remain applicable under the circumstances described below?

FACTS

Rev. Rul. 71-399, as amplified by Rev. Rul. 72-376 and Rev. Rul. 74-221, set forth the tax consequences of the purchase of mortgage participation certificates and whole mortgage loans by FHLMC from savings and loan associations and the issuance by FHLMC of sales certificates to other savings and loan associations and exempt employees trusts. Rev. Rul. 74-300 holds that a real estate investment trust owning certificates issued by the FHLMC is considered as owning "real estate assets" within the meaning of section 856(c)(5)(A) of the Internal Revenue Code and its interest income from such certificates is "interest on obligations secured by mortgages on real property" under section 856(c)(3)(B).

Rev. Rul. 71-399, as amplified, states in part, that the arrangement whereby FHLMC purchases mortgage participation certificates and whole mortgage loans from savings and loan associations followed by FHLMC's sale of its own sales certificates to certain other organizations does not create an association taxable as a corporation, but constitutes a trust; the holders of FHLMC certificates discussed in Rev. Rul. 71-399, as amplified, are owners of the trust under Subpart E of subchapter J of the Code and each certificate holder is treated as the owner of an undivided interest in the entire trust (corpus as well as ordinary income), and that the sale of the FHLMC certificates to the holders transfers equitable ownership in the underlying mortgages to the holders of the certificates.

As decsribed in the above-mentioned rulings, FHLMC combines participation certificates and whole mortgage loans (or interests therein) purchased by it into a "pool" and sells its own participation sales certificates (PCs) representing undivided interests in each of the mortgage loans represented by the participation certificates purchased by FHLMC and undivided interests in each of the whole loans owned by FHLMC. The savings and loan associations and other mortgage originators ("seller/servicers") from whom FHLMC purchases either participation certificates or whole loans generally continue to service such loans.

Rev. Rul. 72-376 and Rev. Rul. 74-221 require that the PCs sold by FHLMC must bear sufficient identification so as to permit tracing them to the participation certificates purchased by FHLMC and to the whole loans owned by FHLMC to which PCs relate and to the underlying mortgages represented by the participation certificates in FHLMC's hands. FHLMC uses a number of internal accounting systems between itself and the seller/servicers, including a fiscal reporting month by the seller/servicers, to insure not only the presence of an ability to trace required by those revenue rulings, but also the ability for FHLMC to verify that the payments received by FHLMC from the seller/servicers are correct.

Under FHLMC procedures PCs are sold by FHLMC representing undivided interests in a pool of mortgages and interests therein as constituted at that time. The ultimate size of a pool formed by FHLMC is adjusted to meet increased or decreased market demands of the purchasers of PCs, as well as to take into account information regarding specific mortgages that is not furnished to FHLMC by the seller/servicer until after the month the pool is formed, or to the extent furnished, has not yet been processed by FHLMC. The adjustments to the pool size by FHLMC are made no later than the date of the first remittance check to holders of its PCs in such pool.

FHLMC is obligated under an agreement with the PC holders to remit to each PC holder the PC holder's pro rata share of principal received by FHLMC and interest to the extent of the certificate rate. The agreement permits FHLMC to make regular monthly payments of principal and interest to PC holders on an estimated basis before actual mortgage loan payment data is processed by FHLMC. In arriving at the amount to be paid to a PC holder, FHLMC makes a calculation based in part on its own experience as to how much principal is due for the normal calendar month to its PC holders. Any minor variances in making this calculation of principal are adjusted by FHLMC in the payment for the fol-following month to its PC holders. This process is repeated for the life of the PC and upon the final payment with respect to the PC all the principal acquired by the PC holder will have been remitted by FHLMC.

In making the calculation discussed in the preceding paragraph, FHLMC follows a set procedure to handle mortgage loans that are prepaid. FHLMC retains any interest remitted by the seller/servicer for the period from the first day of the calendar month to the date of prepayment if the mortgage loan is paid in full or in part on or before the 20th day of the month. FHLMC remits a full 30 days' interest to its PC holders with respect to mortgage loans which are prepaid after the 20th of the month. This FHLMC procedure is fully disclosed to prospective PC holders in FHLMC's PC Offering Circular, as an adjustment to FHLMC's guarantee and management fee.

Upon the sale of a PC, FHLMC retains the right to repurchase such PC from its holder for an amount equal to the then unpaid principal balance of the undivided interest in each mortgage loan represented by each PC. The right to repurchase can be exercised when the dollar size of the pool, and of each PC holder's interest therein, is 10 percent or less of the initial unpaid principal balance of the pool.

While PC holders may sell their PCs to third parties (when the certificates are transferable on the books of FHLMC), the agreement with PC holders does not authorize PC holders to use PCs as a basis for forming any more pools.

HOLDING

The holdings of Rev. Rul. 71-399, as amplified by Rev. Rul. 72-376, Rev. Rul. 74-221, and Rev. Rul. 74-300, are not altered by the above-described procedures under which FHLMC purchases and sells mortgage loans provided the PCs sold by FHLMC continue to bear sufficient identification so as to permit tracing them to the participation certificates purchased by FHLMC and to whole loans owned by FHLMC to which they relate and to the underlying mortgages.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 71-399, as amplified by Rev. Rul. 72-376, Rev. Rul. 74-221, and Rev. Rul. 74-300, is further amplified.

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions

United States-Japan Income Tax Convention

1973-1 C.B. 630

(Also income tax conventions between the United States and Belgium, Finland, France, Iceland, the Netherlands, Norway, Poland, Romania, and Trinidad and Tobago.)
(Also Part I, Section 894; 26 CFR 1.894-1.)

NIH Visiting Fellows Program. Amounts received from the National Institutes of Health under the Visiting Fellows Program by residents of the following countries are exempt from federal income tax under the respective countries' tax conventions with the U.S.: Belgium, Finland, France, Iceland, Japan, the Netherlands, Norway, Poland, Romania, and Trinidad and Tobago. Rev. Rul. 76-567 amplified.

Rev. Rul. 80-98

ISSUE

Are the amounts received by residents of Japan from the National Institutes of Health ("NIH") exempt from federal income taxation pursuant to Article 20 of the United States-Japan Income Tax Convention ("Treaty"), 1973-1 C.B. 630, under the circumstances described in the facts below?

FACTS

NIH has established and continues to maintain the Visiting Fellows Program ("Program") through which it invites distinguished and talented scientists from foreign countries, including Japan, to NIH for a limited amount of time (up to 3 years) for an interchange of scientific information and training at the postdoctoral research level for the purpose of furthering their development in their biomedical specialties.

Visiting Fellows are awarded between $10,000 and $12,500 under the Program as a yearly stipend from NIH to support their postdoctoral research training. These awards are made to individuals whose postgraduate experience does not exceed 3 years in a relevant health science at the time of the award. Visiting Fellows are not required to perform any services for NIH while participating in the Program and are expected to devote their time exclusively to their research training.

LAW AND ANALYSIS

Section 894(a) of the Internal Revenue Code provides that income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation.

Article 20(1)(a)(iii) of the Treaty provides that an individual who is a resident of Japan at the beginning of a visit to the United States and who is temporarily present in the United States for the primary purpose of studying or doing research as a recipient of a grant, allowance, or an award from a governmental, religious, charitable, scientific, literary, or educational institution shall be exempt from federal income taxation with respect to amounts described in Article 20(1)(b) for a period not exceeding 5 taxable years from the date of the individual's arrival in the United States.

Article 20(1)(b) of the Treaty provides that the following amounts shall be exempt from federal income taxation: (i) gifts from abroad for the purpose of maintenance, education, study, research, or training; (ii) the grant, allowance, or award itself; and (iii) income for personal services performed in the United States in an aggregate amount not in excess of $2,000 for any taxable year.

Section B(3)(a) of a National Institutes of Health Manual Transmittal Sheet (Subject: 2300-320-3, The NIH Visiting Program) released May 8, 1978, provides that Visiting Fellows are expected to devote their time exclusively to their research training and are not to perform services for NIH nor are they to be provided training assignments in grants, contracts, or any other administrative functions.

The amounts received by Visiting Fellows as fellowship awards granted by NIH to visiting scientists under the Program fall within the scope of the kind of amounts contemplated by the use of the term "grant, allowance, or award" in Article 20(1)(b)(ii) to be exempt from federal income taxation. Such amounts are not compensation for services and Visiting Fellows are not employees of NIH since it is specifically provided that they are not to perform services for NIH under the Program. Moreover, any amounts received by the Visiting Fellows while in the Program that qualify as gifts from abroad for the purpose of maintenance, education, study, research, or training under Article 20(1)(b)(i) or as income not in excess of $2,000 per year for personal services performed in the United States under Article 20(1)(b)(iii) are also exempt from federal income taxation.

In Rev. Rul. 76-567, 1976-2 C.B. 491, the taxpayer, a citizen and resident of Japan, received funds from a charitable organization paid in connection with the taxpayer's research work at an institute located in the United States. The ruling concludes that the amount paid to the taxpayer for the research work is a grant, allowance, or award from a charitable organization within the meaning of Article 20(1)(a)(iii) of the United States-Japan Income Tax Convention and, thus, is exempt from federal income tax. However, the ruling does not distinguish between an amount paid under a grant for research and an amount paid as compensation for services rendered in performing research.

HOLDING

The amounts received by residents of Japan from NIH under the Program are exempt from federal income taxation under Article 20 of the Treaty under the circumstances described in the facts above.

Tax treaties with the following countries contain provisions that are identical or substantially similar to Article 20 of the Japanese Treaty: Belgium (Article 21), Finland (Article 21), France (Article 18), Iceland

(Article 22), Netherlands (Article XVIII), Norway (Article 16), Poland (Article 18), Romania (Article 20), and Trinidad and Tobago (Article 19). Therefore, amounts received by residents of these countries from NIH under the Program are exempt from federal taxation pursuant to the applicable provisions (parenthetically cited) of the tax treaties with these countries.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 76-567 is amplified.

United States-Belgium Income Tax Convention

1973-1 C.B. 619

Whether amounts received from the National Institutes of Health under the Visiting Fellows Program by residents of Belgium are exempt from federal income tax. See Rev. Rul. 80-98, page 25.

United States-Finland Income Tax Convention

1971-1 C.B. 513

Whether amounts received from the National Institutes of Health under the Visiting Fellows Program by residents of Finland are exempt from federal income tax. See Rev. Rul. 80-98, page 25.

United States-France Income Tax Convention

1968-2 C.B. 691

Whether amounts received from the National Institutes of Health under the Visiting Fellows Program by residents of France are exempt from federal income tax. See Rev. Rul. 80-98, page 25.

United States-Iceland Income and Capital Tax Convention

1976-1 C.B. 442

Whether amounts received from the National Institutes of Health under the Visiting Fellows Program by residents of Iceland are exempt from federal income tax. See Rev. Rul. 80-98, page 25.

United States-Netherlands Income Tax Convention

T.D. 5778, 1950-1 C.B. 92

Whether amounts received from the National Institutes of Health under the Visiting Fellows Program by residents of the Netherlands are exempt from federal income tax. See Rev. Rul. 80-98, page 25.

United States-Norway Income and Property Tax Convention

1973-1 C.B. 669

Whether amounts received from the National Institutes of Health under the Visiting Fellows Program by residents of Norway are exempt from federal income tax. See Rev. Rul. 80-98, page 25.

United States-Poland Income Tax Convention

1977-1 C.B. 416

Whether amounts received from the National Institutes of Health under the Visiting Fellows Program by residents of Poland are exempt from federal income tax. See Rev. Rul. 80-98, page 25.

United States-Romania Income Tax Convention

1976-2 C.B. 492

Whether amounts received from the National Institutes of Health under the Visiting Fellows Program by residents of Romania are exempt from federal income tax. See Rev. Rul. 80-98, page 25.

United States-Trinidad and Tobago Income Tax Convention

1971-2 C.B. 479

Whether amounts received from the National Institutes of Health under the Visiting Fellows Program by residents of Trinidad and Tobago are exempt from federal income tax. See Rev. Rul. 80-98, page 25.

Part III. Administrative, Procedural, and Miscellaneous

Delegation Order No. 66 (Rev. 10) (Effective February 28, 1980)

Authority of Regional Director of Appeals in Protested and Tax Court Cases

The authority vested in the Commissioner of Internal Revenue by 26 CFR 301.6020-1, 26 CFR 301.6201-1, 26 CFR 301.7701-9 and Treasury Department Order No. 150-37, is hereby delegated as follows:

1. (a) In each region the Regional Commissioner, Regional Director of Appeals, Chiefs and Associate Chiefs of Appeals Offices, and Appeals Team Chiefs as to their respective cases, are authorized to represent the Commissioner in determining liability, qualification, exempt status or foundation classification for the following types of cases not docketed in the United States Tax Court when the taxpayer does not agree with the determination made by the District Director or by the Director of International Operations and requests consideration by the Regional Director of Appeals:

(1) Except as excluded under paragraph 5 of this Order, liability for excise, employment, income, profits, estate (including extensions for paying estate tax under Internal Revenue Code Section 6161(a)(2) and determinations whether elections made by estates meet the conditions specified in Internal Revenue Code Sections 6166 and 6166A) and gift taxes including additions to tax, additional amounts and assessable penalties under Chapter 68 of Subtitle F of the Internal Revenue Code of 1954 or corresponding provisions of the Internal Revenue Code of 1939;

(2) Initial or continuing qualification under Subchapter D of Chapter 1 of the Internal Revenue Code of 1954 and initial or continuing exempt status and foundation classification, *except* when a National Office ruling on the case with respect to exempt status or foundation classification, or National Office Technical Advice, with respect to qualification, exempt status or foundation classification, has been issued. In certain instances such as cases arising from the Examination Division or cases in which a National Office Technical Advice covers only a portion of the qualification issue of an employee plan, Appeals officials will have jurisdiction over the *proposed action* where a National Office ruling on the case with respect to exempt status or foundation classification or a National Office Technical Advice, with respect to qualification, exempt status or foundation classification has been issued. If the Appeals proposed disposition is contrary to the National Office ruling on the case with respect to exempt status or foundation classification or the National Office Technical Advice with respect to qualification, exempt status or foundation classification, the Assistant Commissioner (Employee Plans and Exempt Organizations) or the Assistant Commissioner (Technical), in Internal Revenue Code Section 521 cases, will make the final decision.

(b) The authorities delegated in this paragraph are subject to the exceptions set forth in paragraph 3 of this Order and they may not be redelegated, except, the authority with respect to appeals of assessed penalties may be redelegated by the Regional Directors of Appeals to Appeals Officers.

2. (a) In conformity with the provisions of Delegation Order No. 60 (as revised), in each income, excise, profits, estate, and gift tax case docketed in the United States Tax Court, the Regional Directors of Appeals, Chiefs and Associate Chiefs of Appeals Offices, and Appeals Team Chiefs as to their respective cases, are authorized to perform those functions delegated to the Regional Commissioner in that joint Order.

(b) The authorities delegated in this paragraph are subject to the exceptions set forth in paragraph 3 of this Order and may not be redelegated.

3. (a) The authorities delegated to the regional officials do not include authority to:

(1) Eliminate the ad valorem fraud penalty in any case in which the penalty has been determined by the district office or service center office in connection with a tax year or period, or which is related to or affects such year or period, for which criminal prosecution against the taxpayer (or related taxpayer involving the same transaction) has been recommended to the Department of Justice for willful attempt to evade or defeat tax, or for willful failure to file a return, except upon the recommendation or concurrence of Counsel; or

(2) Act in any case in which a recommendation for criminal prosecution is pending, except with the concurrence of Counsel.

(b) If the coordinating official has not concurred in any case referred to in paragraphs 1 and 2 of this Order involving an Appeals Coordinated Issue, except in the event of a final decision made by the Assistant Commissioner (Employee Plans and Exempt Organizations) or the Assistant Commissioner (Technical) as referred to in paragraph 1(a)(2) of this Order, the Regional Director of Appeals in the region having jurisdiction over the case makes the final determination as to the disposition of the Appeals Coordinated Issue. This authority may not be redelegated.

4. In any case not docketed in the Tax Court in which a statutory notice was issued by the office of a District Director, by a Service Center Director or by the Director of International Operations, the Regional Director of Appeals may relinquish the requested jurisdiction by waiver to the office of that Director. No such waiver shall be made in any case in which criminal prosecution has been recommended and not finally disposed of; nor shall such a waiver be made in any case in which the determination in the statutory notice includes the ad valorem fraud penalty. Notwithstanding any such waiver, upon filing of a petition with the Tax Court, jurisdiction shall revest in the Regional Director of Appeals.

5. The excise and employment taxes subject to the provisions of this Order include any Federal excise or employment tax under the Internal Revenue

Code of 1954, except any tax imposed by the following provisions or corresponding provisions of the Internal Revenue Code of 1939:

(a) Subtitle E; or

(b) Subchapter D, Chapter 78 of Subtitle F, insofar as it relates to taxes imposed under Subtitle E.

6. The authority to make and subscribe to a return under provisions of Code section 6020 is delegated to Appeals Officers.

7. The authorities contained in this Order are intended to supplement the authorities contained in Delegation Order No. 60 (as revised).

8. This Order supersedes Commissioner's Delegation Order No. 66 (Rev. 9) [1979-27 I.R.B. 18] and Chief Counsel's Order No. 1031.2C dated June 4, 1979.

N. JEROLD COHEN,
Chief Counsel.

JEROME KURTZ,
Commissioner.

(Filed by the Office of the Federal Register on March 4, 1980, 8:45 a.m., and published in the issue of the Federal Register for March 5, 1980, 45 F.R. 14359)

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26 CFR 601.602: Forms and instructions. (Also Part I, Sections 83, 6042, 6051; 1.83-1, 1.6042-2, 31.6051-1.)

Rev. Proc. 80-11

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide individual taxpayers guidance on reporting dividends on restricted stock that is not substantially vested within the meaning of section 83 of the Internal Revenue Code.

SEC. 2. BACKGROUND

.01 Section 1.83-1 of the Income Tax Regulations provides that property transferred to an employee in connection with the performance of services is not taxable until it has become substantially vested in the employee. Until such property becomes substantially vested, the transferor shall be regarded as the owner of such property, and any income from such property received by the employee constitutes additional compensation and shall be included in the gross income of such employee for the taxable year in which such income is received. Section 3402 of the Internal Revenue Code (relating to income tax collected at source) requires employers to deduct and withhold from an employee a tax on the amount of such additional compensation. Under section 31.6051-1 of the Employment Tax Regulations employers required to deduct and withhold a tax under section 3402 are required to furnish the employee a Wage and Tax Statement, Form W-2, which is required to be attached to the employee's Federal income tax return, Form 1040.

.02 Section 6042 of the Code and the regulations thereunder require every person who makes payment of dividends of more than $10 in any calendar year to make an information return on a Statement for Recipients of Dividends and Distributions, Form 1099-DIV. The Service has become aware that in some cases paying agents have issued Forms 1099 for dividends paid on restricted stock.

SEC. 3. PROCEDURE

The employee whose dividends are reflected on both a Form 1099-DIV and a Form W-2 may list the amount of the dividends reported on Form 1099-DIV on Schedule B of Form 1040, with a statement that the income has been reported as compensation in the appropriate place on Form 1040. The amount reported on the Form 1099-DIV should not be included in the total dividends shown on Schedule B or on page one of Form 1040.

SEC. 4. EFFECTIVE DATE

This revenue procedure is effective April 7, 1980, the date of its publication.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability. (Also Part I, Sections 901, 936; 1.901-1, 7.936-1.)

Rev. Proc. 80-12

SECTION 1. PURPOSE.

The purpose of this revenue procedure is to revoke Rev. Proc. 78-32, 1978-2 C.B. 532.

SEC. 2. BACKGROUND

.01 Rev. Proc. 78-32 provides a procedure whereby a domestic corporation ("possessions corporation") may revoke its election to receive the Puerto Rico and possession tax credit under section 936 of the Internal Revenue Code in order to prevent the double taxation of dividends paid by the possessions corporation to its individual shareholders.

.02 Section 4 of Rev. Proc. 78-32 provides that consent to the revocation of the section 936 election will be granted only if legislation has not been enacted to limit the application of section 901(g) of the Code to corporate shareholders before January 1, 1979.

.03 In providing possessions corporations a tax credit equal to United States tax on possessions business activities and qualifying investment activities (section 936 of the Code), section 1051(f)(1) of the Tax Reform Act of 1976, 1976-3 C.B. (Vol. 1) 1, 122, expanded the intercorporate dividends-received deduction allowed under section 243 to include dividend distributions from possessions corporations. However, section 1051(d)(2) of the 1976 Act also added section 901(g), which denies the foreign tax credit for taxes paid to a foreign country or possession of the United States on such distributions. This denial was intended to apply to those taxpayers receiving the dividends-received deduction in order to eliminate the double benefit of a tax credit and a deduction with respect to the same item of income. *S. Rep. No. 938,* 94th Cong., 2d Sess. 282 (1976), 1976-3 C.B. (Vol. 3) 320. However, the denial as enacted applied to all taxpayers, including individuals. Section 243 does not apply to individuals. Thus, if the distributing corporation had elected to avail itself of the benefit of section 936, the shareholder was denied a credit by section 901(g) for any foreign or possession tax on the dividend.

.04 Section 701(u)(1) of the Revenue Act of 1978, 1978-3 C.B. (Vol. 1) 1, 146, makes a technical correction amending 901(g) of the Code to provide that the denial of the foreign tax credit will not apply where the dividend distribution from a possessions corporation to a shareholder-recipient is fully taxable by the United States. However, if a recipient is entitled to a dividends-received deduction under section 243 with respect to a distribution, a foreign tax credit shall not be allowed to that recipient for taxes paid to a foreign country or possession of the United States on the distribution. This change applies to taxable years beginning after December 31, 1975.

SEC. 3. APPLICATION

The amendment of section 901(g) of the Code by the Revenue Act of 1978 eliminates the need for the revocation procedure provided in Rev. Proc. 78-32.

SEC. 4. INQUIRIES

Inquiries in regard to this revenue procedure should refer to its number and be addressed to the Commissioner of Internal Revenue, Attention: T:C:C:3, 1111 Constitution Avenue, NW, Washington, DC 20224.

SEC. 5. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 78-32 is revoked.

Part IV: Items of General Interest

Correction of Rev. Rul. 80-28

Announcement 80-36

Rev. Rul. 80-28, 1980-4 I.R.B. 14, 15, column 2, paragraph 1, last sentence, is corrected to read as follows:

A deliberate act is not a necessary factor in considering negligence under section 6694(a); it is, however, a factor in determining an intentional disregard of rules and regulations within the meaning of section 6694(a).

This correction will be reflected in Rev. Rul. 80-28 when it is published in 1980-1 C.B.

Form 5309, Application for Determination of Employee Stock Ownership Plan Revised

Announcement 80-38

A revised application Form 5309, Application for Determination of Employee Stock Ownership Plan, will be available after April 1, 1980. This application as revised may be used to request determination letters as to the qualification of both section 409A employee stock ownership plans and section 4975(e)(7) leveraged employee stock ownership plans.

Foundation Status of Certain Organizations

Announcement 80-39

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3) of the Code, eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Access Norwalk Corp., Westminster, CA
Accountants for the Public Interest, Baton Rouge, LA
Acting Off Your Weight, Inc., Panorama City, CA
Adventist Health Fund, Loma Linda, CA
Agency Publication and Information Clearing House, Carson, CA
Akron Task Force on Battered Women, Akron, OH
Albuquerque Public Broadcasting Corp., Albuquerque, NM
Altadena-Pasadena Chapter of the American Institute of Parliamentarians, Altadena, CA
Amazing Prophecy Television Production, Inc., Fullerton, CA
American Animal Assistance League, Inc., Phoenix, AZ
American Family Workshop, Inc., The, Phoenix, AZ
America Foundation, Tucson, AZ
American Service Center, Inc., Huntington Beach, CA
American Youth Fishing Program, Costa Mesa, CA
Andes Society for History and Culture, Andes, NY
Angel City Symphony Society, Inc., Altadena, CA
Antibiotic Research Institute, Philadelphia, PA
Atlantic Legal Foundation, Inc., Delray Beach, FL
Auburn International Center, Auburn, AL
Audio-Visual Broadcasting Systems, Inc., Los Angeles, CA
Baker High Building Trades Corp., Baker, OR
Barnabas, Inc., Irvine, CA
Bellevue West Youth Baseball League, The, Bellevue, WA
Berean Evangelism Reachout Evangelistic Association, Phoenix, AZ
Bethesda Christian Ministries Outreach, Inc., Denver, CO
Bible Truth and Prophecy, Canoga Park, CA
Booster Club of the Valle Lindo School District, The, South El Monte, CA
Brotherhood of the Bleeding Hearts, Inc., Keansburg, NJ
California Foundation for Dental Health, Los Angeles, CA
Camp Whe-Cha Pines, Inc., Anaheim, CA
Canaan Blessing School, Inc., Los Angeles, CA
Canyon Hills Junior Athletic Association, Anaheim, CA
Canyon Volunteer Fire Co., Globe, AZ
Center of the Fifth Dimension, Tarzana, CA
Central Area Human Service Agency, Inc., The, Long Beach, CA
Centro Bautista De Aztlan, Inc., Los Angeles, CA
Centro Guardian, South Tucson, AZ
Cerritos Gardens General Hospital Auxiliary Hawaiian Gardens, CA
Chinese Historical Society of Southern California, Inc., Los Angeles, CA
Christ Faith Laboratory, Inc., Los Angeles, CA
Christian Church Foundation, San Fernando, CA
Christian Party Crusaders, Torrance, CA
Circle Foundation of Coolidge, Arizona, The, Coolidge, AZ
Citizen's Community Alert Patrol, Claremont, CA
Club France Polynesie, Inc., Honolulu HI
Coachella Valley Educational Center, Palm Springs, CA
Cobbs Sickle Cell Center, Inc., Jean, Delray Beach, FL
Community Alcohol Counseling Center, Bakersfield, CA
Community Guild Charitable Trust, The, Beverly Hills, CA
Community Involvement Teams in Every Sector, San Diego Chapter, San Diego, CA
Concerned Citizens for Better Communities, Los Angeles, CA
Concerned Parent Group of Lakeview Terrace, San Fernando and Pacoima, Pacoima, CA

Desiderata Community Center and Crisis Hotline, Inc., Garden Grove, CA
Direct International Development, Inc., Santa Barbara, CA
Drowty Youth Foundation, Don, Santa Monica, CA
East Los Angeles Health System, Inc., Alhambra, CA
El Cajon Valley High School Booster Club, Inc., El Cajon, CA
En Passant Foundation, Inc., Los Angeles, CA
Everychild, Inc., Stockton, CA
F.C.C. Associates, New Hope, PA
Fashion Scholarship Trust Fund, The, Los Angeles, CA
Fine Arts Forum, Inc., San Diego, CA
Fire Company 24, Cabazon, CA
Flagstaff Arts Council, Inc., Flagstaff, AZ
Floating Wall, The, Newport Beach, CA
Friends of the Arts Productions, Boulder, CO
Gemwood Homes for Boys, Palmdale, CA
Gladstone Scholarship Foundation, Gladstone, MI
Graveure Foundation, Inc., The Louis, North Hollywood, CA
Growth Resources Organization, Inc., Phoenix, AZ
H M O Services Institute, Los Angeles, CA
Harbor Community Development Corp., Wilmington, CA
Harmony Christian Ministries, Sacramento, CA
Hart Resources, Inc., Yucca Valley, CA
Hawaii Kidney Association, Honolulu, HI
Hawaii Shima Japanese Imin Shiryo Kan, Hilo, HI
Hawaiian Cultural Center, Waiane, HI
Health Systems Agency for Los Angeles County, Inc., Los Angeles, CA
Here's Life, Central Coast, Inc., San Luis Obispo, CA
Hillcrest, Inc., Tucson, AZ
Hip Research Foundation, Los Angeles, CA
"His Place" Foundation, San Bernardino, CA
Hosanna Tape Library of Kansas, Inc., Wichita, KS
House of Swift Changes, Inc., Lakeside, CA
Human Research Development Association, San Diego, CA
Indian Wells Valley Help Line, Inc., Ridgecrest, CA
Institute for Athletic Perfection, The, Prescott, AZ
Institute for Medical Practice Management, Van Nuys, CA
Institute for Multicultural Multilingual Resource Services, Inc., Lakeside, CA
International Center for Strategic Studies, Los Angeles, CA
International Self-Help Partners, Inc., Woodland Hills, CA
International Society for Chinese Philosophy, Honolulu, HI
Intravision, Inc., Anaheim, CA
JMJ Center, Inc., Santa Barbara, CA.
James Anti-Drug Abuse Foundation, Inc., The Etta, Los Angeles, CA
Joslyn Medical Library Foundation, Marcellus L., San Luis Obispo, CA
National Junior Tennis League of Fort Wayne, Indiana, Fort Wayne, IN
North County Child Care Council, Inc., Escondido, CA
Oconee Area Older Americans Council, Inc., Milledgeville, GA
Organizacion Agricola Del Valle, Santa Maria, CA
Oriental Services Center, Palos Verdes, CA
Orpheum Theatre Corp., Los Angeles, CA
Own Image Workshops, Inc., Inglewood, CA
Pacific Coast Media Center, The, Beverly Hills, CA
Palo Verde Jubileers Parents Association, Tucson, AZ
Parenting Programs, Inc., Beverly Hills, CA
Prairie Partners, Inc., Indian Wells, CA
Primary Family Foundation, Montgomery Creek, CA
Project Jove II, Berkeley, CA
Project Mobility, Inc., Mesa, AZ
Projects for People, Los Angeles, CA
Pynyon Press and Foundry, Inc., The, Atlanta, GA
Rancho Temecula Community Park Association, Inc., Temecula, CA
Reach the People of Hawaii, Inc., Honolulu, HI
Realistic Education, Los Angeles, CA
Residential Services, Inc., Nashville, TN
Robinson Senior Baseball Association, Jackie, Los Angeles, CA
Ross Evangelistic Association, Willis, Woodland Hills, CA
Rural Health Care, Inc., Phoenix, AZ
Ruttinger Memorial Scholarship Fund, Inc., Russ, Brookings, OR
Rynelde, Anaheim, CA
St. Joseph County Medical Society Education Foundation, Inc., South Bend, IN
St. Mary's LPB, Inc., Escondido, CA
Samoan Youth Council, Seattle, WA
San Diego Eye Foundation, The, San Diego, CA
Santa Barbara Youth Services Project, Inc., Santa Barbara, CA
School of Human Dignity, Riverside, CA
Scripture/Science Institute, The, Scottsdale, AZ
Senior Citizens Transportation Service, Los Angeles, CA
Sierra Association of Community Services, Sierra Vista, AZ
Sigma Delta Alumni Association Scholarship Fund, Newhall, CA
Something Beautiful, Inc., Irvine, CA
Sonshine Specialized Camping Ministry, Orange, CA
South Mountain Association for the Handicapped, Phoenix, AZ
Southeast Training, Education and Placement, Inc., Norwalk, CA
Star Productions, Inc., Portland, OR
Stepping Stone of San Diego, The, San Diego, CA
Studio Z Inc., Los Angeles, CA
Sultan Foundation, Honolulu, HI
Take-A-Bus-Spokane Tabs, Spokane, WA
Tax Management Institute, San Gabriel, CA
Tierrasanta Little League, San Diego, CA
Tiny Town Kollege Services, Inc., Los Angeles, CA
Torch of Triumph, Inc., The, Orange, CA
Treasure Valley Multi-Trades Apprenticeship & Training Committee, Inc., Boise, ID
Tri-County Performing Arts Corp., Camp Hill, PA
Undena Publications, Inc., Malibu, CA

Union Management Painting & Decorating Industry Scholarship Fund, Los Angeles, CA
United Charity Foundation, San Diego, CA
United International Christian Medical Appeal Fund, Seattle, WA
United Psychological Counseling and Tutoring Service, Inc., Bessemer, AL
United Rescue Workers Corp., Los Angeles, CA
Unity Development Corp., St. Louis, MO
University Legal Assistance, Spokane, WA
Valley High Band Booster Club, Inc., Santa Ana, CA
Van Ness Recovery House, Los Angeles, CA
West Bluff Neighborhood Housing Services, Peoria, IL
Wilmington—New Hanover County American Revolution Bicentennial Association, Wilmington, NC
Windmill House, Los Angeles, CA
Women's Counseling Clinic and Resource Center, Honolulu, HI
Women's Resource Center, Inc., Tampa, FL
Woodstock, Inc., Tucson, AZ
World Youth Communication Council, Santa Barbara, CA
Yalof Theatre Workshop, Helen, San Diego, CA
Yeprad, Studio City, CA
Youth Unlimited, Inc., Memphis, TN
Yuma W.O.R.C. Center, Inc., Yuma, AZ
Xenia Kiwanis Foundation, Inc., Xenia, OH
18-Inch Review, The, North Hollywood, CA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Form 1090 Revised

Announcement 80-40

Form 1090, Statement of Income, and Profit and Loss Accounts, which is filed by railroad companies that file Form 1120, has been revised (January 1980). The account number and line items have been revised to conform to the current railroad accounts as reported to the Interstate Commerce Commission.

The form has also been changed to make it the same size as Form 1120, U.S. Corporation Income Tax Return. The new revision is expected to make handling and filing the form much easier.

Railroads file Form 1090 instead of page 1 of their Form 1120.

Copies of the form will be available on or about April 1 at Internal Revenue Service district offices.

Schedules D, Capital Gains and Losses

Announcement 80-41

A question has been raised about reporting installment payments that involve capital gains on sales that occurred before November 1, 1978.

The phrase "transactions entered into," found on the 1979 Schedules D, Capital Gains and Losses, filed with various federal income tax returns, includes installment payments.

A receipt of payment after October 31, 1978, is treated as a transaction after October 31, 1978, for purposes of the 60% capital gain deduction even if the actual sale took place before November 1, 1978. This was stated in Rev. Rul. 79-22, 1979-1 C.B. 275.

Statistics from 1968 and 1972 U.S. Corporations and Their Foreign Subsidiaries

Announcement 80-42 [1]

Publication 1026, Supplemental Report, Statistics of Income—1968 and 1972, International Income and Taxes, U.S. Corporations and Their Controlled Foreign Corporations, is now available and may be purchased for $5.50 from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

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[1] Based on News Release IR-80-18, dated February 5, 1980.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants and Enrolled Agents from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the instituton or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation at attorney, certified public account or enrolled agent, and the date or period of suspenison. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following persons have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
John E. Bishop	Greenville, SC	Attorney	Indefinite effective October 24, 1979
Raymond A. Carr	Roanoke, VA	Certified Public Accountant	Indefinite effective February 11, 1980
Philip R. Hedrick	Charlotte, NC	Attorney	One Year effective February 22, 1980
Edward J. Loughery	Succasunna, NJ	Enrolled Agent	Indefinite effective February 1, 1980
C. Rex Olson	Phoenix, AZ	Certified Public Accountant	Four months effective February 15, 1980
Julian S.H. Weiner	Beverly Hills, CA	Certified Public Accountant	Indefinite effective August 23, 1979
W. Frank Wolfenbarger	Irving, TX	Certified Public Accountant	Indefinite effective January 1, 1980

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants or enrolled agents to practice before the Internal Revenue Service.

Attorneys, certified public accounts and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify such disbarred or suspended

practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant or enrolled agent so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing, the following individual was disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
John J. McBurney	College Park, MD	Attorney	October 22, 1979

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.401-2, 1.403(b)-1, 1.405-1, amended; 1.401-8A redesignated 1.401-8 and as redesignated amended; 1.401-8 redesignated 1.401(f)-1 and as redesignated amended; 1.401(a)-1, 1.401(a)-2, 1.401(a)-16, 1.415-1 through 1.415-10 added.	Limitations on benefits and contributions under qualified plans.	Jan. 24, 1980	Apr. 23, 1980
26 CFR 138.4064-1, 138.4222-1 added; published as temporary regulations in T.D. 7674, 1980-11 I.R.B.	Gas Guzzler Tax.	Feb. 8, 1980	Apr. 8, 1980
26 CFR 31.6302(c)-1 amended.	Deposit requirements for social security and withheld income taxes.	Feb. 8, 1980	Apr. 8, 1980
26 CFR 1.861-8, 1.882-4, amended.	Allowance of deductions to foreign corporations doing business in the U.S.	Feb. 27, 1980	Apr. 28, 1980
26 CFR 301.7216-2 amended.	Disclosure of tax return information by tax return preparers.	Feb. 21, 1980	Apr. 21, 1980
26 CFR 1.37, 1.37-4, 1.37-5, deleted; 1.37-1, 1.37-2, 1.37-3, revised; 7.0, amended.	Credit for the elderly.	Feb. 27, 1980	Apr. 28, 1980
26 CFR 1.105-7, added.	Self-insured medical reimbursement plans.	Feb. 28, 1980	Apr. 28, 1980
26 CFR 1.175, deleted; 1.175-2, 1.175-4, amended; 1.175.7, added.	Definition of "land used in farming" for purposes of determining deductibility of soil and water conservation expenditures.	Feb. 27, 1980	Apr. 28, 1980

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1, dated January 7, 1980.

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* Denotes entry since last publication

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1 I.R.B., dated January 7, 1980.

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Key to Abbreviations:

RR	Revenue Ruling
RP	Revenue Procedure
TD	Treasury Decision
CD	Court Decision
PL	Public Law
EO	Executive Order
DO	Delegation Order
TDO	Treasury Department Order
TC	Tax Convention
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Internal Revenue
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Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENT

Announcement 80-53, page 18.

A public hearing will be held on May 1, 1980, in Atlanta, Georgia; Omaha, Nebraska; Burlington, Vermont; Seattle, Washington to receive comments and suggestions concerning tax return forms, instructions, and related schedules. Written comments on the forms instructions, and related schedules are also invited and should be submitted by June 1, 1980.

INCOME TAX

Rev. Rul. 80-99, page 6.

Reimbursed expenses; political fund-raising event; state government employee. Reimbursement made by a political organization to an appointed state government employee for travel expenses incurred in attending and addressing a political fund-raising event is not includible in the individual's gross income to the extent such reimbursement does not exceed actual expenses.

Rev. Rul. 80-100, page 6.

Industrial development bonds; exempt small issue; perpetual easement. The use of a portion of bond proceeds to acquire a perpetual easement to use land adjacent to a proposed plant site to provide better access will be treated as an acquisition of land within the meaning of section 103 (b)(6)(A) of the Code.

Rev. Rul. 80-101, page 8.

Stock redemption; liquidation; stock for stock and other property. A corporation that transferred appreciated stock of another corporation in exchange for its own stock and other property in complete liquidation of the other corporation recognizes no gain or loss under section 311(a)(2) of the Code on the portion of the liquidating corporation's stock exchanged for its own stock of equal value, but recognizes gain under section 1001 on the portion exchanged for the other property.

Rev. Rul. 80-102, page 11.

Livestock acquired for resale; transportation costs. The cost of transportation incurred in acquiring livestock is part of the cost of the livestock that is deductible by a cash method farmer when the livestock are sold.

Rev. Rul. 80-103, page 12.

Political organization; "exempt function income". A political organization sold reproductions of an original work of art, which was not of a political nature, over a period of several months to raise operating funds. The sales were not undertaken to encourage support (other than financial) for the organization or for any individual seeking political office. The proceeds were not "exempt function income" within the meaning of section 527(c)(3)(C) of the Code.

Rev. Rul. 80-104, page 13.

Charitable remainder unitrust; change in percentage paid. The governing instrument of a trust, which otherwise qualifies as a charitable re-

(Continued on page 4)

Finding Lists begin on page 24.
Announcement Relating to Decisions of the Tax Court on page 5.
Announcement of Disbarments and suspensions begins on page 19.
Announcement of Notice of Proposed Rulemaking on page 21.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part includes rulings and decisions based on Subpart A, Tax Conventions and related Treasury Decisions and Revenue Rulings; Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of Revenue Rulings, Revenue Procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

mainder unitrust, provides for an increase in the percentage to be paid to the income beneficiary upon the death of the donor. The trust agreement of a similar trust provides that upon the death of the first income beneficiary, an increased percentage will be paid to a new beneficiary. These provisions do not meet the "fixed percentage" requirement of section 664 of the Code, and the trusts do not qualify as charitable remainder unitrusts.

T.D. 7679, page 7.
Amendments to the regulations under section 170 of the Code relate to qualifying 100 percent distribution by a private foundation either of proceeds of the sale of contributed property or of the contributed property itself.

T.D. 7680, page 9.
Amendments to the regulations under sections 422 and 424 of the Code relate to transitional rules for qualified stock options granted after May 20, 1976, and certain options exercised after May 20, 1981.

Announcement 80-43, page 17.
Certain instructions for the 1979 Form 4874, Credit for Work Incentive (WIN) Program Expenses, do not apply to an employer's WIN credit that is based on salaries or wages that are not deductible for tax purposes.

Announcement 80-44, page 17.
Various areas of the States of Arizona and California have been declared disaster areas in which losses qualify for the special tax treatment under section 165(h) of the Code.

EMPLOYEE PLANS

Announcement 80-45, page 17.
An optional trust statement has been inserted into the instructions of the 1979 Form 5500 package, Annual Return/Report of Employee Benefit Plan. The statement may be completed by the trustee or custodian of an employee benefit trust as the annual return of the trust and will commence the running of the statute of limitations for the trust.

EXEMPT ORGANIZATIONS

T.D. 7678, page 14.
Amendments to the regulations under sections 507, 508, 537, and 4941 of the Code relate to transitional rules for acts of self-dealing between private foundations and disqualified persons.

ADMINISTRATIVE

Announcement 80-46, page 17.
The 10½ percent Treasury Bonds of 1995, the 11½ percent Treasury Notes of Series N-1982, the 11⅞ percent Treasury Notes of Series J-1983, the 12 percent Treasury Notes of Series C-1987, and the 11¾ percent Treasury Bonds of 2005-2010 will not be acceptable in payment of taxes.

Announcement 80-47, page 18.
Form 1099-PATR, Statement for Recipients (Patrons) of Taxable Distributions Received From Cooperatives, has been revised and is available at Service offices.

Announcement Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issues or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by Revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the Court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the Tax Court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Globe Products Corp.	9070-75	72	609
Goodwin, David C.	2087-77	73	—
Hyde, Gordon I.[1]	9044-72	64	300
Hyde, Janet C.[1]	9045-72		
Middle Atlantic Distributors, Inc.[2]	1982-78	72	1136

The Commissioner does NOT ACQUIESCE in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Bankers Union Life Insurance Co.	5807-71 442-73	62	661
Hyde, Gordon I.[3]	9044-72	64	300
Hyde, Janet C.[3]	9045-72		
Lee, Elizabeth M., Est. of, Rhoady R. Lee, Sr., executor & Rhoady R. Lee, Sr., individually[4]	8782-75	69	860

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[1] Acquiescence in the issues relating to (1) whether the acquisition of property on December 1, 1967 through a quitclaim deed resulted in the realization of income, and (2) whether petitioner must recognize gain on the sale of certain stock in 1968.

[2] Acquiescence in result. Acquiescence "in result" means acceptance of the decision of the Court but disagreement with some or all the reasons assigned for the decision.

[3] Nonacquiescence in the issue relating to whether a statutory redemption fee of $2,861.22 paid by Gordon Hyde in 1968 is deductible as interest.

[4] Estate and Gift Tax decision.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-1: Gross income.

Reimbursed expenses; political fund-raising event; state government employee. Reimbursement made by a political organization to an appointed state government employee for travel expenses incurred in attending and addressing a political fund-raising event is not includible in the individual's gross income to the extent such reimbursement does not exceed actual expenses.

Rev. Rul. 80-99

ISSUE

Is a reimbursement received by an individual, under the circumstances described below, includible in the individual's gross income pursuant to section 61 of the Internal Revenue Code?

FACTS

An individual employed by a state government in an appointive position was invited to attend and address a political fund-raising event sponsored by a political organization described in section 527 of the Code, and was authorized to do so by the individual's superiors. The political organization reimbursed the individual for expenses incurred in attending the fund-raising event, in an amount not exceeding the individual's actual expenditures for the reasonable costs of traveling away from home to and from the event, including meals and lodging in connection therewith.

LAW AND ANALYSIS

Section 61(a) of the Code and the Income Tax Regulations thereunder provide that, except as otherwise provided by law, gross income means all income from whatever source derived.

It is a well-established general rule that reimbursements (other than those specifically excluded by law) for personal expenses of the taxpayer are includible in the taxpayer's gross income. See, for example, *Old Colony Trust Co. v. Commissioner*, 279 U.S. 716 (1929), VIII-2 C.B. 222 (1929); *Silverman v. Commissioner*, 253 F. 2d 849 (8th Cir. 1958); Rev. Rul. 74-75, 1974-1 C.B. 19; and Rev. Rul. 79-49, 1979-1 C.B. 57.

However, it is also a well-established position of the Internal Revenue Service that reimbursements for expenses incurred by a taxpayer on behalf of another in a nonemployment context are not includible in the taxpayer's gross income. See, for example, Rev. Rul. 55-555, 1955-2 C.B. 20; Rev. Rul. 57-60, 1957-1 C.B. 25, clarified by Rev. Rul. 60-280, 1960-2 C.B. 12; Rev. Rul. 63-77, 1963-1 C.B. 177; Rev. Rul. 67-30, 1967-1 C.B. 9; Rev. Rul. 77-280, 1977-2 C.B. 14; and Rev. Rul. 79-142, 1979-1 C.B. 8.

HOLDING

The reimbursement received by the individual is not includible in the individual's gross income under section 61 of the Code because the reimbursement was made in a nonemployment context for the reasonable expenses incurred by the individual in traveling away from home on behalf of the political organization, and such reimbursement did not exceed the individual's actual expenses for such travel.

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26 CFR 1.61-4: Gross income of farmers.

Whether transportation-in costs are part of the cost of livestock that is deducted when the livestock are sold by a farmer using the cash receipts and disbursement method of accounting. See Rev. Rul. 80-102, page 11.

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26 CFR 1.61-7: Interest.

Whether interest to be paid on obligations of a political subdivision of a state will be exempt from tax. See Rev. Rul. 80-100, below.

Section 103.—Interest on Certain Governmental Obligations

26 CFR 1.103-10: Exemption for certain small issues of industrial development bonds.
(Also Section 61; 1.61-7.)

Industrial development bonds; exempt small issue; perpetual easement. The use of a portion of bond proceeds to acquire a perpetual easement to use land adjacent to a proposed plant site to provide better access will be treated as an acquisition of land within the meaning of section 103(b)(6)(A) of the Code.

Rev. Rul. 80-100

ISSUE

Will the use of bond proceeds to acquire a perpetual easement be treated as an acquisition of land within the meaning of section 103(b)(6)(A) of the Internal Revenue Code?

FACTS AND LAW

M, a political subdivision of a state, proposes to issue industrial development bonds in the amount of $1,000,000 to finance the purchase of a manufacturing plant situated on land within *M* for lease to corporation *X*, a nonexempt person. Bond proceeds of $850,000 will be used to purchase the plant and land. The remaining bond proceeds of $150,000 will be used to acquire a perpetual easement to use land adjacent to the plant site that will provide better access to the plant. Under local law the easement is an interest in real estate. The political subdivision will not have any prior exempt small issues outstanding when the bonds are issued. The bonds will not be arbitrage bonds within the meaning of section 103(c) of the Code.

Section 103(a)(1) of the Code provides that interest on obligations of a political subdivision of a state is excludable from gross income. Section 103(b)(1) provides that, with certain exceptions, industrial development bonds will not be treated as obligations described in section 103(a)(1). Section 103(b)(6)(A) provides one such exception. This section provides that an exempt small issue of $1,000,000 or less of industrial development bonds will be treated as obligations described in section 103(a)(1) if substantially all (90 percent or more) of the bond proceeds are to be used for the acquisition of land or property of a character subject to the allowance for depreciation.

HOLDING

The perpetual easement to be acquired by *M* is an interest in land and will be treated as an acquisition of land within the meaning of section 103(b)(6)(A) of the Code. Because all of the bond proceeds will be used to acquire land, an interest in land, or property of a character subject to the allowance for depreciation, the exception provisions relating to exempt small issues under section 103(b)(6)(A) will apply. Therefore, the proposed bond issue will not be treated as an industrial development bond and the interest on the bonds will be excludable from the gross incomes of the bondholders under section 103(a)(1).

Section 162.—Trade or Business Expenses

26 CFR 1.162-12: Expenses of farmers.

Whether transportation-in costs are part of the cost of the livestock that is deducted when the livestock are sold by a farmer using the cash receipts and disbursement method of accounting. See Rev. Rul. 80-102, page 11.

Section 170.—Charitable, Etc., Contributions and Gifts

26 CFR 1.170A-9: Definition of section 170(b)(1)(A) organization.

T.D. 7679

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Qualifying distribution by private foundation of proceeds of sale of contributed property

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to qualifying 100 percent distribution by a private foundation either of proceeds of the sale of contributed property or of the contributed property itself. The final regulations liberalize existing rules with respect to 100 percent distribution of contributed property by allowing the private foundation to take account of reasonable expenses incurred in the sale of contributed property, and by giving the foundation the option to calculate the fair market value of the property as its value at the date of sale or distribution if it is sold or distributed within 30 days of receipt by the foundation.

DATE: The amendments are effective on March 31, 1980.

FOR FURTHER INFORMATION CONTACT: Eileen Murphy of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3297).

SUPPLEMENTARY INFORMATION:

BACKGROUND

Issuance of this regulation was not preceded by publication in the Federal Register of a notice of proposed rulemaking and request for comments. These steps were dispensed with as unncessary because it is believed that this regulation, which liberalizes existing requirements, is beneficial to all interested parties.

EXPLANATION OF PROVISIONS

In order for section 170(b)(1)(A)(vii) of the Internal Revenue Code of 1954 (relating to percentage limitations for a charitable contribution deduction) to apply to contributions to a private "nonoperating" foundation, the foundation must distribute 100 percent of the contributions received by it. This 100 percent requirement is satisfied if an amount is distributed that is equal to the fair market value of the contributed property on the date of its contribution. This regulation project amends § 1.170A-9(g)(2)(iv) to provide that:

a. The amount of this fair market value is reduced by reasonable selling expenses, if any, incurred by the private foundation in the sale of the contributed property; and

b. At the choice of the private foundation, if the contributed property is either sold or distributed within 30 days of its receipt by the foundation, the amount of this fair market value is either—

1. The gross amount received on the sale of the property, less reasonable selling expenses incurred, or
2. An amount equal to the fair market value of the property on the date of its distribution to a public charity,

and not the fair market value of the contributed property on the date of its contribution.

DRAFTING INFORMATION

The principal author of these regulations is Eileen Murphy of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended by revising § 1.170A-9(g)(2)(iv) to read as follows:

§ 1.170A-9 Definition of section 170(b)(1)(A) organization.

* * * * *

(g) *Private nonoperating foundation distributing amount equal to all contributions received*—

* * * * *

(2) *Special rules.* In applying subparagraph (1) of this paragraph—

* * * * *

(iv) For purposes of satisfying the requirements of section 170(b)(1)(D)(ii), except as provided to the contrary in this subdivision (iv), the fair market value of contributed property, determined on the date of contribution, is required to be used for purposes of determining whether an amount equal in value to 100 percent of the contributions received has been distributed. However, reasonable selling expenses, if any, incurred by the foundation in the sale of the contributed property may be deducted from the fair market value of the contributed property on the date of contribution, and distribution of the balance of the fair market value will satisfy the 100 percent distribution requirement. If a private foundation receives a contribution of property and, within 30 days thereafter, either sells the property or makes an in kind distribution of the property to a public charity, then at the choice of the private foundation the gross amount received on the sale (less reasonable selling expenses incurred) or the fair market value of the contributed property at the date of its distribution to the public charity, and not the fair market value of the contributed property on the date of contribution (less reasonable selling expenses, if any), is considered to be the amount of the fair market value of the contributed property for purposes of the requirements of section 170(b)(1)(D)(ii).

* * * * *

This Treasury decision liberalizes existing rules with respect to distributions of contributed property received by private foundations and is considered to be beneficial to all interested parties. For these reasons, it is found unnecessary to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved February 14, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on February 28, 1980; 8:45 a.m., and published in the issue of the Federal Register for February 29, 1980, 45 F.R. 13452)

Section 302.—Distributions in Redemption of Stock

26 CFR 1.302-1: General.

Whether a liquidating distribution by one corporation to a second corporation that includes stock in the second corporation that was held by the liquidating corporation constitutes a distribution in redemption by the second corporation to the extent it receives its own stock. See Rev. Rul. 80-101, below.

Section 311.—Taxability of Corporation on Distribution

26 CFR 1.311-1: General.
(Also Sections 302, 331, 1001; 1.302-1, 1.331-1, 1.1001-1.)

Stock redemption; liquidation; stock for stock and other property. A corporation that transferred appreciated stock of another corporation in exchange for its own stock and other property in complete liquidation of the other corporation recognizes no gain or loss under section 311(a)(2) of the Code on the portion of the liquidating corporation's stock exchanged for its own stock of equal value, but recognizes gain under section 1001 on the portion exchanged for the other property.

Rev. Rul. 80-101

ISSUE

Do the nonrecognition of gain or loss provisions of section 311(a)(2) of the Internal Revenue Code apply to the receipt by a corporation (*X*) of its stock from another corporation (*Y*) upon the liquidation of *Y*?

FACTS

X corporation, an operating company, held 70 percent of the outstanding stock of *Y* corporation. *A*, an individual, held the other 30 percent of the outstanding *Y* stock. *Y*, a corporation engaged in holding certain investments, owned 25 percent of the outstanding *X* stock. The value of the *X* stock owned by *Y* constituted half of the net value of all of *Y*'s assets. For various reasons, both *X* and *A* felt it would be desirable for *Y* to dispose of, or otherwise cease to hold, the *X* stock. After a series of negotiations, *X* and *A* agreed to liquidate *Y* and have *Y* distribute its assets, including the *X* stock, to *X* and *A*.

In accord with the plan of liquidation, *Y* paid all its liabilities and then distributed 70 percent of each remaining asset to *X* and 30 percent of each remaining asset to *A*. One-half of the value of the distribution to both *X* and *A* consisted of *X* stock. At the time of exchange, the fair market value of the *Y* stock held by *X* was 16*x* dollars and *X*'s adjusted basis in the *Y* stock was 10*x* dollars. Therefore, *X* realized a gain of 6*x* dollars on the transaction.

LAW AND ANALYSIS

Pursuant to section 336 of the Code, gain or loss realized by *Y* on the distribution of its property to *X* and *A* in complete liquidation is not recognized. The property received by *A* in the liquidating distribution from *Y* is treated as in full payment in exchange for *A*'s *Y* stock pursuant to section 331(a), and the gain or loss realized is recognized pursuant to section 1001(c).

Upon the liquidation of *Y*, *X* in its capacity as a shareholder of *Y* received *X* stock and other assets from *Y* in exchange for the *Y* stock *X* owned. Under section 331(a) of the Code, the distribution is treated as received by *X* in full payment in exchange for the *Y* stock, and, under section 1001, the gain realized by *X* is recognized unless, as provided in section 1001(c), another provision of Subtitle A of the Code requires otherwise. There is no provision of the Code that provides nonrecognition for the gain realized by *X* on the liquidating distribution in its capacity as a shareholder.

However, the exchange by *X* of its *Y* stock for *X* stock owned by *Y* upon liquidation of *Y* meets the definition of a "redemption" as defined in section 317(b) of the Code (the acquisition by a corporation (*X*) of its stock from a shareholder (*Y*) in exchange for property (*Y* stock) as defined in section 317(a)). Section 311(a)(2) provides the general rule that gain or loss is not recognized to a corporation on a distribution of property with respect to its stock. Section 1.311-1(a) of the Income Tax Regulations states that the term "distributions with respect to its stock" includes distributions made in redemption of stock (other than distributions in complete or partial liquidation). Thus, since that portion of the transaction that resulted in *X* receiving its own stock from *Y* is a redemption, the general nonrecognition rule of section 311(a)(2) is applicable to that part of the *Y* stock that *X* transferred (distributed) to *Y* in exchange (redemption) for the *X* stock received from *Y*.

Moreover, since *Y* completely terminated its interest in *X* within the meaning of section 302(b)(3), and since the other requirements of section 311(d)(2)(A) are met, the provisions of section 311(d)(1) do not apply. Nor are any of the other exceptions to section 311(a) applicable.

Rev. Rul. 79-314, 1979-41 I.R.B. 10, holds in a similar situation that the nonrecognition provision of section 311(a) prevails over the recognition provisions of section 1001 of the Code where one corporation (*X*) acquires (redeems) part of its stock from a second corporation (*Y*) in exchange for *Y* stocked owned by *X*. Although the transaction in Rev. Rul. 79-314 did not involve the liquidation of *Y*, the holding therein that the nonrecognition provision of section 311(a) prevails over the general recognition provision of section 1001 is applicable to the transaction in the present case.

HOLDING

No gain is recognized to *X* under section 311(a)(2) on that part of the *Y* stock (one half) that was exchanged for *X* stock of equal value. However, gain is recognized to *X* under section 1001 on that part of the *Y* stock (one half) that was exchanged for property other than *X* stock. Thus, of the total 6*x* dollars gain realized by *X* 3*x* dollars is not recognized under section 311(a) and 3*x* dollars is recognized under section 1001.

Section 331.—Gain or Loss to Shareholders in Corporate Liquidations

26 CFR 1.331-1: Corporate liquidations.

Whether the provisions of section 311(a) of the Code prevail over the provisions of section 331(a) where part of the assets of each of two corporations includes some stock in the other corporation, one of the corporations is liquidated, and as part of the transaction there is an exchange of stock for stock. See Rev. Rul. 80-101, page 8.

Section 422.—Qualified Stock Options

26 CFR 1.422-2: Qualified stock options defined.
(Also Section 424, 1.424-2.)

T.D. 7680

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Qualified stock options granted after May 20, 1976

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to transitional rules for qualified stock options granted after May 20, 1976 and certain options exercised after May 20, 1981. Changes to the applicable tax law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1]. The regulations would provide the public with the guidance needed to comply with that Act and would affect grantors and grantees of stock options.

EFFECTIVE DATE: These regulations will be effective for taxable years ending after December 31, 1975.

FOR FURTHER INFORMATION CONTACT: Annie R. Alexander of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGOUND

On December 18, 1978, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 422 and 424 of the Internal Revenue Code of 1954 (43 FR 58830). The amendments were proposed to conform the regulations to section 603 in the Tax Reform Act of 1976 (90 Stat. 1574). There was no request for a public hearing and accordingly none was held. One comment was received but that comment did not result in any changes to the proposed regulations because it was felt that the regulations do not require additional clarification, or the change would make the regulations inconsistent with the statute. After consideration of the comment regarding the proposed amendments, those amendments are adopted without change by this Treasury decision. The preamble to the notice of proposed rulemaking summarizes and explains the proposed amendments.

DRAFTING INFORMATION

The principal author of this regulation is Annie R. Alexander of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended as follows:

Paragraph 1. Section 1.422 is deleted.

Par. 2. Section 1.422-2 is amended by revising the first sentence of paragraph (a)(1)(i) of § 1.422-2 and by inserting three new sentences immediately after that sentence, and by adding a new paragraph (i) to § 1.422-2. The revised and added provisions read as follows:

§ 1.422-2 Qualified stock options defined.

(a) *Qualified stock option defined.* (1)(i) The term "qualified stock option" means an option that meets the requirements of section 422(b) and this section. Generally, section 422(b) requires a qualified stock option to be granted to an individual after December 31, 1963, and before May 21, 1976. However, a qualified stock option may be granted after May 20, 1976, if it meets the requirements of section 422(c)(7). See paragraph (i) of this section for rules relating to options granted after May 20, 1976. * * *

* * * *

(i) *Certain options granted after May 20, 1976*—(1) ***In general.*** An option granted to an individual after May 20, 1976 is not a qualified stock option unless the option meets the requirements of section 422(c)(7) and this paragraph. Generally, an option meets the requirements of section 422(c)(7) if it either is granted under a written plan adopted before May 21, 1976, or is substituted for a qualified stock option described in paragraph (i)(3) of this section. An option meeting the requirements of section 422(c)(7) and this paragraph that is exercised after May 20, 1981, will be treated under § 1.83-7(a) as if it were a nonqualified stock option without a readily ascertainable fair market value at the time of its grant.

(2) *Options granted under a written plan adopted before May 21, 1976.* (i) An option granted after May 20, 1976, is a qualified stock option if it otherwise meets the requirements of section 422(b) and this section and if the option is granted under a written plan that was adopted before May 21, 1976. A plan will be treated as having been adopted as of the date all actions needed for adoption have been completed. Ordinarily, a plan is adopted when approved by the board of directors of the granting corporation. However, if the board's action is subject to a condition or the happening of a particular event, the plan is adopted on the date the condition is met or the event occurs unless the board's resolution fixes the date of approval as the date of the board's action. For purposes of determining the date of the adoption of a plan, the date of the approval of the plan by the shareholders of the granting corporation is disregarded. Thus, it is immaterial whether the shareholders approved the plan before, on, or after May 21, 1976, although the plan must satisfy the requirements of paragraph (b) of this section, which requires that the shareholders approve the plan within 12 months before or after its adoption by the board. The authorization of specific grants of options to specific individuals under the plan is not required in order for options granted under the plan to be qualified stock options.

(ii) A corporation that merely changes its identity or place of incorporation may continue to grant qualified stock options under a written plan adopted before May 21, 1976, to the extent permissible had the change not occurred. In all other reorganizations a written option plan will be treated as being adopted after May 20, 1976, unless the corporation that adopted the plan before May 21, 1976, survives the reorganization. Of course, the surviving corporation may continue to grant options under the plan only to the extent it would have been able to do so had the reorganization not occurred.

(3) *Substituted stock options.* An option granted after May 20, 1976, is a qualified stock option if the option is an option that has been substituted, in a transaction to which section 425(a) applies (relating to certain corporate reorganizations, liquidations, etc.), for a qualified stock option granted before May 21, 1976 (or any option that is a qualified stock option under the requirements of section 422(c)(7)(A) or (B) and paragraph (i)(2) or (3) of this section.

(4) *Modifications to option plans.* An option plan adopted before May 21, 1976, may be modified after May 20, 1976, and options granted under such a plan, as modified, will be considered options granted under a plan adopted before May 21, 1976, unless the modification is considered the adoption of a new plan. See paragraph (b) of this section for rules relating to modifications that will be considered the adoption of a new plan. If a plan is modified after May 20, 1976, such that the modification is considered under paragraph (b) of this section to be the adoption of a new plan, any option granted as a result of such modification will not be a qualified stock option. An option will be considered to have been granted as a result of such modification if it could not have been granted but for such modification of the plan. For example, if the modification changes the terms of the options to be granted in such a way that the modification is considered the adoption of a new plan, then no option granted with such terms is a qualified stock option since it could not have been granted but for the modification. If a plan is modified to increase the number of shares that can be transferred upon exercise of the options granted under the plan, any option granted after the modification will be a qualified stock option only if the option could have been granted without the modification to the plan. For example, if the number of shares authorized under a plan is increased from 4,000 shares to 10,000 shares at a time when options have already been granted under the plan to purchase 3,000 of the previously authorized shares, an option granted after the modification will be a qualified stock option if it is not an option to purchase any of the additional 6,000 shares authorized by the modification. In determining for this purpose which shares are subject to a particular option, the first option granted after the modification will be considered an option to buy originally authorized shares to the extent there are any such shares not subject to a previously granted option. If options to buy originally authorized shares and options to buy additional shares are granted, the granting corporation may designate which options are options to buy originally authorized shares to the extent there are originally authorized shares not subject to a previously granted option. In the previous example, absent such a designation, if ten options were granted on different days after the plan modification, each option for the purchase of 700 shares, the first option would be a qualified stock option since 1,000 originally authorized shares are not subject to any previously granted option. The second option would not be a qualified stock option because it includes an option to buy 400 shares that were not originally authorized and therefore could not have been granted without the

modification. If the order in which the ten options were granted could not be determined and no such designation were made under this paragraph, none of the options would be a qualified stock option. If the modification enlarges the class of employees eligible to receive options, any option granted to a newly eligible employee would not be a qualified stock option.

(5) *Exercise of certain options after May 20, 1981.* If a qualified stock option granted after May 20, 1976, is exercised after May 20, 1981, the option will be treated as if it were a nonqualified stock option that did not have a readily ascertainable fair market value at the time it was granted. Thus, if such a qualified stock option is exercised after May 20, 1981, section 421(a) will not apply to the transfer of stock pursuant to the exercise of the option, and such transfer will be taxed under section 83. See § 1.83-7(a) for rules relating to the treatment of nonqualified stock options under section 83.

Par. 3. Section 1.424 is deleted.

Par. 4. Section 1.424-2 is amended by adding a new paragraph (d)(5) to read as follows:

§ 1.424-2 Restricted stock options.

* * * * *

(d) *Certain options granted after December 31, 1963.* * * *

* * * * *

(5) An option granted after December 31, 1963, that is treated as a restricted stock option under section 424(c)(3) and this paragraph must be exercised before May 21, 1981, in order for section 421(a) to apply to the transfer of stock pursuant to such exercise. If such an option is exercised after May 20, 1981, section 421(a) will not apply to the transfer of stock pursuant to such exercise, and section 83 will apply to such transfer as if the option were a nonqualified stock option without a readily ascertainable fair market value at the time of its grant. See § 1.83-7(a) for rules relating to the treatment of nonqualified stock options under section 83.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved February 20, 1980.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on February 28, 1980, 8:45 a.m., and published in the issue of the Federal Register for February 29, 1980, 45 F.R. 13453)

Section 424.—Restricted Stock Options

26 CFR 1.424-2: Restricted stock options.

Transitional rules for qualified stock options granted after May 20, 1976 and certain options exercised after May 20, 1981. See T.D. 7680, page 9.

Section 461.—General Rule for Taxable Year of Deduction

26 CFR 1.461-1: General rule for taxable year of deduction.
(Also Sections 61, 162; 1.61-4, 1.162-12.)

Livestock acquired for resale; transportation costs. The cost of transportation incurred in acquiring livestock is part of the cost of the livestock that is deductible by a cash method farmer when the livestock are sold.

Rev. Rul. 80-102

ISSUE

Are transportation-in costs part of the cost of livestock that is deductible for the taxable year in which the livestock are sold by a farmer using the cash receipts and disbursements method of accounting?

FACTS

X is a partnership engaged in the business of farming and uses the cash receipts and disbursements method of accounting. *X* purchases calves from various ranchers and fattens them on its own grassland until the calves are large enough to go to a feedlot. Afterwards, the cattle are either sold as yearlings or sent to a feedlot to be sold later to a packing plant.

When *X* purchases the calves from ranchers, *X* pays the freight from the seller's ranch to its own grassland. This freight cost (hereinafter transportation-in cost) is either paid separately by *X* or is separately stated on the invoice given to *X* at the time of purchase. *X* treats the transportation-in cost as a deductible expense in the year in which paid regardless of when the livestock are sold.

LAW AND ANALYSIS

Section 1.461-1(a)(1) of the Income Tax Regulations provides that under the cash receipts and disbursements method of accounting amounts representing allowable deductions shall, as a general rule, be taken into account for the taxable year in which paid.

Section 1.162-12(a) of the regulations provides that a farmer who operates a farm for profit is entitled to deduct from gross income as necessary expenses all amounts actually expended in carrying on the business of farming. The purchase of feed and other costs connected with raising livestock may be treated as expense deductions.

Section 1.61-4(a) of the regulations provides that a farmer using the cash receipts and disbursements method of accounting shall include in gross income the profit from the sale of purchased livestock and that the profit from such sale is to be ascertained by deducting the cost from the sales price in the year in which the sale occurs. In *Alexander v. Commissioner*, 22 T.C. 234 (1954), *acq.*, 1954-2 C.B. 3, the court held that the predecessor of the above regulation was valid.

Rev. Rul. 72-113, 1972-1 C.B. 99 holds that when a taxpayer in the business of raising horses purchases several horses for breeding purposes, the transportation cost and the incidental charges incurred en route are capital expenditures under section 263(a) of the Code and are includible in the basis of the horses acquired.

In the present situation, *X* incurred the transportation-in cost when it purchased the calves. Section 1.162-12(a) of the regulations allows a deduction from gross income for all amounts actually expended in connection with raising livestock. But the deductible expenses under section 1.162-12(a) do not include transportation-in costs because transportation-in costs are incurred in purchasing livestock, not in raising livestock. *See* Rev. Rul. 72-113.

HOLDING

Transportation-in costs are part of the cost of livestock that is deductible when the livestock are sold by a farmer using the cash receipts and disbursements method of accounting.

Section 507.—Termination of Private Foundation Status

26 CFR 1.507-3: Special rules; transferee foundations.

Transitional rules for acts of self-dealing between private foundations and disqualified persons. See T.D. 7678, page 14.

Section 508.—Special Rules with Respect to Section 501(c)(3) Organizations

26 CFR 1.508-3: Governing instruments.

Transitional rules for acts of self-dealing between private foundations and disqualified persons. See T.D. 7678, page 14.

Section 527.—Political Organizations

Political organization; "exempt function income". A political organization sold reproductions of an original work of art, which was not of a political nature, over a period of several months to raise operating funds. The sales were not undertaken to encourage support (other than financial) for the organization or for any individual seeking political office. The proceeds were not "exempt function income" within the meaning of section 527(c)(3)(C) of the Code.

Rev. Rul. 80-103

ISSUE

Are proceeds received by a political organization from sales of art reproductions "exempt function income" within the meaning of section 527(c) of the Internal Revenue Code of 1954?

FACTS

An organization that qualifies as a political organization under section 527(e)(1) of the Code and files its returns on a calendar year basis solicited a well-known artist to produce a work of art to be reproduced for sale by the organization to raise funds. The artist produced an original work, the subject of which was not of a political nature, and donated it to the organization. The organization contracted with a local gallery, for a fee, to have the work reproduced and to sell the reproductions at the gallery over a period of several months. At the end of this period, the gallery turned over the proceeds from the sales, less the negotiated fee, to the organization.

The sole purpose of the sales was to raise funds for the operation of the organization. The sales were not undertaken to encourage support (aside from financial) for the organization or for any individual seeking political office.

LAW AND ANALYSIS

Section 527(c)(1) of the Code excludes "exempt function income" from the taxable income of a political organization.

Section 527(c)(3) of the Code provides that the term "exempt function income" means any amount segregated for exempt function use that is received as (A) a contribution of money or other property, (B) membership dues, a membership fee or assessment from a member of the political organization, (C) proceeds from a political fund raising or entertainment event, or proceeds from the sale of political campaign materials, that are not received in the ordinary course of any trade or business, or (D) proceeds from the conducting of any bingo game (as defined in section 513(f)(2)).

In discussing the taxation of political organizations, the Senate Finance Committee stated that political organizations are not to be taxed on proceeds received from political fund raising or political entertainment events, or proceeds from the sale of political campaign materials which are not received in the ordinary course of any trade or business. Thus, proceeds received from casual sporadic fund raising events or political entertainment events, such as an annual political dinner or an annual athletic exhibition, are to be treated as exempt function income. Similar fund raising events would include political breakfasts, receptions, picnics, dances, etc. However, in all of these cases the income would be exempt function income only if the event is a political event and is not carried on in the ordinary course of a trade or business. Factors to be taken into account in determining whether an activity is a trade or business, for purposes of this section, are to include the frequency of the event, the manner in which the event is conducted, and the span of time over which the event is carried on. Whether an event is a political fund raiser or a political entertainment event will depend upon the facts and circumstances of the particular event, taking into account the extent to which the event is related to a political activity aside from the need of the organization for income or funds. *S. Rep. No. 1357*, 93rd Cong., 2d Sess. 1, 28 (1974), 1975-1 C.B. 517, 533.

In this case, the sales of the reproductions were made solely for fund raising purposes, and, thus, were not related to a political activity aside from the need of the political organization to raise funds. In addition, the sales occurred over a period of several months. Therefore, the proceeds from the sales (1) were not received from a specific political fund raising event or activity, and (2) were received in the ordinary course of a trade or business. Also, the sales were not sales of political campaign materials, since the art work was not of a political nature.

HOLDING

Proceeds received by the political organization from the sales of art reproductions are not "exempt function income" within the meaning of section 527(c)(3)(C) of the Code.

Section 537.—Reasonable Needs of the Business

26 CFR 1.537-1: Reasonable needs of the business.

Transitional rules for acts of self-dealing between private foundations and disqualified persons. See T.D. 7678, page 14.

Section 664.—Charitable Remainder Trusts

26 CFR 1.664-3: Charitable remainder unitrust.

Charitable remainder unitrust; change in percentage paid. The governing instrument of a trust, which otherwise qualifies as a charitable remainder unitrust, provides for an increase in the percentage to be paid to the income beneficiary upon the death of the donor. The trust agreement of a similar trust provides that upon the death of the first income beneficiary, an increased percentage will be paid to a new beneficiary. These provisions do not meet the "fixed percentage" requirement of section 664 of the Code, and the trusts do not qualify as charitable remainder unitrusts.

Rev. Rul. 80-104

ISSUE

Do the trusts described below qualify as charitable remainder unitrusts under section 664 of the Internal Revenue Code?

FACTS

Situation 1. The governing instrument of a trust established by a taxpayer provides that the trustee will pay *A*, the unitrust amount beneficiary, seven percent of the net fair market value of the trust assets, valued annually, until the death of the donor. Upon the death of the donor the trustee is to pay *A* nine percent of the net fair market value of the trust assets until death. The trust otherwise meets all the requirements of a charitable remainder unitrust set forth in section 664 of the Code and the underlying regulations.

Situation 2. The facts are the same as above, except that the trust agreement provides that the trustee shall pay *A* seven percent until *A*'s death, and nine percent thereafter to *B* until *B*'s death.

LAW AND ANALYSIS

Section 664(d)(2)(A) of the Code provides that a charitable remainder unitrust is a trust from which a fixed percentage (which is not less than five percent) of the net fair market value of its assets, valued annually, is to be paid, not less often than annually, to one or more persons (at least one of which is not an organization described in section 170(c) and, in the case of individuals, only to an individual who is living at the time of the creation of the trust) for a term of years (not in excess of 20 years) or for the life or lives of such individual or individuals.

Section 664(d)(2)(B) and (C) of the Code provide that a charitable remainder unitrust is a trust from which no amount other than the payments described in section 664(d)(2)(A) may be paid to or for the use of any person other an organization described in section 170(c), and following the termination of the payments, the remainder interest in the trust is to be transferred to, or for the use of, an organization described in section 170(c) or is to be retained by the trust for such a use.

Section 1.664-3(a)(1)(ii) of the Income Tax Regulations provides that a fixed percentage must be payable each year in the period specified by section 1.664-3(a)(5). This percentage may be expressed either as a fraction or as a percentage; and a percentage is fixed if it is the same either as to each recipient or as to the total percentage payable each year of the period specified in section 1.664-3(a)(5). Thus, provision for a fixed percentage that is the same every year to one income recipient until death and concurrently a fixed percentage that is the same every year to a second income recipient until death (the fixed percentage to each to terminate at their respective deaths) satisfies the rule, if the percentage given to each recipient is not less than five percent. Also, a fixed percentage (not less than five percent) to two income recipients for their joint lives and then to the survivor, satisfies the rule.

Section 1.664-3(a)(5)(i) of the regulations provides that the fixed percentage of section 1.664-3(a)(1) is payable for the period beginning with the first year of the charitable remainder trust and continues either for the life or lives of a named individual or individuals or for a term of years not to exceed 20 years.

Section 1.664-3(a)(2) of the regulations provides that the fixed percentage described in section 1.664-3(a)(1) with respect to all beneficiaries taken together must not be less than five percent. Section 1.664(a)(5)(ii) provides that this five percent requirement must be met until the termination of all of the payments required under section 1.664-3(a)(1).

Section 1.664-3(a)(1)(ii) and 3(a)(2)(ii) of the regulations permit a charitable remainder trust to provide for a reduction of the fixed percentage payable upon the death of a recipient or the expiration of a term of years provided that a distribution is made to a qualified charity at the death of such recipient or the expiration of such term of years and the total of the percentage payable after such distribution is not less than five percent.

In order to qualify as a charitable remainder unitrust, the provisions of a governing instrument (that has not adopted the income exception alternative of section 1.664-3(a)(1)(i)(*b*) of the regulations), must provide for an annual payout that meets the definition of a fixed percentage provided in section 1.664-3(a)(1)(ii) either as to each recipient or as to the total percentage payable each year, and also such payout must be "fixed" for the entire duration of the period prescribed in section 1.664-3(a)(5).

Thus, under these provisions of the Code and regulations, if it is possible for the percentage of the net fair market value of the assets of the trust paid annually to change (1) as to the total percentage payable each year during the period commencing with the first year of the charitable remainder trust and terminating with the last of all the annual payments, and also (2) as to the individual recipients for the duration of the period commencing with the first year of the charitable remainder trust and continuing for a term not to exceed 20 years, or until the death of the respective recipients, then the percentage is not fixed, unless it is reduced as prescribed in section 1.664-3(a)(1)(ii) of the regulations.

HOLDINGS

Situation 1. Because *A* could survive the donor, it is possible for the percentage of the net fair market value of the trust's assets payable in the first year of the trust (seven percent) to be different from that payable at the termination of the payout period (nine percent), with respect to both the total percentage payable and also the amount payable to the individual recipient, *A*. Therefore, such percentage is not fixed and the trust does not qualify as a charitable remainder unitrust within the meaning of section 664 of the Code.

Situation 2. Because *B* could survive *A*, it is possible for the total percentage of the net fair market value of the trust's assets payable, upon termination of all the required annual payouts (nine percent), to be different from the total percentage payable in the first year of the trust (seven percent). Therefore, the percentage is not fixed as to the total percentage payable. Similarly, because it is possible for the percentage payable to each recipient until the time of each recipient's respective deaths (seven percent and nine percent) to be different from the percentage payable to each recipient in the first year of the trust (seven percent and zero percent, depending on whether *A* survived the first year), the percentage is not fixed as to each recipient; and the trust does not qualify as a charitable remainder unitrust within the meaning of section 664 of the Code.

Section 1001.—Determination of Amount of and Recognition of Gain or Loss

26 CFR 1.1001-1: Computation of gain or loss.

Whether the provisions of section 311(a) of the Code prevail over the provisions of section 1001(c) in a situation where because of stock cross-ownership the liquidation of one corporation constitutes, in part, a redemption by another corporation. See Rev. Rul. 80-101, page 8.

Section 4941.—Taxes on Self-dealing

26 CFR 53.4941(d)-4: Transitional rules. (Also Sections 507, 508, 537; 1.507-3, 1.508-3, 1.537-1.)

T.D. 7678

TITLE 26.—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953.—SUBCHAPTER D, PART 53. — FOUNDATION EXCISE TAXES

Transitional rules for acts of self-dealing involving private foundations

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to transitional rules for acts of self-dealing between private foundations and disqualified persons. Changes to the applicable tax law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1]. The regulations would affect all private foundations.

DATES: The amendments are effective with respect to certain dispositions of property by private foundations after October 4, 1976.

FOR FURTHER INFORMATION CONTACT: Margie Glass of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C., 20224 (Attention: CC:LR:T) (202-566-3544, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On August 31, 1979, proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 507, 508 and 537 of the Internal Revenue Code of 1954, and to the Foundation Excise Tax Regulations (26 CFR Part 53) under section 4941 of the Code were published in the Federal Register (44 FR 51242). The amendments were proposed to conform the regulations to sections 1301 and 1309 of the Tax Reform Act of 1976 (90 State. 1713, 1729). No comments were received and no public hearing was requested or held. This Treasury decision adopts the proposed amendments without change.

EXPLANATION OF REGULATIONS

Section 101(l)(2) of the Tax Reform Act of 1969 [Pub. L. 91-172, 1969-3 C.B. 10, 35] (83 Stat. 533) created special transitional rules that exempted certain transactions between private foundations and disqualified persons from the definition of self-dealing. Under prior law, these rules permitted private foundations to sell, exchange, or otherwise dispose of certain "nonexcess" business holdings to disqualified persons before January 1, 1975. There was no transitional rule that permitted the disposition of property leased by a private foundation to a disqualified person. Section 1309 of the Tax Reform Act of 1976 extends the rule permitting disposition of "nonexcess" business holdings to dispositions made after October 4, 1976, and before January 1, 1977. Section 1301 of the Act generally permits a foundation to sell, exchange, or otherwise dispose of certain property to a disqualified person where the property is being leased to the disqualified person pursuant to a binding contract in effect on October 9, 1969, if the foundation receives no less than fair market value for the property. This provision applies to dispositions made after October 4, 1976, and befor January 1, 1978.

DRAFTING INFORMATION

The principal author of these regulations is Margie Glass of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly the following amendments to 26 CFR Parts 1 and 53 are hereby adopted:

INCOME TAX REGULATIONS
(26 CFR Part 1)

Paragraph 1. The Income Tax Regulations, 26 CFR Part 1, are amended by revising paragraph (a) (8)(ii)(*c*) of § 1.507-3 to read as follows:

§ 1.507-3 Special rules; transferee foundations.

(a) *General rule.* * * *

(8) * * *

(ii) * * *

(*c*) Section 101(l)(2) of the Tax Reform Act of 1969 (83 Stat. 533), as amended by sections 1301 and 1309 of the Tax Reform Act of 1976 (90 Stat. 1713, 1729), with respect to the provisions of section 4941.

* * * * *

Par. 2. The Income Tax Regulations are further amended by revising paragraph (b)(3) of § 1.508-3 to read as follows:

§ 1.508-3 Governing instruments.

* * * * *

(b) *Effect and nature of governing ing instrument.* * * *

(3) *Savings provisions.* For purposes of section 508(d)(2)(A) and (e), a governing instrument need not include any provision which is inconsistent with section 101(l)(2), (3), (4) or (5) of the Tax Reform Act of 1969 (83 Stat. 533), as amended by sections 1301 and 1309 of the Tax Reform Act of 1976 (90 Stat. 1713, 1729), with respect to the organization. Accordingly, a governing instrument complying with the requirements of subparagraph (1) of this paragraph may incorporate any savings provision contained in section 101(l)(2), (3), (4) or (5) of the Tax Reform Act of 1969, as amended by sections 1301 and 1309 of the Tax Reform Act of 1976, as a specific exception to the general provisions of paragraph (a) of this section. In addition, in the absence of any express provisions to the contrary, the exceptions contained in such savings provisions will generally be regarded as contained in a governing instrument meeting the requirements of subparagraph (1) of this paragraph.

* * * * *

Par. 3. The Income Tax Regulations are further amended by revising paragraph (d)(1)(iii) of § 1.537-1 to read as follows:

§ 1.537-1 Reasonable needs of the business.

* * * * *

(d) *Excess business holdings redemption needs.* (1) * * *

(iii) Constituted stock redemption of which before January 1, 1975, or after October 4, 1976, and before January 1, 1977, is, by reason of section 101(l)(2)(B) of the Tax Reform Act of 1969, as amended by section 1309 of the Tax Reform Act of 1976, and § 53.4941(d)-4(b), permitted without imposition of tax under section 4941, but only to the extent such stock is to be redeemed before January 1, 1975 or after October 4, 1976, and before January 1, 1977, or is to be redeemed thereafter pursuant to the terms of a binding contract entered into on or before such date to redeem all of the stock of the corporation held by the private foundation on such date.

* * * * *

FOUNDATION EXCISE TAX REGULATIONS
(26 CFR Part 53)

Par. 4. The Foundation Excise Tax Regulations, 26 CFR Part 53, are amended by revising the last sentence of paragraph (b)(1) of § 53.4941(d)-4 and by adding a new paragraph (f) to that section. These revised and added provisions read as follows:

§ 53.4941(d)-4 Transitional rules.

* * * * *

(b) *Disposition of certain business holdings*—(1) *In general.* * * * For purposes of applying this paragraph in the case of a disposition completed before January 1, 1975, or after October 4, 1976, and before January 1, 1977, the amount of excess business holdings is determined under section 4943(c) without taking subsection (c)(4) into account.

* * * * *

(f) *Disposition of leased property*—(1) *In general.* Under section 101 (l)(2)(F) of the Tax Reform Act of 1969, as amended by the Tax Reform Act of 1976 (90 Stat. 1713), the sale, exchange or other disposition (other than by lease) to a disqualified person of property being leased to the disqualified person by a private foundation is not an act of self-dealing if—

(i) The private foundation is leasing substantially all of the property to the disqualified person under a lease to which paragraph (c) of this section applies;

(ii) The disposition occurs after October 4, 1976, and before January 1, 1978; and

(iii) The disposition satisfies the requirements of paragraph (f)(2) of this section.

(2) *Terms of disposition.* Paragraph (f)(1) of this section applies only if—

(i) The private fundation receives an amount that equals or exceeds the fair market value of the property either at the time of the disposition or at the time (after June 30, 1976) the contract for such disposition was executed;

(ii) In computing the fair market value of the property, no diminution of that value results from the fact that the property is subject to any lease to disqualified persons; and

(iii) At the time with respect to which subdivision (f)(2)(i) of this section is applied, the transaction would not have constituted a prohibited transaction within the meaning of section 503(b) or the corresponding provisions of prior law if those provisions had been applied at the time of the transaction.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved February 15, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on February 25, 1980, 8:45 a.m., and published in the issue of the Federal Register for February 26, 1980, 45 F.R. 12415.)

Part IV. Items of General Interest

Correction to 1979 Form 4874 Instructions

Announcement 80-43

Certain instructions for the 1979 Form 4874, Credit for Work Incentive (WIN) Program Expenses, do not apply to an employer's WIN credit that is based on salaries or wages that are not deductible for tax purposes.

These instructions are printed at the top of the 1979 Form 4874 and in General Instruction E of the related instructions. They state that the taxpayer's salary and wage expense deduction must be reduced by the allowable WIN credit on line 11 of the form. The requirement to reduce salaries and wages by the allowable WIN credit does not apply to any part of a taxpayer's WIN credit on line 10 (and included in line 11) that relates to the nonbusiness employee's salary or wages that are not deductible for tax purposes.

If a taxpayer has already filed a 1979 income tax return on which a salary and wage deduction was incorrectly reduced as explained above, the taxpayers should file Form 1040X or the appropriate amended return to make a correction. This would most likely have happened where a taxpayer claimed a WIN credit for both business and nonbusiness employees.

Disaster Areas

Announcement 80-44

The President of the United States has determined that the areas listed below were adversely affected by disasters of sufficient sevrity and magnitude to warrant Federal disaster assistance.

Taxpayers who suffered losses in these areas as a result of these disasters may elect the special tax treatment provided under section 165(h) of the Internal Revenue Code of 1954. Section 1.165-11 of the Income Tax Regulations sets forth the procedure for making this election. Losses not incurred with respect to a trade or business or any transaction entered into for profit will not qualify for treatment under section 165(h) unless such losses qualify as casualty losses.

State: Arizona

Areas affected: Gila, Maricopa, Mohave, Yavapai Counties; Fort Apache, San Carlos Apache Indian Reservations

Type of disaster: Severe storms and flooding

Begun on or about: February 13, 1980

State: California

Counties affected: Los Angeles, Orange, Riverside, San Bernardino, San Diego, Santa Barbara, Ventura

Type of disaster: Severe storms, mudslides, and flooding

Begun on or about: January 8, 1980

Optional Trust Statement in Form 5500 Package

Announcement 80-45

An optional trust statement (trust statement), which may be completed by a trustee of an employee benefit trust as the annual return of that trust, has been inserted into the instructions of the Form 5500 package for 1979 and subsequent years.

To commence the running of the statute of limitations for any trust described in section 401(a) of the Internal Revenue Code and exempt from tax under section 501(a), or for any custodial account described in section 401(f), the trustee or custodian may file the trust statement for years ending with or within plan years that begin January 1, 1979, or later. This statement will be treated as a return of the trust for the period for which it is filed.

The trust statement may be filed only as an *attachment* to an "Annual Return/Report of Employee Benefit Plan" (Form 5500, 5500-C, 5500-G, or 5500-K). The Service will not accept separate filings of the trust statement. The trustee may use or copy the trust statement from the instructions of the Form 5500 series return. Any employer or administrator of a plan whose assets comprise all or a portion of a trust's corpus may attach a complete copy of the trust statement to that plan's Annual Return filing for each trust which formed part of the plan during the plan year. If assets from two or more plans are held in a single trust, the trust statement may be attached to the Form 5500 series filing of any one of those plans.

For 1979 and later years the statutory period during which the Service may assess taxes under section 6501(a) of the Code (other than taxes for unrelated business income) against a trust which was believed to be tax exempt but later was determined not to be so exempt, expires three years after the later of : 1) the date an employer or administrator files its Form 5500 series return, with the trust statement attached; or 2) the last day allowed by law or regulation for filing the returns (with the trust statement attached). If the trust statement is not filed, the statute of limitations will not begin to run for the trust.

For trust years ending on or after December 31, 1975, and with or within plan years that begin before January 1, 1979, for ease of administration, the Service will treat the filing of the Annual Return (Form 550 series) by the employer or administrator as sufficient to begin the running of the statute of limitations for the trust.

With respect to unrelated business income, the statute of limitations begins to run when the Form 990-T, Exempt Organization Business Income Tax Return, is filed. See Rev. Rul. 62-10 1962-1 C.B. 305, and Rev. Rul. 69-247, 1969-1 C.B. 303.

10½ Percent Treasury Bonds of 1995
11½ Percent Treasury Notes of Series N-1982
11⅞ Percent Treasury Notes of Series J-1983
12 Percent Treasury Notes of Series C-1987

11¾ Percent Treasury Bonds of 2005-2010

Announcement 80-46

The Secretary of the Treasury announced the offering of Treasury Bonds and Treasury Notes as follows:

Treasury Department Circular, Public Debt Series 32-79, dated December 28, 1979, and published in the Federal Register for January 3, 1980, 45 F.R. 869, and the supplement published in the Federal Register for January 9, 1980, 45 F.R. 1960; 10½ percent Treasury Bonds of 1995.

Treasury Department Circular, Public Debt Series 4-80, dated January 17, 1980, and published in the Federal Register for January 22, 1980, 45 F.R. 4489, and the supplement published in the Federal Register for January 29, 1980, 45 F.R. 6684; 11½ percent Treasury Notes of January 31, 1982, Series N-1982.

Treasury Department Circular, Public Debt Series 5-80, dated January 31, 1980, and published in the Federal Register for February 5, 1980, 45 F.R. 7885, and the supplement published in the Federal Register for February 11, 1980, 45 F.R. 9148; 11⅞ percent Treasury Notes of August 15, 1983, Series J-1983.

Treasury Department Circular, Public Debt Series 6-80, dated January 31, 1980, and published in the Federal Register for February 5, 1980, 45 F.R. 7887, and the supplement published in the Federal Register for February 12, 1980, 45 F.R. 9447; 12 percent Treasury Notes of May 15, 1987, Series C-1987.

Treasury Department Circular, Public Debt Series 7-80, dated January 31, 1980, and published in the Federal Register for February 5, 1980, 45 F.R. 7883, and the supplement published in the Federal Register for February 13, 1980, 45 F.R. 9843; 11¾ percent Treasury Bonds of 2005-2010.

The income derived from the bonds and notes is subject to all taxes imposed by the Internal Revenue Code of 1954. The notes are subject to estate, inheritance, gift, or other excise taxes whether Federal or State, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any State, any possession of the United States, or any local taxing authority.

The bonds and notes will be acceptable to secure deposits of public moneys. They will not be acceptable in payment of taxes.

1099-PATR Revised

Announcement 80-47

The 1980 version of Form 1099-PATR, Statement for Recipients (Patrons) of Taxable Distributions Received From Cooperatives, has been revised to delete boxes 5 and 6. These boxes were added to the 1979 version to allow cooperatives to report any unused investment credit or energy investment credit that they elect to pass through to their patrons. Such a passthrough is permitted by the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1].

Regulations are now being developed that will explain the new reporting method.

The revised form is available at Internal Revenue Service district offices.

Tax Forms Coordinating Committee—Public Hearing and Request for Forms Suggestions

Announcement 80-53

As part of its annual forms review process, the Internal Revenue Service will hold public hearings to receive comments and suggestions concerning its tax return forms, instructions, and related schedules. It should be emphasized that the comments may apply to any tax form issued by the Service. The hearings will be held in 4 separate cities on Thursday, May 1, 1980. The hearings will be held in Atlanta, Georgia, Omaha, Nebraska, Burlington, Vermont, and Seattle, Washington, beginning at 10 a.m. local time.

A person wishing to speak at one of these hearings should write or call the Internal Revenue Service at the address or phone number given below for the city of the particular hearings he or she plans to attend. If the Service is contacted by letter, the letter should be marked "Attention: Public Hearings on Forms" and should give both the return address and telephone number of the person desiring to speak.

The addresses and phone numbers to contact the Service regarding the hearings, as well as the hearing locations, are listed below:

Atlanta

Internal Revenue Service, 275 Peachtree St., N.E., Room 512, Atlanta, Georgia, 30303; phone 404-212-4501.

Hearing location: Internal Revenue Service, 275 Peachtree St., N.E., Room 556, Atlanta, Georgia.

Omaha

Internal Revenue Service, Attn: Public Affairs, P.O. Box 1052, Omaha, Nebraska, 68101; phone 402-221-3504.

Hearing location: Civic Center, Legislative Chamber, 1819 Farnam, Omaha, Nebraska.

Burlington

Internal Revenue Service, 11 Elmwood Ave., Burlington, VT 05401; phone 802-951-6354.

Hearing location: City Hall, Contois Auditorium, Church Street, Burlington, VT.

Seattle

Internal Revenue Service, Public Affairs Office, P.O. Box 854, Seattle, Washington, 9811; phone 206-442-5515.

Hearing location: Internal Revenue Service, 915 2nd Ave., North Auditorium, Seattle, Washington.

Although not required, it would be helpful to receive a copy of any written comments and suggestions a speaker may prepare. These should be sent to the appropriate mailing address listed above or may be left with the hearing panel on the day of the hearing.

In order to afford as many speakers as possible a chance to participate, each speaker's remarks will be limited to 10 minutes. Persons who have advised the Service that they wish to speak at the hearings will be notified in advance concerning the approximate time for their scheduled appearance. The last date for submitting requests to speak is April 22, 1980. However, if there is time remaining after scheduled speakers have been heard, the remaining time will be offered to persons in attendance not previously scheduled who wish to speak.

The panel for each hearing will be made up of representatives from the District Director's Office concerned and the National Office in Washington, D.C.

Request for Written Forms Suggestions

In addition to receiving comments at the public hearings, the Service also desires to receive written comments and suggestions for improving its tax return forms, instructions, and related schedules from those persons unable to attend the hearings. Again, it should be emphasized that the comments may apply to any tax form issued by the Service. The written submissions should be self-explanatory and in sufficient detail to communicate clearly what is being suggested. Careful consideration will be given to all comments and suggestions received. However, individual responses to the submissions will not be made because of the volume of correspondence involved.

In order to meet our work schedule and early printing deadlines, it is requested that written submissions be made on or before June 1, 1980.

Comments and suggestions should be sent to the Chairman, Tax Forms Coordinating Committee, Room 5577, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. Further information concerning this notice may be obtained by calling 202-566-6254.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants and Enrolled Agents from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the instituton or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation at attorney, certified public account or enrolled agent, and the date or period of suspenison. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following persons have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
John E. Bishop	Greenville, SC	Attorney	Indefinite effective October 24, 1979
Raymond A. Carr	Roanoke, VA	Certified Public Accountant	Indefinite effective February 11, 1980
Philip R. Hedrick	Charlotte, NC	Attorney	One Year effective February 22, 1980
Edward J. Loughery	Succasunna, NJ	Enrolled Agent	Indefinite effective February 1, 1980
C. Rex Olson	Phoenix, AZ	Certified Public Accountant	Four months effective February 15, 1980
Julian S.H. Weiner	Beverly Hills, CA	Certified Public Accountant	Indefinite effective August 23, 1979
W. Frank Wolfenbarger	Irving, TX	Certified Public Accountant	Indefinite effective January 1, 1980
Stephen K. Easton	New York, NY	Certified Public Accountant	Indefinite from February 29, 1980

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants or enrolled agents to practice before the Internal Revenue Service.

Attorneys, certified public accounts and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify such disbarred or suspended

practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant or enrolled agent so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing, the following individual was disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
John J. McBurney	College Park, MD	Attorney	October 22, 1979
Robert W. Tufts	St. Petersburg, FL	Certified Public Accountant	March 17, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.401-2, 1.403(b)-1, 1.405-1, amended; 1.401-8A redesignated 1.401-8 and as redesignated amended; 1.401-8 redesignated 1.401(f)-1 and as redesignated amended; 1.401(a)-1, 1.401(a)-2, 1.401(a)-16, 1.415-1 through 1.415-10 added.	Limitations on benefits and contributions under qualified plans.	Jan. 24, 1980	Apr. 23, 1980
26 CFR 1.861-8, 1.882-4, amended.	Allowance of deductions to foreign corporations doing business in the U.S.	Feb. 27, 1980	Apr. 28, 1980
26 CFR 301.7216-2 amended.	Disclosure of tax return information by tax return preparers.	Feb. 21, 1980	Apr. 21, 1980
26 CFR 1.37, 1.37-4, 1.37-5, deleted; 1.37-1, 1.37-2, 1.37-3, revised; 7.0, amended.	Credit for the elderly.	Feb. 27, 1980	Apr. 28, 1980
26 CFR 1.105-7, added.	Self-insured medical reimbursement plans.	Feb. 28, 1980	Apr. 28, 1980
26 CFR 1.175, deleted; 1.175-2, 1.175-4, amended; 1.175.7, added.	Definition of "land used in farming" for purposes of determining deductibility of soil and water conservation expenditures.	Feb. 27, 1980	Apr. 28, 1980
26 CFR 53.4942 revoked; 53.4942(a)-2 amended.	The use of blockage or similar factors in determining the value of private foundations' noncharitable assets consisting of listed securities for purposes of determining the amount foundations must distribute annually for charitable purposes.	March 12, 1980	May 12, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1, dated January 7, 1980.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1 I.R.B., dated January 7, 1980.

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______	*1932–1*	*2.80*
______	1932–2	8.65
______	*1933–1*	*3.35*
______	*1933–2*	*3.45*
______	*1934–1*	*3.70*
______	*1934–2*	*4.10*
______	1935–1	6.90
______	*1935–2*	*4.00*
______	*1936–1*	*3.55*
______	*1936–2*	*3.90*
______	*1937–1*	*3.75*
______	1937–2	7.70
______	*1938–1*	*4.05*
______	*1938–2*	*3.50*
______	1939–1–1	8.25
______	1939–1–2	10.90
______	1939–2	9.40
______	1940–1	5.55
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______	1941–1	*$6.95*
______	*1941–2*	*3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
______	*1944*(*)	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*2.65*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$10.10
______	1957–2	13.00
______	1958–1	9.60
______	1958–2	13.00
______	1958–3	15.00
______	1959–1	15.00
______	1959–2	9.60
______	1960–1	9.00
______	1960–2	11.50
______	1961–1	14.00
______	1961–2	10.00
______	1962–1	6.20
______	1962–2	7.15
______	1962–3	15.00
______	1963–1	9.00
______	1963–2	10.75
______	1964–1–1	10.00
______	1964–1–2	11.00
______	1964–2	9.80
______	1965–1	10.70
______	1965–2	12.25
______	1966–1	9.25
______	1966–2	14.05
______	1967–1	10.00
______	1967–2	10.00
______	1968–1	14.00
______	1968–2	11.75
______	1969–1	7.50
______	1969–2	6.50
______	1969–3	$12.50
______	1970–1	11.00
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______	1977–1	10.75
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April 21, 1980
Bulletin No. 1980-16

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENT

Announcement 80-56, page 34.

A public hearing will be held on May 21, 1980, concerning proposed regulations relating to the treatment of partnership organization and syndication fees.

INCOME TAX

Rev. Rul. 80-105, page 5.

Reorganizations; savings and loan association; change in form. The conversion of a federal mutual savings and loan association to a state or federal stock savings and loan association, and the conversion of a state chartered mutual savings and loan association that is subject to the rules and regulations of the Federal Home Loan Bank Board to a stock savings and loan association in the same state are reorganizations under section 368(a)(1)(F) of the Code; Rev. Rul. 54-193 superseded.

Rev. Rul. 80-109, page 8.

Intangible drilling costs; operating interests in separate tracts. A taxpayer agreed to drill and operate oil wells on each of two noncontiguous tracts in exchange for the entire operating interest in each tract until the aggregate gross income from both tracts equaled the cost of developing and operating both tracts and a 75 percent operating interest in each tract thereafter. The taxpayer's deduction for intangible drilling and development costs is limited to the portion of those costs attributable to the 75 percent operating interest in each tract. Rev. Rul. 70-336 modified.

Rev. Proc. 80-14, page 32.

Rulings under section 367; guidelines amplified. Guidelines are set forth regarding requests for rulings under section 367(a)(1) of the Code in situations in which tangible personal property is transferred by a U.S. person to a foreign corporation in a transaction described in section 351 and the property transferred is leased to other persons who will not use it in the U.S.; Rev. Proc. 68-23 amplified.

Announcement 80-50, page 34.

New regulations on the submission of copies of Form W-4, Employee's Withholding Allowances Certificate, to the Service by an employer apply to Forms W-4 received from employees on or after April 1, 1980, rather than October 9, 1979.

EXEMPT ORGANIZATIONS

Rev. Rul. 80-106, page 6.

Thrift shop; consignment sales. An organization operates a thrift shop that sells items that are either donated or received on consignment. Substantially all of the work in operating the thrift shop is performed without compensation, all transactions are at arm's length, and all profits are distributed to section 501(c)(3) organizations. The organization is not a feeder organization described in section 502(a) of the Code and qualifies for exemption as an organization operated for charitable purposes.

Rev. Rul. 80-107, page 7.

Public utility stockholders' organization. An orga-

(Continued on page 4)

Finding Lists begin on page 39.
Announcement of Disbarments and Suspensions begins on page 35.
Announcement of Notice of Proposed Rulemaking on page 37.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part includes rulings and decisions based on Subpart A, Tax Conventions and related Treasury Decisions and Revenue Rulings; Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of Revenue Rulings, Revenue Procedures, and other published items, and (3) topical Indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

EXEMPT ORGANIZATIONS—Cont'd

nization of individuals and institutions, having beneficial interests in shares of any public utility located in the state, that was formed to promote the interests of the public utility industry and its stockholders by preparing and filing statements relating to public utility matters pending before state and federal agencies and legislative bodies and by publishing a newsletter about matters affecting the stockholders does not qualify for exemption under section 501(c)(4) of the Code.

Rev. Rul. 80-108, page 8.
Status; application for recognition; untimely notice. An organization that otherwise qualifies for exemption under both section 501(c)(3) and section 501(c)(4) of the Code filed the notice required by section 508(a) more than 15 months after the end of the month in which it was organized. The organization may apply for and obtain exemption under section 501(c)(4) from the date of its inception to the date the exemption under section 501(c)(3) becomes effective.

Announcement 80-57, page 34.
Contributions to the American Institute for Economic Research, Inc., continue to be deductible under section 170(c) of the Code.

ESTATE TAX

Rev. Rul. 80-112, page 31.
Bankruptcy and receiverships; priority; taxes. Claims against a decedent's estate for funeral and administrative expenses and a family allowance required to be paid by state law have priority over the tax claims of the government for which the government has no lien. However, such tax claims are superior to claims against the estate for doctor bills from the decedent's last illness and wages due a household employee.

GIFT TAX

Rev. Rul. 80-111, page 10.
Valuation; state tax paid by donee; Wisconsin. Wisconsin law establishes a joint liability for the Wisconsin gift tax between the donor and the donee, both before and after the tax becomes overdue. For federal gift tax purposes, the gross value of transferred property is reduced by one-half of the amount of the Wisconsin gift tax if the donor transfers the property subject to the condition that the donee pay all the resulting Wisconsin gift tax and the donee relinquishes the right to contribution.

SELF-EMPLOYMENT TAX

Rev. Rul. 80-110, page 10.
Minister employed by church; unreimbursed expenses. Unreimbursed business expenses (other than travel or transportation expenses) incurred by a duly ordained minister who is an employee of a church and who is subject to self-employment tax are not deductible from gross income in arriving at adjusted gross income. The unreimbursed expenses are deductible in computing the minister's self-employment tax.

EXCISE TAXES

T.D. 7690, page 11.
Temporary regulations relate to the Crude Oil Windfall Profit Tax Act of 1980.

ADMINISTRATIVE

Rev. Proc. 80-13, page 32.
Forms 949 and 949-A; filing extension. Contractors and subcontractors with contracts subject to the Vinson-Trammell Act are granted an extension until October 15, 1980, to file Forms 949 and 949-A for taxable years ended before January 31, 1980; Rev. Proc. 77-47 modified and Rev. Proc. 79-53 superseded.

Treasury Department Order 150-69, page 33.
Collections from delinquent officers and employees. Functions relating to officers and employees of the Treasury who fail to account for any pay over any amounts collected or received in connection with the internal revenue laws are transferred to the Commissioner. Treas. Dept. Order 150-69 revised.

Announcement 80-51, page 34.
Publication 453, Preliminary Report, Statistics of Income—1977, Business Income Tax Returns, is now available and may be purchased from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 62.—Adjusted Gross Income Defined

26 CFR 1.62-1: Adjusted gross income.

Treatment of unreimbursed expenses of a minister. See Rev. Rul. 80-110, page 10.

Section 263.—Capital Expenditures

26 CFR 1.263(c)-1: Intangible drilling and development costs in the case of oil and gas wells.

Whether the taxpayer is entitled to deduct all of the intangible drilling and development costs incurred in developing two noncontiguous tracts. See Rev. Rul. 80-109, page 8.

Section 351.—Transfer to Corporation Controlled by Transferor

26 CFR 1.351-1: Transfer to corporation controlled by the transferor.

Whether a favorable ruling will be issued under section 367(a)(1) of the Code where tangible property is transferred by a United States person to a foreign corporation, in a transaction described in section 351, and the tangible property transferred is leased by the foreign corporation to other persons who will not use it in the United States. See Rev. Proc. 80-14, page 32.

Section 367.—Foreign Corporations

26 CFR 7.367(a)-1: Ruling request under section 367 relating to certain transfers involving a foreign corporation.

Whether a favorable ruling will be issued under section 367(a)(1) of the Code where tangible property is transferred by a United States person to a foreign corporation, in a transaction described in section 351, and the tangible property transferred is leased by the foreign corporation to other persons who will not use it in the United States. See Rev. Proc. 80-14, page 32.

Section 368.—Definitions Relating to Corporate Reorganizations

26 CFR 1.368-1: Purpose and scope of exception of reorganization exchanges.

Reorganizations; savings and loan association; change in form. The conversion of a federal mutual savings and loan association to a state or federal stock savings and loan association, and the conversion of a state chartered mutual savings and loan association that is subject to the rules and regulations of the Federal Home Loan Bank Board to a stock savings and loan association in the same state are reorganizations under section 368(a)(1)(F) of the Code; Rev. Rul. 54-193 superseded.

Rev. Rul. 80-105

ISSUE

Does the conversion of a federal mutual savings and loan association to a state stock savings and loan association under the circumstances described below, constitute a reorganization within the meaning of section 368(a) of the Internal Revenue Code?

FACTS

X is a federal mutual savings and loan association chartered pursuant to the Home Owner's Loan Act of 1933, as amended, 48 Stat. 128, 12 U.S.C. § 1461 *et seq.* *X* is a member of the Federal Savings and Loan Insurance Corporation (FSLIC) and is subject to the rules and regulations of the Federal Home Loan Bank Board (FHLBB).

As a mutual savings and loan association *X* has no authorized capital stock. Instead, the mutual savings and loan has a unique equity structure. An *X* savings depositor is entitled to interest on the depositor's account balance that is declared and paid by *X*. The maximum permissible interest rate that *X* may pay its depositors is established by the FHLBB. A savings depositor has no right to a distribution of any earnings of *X* but rather these amounts become retained earnings of *X*. Although an *X* savings depositor does have a right to share pro rata, with respect to the amount in the depositor's savings account as a fraction of the sum of all savings accounts, in any liquidation proceeds distributed, liquidation requires approval by the FHLBB which rarely, if ever, approves liquidation of a solvent company. Voting rights in *X* are held by its savings depositors and borrowers, with each savings depositor being entitled to 1 vote for each 100 dollars or fraction thereof deposited in a savings account (up to a maximum number of 50 votes per depositor) and each borrower being entitled to 1 vote per loan. However, actual voting control of *X* is held by its board of directors through voting proxies. All of these interests of the *X* savings depositors cease when a depositor closes the account with *X*.

In order to stimulate growth and expansion of *X* through the raising of additional capital, the board of directors of *X* adopted a plan of conversion whereby *X* will convert itself into a state stock savings and loan association. The conversion will be accomplished pursuant to the rules and regulations of the FHLBB and the banking authority of state *A* and a majority of the total outstanding votes of the association members.

Under the plan of conversion, *X* will issue up to 1,000,000 shares of 5 dollar par value voting permanent reserve fund common stock. The *X* stock will be sold to qualified purchasers pursuant to nontransferable subscription rights. The price per share of the *X* stock will be determined by an independent appraiser and will represent the fair market value of *X* at the time of conversion, exclusive of *X*'s net worth at that time. As required by FHLBB regulations, the nontransferable subscription rights will be offered first without compensation therefor to persons who were depositors of *X* on a date not less than 90 days before the plan is adopted (eligible account holders). To the extent that there are shares available after these depositors have exercised their rights, then rights to subscribe will be offered to the remaining depositors and if any shares are then available, to the borrowers of *X*. As permitted by the FHLBB regulations, unsubscribed for stock may then be purchased by the directors, officers and employees of *X*, but limited in amount to 25 percent of the total offering of shares. Any remaining balance of the unsubscribed for stock will thereafter be made available to the public at the same offering price.

After *X* converts itself to a stock savings and loan association all voting rights not attributable to *X*'s stock will expire. A liquidation account will be established in an amount equal to the net worth of *X* as of the time of the conversion. While the establishment of the liquidation account will not operate to restrict *X*'s use of its net worth, each eligible account holder who maintains a savings account in *X* at the time of conversion will have an interest in a portion of the liquidation account balance. This interest constitutes a right to receive an amount representing the depositor's interest in the net worth of *X* at the time of the conversion before any liquidation distribution can be made with respect to capital stock. An eligible account holder's interest in the liquidation account will never be increased. It will, however, be decreased to reflect subsequent withdrawals from the depositor's account that reduce the amount in the depositor's account below the amount in such account at the time of conversion.

The conversion will not interrupt the business of *X*, and its business will continue as usual. Each depositor will retain a withdrawable savings account or accounts equal in amount to the withdrawable account at the time of conversion. Mortgage loans of *X* will remain unchanged and retain their same characteristics after the conversion. *X* will continue its membership in the FSLIC and will remain subject to the regulatory authority of the FHLBB.

LAW, ANALYSIS AND HOLDINGS

The financial structure and control of federal regulated savings and loan associations, such as those described above, are unique among business organizations. Accordingly, the law and analysis as applied to these conversions is peculiar to such associations.

Section 368(a)(1)(F) of the Code provides that a mere change in identity, form or place of organization, however effected, is a reorganization.

If *X* converts itself from a federal mutual savings and loan association to a state stock savings and loan association the changes at the corporate level other than its place of organization and form of organization described above will be insubstantial. *X* will continue its business in the same manner. It will have the same savings accounts and loans; it will continue its membership in the FSLIC; and it will remain subject to the regulatory authority of the FHLBB. Since the equity interest of a depositor in a mutual savings and loan association is more nominal than real, unlike that of a shareholder in a corporation, the conversion into a state stock savings and loan association is a mere change in identity, form, or place of organization within the meaning of section 368(a)(1)(F).

If *X* converted itself from a federal mutual savings and loan association to a federal stock savings and loan association, the same result would obtain. Likewise, the same result would obtain if a state chartered mutual savings and loan association which was subject to the FHLBB regulations converted itself to a stock savings and loan association in the same state.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 54-193, 1954-1 C.B. 106, is superseded.

Section 501.—Exemption from Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals. (Also Section 502; 1.502-1.)

Thrift shop; consignment sales. An organization operates a thrift shop that sells items that are either donated or received on consignment. Substantially all of the work in operating the thrift shop is performed without compensation, all transactions are at arm's length, and all profits are distributed to section 501(c)(3) organizations. The organization is not a feeder organization described in section 502(a) of the Code and qualifies for exemption as an organization operated for charitable purposes.

Rev. Rul. 80-106

ISSUES

(1) Is the organization described below that operates a thrift shop, substantially all the work in the operation of which is performed without compensation, a feeder organization within the meaning of section 502 of the Internal Revenue Code?

(2) Does a nonprofit organization that operates a thrift shop that sells consigned goods as well as donated goods in the manner described below qualify for exemption under section 501(c)(3) of the Code?

FACTS

The organization operates a thrift shop that sells used clothing and household furnishings to the general public. All of the organization's profits are required by its governing documents to be distributed to specified organizations that are described in section 501(c)(3) of the Code. Substantially all of the work in operating the thrift shop is performed by volunteers without compensation.

The items sold by the organization are collected from the general public. Some items are donated, but most are received on consignment. In such cases, the organization and the consignor enter into an arm's-length agreement that includes the following provisions: (1) the retail price of the item will be agreed upon by the consignor and the organization; (2) if any item on consignment is not sold within a specified period of time, it will become a donation to the organization unless the consignor picks it up before the end of the period; and (3) the organization will pay the consignor a reasonable fixed percentage of the retail price received and will retain the remaining amount.

LAW AND ANALYSIS

Section 501(c)(3) of the Code provides for exemption from federal income tax of organizations organized and operated exclusively for charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 502(a) of the Code provides that an organization operated for the primary purpose of carrying on a trade or business for profit shall not be exempt from taxation under section 501 on the ground that all of its profits are payable to one or more organizations exempt from taxation under section 501.

Section 502(b)(2) provides that the term "trade or business" shall not include any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation.

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations provides that an organization is not organized or operated exclusively for one or more charitable purposes unless it serves a public rather than a private interest.

Section 1.501(c)(3)-1(e)(1) of the regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purpose of carrying on an unrelated trade or business, as defined in section 513.

Section 513(a)(1) of the Code provides that the term "unrelated trade or business" does not include any trade or business in which substantially all the work in carrying on such trade or business is performed for the organization without compensation.

The organization was created to serve the group of exempt organizations by obtaining donated and consigned items on behalf of the exempt organizations and converting the items to cash for charitable uses with a minimum of expense by the use of volunteer labor. Pursuant to section 502(b)(2) of the Code, the organization is not a feeder organization described in section 502(a) because substantially all the work is performed without compensation. For the same reason, pursuant to section 1.501(c)(3)-1(e)(1) of the regulations, the organization is not organized and operated for the primary purpose of carrying on an unrelated trade or business as defined in section 513.

Expenditures made by an organization for the acquisition of inventory do not constitute inurement of the organization's income to the seller if the purchase price is reasonable. In this case, the organization's method of inventory acquisition is through a consignment arrangement in which the purchase price paid to the consignor is a reasonable fixed percentage of the retail sales price.

In this case, all transactions between the consignors and the organization are at arm's-length. The amounts received by the consignors are reasonable in relation to the retail sales prices, and any benefit to the consignors is clearly incidental to the charitable purposes served by the organization. Thus, the sale of items on consignment does not result in the inurement of the organization's net income to the benefit of any private shareholder or individual, nor do the transactions serve a private rather than a public interest.

HOLDINGS

(1) An organization that operates a thrift shop, substantially all the work in the operation of which is performed without compensation, is not a feeder organization described in section 502(a) of the Code.

(2) The sale of items on consignment by a nonprofit organization that operates a thrift shop does not result in the inurement of net earnings to the benefit of any private shareholder or individual, nor do the transactions serve a private rather than a public interest. Therefore, the organization is operated exclusively for charitable purposes and is exempt from federal income tax under section 501(c)(3) of the Code.

APPLICATION INSTRUCTIONS

Even though an organization considers itself within the scope of this revenue ruling, it must file an application on Form 1023, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. See sections 1.501(a)-1 and 1.508-1(a) of the regulations. In accordance with the instructions to Form 1023, the application should be filed with the District Director of Internal Revenue for the key district indicated herein.

26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Whether an organization that fails to file for recognition of exemption under section 501(c)(3) of the Code within 15 months from the end of the month in which it was organized which is required by section 1.508-1(a)(2)(i) of the regulations, may qualify for exemption under section 501(c)(4) from the date of its organization and up to the date it applied for exemption under section 501(c)(3), if it otherwise qualifies for exemption under section 501(c)(4). See Rev. Rul. 80-108, page 8.

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26 CFR 1.501(c)(4)-1: Civic organizations and local associations of employees.

Public utility stockholders' organization. An organization of individuals and institutions, having beneficial interests in shares of any public utility located in the state, that was formed to promote the interests of the public utility industry and its stockholders by preparing and filing statements relating to public utility matters pending before state and federal agencies and legislative bodies and by publishing a newsletter about matters affecting the stockholders does not qualify for exemption under section 501(c)(4) of the Code.

Rev. Rul. 80-107

ISSUE

Under the circumstances described below, does a membership organization open to individuals and institutions having a beneficial interest in shares of any public utility company located in a certain state qualify for exemption from federal income tax under section 501(c)(4) of the Internal Revenue Code?

FACTS

The organization's purposes are the expansion of industry, the creation of employment, the increase of scientific knowledge, and the support of economic growth through the advancement of the interests of persons who invest in public utility stocks.

The organization prepares and files, on behalf of the public utility companies in which its members own shares, statements relating to rate and regulatory matters pending before the state public utilities commission and other state and federal regulatory agencies and legislative bodies. The organization also distributes among its members a newsletter concerning specific matters affecting public utility shareholders.

LAW AND ANALYSIS

Section 501(c)(4) of the Code provides for the exemption from federal income tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(a)(2) of the Income Tax Regulations provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one that is operated primarily for the purpose of bringing about civic betterments and social improvements.

An organization that is operated essentially for the private benefit of its members is not primarily engaged in activities for the common good and general welfare of the people of the community. See Rev. Rul. 73-306, 1973-2 C.B. 179.

In this case, the primary beneficiaries of the organization's activities are its members, together with other individuals who own shares in the public utlity companies of the state. Therefore, the organization is primarily operated to serve private interests rather than the interests of the community as a whole.

HOLDING

An organization, which is open to individuals and institutions having a beneficial interest in shares of any public utility company located in the state, in the manner described above, does not qualify for exemption from federal income tax under section 501(c)(4) of the Code.

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26 CFR 1.501(c)(4)-1: Civic organizations and local associations of employees.

Whether an organization, which otherwise qualifies for exemption under section 501(c)(3) of the Code may qualify for exemption under section 501(c)(4) from the date it was organized, if it fails to apply for recognition of exemption under section 501(c)(3) within 15 months from the end of the month in which it was organized, which is required by section 1.508-1(a)(2)(i) of the regulations. See Rev. Rul. 80-108, this page.

Section 502.—Feeder Organizations

26 CFR 1.502-1: Feeder organizations.

Whether an organization that operates a thrift shop, substantially all the work in the operation of which is performed without compensation, is a feeder organization described in section 502(a) of the Code. See Rev. Rul. 80-106, page 6.

Section 508.—Special Rules with Respect to Section 501(c)(3) Organizations

26 CFR 1.508-1: Notices.
(Also Section 501; 1.501(c)(3)-1, 1.501(c)(4)-1.)

Status; application for recognition; untimely notice. An organization that otherwise qualifies for exemption under both section 501(c)(3) and section 501(c)(4) of the Code filed the notice required by section 508(a) more than 15 months after the end of the month in which it was organized. The organization may apply for and obtain exemption under section 501(c)(4) from the date of its inception to the date the exemption under section 501(c)(3) becomes effective.

Rev. Rul. 80-108

ISSUE AND FACTS

May an organization, which otherwise qualifies for exemption from federal income tax under both section 501(c)(3) and section 501(c)(4) of the Internal Revenue Code, and which did not file for recognition of exemption under section 501(c)(3) within 15 months from the end of the month in which it was organized as required by section 1.508-1(a)(2)(i) of the Income Tax Regulations, establish that it qualifies for exemption under section 501(c)(4) from the date of its organization to the date its exemption under section 501(c)(3) becomes effective?

HOLDING

Because the organization qualifies for exemption under section 501(c)(4) of the Code from the date of its organization, it may apply for and obtain such status for the period during which section 1.508-1(a)(2)(i) of the regulation precludes it from being exempt under section 501(c)(3).

APPLICATION INSTRUCTIONS

Even though an organization considers itself within the scope of this Revenue Ruling, it must file an application on Form 1024, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(4) of the Code. See section 1.501(a)-1 of the regulations. In accordance with the instructions to Form 1024, the application should be filed with the District Director of Internal Revenue for the key district indicated therein.

Section 612.—Basis for Cost Depletion

26 CFR 1.612-4: Charges to capital and to expense in case of oil and gas wells.
(Also Sections 263, 614, 7805; 1.263(c)-1, 1.614-1, 301.7805-1.)

Intangible drilling costs; operating interests in separate tracts. A taxpayer agreed to drill and operate oil wells on each of two noncontiguous tracts in exchange for the entire operating interest in each tract until the aggregate gross income from both tracts equaled the cost of developing and operating both tracts and a 75 percent operating interest in each tract thereafter. The taxpayer's deduction for intangible drilling and development costs is limited to the portion of those costs attributable to the 75 percent operating interest in each tract. Rev. Rul. 70-336 modified.

Rev. Rul. 80-109

ISSUE

Whether a taxpayer is entitled to deduct all of the intangible drilling and development costs (IDC) incurred in developing two tracts of land for the production of oil and gas under the carrying arrangement discussed below.

FACTS

L owned the operating interests in two undeveloped noncontiguous tracts that were situated on the same geologic prospect. Under a joint venture agreement betwween *O* (the carrying party) and *L* (the carried party), *O* agreed to drill, complete, equip, and operate an initial well on each of these tracts. *O* also agreed to drill and complete any additional wells necessary to develop each tract. In return for paying these costs, *O* received the entire operating interest in each tract and was entitled to the entire income until the aggregate gross income from both tracts equaled the sum of all of *O*'s costs of drilling, completing, equipping, and operating the wells on both tracts. Thereafter, in each tract, *O* will own a "permanent" operating interest of 75 percent, will pay 75 percent of the operating costs, and will be entitled to 75 percent of all oil and gas production. And *L* will own a permanent operating interest of 25 percent, will pay 25 percent of the operating costs, and will be entitled to 25 percent of all oil and gas produced.

O and *L* made the proper election for the joint venture to be excluded from the application of the provisions of subchapter K, Chapter 1, Subtitle A of the Internal Revenue Code. *O* properly elected to treat IDC as expenses.

LAW AND ANALYSIS

Although the two tracts are situated on the same prospect and are expected to produce from the same deposit, *O*'s operating interest in each of the two tracts is a separate property because the operating interests in separate noncontiguous tracts cannot be combined and treated as one property. (Section 614(b)(1)(B) of the Code.)

If drilling and development is undertaken for the grant of or assignment of a fraction of the operating rights, the option to expense IDC is only available for the fraction of the IDC that is attributable to the fractional interest acquired. (Section 1.612-4(a) of the regulations.)

Rev. Rul. 70-336, 1970-1 C.B. 145, provides that the carrying party will have undertaken the drilling and development project for the entire working interest only if the carrying party holds the entire working interest throughout the complete pay-out period. Rev. Rul. 70-336 further provides that, if the carrying party holds the entire working interest for a period that is less than the complete pay-out period, it will have undertaken the drilling and development project for the fraction of the operating rights that the carrying party receives as a "permanent" share in the mineral property.

Rev. Rul. 70-336 also provides that the pay-out period ends when gross income attributable to all of the operating mineral interests in the well (or wells in the case of agreements covering more than a single well) equal all expenditures for drilling and development of such well (or wells) plus the costs of operating the well (or wells) to produce such gross income. The term operating mineral interest referred to above is an operating interest in each separate mineral property within the meaning of section 614 of the Code.

If it is possible for the carrying party's operating interest in an oil and gas property to be reduced from an initial fractional interest to the "permanent" fractional interest on the occurrence of some event other than pay-out from gross income from that property, then it is not certain that the carrying party will hold the initial fractional interest through the complete pay-out period. If the carrying party will not in all events hold the initial fractional interest through complete pay-out (or the life of the property if the property does not pay-out), the carrying party will be treated as having undertaken the drilling and development for the fraction of the operating rights that are received as a "permanent" share, and the carrying party's deduction for IDC will be limited to the fraction of the IDC that is attributable to such "permanent" fraction of the operating interest.

In the instant case, the income from one tract may be sufficient to equal the sum of *O*'s costs of drilling, completing, equipping, and operating the wells on both tracts before the income from the other tract is sufficient to pay-out the costs attributable to that other tract. Because this can occur, it is possible for *O*'s operating interest to be reduced to 75 percent in the two tracts although *O* would not have held the entire operating interest in one tract during the complete pay-out period for that tract.

HOLDING

Because it is possible that *O* may not hold the entire operating interest in each tract through the complete pay-out period for each property (or the life of the property if the property never pays out), *O* is entitled to deduct only that fraction of IDC that is attributable to its 75 percent operating interest in each tract.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 70-336, 1970-1 C.B. 145, is modified to hold that the conclusion in that ruling would be the same even if the carried party had not exercised its option to convert its retained overriding royalty into 50 percent of the operating interest. The terms of the carrying arrangement must provide that the carrying party, in all events, will hold the initial fraction through the complete payout period, if the carrying party is to qualify to deduct this same fraction of IDC.

PROSPECTIVE APPLICATION

Pursuant to the authority contained in section 7805(b) of the Code, the conclusions of this revenue ruling will not be applied adversely to taxpayers who executed carrying arrangements before April 21, 1980, or who had entered into written binding agreements to execute carrying arrangements before such date, if such taxpayers do in fact hold the initial fraction of the operating interest through the complete payout period.

Section 614.—Definition of Property

26 CFR 1.614-1: Definition of property.

Whether the taxpayer is entitled to deduct all of the intangible drilling and development costs incurred in developing two noncontiguous tracts. See Rev. Rul. 80-109, page 8.

Section 1402.—Definitions [Tax on Self-Employment Income]

26 CFR 1.1402(a)-2: Computation of net earnings from self-employment.
(Also Section 62; 1.62-1.)

Minister employed by church; unreimbursed expenses. Unreimbursed business expenses (other than travel or transportation expenses) incurred by a duly ordained minister who is an employee of a church and who is subject to self-employment tax are not deductible from gross income in arriving at adjusted gross income. The unreimbursed expenses are deductible in computing the minister's self-employment tax.

Rev. Rul. 80-110

ISSUE

Is a minister allowed to deduct unreimbursed business expenses from gross income to arrive at adjusted gross income? Is the unreimbursed business expense deductible in computing the minister's income for self-employment tax purposes?

FACTS

A duly ordained minister, an employee of a church, received a salary of $15,000 in 1979. The minister received no parsonage allowance. During 1979 the minister incurred unreimbursed business expenses (other than travel or transportation expenses) of $500. The minister has not filed for an exemption, under section 1402(e) of the Internal Revenue Code, from the tax imposed by the Self-Employment Contributions Act of 1954.

LAW AND ANALYSIS

Section 62(1) of the Code provides that adjusted gross income means gross income minus deductions attributable to a trade or business carried on by the taxpayer, if such trade or business does not consist of the performance of services by the taxpayer as an employee.

Trade and business deductions of employees under section 62(2) of the Code are reimbursed expenses, expenses for travel away from home, transportation expenses, and outside salesmen's expenses.

Section 1402(c)(2)(D) of the Code provides that the term "trade or business", when used with reference to self-employment income, does not include the services of an employee other than the performance of service by a duly ordained minister of a church in the exercise of the ministry. Section 1402(a) provides that the term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by the individual, less the deductions attributable to the trade or business.

The services of a duly ordained minister of a church are excepted from "employment" under section 3121(b)(8)(A) of the Code for purposes of the Federal Insurance Contributions Act.

The trade and business deductions of a minister are allowable as deductions for purposes of computing the tax on self-employment income. However, if the minister is performing services as an employee in the exercise of the ministry the deductions are allowable as deductions from gross income to arrive at adjusted gross income only if they are of the type described in section 62(2) of the Code.

HOLDING

The $500 unreimbursed expenses are not allowable as a deduction in arriving at the minister's adjusted gross income. The $500 is deductible only as an itemized deduction on Schedule A (Form 1040), Itemized Deductions. However, the $500 is deductible on the Schedule SE (Form 1040) Computation of Social Security Self-Employment Tax, in computing the minister's self-employment tax.

Section 2512.—Valuation of Gifts

26 CFR 25.2512-1: Valuation of property; in general.

Valuation; state tax paid by donee; Wisconsin. Wisconsin law establishes a joint liability for the Wisconsin gift tax between the donor and the donee, both before and after the tax becomes overdue. For federal gift tax purposes, the gross value of transferred property is reduced by one-half of the amount of the Wisconsin gift tax if the donor transfers the property subject to the condition that the donee pay all the resulting Wisconsin gift tax and the donee relinquishes the right to contribution.

Rev. Rul. 80-111

ISSUE

What portion of the Wisconsin gift tax is allowable to offset the gross value of transferred property under section 2512 of the Code, if the donor transferred the property with the understanding that the donee would pay all the resulting Wisconsin gift tax?

FACTS

In December 1976, *G* gratuitously transferred $100x$ dollars to *A* upon the condition that *A* would pay the resulting Wisconsin gift tax. *G* filed the required donor's return and *A* filed the required donee's return. *A* paid the Wisconsin gift tax in the amount of $10x$ dollars.

LAW AND ANALYSIS

Section 2512(a) of the Internal Revenue Code of 1954 provides that, if a gift is made in property, the value thereof at the date of gift is considered the amount of the gift. Section 2512(b) of the Code states that if property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the transferred property exceeds the value of the consideration is deemed a gift.

The donor is liable for the payment of the federal gift tax before the tax is overdue. The donor, therefore, receives consideration for a transfer to the extent of the federal gift tax that the donee has, by prior arrangement, agreed to pay. In computing the value of the gift, the federal gift tax paid by the donee may be deducted from the value of transferred property, if it can be shown that the payment of tax by the donee or from the transferred property was a condition of the transfer. *See,* Rev. Rul. 75-72, 1975-1 C.B. 310.

Similarly the amount of state gift tax paid by the donee is deductible in computing the value of the transfer for federal gift tax purposes, to the extent that the donor would have been liable for the payment of the tax before it was overdue and the donee, prior to the transfer, agreed to pay the tax. *See* Rev. Rul. 76-49, 1976-1 C.B. 294; Rev. Rul. 76-57, 1976-1 C.B. 297; Rev. Rul. 76-104, 1976-1 C.B. 301; and Rev. Rul. 76-105, 1976-1 C.B. 304.

Wis. Stat. Ann. section 72.85(2) (West) provides that by April 15 of each year both the donor and donee of any transfers during the preceding year must report the transfers and pay the tax. Wis. Stat. Ann. section 72.85 (3) provides that if the tax is not paid by the due date, the donor and donee are jointly and severally liable for the tax, penalty, and interest, and that if one person pays the tax, there is no right of contribution unless the person paying the tax reserves it in writing on the filed tax return.

Wis. Stat. Ann. sections 72.85(2) and 72.85(3) establish a joint liability for the Wisconsin gift tax between the donor and the donee both before and after the tax becomes overdue. The donor and the donee, therefore, are joint obligors for the gift tax. The term "joint" signifies shared by or between two or more, coupled together in interest or liability. *Black's Law Dictionary* 971 (4th ed. 1968). Wisconsin recognizes a right of contribution between co-obligors. The right of contribution arises between parties, when one party pays more than that party's share of the joint obligation. *See Sattler v. Neiderkorn,* 190 Wis. 464, 209 N.W. 607 (1926); *Western Casualty and Surety Co. v. Milwaukee General Construction Co.,* 213 Wis. 302, 251 N.W. 491 (1934). Thus, the donee's share of the Wisconsin gift tax is one-half.

Prior to the transfer, *A* agreed to pay all the Wisconsin gift tax, *A* thereby relinquished *A*'s right to contribution and relieved *G* of any obligation to pay one-half of the gift tax. Thus, *A* furnished consideration to *G* for the transfer to the extent of one-half of the amount of Wisconsin gift tax.

HOLDING

The gross value of transferred property for federal gift tax purposes is reduced by one-half of the amount of the Wisconsin gift tax, because the donor transferred the property subject to the condition that the donee would pay all the resulting Wisconsin gift tax. Therefore, the value of the transfer for federal gift tax purposes is $95x$ dollars.

Section 4986.—Imposition of Tax [Windfall Profit Tax]

26 CFR 150.4986-1: Imposition of tax.
(Also Sections 4987, 4988, 4989, 4991, 4992, 4993, 4994, 4995, 4996, 4997, 6050C, 6076, 6402; 150.4987-1, 150.4988-1, 150.4989-1, 150.4991-1, 150.4992-1, 150.4993-1, 150.4994-1, 150.4995-1, 150.4996-1, 150.4997-1, 150.6050C-1, 150.6076-1, 150.6402-1.)

T.D. 7690

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 150.—TEMPORARY EXCISE TAX REGULATIONS UNDER THE CRUDE OIL WINDFALL PROFIT TAX ACT OF 1980

Crude Oil Windfall Profit Tax

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides temporary excise tax regulations relating to the windfall profit tax on domestic crude oil imposed by title I of the Crude Oil Windfall Profit Tax Act of 1980. The temporary regulations provide rules to be followed by operators, producers, and purchasers of domestic crude oil. In addition, the text contained in the temporary regulations set forth in this document also serves as the comment document for the notice of proposed rulemaking published in the Proposed Rules section of this issue of the Federal Register.

DATES: These temporary regulations are generally effective with respect to oil removed after February 29, 1980. However, certain rules are effective at later dates. A complete explanation of the effective dates is contained in the Supplementary Information section of this document. Written comments and requests for a public hearing must be delivered or mailed by June 3, 1980.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-48-80), Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: David B. Cubeta of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224 (Attention: CC:LR:T) (202-566-3926 or 202-566-3299).

SUPPLEMENTARY INFORMATION

BACKGROUND

This document contains temporary regulations under sections 4986, 4987, 4988, 4989, 4991, 4992, 4993, 4994, 4995, 4996, 4997, 6050C, 6076, and 6402 of the Internal Revenue Code of 1954. The temporary regulations are required to implement various sections of the Crude Oil Windfall Profit Tax Act of 1980.

The regulations promulgated in this document are also proposed to be prescribed as final Income Tax Regulations (26 CFR Part 51).

EXPLANATIONS OF PROVISIONS

In general

The windfall profit tax is a temporary excise tax imposed upon the windfall profit from domestically produced taxable crude oil removed from the premises during each taxable period (generally a calendar quarter). The rate of tax varies with each of three tax tiers. Tier 1 oil is all taxable crude oil other than tier 2 or tier 3 oil. Tier 2 oil is oil (other than tier 3 oil) from a stripper well property or from a National Petroleum Reserve. Tier 3 consists of newly discovered oil, heavy oil, and incremental tertiary oil. Generally, the tax rate is 70 percent for tier 1, 60 percent for tier 2, and 30 percent for tier 3. However, "independent producer oil" is subject to a

50 percent rate in tier 1 and a 30 percent rate in tier 2. Oil attributable to qualified governmental interests or qualified charitable interests, Indian oil, certain Alaskan oil, and oil used to finance certain tertiary recovery projects is exempt from tax.

The term "windfall profit" is defined as the excess of the removal price of the barrel of oil over the sum of the adjusted base price and the severance tax adjustment. The removal price is generally the amount for which the barrel is sold, but in certain cases is the constructive sales price used for percentage depletion purposes. The adjusted base price is the base price adjusted for inflation. The base price for tier 1 oil is the ceiling price which would have applied to the oil under the March 1979 energy regulations if it had been sold in May 1979 as upper tier oil, reduced by 21 cents. The base price for tier 2 oil and tier 3 oil is determined under an interim rule provided in section 4989(d)(2) until regulations providing a permanent method are promulgated. These regulations will be issued in a separate document.

Administrative provisions

Introduction

Although the windfall profit tax is imposed upon the producer, the Act provides that the first purchaser of domestic crude oil generally is liable for deducting and withholding tax from the purchase price, for depositing the tax, and for filing quarterly tax returns. The obligations of the first purchaser arise except when the oil is removed from the premises before sale, purchased from an integrated oil company, or refined on the premises. In these cases the producer of the oil rather than the purchaser deposits the tax and files the returns.

Withholding system

When the purchaser is obligated to withhold, the amount to be withheld is generally the amount of windfall profit tax imposed by section 4986 on the oil purchased. Since it is the operator of the well who is in a position to know the type of oil sold, section 6050C requires the operator to provide the purchaser with the information necessary for a correct computation of the tax. Therefore, the regulations establish the general rule that the operator must certify detailed information regarding the type of oil purchased, the volume in each tax tier, and other data necessary for a correct computation of the tax.

However, the type and amount of information needed by a purchaser will vary depending upon various factors. For instance, if the operator sells all the production from a particular property to one purchaser, the purchaser may be able to determine the correct amount of tax based upon minimal information provided by the operator. In other situations, however, the purchaser may not know the tier into which the oil falls and other necessary information unless informed by the operator. In order to facilitate the various arrangements that operators and purchasers may wish to make, the regulations provide that the operator and purchaser may agree to relieve the operator of the duty of providing any or all of this information if the purchaser is able to meet its obligations without it.

Oil attributable to qualified governmental interests or qualified charitable interests and Indian oil is exempt from the tax. Under the regulations, these persons may furnish a certificate to the operator or to the purchaser certifying their exempt status and setting forth the facts that establish entitlement to the exemption. An operator who receives a producer's certificate is required to furnish the information to each purchaser of that oil. A purchaser who receives an exemption certificate and who has no reason to believe it is not correct must not withhold any windfall profit tax from payments for oil to which the certificate applies. A similar procedure is to be followed by persons who produce independent producer oil qualifying for the lower rates of tax. These persons may certify their entitlement to the lower rate, and the purchaser adjusts the amount to be withheld accordingly. If payment for the oil is made by the purchaser to the operator or to a partnership rather than directly to the producer of the oil, the amount to be withheld from the payment generally is based on information received from the operator or partnership that summarizes the status of the producers.

The amount of tax withheld by the purchaser from the purchase price generally is the amount of the windfall profit tax determined on the basis of the information provided in the operator's certification and any producers' certificates. However, situations may arise in which the purchaser does not have the necessary information for a correct computation of the tax. This may result during the initial implementation of the tax or when a purchaser first begins purchasing oil from a property. Therefore, special withholding rules are to be followed by the purchaser if the purchaser has not received from the operator the information necessary to properly compute the tax or if the purchaser has reason to believe that information contained in the operator's certification that affects the tax computation is not correct.

The special withholding rules establish an amount to be withheld from the purchase price based upon the amount paid for the crude oil purchased even though the purchaser does not have specific knowledge of the windfall profit tax category into which the oil falls. The rules provide different amounts to be withheld depending upon whether, pursuant to the price control regulations, the purchaser has paid the lower tier ceiling price, the upper tier ceiling price, or an uncontrolled price.

No windfall profit tax liability arises upon the removal of crude oil which is sold at the lower tier ceiling price. Therefore, withholding is not required when the purchaser pays the lower tier ceiling price for oil. However, if the purchaser pays either the upper tier ceiling price or an uncontrolled price, the purchaser is required to withhold. The amount to be withheld per barrel is 70 percent (the windfall profit tax rate on tier 1 oil) of the excess of the purchase price over the amount equal to (1) $11.01 (the lowest upper tier ceiling price as of May 1979 reduced by the 21 cent "balancer" provided in section 4989(c)(2)), plus (2) the inflation adjustment for the calendar quarter in which the oil was removed, plus (3) the amount of any severance tax adjustment known by the purchaser.

An interim withholding rule is provided for use until the generally applicable rules take effect. This rule requires withholding on the excess, if any, of the purchase price over $11.22 for oil removed during March 1980 and $11.47 for oil removed after March (the amount equal to the lowest upper tier ceiling price as of May 1979 reduced by the section 4989(c)(2) "balancer" and increased by the inflation adjustment for the applicable taxable period). However, purchasers may withhold under the permanent rules during the interim period if they choose to.

In certain situations the purchaser will withhold more or less than the amount of tax imposed by section 4986 with respect to oil purchased. For instance, the special rules to be followed in the absence of a valid operator's certificate may result in the withholding of tax in excess of the amount that would have been withheld if the certificate had been received, or computational errors by one of the parties to a transaction may cause under or overwithholding. Furthermore, due to the retroactive effective date of the windfall profit tax, payments may be made for taxable crude oil from which no tax is withheld. Therefore, rules are provided to be followed by the purchaser in withholding on later payments in order to adjust the under or overpayment.

The regulations also provide that a purchaser is not liable to any other person for the amount of tax withheld and deposited. However, every purchaser required to withhold is liable for the payment of the tax whether or not it is actually collected from the producer by the purchaser.

Purchasers that are not integrated oil companies generally deposit the amounts required to be withheld not later than 45 days after the end of the calendar month in which the oil was removed. Independent refiners purchasing oil under a contract under which no payment is required to be made before the 46th day after the end of the month in which the oil is purchased must deposit before the first day of the third month which begins after the end of the month in which the oil was removed. Independent refiners not purchasing pursuant to a delayed payment contract deposit in accordance with the generally applicable 45 day rule. If a purchaser underwithholds on a producer for a calendar year, the producer must attach payment to the return filed after the end of the year or must deposit payment on or before the last day for filing the return. Integrated oil companies must deposit both amounts required to be withheld and amounts of the tax liability from their own production twice monthly.

All purchasers subject to the withholding rules must provide each producer from whom they have purchased crude oil a monthly statement of the amount of tax withheld. An annual statement of the producer's tax liability and other pertinent information is to be sent both to the producer and to the Internal Revenue Service. If the purchaser withheld tax from payments made to an operator or partnership rather than directly to the producer of the oil, the purchaser is to furnish the statement to the person who received the payment. That person is then required to promptly relay the information and to file information returns with the Internal Revenue Service.

For most taxpayers, the income tax deduction for the windfall profit tax will be the amount actually withheld during the year, rather than the amount of tax imposed upon oil removed during the year. Therefore, the annual statement must set forth the amount withheld in the course of the year.

Generally, it is the purchaser rather than the producer who is to file the quarterly windfall profit tax return. However, the producer must file the return if the oil removed during the taxable period was not subject to withholding. Furthermore, the producer must file an annual return if the producer's liability for the tax exceeds the amount of tax withheld. The quarterly windfall profit tax return is to be filed no later than the last day of the second month following the close of the taxable period. However, a producer who has a liability remaining at the end of the year due to underwithholding is required to file only one return at the end of the calendar year with respect to which the underpayment occurred. This return is due by the last day of February.

In the case of overwithholding, it is anticipated that later adjustments made by the purchaser will generally correct for the overpayment. However, if an amount remains overpaid for a calendar year, the producer may either file a claim for credit or refund in connection with the producer's income tax return for that year or claim a refund on Form 843.

An exception to the annual refund rule is provided for producers whose oil interests are exempt from the windfall profit tax and have been withheld upon during the initial implementation of the tax. These producers may file an early claim for credit or refund on or after July 1, 1980.

Section 4995(a)(7) permits an election substituting the operator for the purchaser in the administration of the windfall profit tax. That section also authorizes the Secretary to limit the election to situations where the substitution is administratively more practicable. The regulations provide that the operator and purchaser may elect to have the operator responsible for all windfall profit tax responsibilities otherwise imposed upon the purchaser when the operator is otherwise required to make deposits as a purchaser of oil produced from a different reservoir. Consideration will be given to providing for this election in other circumstances in response to publc comment.

Procedures when purchaser not required to withhold

As noted earlier, the withholding system is in effect unless the oil is removed from the premises before sale, refined on the premises, or purchased from an integrated oil company. If withholding is not required, the purchaser does not perform such other duties as furnishing information or filing returns.

When the oil sold is not subject to withholding, the operator must supply each producer with the information required to enable the producer to compute the amount of the windfall profit tax liability on the producer's share of production. This is the same information that would be furnished to the purchaser if the oil were subject to withholding.

A producer that is not an integrated oil company must deposit its tax liability (if it is $100 or more) for the calendar quarter within 45 days after the end of the month in which the oil is removed (or deemed removed) from the premises. An integrated oil company must deposit not later than 9 days after each semimonthly period the amounts required to be withheld from payments made to other producers for oil removed in that period plus the company's windfall profit tax liability as a producer of oil removed in that period. A semimonthly period means the first 15 days of a calendar month or the portion of a calendar month following the 15th day of such month. The depositary requirements are considered met for a month or a semimonthly period if one of the safe-haven rules is met.

Deposits are to be made with a Federal Reserve bank or an authorized financial institution.

When the windfall profit tax is not withheld by the purchaser, the return filing requirement is imposed directly upon the producer. Thus, the producer must file the quarterly windfall profit tax return not later than the last day of the second month following the close of the taxable period.

Generally, if a producer overpays his windfall profit tax liability for a taxable period, the producer may either file a claim for refund on or after the date for filing the return for the taxable period of the overpayment or may claim credit for the overpayment by making an adjustment on the windfall profit tax return for later taxable periods within the applicable period of limitation. However, a claim for credit or refund based on an overpayment due to the operation of the net income limitation on windfall profit provided in section 4988(b) may not be claimed until the producer's income tax return is filed for the taxable year that includes the last day of the taxable period for which the overpayment was made.

Other rules

Tertiary recovery projects

These regulations also provide rules for the certification of tertiary recovery projects. In order to self-certify a tertiary recovery project the regulations require the operator to submit a certification from a petroleum engineer to the service center with which the operator files an income tax return. Rules are also provided for the certification of a tertiary recovery project approved by a jurisdictional agency. In determining a project beginning date, a special rule is provided for certifications submitted by May 1, 1980.

A taxpayer may request a ruling with respect to whether a project for which a jurisdictional agency's certification is submitted is a qualified tertiary recovery project. The ruling generally must be issued within 180 days of the request. The regulations set forth the information that must be supplied in the request in addition to the information normally required to be included in a ruling request.

Post-1978 transfers

The regulations also provide special rules for post-1978 transfers of portions of a property. If a portion of a property is transferred after December 31, 1978, the oil produced from the property transferred constitutes oil from a stripper well property, newly discovered oil, or heavy oil only if it would be so classified if there had been no transfer.

Effective dates

Except as otherwise provided, the temporary regulations are effective with respect to oil removed after February 29, 1980. Certain sections of the temporary regulations contain a different effective date. Paragraphs (a), (b), and (c) of § 150.4995-1 (relating to the requirement of withholding) are effective with respect to payments made after June 3, 1980 for oil removed on or after March 1, 1980. However, for purposes of applying paragraph (c) (relating to adjustments in the amount required to be withheld) of § 150.4995-1 to payments described in the preceding sentence, payments made before June 4, 1980 for oil removed on or after March 1, 1980, are treated as if paragraphs (a) and (b) applied to them. The rules of paragraph (d) (relating to an interim withholding rule) apply to payments made after April 18, 1980 and before June 4, 1980, with respect to oil removed on or after March 1, 1980. The rules of paragraph (d) may, at the option of the purchaser, be applied with respect to payments made prior to the above period with respect to such oil. Paragraph (a) of § 150.4995-3 (relating to depositary requirements) contains a special effective date rule for integrated oil companies which provides that, for purposes of the depositary rules, oil removed prior to April 4, 1980 is considered to have been removed on April 4, 1980. Section 150.6050C-1 (relating to information furnished by the operator of a property) contains a rule providing that, for purposes of § 150.6050C-1, the statement for oil removed during March 1980 shall be furnished no later than April 25, 1980. The proposed regulations are to be effective for the same period as the temporary regulations.

WAIVER OF PROCEDURAL REQUIREMENTS OF TREASURY DIRECTIVE

The expeditious adoption of the provisions contained in this document is necessary because of the need for immediate guidance to taxpayers liable for the windfall profit tax on domestic crude oil and to other persons required to withhold and deposit tax, file returns, provide information, etc. For this reason, Jerome Kurtz, Commissioner of Internal Revenue, has determined that the provisions of paragraphs 8 through 14 of the Treasury Department directive implementing Executive Order 12044 must be waived.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adoption of the final regulations proposed in this document, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

DRAFTING INFORMATION

The principal author of these regulations is David B. Cubeta of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, a new part 150, Temporary Excise Tax Regulations Under the Crude Oil Windfall Profit Tax Act of 1980, is added and the following temporary regulations are adopted:

§ 150.0 Introduction.

Each section of the regulations in this part is designated by a number composed of the part number followed by a decimal point [150.], the section of the Internal Revenue Code of 1954 to which it relates, a hyphen [-] and a number identifying the section. By use of these designations, the reader can associate sections of the regulations with provisions of the Code. For example, § 150.4986-1 pertains to section 4986 of the Code.

§ 150.4986-1 Imposition of tax.

Section 4986 imposes an excise tax on the windfall profit from taxable crude oil removed from the premises on or after March 1, 1980, and before the end of the phaseout period. See §§ 150.4988-1, 150.4991-1, and 150.4996-1 for the definitions of "windfall profit", "taxable crude oil", and "removed from the premises", respectively. See section 4990(c) for the definition of "phase-out period". The tax imposed by section 4986 is to be paid by the producer of the crude oil. However, see § 150.4995-1, relating to the requirement of withholding by the purchaser of the crude oil. See § 150.4996-1 for the definitions of "purchaser" and "producer".

§ 150.4987-1 Amount of tax.

Section 4987 establishes that the amount of tax imposed by section 4986 with respect to any barrel of taxable crude oil is the applicable percentage of the windfall profit on that barrel. The applicable percentage for tier 1 oil and tier 2 oil which is not independent producer oil is 70 in the case of tier 1 and 60 in the case of tier 2. The applicable percentage for independent producer oil is 50 for tier 1 and 30 for tier 2. The applicable percentage for tier 3 oil is 30. In the case of a fraction of a barrel, the tax is the same fraction of the amount of the tax imposed on the whole barrel.

§ 150.4988-1 Windfall profit; removal price.

(a) *Windfall profit.* For purposes of this part and chapter 45 of the Code, the term "windfall profit" means the excess of the removal price of the barrel of crude oil over the sum of—

(1) The adjusted base price of the barrel, and

(2) The amount of the severance tax adjustment with respect to the barrel provided by section 4996(c) and § 150.4996-2.

Section 4988(b) provides that the windfall profit on any barrel of crude oil shall not exceed 90 percent of the net income attributable to the barrel. The computation of the net income limitation is determined under special rules set forth in section 4988(b).

(b) *Removal price*—(1) *In general.* The "removal price" generally is the amount for which the barrel is sold (including any adjustments to the sales price made after sale). However, in the case of a sale between related persons (within the meaning of section 103(b)(6)(C)), the removal price shall not be less than the constructive sales price for purposes of determining gross income from the property under section 613. Also, if crude oil is removed from the premises before it is sold (or is deemed removed under section 4988(c)(4) or § 150.4996-1(d)), the removal price shall be the constructive sales price for purposes of determining gross income from the property under section 613.

(2) *Alaskan oil from Sadlerochit reservoir.* In the case of Sadlerochit oil, the removal price of such oil removed during any calendar month shall be the average of the producer's removal prices for such month.

(3) *District director's authority.* In determining the removal price of oil from a property in the case of any transaction, a district director may adjust the removal price to reflect clearly the fair market value of oil removed.

§ 150.4989-1 Adjusted base price.

(a) *Adjusted base price defined.* For purposes of this part and chapter 45 of the Code, the "adjusted base price" is the base price for the barrel of crude oil plus the amount equal to the base price multiplied by the inflation adjustment for the calendar quarter in which the crude oil is removed from the premises, rounded to the nearest cent. The inflation adjustment, which is determined under a formula set out in section 4989(b), is greater for tier 3 oil than it is for tier 1 oil or tier 2 oil. For March 1980, the inflation adjustment is .0195 in the case of tier 1 or tier 2 oil and .0246 in the case of tier 3 oil. Future inflation adjustments will be published periodically by the Internal Revenue Service. For a special adjustment to the base price for Alaskan oil from the Sadlerochit reservoir, see section 4996(d).

(b) *Base price for tier 1 oil.* The base price for tier 1 oil is the ceiling price which would have applied to the oil under the March 1979 energy regulations (see § 150.4996-1(f)) if it had been produced and sold in May 1979 as upper tier oil, reduced by 21 cents. For purposes of this determination, the grade and quality of the oil produced from the property in May 1979 shall be used.

(c) *Base prices for tier 2 and tier 3 oil*—(1) *General rule.*

[Reserved]

(2) *Interim rule.* This subparagraph and subparagraph (3) apply to

oil removed during a month beginning before October 1980 (or such earlier date as may be provided in regulations taking effect before such earlier date). Except as provided in subparagraph (3), the base prices for tier 2 oil and tier 3 oil, respectively, shall be the product of—

(i) (A) The highest posted price for December 31, 1979, for uncontrolled crude oil of the same grade, quality, and field, or

(B) If there is no posted price described in inferior subdivision (A), the highest posted price for such date for uncontrolled crude oil at the nearest domestic field for which prices for oil of the same grade and quality were posted for such date, multiplied by

(ii) A fraction the denominator of which is $35, and the numerator of which is—

(A) $15.20 for purposes of determining base prices of tier 2 oil, and

(B) $16.55 for purposes of determining base prices of tier 3 oil.

In determining the base price for tier 2 or tier 3 oil, the grade and quality of the oil produced from the property in December 1979 shall be used. For purposes of determining the highest posted price for December 31, 1979, no price which was posted after January 14, 1980, shall be taken into account. For a posted price to qualify for use in determining a producer's base price, the price must be published in writing by a purchaser of a substantial volume of crude oil in the field.

(3) *Minimum interim base price.* The base price determined under paragraph (c)(2) of this section for tier 2 oil or tier 3 oil shall not be less than the sum of—

(i) The ceiling price which would have applied to such oil under the March 1979 energy regulations if it had been produced and sold in May 1979 as upper tier oil, plus

(ii) (A) $1 in the case of tier 2 oil, or

(B) $2 in the case of tier 3 oil.

For purposes of this determination, the grade and quality of the oil produced from the property in May 1979 shall be used.

(d) *Variations in grade or quality of oil.* For purposes of paragraphs (b) and (c) of this section, if the production from a property in May or December 1979 varied in grade or quality during the month, the per barrel average grade and quality for the month shall be used. If there was no commercial production in May or December 1979, the grade and quality of the oil produced in the first month of commercial production after such month shall be used. Once the base price is determined, it is not to be adjusted for later changes in grade or quality.

§ 150.4991-1 Taxable crude oil; tiers of oil.

(a) *Taxable crude oil.* Section 4991 defines the term "taxable crude oil" to mean all domestic crude oil (including crude oil derived by the producer from the production of natural gas) other than exempt oil. The term "exempt oil" is any crude oil from a qualified governmental interest (see section 4994(a)) or a qualified charitable interest (section 4994(b)), any exempt front-end oil (see section 4994(c)), any exempt Indian oil (see section 4994(d)), and any exempt Alaskan oil (see section 4994(e)).

(b) *Tiers of oil.* Section 4991 defines the tiers of taxable crude oil. Tier 1 oil is any taxable crude oil other than tier 2 oil and tier 3 oil. Tier 2 oil is any oil which is produced from a stripper well property within the meaning of the June 1979 energy regulations (see § 150.4996-1(f)) and any oil from an economic interest in a National Petroleum Reserve held by the United States. However, the term "tier 2 oil" does not include tier 3 oil. Tier 3 oil is newly discovered oil, heavy oil, and incremental tertiary oil. The term "newly discovered oil" has the meaning given to that term by the June 1979 energy regulations. The term "heavy oil" means all crude oil which is produced from a property if crude oil produced and sold from that property during either—

(1) The last month before July 1979 in which crude oil was produced and sold from that property, or

(2) The taxable period,

had a weighted average gravity of 16 degrees API or less (corrected to 60 degrees Fahrenheit). For the definition of incremental tertiary oil, see § 150.4993-1.

§ 150.4992-1 Independent producer oil.

(a) *General rule.* "Independent producer oil" is that portion of an independent producer's qualified production for the quarter which does not exceed such person's independent producer amount for the quarter.

(b) *Independent producer defined.* An "independant producer", with respect to any quarter, is any person other than a person to whom subsection (c) of section 613A does not apply by reason of paragraph (2) (relating to certain retailers) or paragraph (4) (relating to certain refiners) of section 613A(d) (or to whom subsection (c) would not apply if subsection (d)(2) or (4) were applied on a quarterly rather than an annual basis).

(c) *Independent producer amount.* A person's independent producer amount for any quarter is the product of 1,000 barrels multiplied by the number of days in the quarter. For March 1980, the independent producer amount is 31,000 barrels. If a person's qualified production for any quarter exceeds that person's independent producer amount for the quarter, the independent producer amount is to be allocated between tiers 1 and 2 in proportion to the person's production for the quarter of domestic crude oil in each such tier, and is to be allocated within any tier on the basis of the removal prices for such person's domestic crude oil in that tier removed during that quarter, beginning with the highest of those prices.

(d) *Qualified production of oil defined*—(1) *In general.* An independent producer's qualified production of oil for any quarter is the number of barrels of taxable crude oil of which such person is the producer which is removed during that quarter, which is tier 1 oil or tier 2 oil, and which is attributable to the independent producer's working interest in a property.

(2) *Working interest defined.* The term "working interest" means an operating mineral interest (within the

meaning of section 614(d)) which was in existence as an operating mineral interest on January 1, 1980, or which is an operating mineral interest derived from a qualified overriding royalty interest after that date. A "qualified overriding royalty interest" is an overriding royalty interest in existence as such an interest on January 1, 1980, but only if on or before February 20, 1980, there was in existence a binding contract under which such interest was to be converted into an operating mineral interest.

(3) *Production from transferred property*—(i) *In general.* Except as otherwise provided in this subparagraph, in the case of a transfer (as defined in § 150.4996-3(b)) on or after January 1, 1980, of an interest in any property, the qualified production of the transferee shall not include any production attributable to such interest.

(ii) *Small producer transfer exemption*—(A) *In general.* Subdivision (i) shall not apply to any transfer of an interest in property if the transferee establishes, to the satisfaction of the district director for the district in which the property is situated, that at no time after December 31, 1979, has the property been held by a person who was a disqualified transferor for any quarter ending after September 30, 1979, and ending before the date such person transferred the interest.

(B) *Disqualified transferor.* The term "disqualified transferor" means, with respect to any quarter, any person who either had qualified production for such quarter which exceeded such person's independent producer amount for such quarter or was not an independent producer for such quarter.

(C) *Special rules.* For purposes of this paragraph, property held by a partnership at any time shall be treated as owned proportionately by the partners of such partnership at such time. Property held by any trust or estate shall be treated as owned both by such trust or estate and proportionately by its benefitciaries. Chapter 45 and this part shall be treated as having been in effect for periods after September 30, 1979, for purposes of making any determination under subdivision (ii)(B).

(iii) *Other exceptions.* Subdivision (i) shall not apply in the case of—

(A) A transfer of property at death,

(B) A change of beneficiaries of a trust which qualifies under clause (iii) of section 613A(c)(9)(B) (determined without regard to the exception at the end of such clause), and

(C) Any transfer so long as the transferor and transferee are required by section 4992(e) to share the 1,000 barrel amount referred to in paragraph (c) of this section.

The preceding sentence shall apply in the case of any property only if the production from the property was qualified production for the transferor.

(e) *Allocation within related group*—(1) *In general.* Section 4992(e) contains rules for the allocation of the 1,000 barrel per day amount among all persons who are members of the same related group.

(2) *Special rules.*
[Reserved]

§ 150.4993-1 Incremental tertiary oil.

(a) *In general*—(1) *Incremental tertiary oil.* "Incremental tertiary oil" is the excess of the amount of crude oil which is removed from a property during any calendar month and which is produced on or after the project beginning date and during the period for which a qualified tertiary recovery project is in effect on the property over the base level for the property for that month.

(2) *Base level.* (i) The base level for any property for any month is determined by ascertaining (under the principles reflected in the rules used in determining the base production control level in the June 1979 energy regulations) the average monthly amount of crude oil removed from the property during the 6-month period ending March 31, 1979. To arrive at the base level, that average monthly amount is then reduced (but not below zero) by the sum of 1 percent of such amount for each month which begins after 1978 and before the first calendar month beginning after the project beginning date, and 2½ percent of such amount for each month which begins after the project beginning date (or after 1978 if the project beginning date is before 1979) and before the month for which the base level is being determined.

(ii) [Reserved]

(3) *Minimum amount.* If a qualified tertiary recovery project has been certified under the June 1979 energy regulations, and the certification is in effect, the amount of the incremental tertiary oil shall not be less than the incremental production determined under the June 1979 energy regulations.

(4) *Allocation rules.* The determination of which barrels of crude oil removed during any calendar month are incremental tertiary oil shall be made—

(i) First by allocating the amount of incremental tertiary oil between oil which (but for this paragraph) would be tier 1 oil, and oil which (but for this paragraph) would be tier 2 oil, in proportion to the respective amounts of each such oil removed from the property during such month, and

(ii) Then by taking into account barrels of crude oil so removed in the order of their respective removal prices, beginning with the highest of such prices.

(b) *Qualified tertiary recovery project*—(1) *In general.* A "qualified tertiary recovery project" is either a qualified tertiary enhanced recovery project with respect to which a certification as such has been approved and is in effect under the June 1979 energy regulations or any project for enhancing recovery of crude oil which meets the requirements of subparagraph (2) of this paragraph. Because of the energy regulations, as in effect on June 1, 1979, did not permit self-certification of projects, such a project must meet the requirements of subparagraph (2) of this subparagraph to be a "qualified tertiary recovery project".

(2) *Requirements.* A project meets the requirements referred to in subparagraph (1) of this paragraph if it satisfies subdivisions (i) through (iv) of this subparagraph.

(i) The project involves the application (in accordance with sound engineering principles) of one or more tertiary recovery methods which can reasonably be expected to result in more than an insignificant increase (determined in light of all the facts and circumstances) in the amount of crude oil which will ultimately be recovered;

(ii) The project beginning date is after May 1979;

(iii) The portion of the property to be affected by the project is adequately delineated; and

(iv) The operator submits either—

(A) A certification from a petroleum engineer that the project meets the requirements of subdivisions (i), (ii), and (iii), or

(B) A certification that a jurisdictional agency (as defined in section 4993(d)(5)) has approved the project as meeting those requirements, and that such approval is still in effect.

For rules relating to the submission of a certification from a petroleum engineer, see § 150.4993-2. For rules relating to the submission of a certification from a jurisdictional agency, see § 150.4993-3.

(c) *Definitions and special rules.* Under section 4993(d), the term "tertiary recovery method" means any method which is described in subparagraphs (1) through (9) of section 212.78(c) of the June 1979 energy regulations, or any other method to provide tertiary enhanced recovery which is approved in writing by the Office of the Assistant Commissioner (Technical). The "project beginning date" is the later of—

(1) The date on which the injection of liquids, gases, or other matter begins, or

(2) The date on which—

(i) The project is certified as a qualified tertiary enhanced recovery project under the June 1979 energy regulations, or

(ii) All of the requirements of § 150.4993-2 are met with respect to the submission of a petroleum engineer's certification, or all of the requirements of § 150.4993-3 are met with respect to the submission of a certification of jurisdictional agency approval. However, for purposes of the preceding sentence only, in the case of a submission received by an Internal Revenue Service Center on or before May 1, 1980, such submission shall be considered to have been received on the later of March 1, 1980, or the date on which the petroleum engineer executed the certification or the jurisdictional agency issued its approval.

If a qualified tertiary recovery project can reasonably be expected to increase the ultimate recovery of crude oil from only a portion of a property, the portion shall be treated as a separate property for purposes of this section. A significant expansion of any project shall be treated as a separate project. A taxpayer may request a ruling with respect to whether a project is a qualified tertiary recovery project. For rules relating to the request for such a ruling see § 150.4993-4.

§ 150.4993-2 Self-certification of tertiary recovery projects.

(a) *Certification of petroleum engineer.* In order to qualify under section 4993(c)(2)(D)(i), relating to the self-certification of a qualified tertiary recovery project, the operator shall submit a certification, signed under penalties of perjury by a petroleum engineer (who has been duly registered or certified in accordance with applicable state law, if any), to the Internal Revenue Service Center for the region with which the income tax return of the operator is filed. The certification shall contain the following:

(1) A statement that the project involves a tertiary recovery method (as defined in section 4993(d)(1) and § 150.4993-1(c)) that is expected to result in more than an insignificant increase in the ultimate recovery of crude oil, together with a description of the process used and the increase in the amount of oil to be recovered by reason of the application of the method,

(2) A description of the implementation and operation of the project sufficient to establish that its implementation and operation are in accordance with sound engineering principles,

(3) An identification of the area from which the ultimate recovery of crude oil is expected to be increased as a result of the implementation and operation of the project, and, if that area is less than the entire property, a precise delineation of the portion of the property that is expected to yield the increase in the ultimate recovery of oil,

(4) The date on which the tertiary injectant was, or is expected to be, initially introduced into the reservoir,

(5) An explanation of the number and frequency of injections to be made and the expected duration of the project,

(6) If the project involves a single injection, an estimate of the period of time during which the injectant will continue to increase the recovery of crude oil,

(7) Data on oil reserve estimates covering the project area with and without the tertiary recovery process,

(8) The past production history and estimates of future production,

(9) The number of wells in the project area and the number of both producing and injection wells expected to be drilled,

(10) Projected future income and expenses, and

(11) The operator's employer identification number.

The petroleum engineer's certification may be submitted at any time. However, for purposes of section 4993(d)(2)(B) and paragraph (c) of § 150.4993-1 relating to the "project beginning date", a petroleum engineer shall not be considered as having certified a project until the certification is received by the Internal Revenue Service Center. If the certification is sent to the Service Center by mail, it shall be considered received when posted by United States mail, properly addressed, and with sufficient postage.

(b) *Termination of injection.* If any project certified under paragraph (a) of this section involves the continuous or repetitious injection of liquids, gases, or other matter and if the injection is terminated, the operator shall promptly send a written statement to that effect to the Internal Revenue Service Center setting forth the date that the injection was terminated.

(c) *Significant expansion.* If a project is significantly expanded, the expansion shall be treated as a separate project requiring separate certification.

§ 150.4993-3 Jurisdictional agency certification of tertiary recovery projects.

(a) *Initial certification.* In order to qualify under section 4993(c)(2)(D)(ii), relating to the approval of tertiary recovery projects by a jurisdictional agency, the operator shall submit the certification to the Internal Revenue Service Center for the region with which the income tax return of the operator is filed. The certification shall state that the appropriate jurisdictional agency has approved the project as having met the requirements set forth in section 4993(c)(2)(A), (B), and (C), and the operator shall attach the approving document or a certified copy therof. The certification of the jurisdictional agency's approval may be submitted at any time. However, for purposes of section 4993(d)(2)(B)(ii) and paragraph (c) of § 150.4993-1, relating to the "project beginning date", a jurisdictional agency shall not be considered as having approved a project until the certification is received by the Service Center. If the certification is sent to the Service Center by mail, it shall be considered received when posted by United States mail, properly addressed, and with sufficient postage.

(b) *Revocation of certification.* If the agency revokes the approval, it shall immediately notify the operator and the Service Center of the revocation setting forth the date of the revocation and stating whether the revocation has retroactive effect (and, if so, to what date the revocation is retroactive), and the operator shall send a copy of the revocation to the Service Center within 10 days after receiving it.

§ 150.4993-4 Internal Revenue Service rulings relating to qualified tertiary recovery projects.

(a) *In general.* Either the operator of a property or any producer of oil from that property may request a ruling from the Internal Revenue Service as to whether any tertiary recovery project involving that property is a "qualified tertiary recovery project" within the meaning of section 4993(c). If a producer submits the request, the producer shall notify the operator in writing that the request was submitted.

(b) *Manner of requesting ruling.* The request for a ruling described in paragraph (a) of this section shall be made by submitting the request to the Commissioner of Internal Revenue, Attention: Assistant Commissioner (Technical), Washington, D.C. 20224. In addition to meeting the requirements of § 601.201(e) of this chapter (Statement of Procedural Rules), the request shall contain the following:

(1) A statement as to whether a jurisdictional agency has approved the project, and if so, a copy of the approving document and a copy of the material upon which the approval was based together with any certification submitted to a Service Center and identification of such Service Center,

(2) A statement from the operator of the property as to whether the operator has previously submitted a request for a ruling on that project and as to whether any producer has notified the operator that a request has been submitted, as well as the date and name of the person who made a request,

(3) A description of the location of the project,

(4) The type of tertiary recovery process instituted,

(5) Data on oil reserve estimates covering the project area with and without the tertiary recovery process,

(6) The past production history and estimates of future production,

(7) The characteristics of the formation such as the name, depth, lithology, thickness, porosity, permeability, and reservoir pressure and temperature history,

(8) A description of any secondary or tertiary process previously used, or in use, in the project area,

(9) A full and complete description of the tertiary process stating how it will be developed from the pilot flood through full development, and

(10) A complete description of the geological and engineering factors taken into consideration, together with sufficient data to support the conclusion that the project meets the requirements of section 4993(c) for a "qualified tertiary recovery project".

(c) *Special rule for projects for which a certification of approval by a jurisdictional agency has been submitted.* If, pursuant to section 4993(c)(2)(D)(ii) and § 150.4993-3, the operator of the property has submitted a certification of approval by a jurisdictional agency, the ruling described in paragraph (a) of this section will be issued within 180 days of the date that a request for the ruling, meeting the requirements of paragraph (b) of this section and § 601.201(e) of this chapter (Statement of Procedural Rules) is received by the Office of the Assistant Commissioner (Technical). However, if the request for a ruling is not complete as to the information required in paragraph (b)(1) through (10) of this section, the Office of the Assistant Commissioner (Technical) may send written notice to the person making the request specifying the further information that must be submitted. The 180-day period shall not include any days after the date of the mailing of the written notice and before the date on which the additional information is received.

§ 150.4994-1 Exemptions.

Section 4994 defines the terms "qualified governmental interest", "qualified charitable interest," "exempt front-end oil", "exempt Indian oil", and "exempt Alaskan oil", the categories of oil that are exempt from the tax imposed by section 4986.

§ 150.4995-1 Requirement of withholding.

(a) *General rule; when required.* Except as otherwise provided in this section, the purchaser (as defined in § 150.4996-1(a)) of domestic crude oil shall deduct and withhold tax from amounts payable by that purchaser for the oil. However, the preceding sentence shall not apply if—

(1) The crude oil is removed from the premises (as defined in § 150.4996-1(d)) before it is sold, or

(2) The manufacture or conversion of crude oil into refined products begins before the oil is removed from the premises, or

(3) The producer of the oil is an integrated oil company (as defined in § 150.4996-1(g)).

The amount of tax to be deducted and withheld shall be determined in accordance with the rules of paragraphs (b) and (c) of this section. See, however, paragraph (d) of this section for rules applicable to certain payments made prior to June 4, 1980. The producer shall be treated as having paid on the last day of the first February after the calendar year in which the oil is removed from the premises the amount deducted and withheld with respect to such oil by the purchaser under this section.

(b) *Amount to be deducted and withheld*—(1) *Operator's certification.* If the purchaser has received the certification required to be furnished by the operator pursuant to section 6050C and § 150.6050C-1, and if the purchaser has no reason to believe that any information contained in that certification that affects the computation of the windfall profit tax is not correct, the amount of tax to be deducted and withheld under paragraph (a) of this section is the amount of tax imposed by section 4986 based on the information provided in the operator's certification. However, in determining the amount to be deducted and withheld, section 4988(b) (relating to the net income limitation on windfall profit) shall not apply.

(2) *Absence of effective operator's certification.* If the purchaser has not received the certification required to be furnished by the operator pursuant to section 6050C and § 150.6050C-1, or if the purchaser has reason to believe that any information contained in that certification that affects the tax computation is not correct, the purchaser shall deduct and withhold in accordance with the following rules:

(i) If the purchaser pays the lower tier ceiling price for oil, the purchaser shall not deduct and withhold any windfall profit tax from the purchase price of that oil.

(ii) If the purchaser pays either the upper tier ceiling price or an uncontrolled price for oil, the purchaser shall deduct and withhold from the purchase price of each barrel of such oil an amount equal to 70 percent of the excess, if any, of the removal price over the amount equal to the sum of—

(A) $11.01, plus

(B) The amount equal to $11.01 multiplied by the inflation adjustment provided under section 4989(b)(1) for the calendar quarter in which the oil was removed, plus

(C) The amount of the severance tax adjustment provided by section 4996(c), if the amount of that adjustment is known by the purchaser.

(3) *Purchaser's certification.* If, pursuant to § 150.4995-2 or § 150.6050C-1, the purchaser has received a certification that a producer's share of production from a property qualifies as "exempt oil" or "independent producer oil", and if the purchaser has no reason to believe that any statement in the certification bearing on such qualification is not correct, the purchaser—

(i) Shall not withhold tax from amounts payable for the share of production that has been certified as exempt oil (the provisions of paragraph (b)(1) and (2) of this section notwithstanding), and

(ii) In determining the amount to be withheld under paragraph (b)(1) of this section from amounts payable for the share of production that has been certified as independent producer oil, shall apply the rates provided in section 4987(b)(2) and, in determining the amount to be withheld under paragraph (b)(2) of this section, shall substitute 50 percent for 70 percent.

If a payment by a purchaser is made to an operator or to a partnership, rather than directly to the producer of the oil, the amount of exempt oil and independent producer oil shall be determined on the basis of information provided to the purchaser by the operator pursuant to § 150.6050C-1 or by the partnership pursuant to paragraph (e) of § 150.4995-2.

(4) *Lower tier and upper tier ceiling prices.* For purposes of this section, the terms "lower tier ceiling price" and "upper tier ceiling price" have the same meaning as those terms are given in the energy regulations (see § 150.4996-1(f)).

(c) *Withholding adjustments*—(1) *General rule.* (i) A purchaser who ascertains that the amount of tax withheld from any payment for crude oil was more or less than the amount of tax imposed by section 4986 (computed without regard to the net income limitation) with respect to that crude oil shall make adjustments in the amount to be withheld from subsequent payments to the same person as provided in this paragraph. For purposes of this paragraph, a purchaser has ascertained that the amount withheld was more or less than the tax imposed when the purchaser has sufficient information to be able to determine the amount of tax imposed by section 4986 (computed without regard to the net income limitation) with respect to that crude oil. Thus, adjustments are generally required when the purchaser made an incorrect calculation with respect to a prior payment, when the purchaser has withheld in accordance with the rules of paragraph (b)(2) because of the absence of an effective operator's certification and the purchaser later receives an effective certification, when an earlier certificatioin is corrected, or when the purchaser has withheld tax from a producer at the generally applicable rates and the purchaser subsequently receives a retroactively effective independent producer's certificate. Every adjustment under this paragraph shall be reflected on Form 720 (the return form which is prescribed for use in reporting windfall profit tax withholding). If the entire adjustment would be reported in the return for the same taxable period as the withholding giving rise to the adjustment, the return for that period shall reflect only the amount withheld as adjusted. Otherwise, every return on which an overpayment or underpayment is adjusted pursuant to this paragraph must include a statement explaining the adjustment, designating the return period to which the adjustment relates, and setting forth such other information as may be required by the instructions to the return.

(ii) Except as otherwise provided in subparagraph (3) of this paragraph, the purchaser must make a full adjustment by underwithholding or overwithholding in subsequent payments to the same person (whether or not from the same property) so that the total amount withheld is equal to the tax imposed by section 4986 (computed without regard to the net income limitation) as soon as possible. The full adjustment must be made, if possible, in the next payment. If it is not possible to complete the adjustment in the next payment, the purchaser shall adjust by underwithholding or overwithholding to the fullest extent possible in each subsequent payment until the adjustment is completed. However, no adjustment is to be made in the amount withheld from payments made for oil removed in a later calendar year or from payments made after the statement required by § 150.4997-2(c) (relating to annual statement of windfall profit tax liability) is furnished. If the error is one of underwithholding that cannot be fully adjusted under this paragraph (*e.g.*, where the relationship between the producer and the purchaser has terminated, or where the next payment is for oil removed in the following calendar year), the producer is required to file a return at the end of the year in accordance with § 150.4997-1 unless the producer's liability for tax under section 4986 has been completely satisfied by reason of overwithholding with another purchaser. If the error is one of overwithholding that cannot be fully adjusted under this paragraph, the rules of § 150.6402-1 with respect to claims for credit or refund are applicable to the producer.

(2) *Special rules.* (i) If the need for an adjustment arises with respect to a payment for oil removed in a calendar year prior to the year within which the purchaser ascertains the need for an adjustment, no adjustment shall be made unless the adjustment can be made in a payment for oil removed in the prior year and unless that payment is made prior to the furnishing of the statement required by § 150.4997-2(c). However, see § 150.4997-2(c)(2) (relating to certain information furnished by purchaser to producer).

(ii) No amount shall be deducted or withheld from any payment in excess of the windfall profit with respect to the oil giving rise to that payment.

(iii) If, pursuant to section 4995 (a)(3)(D), the producer and purchaser agree to additional withholding, any amount withheld pursuant to the agreement shall be treated as an amount required to be withheld.

(3) *Examples.* The provisions of this paragraph may be illustrated by the following examples:

Example (1). A, a purchaser of crude oil, has been withholding in accordance with the special rules of paragraph (b)(2) because the operator of the property from which A purchases oil has not provided A with the certification required by § 150.6050C-1. Subsequently, the operator does provide A with the certification, and A, withholding under the rules of paragraph (b)(1), ascertains that the amount withheld earlier exceeds the amount of tax imposed by section 4986 based upon the information provided by the operator. Although A withheld properly in accordance with the information available during the earlier period, the amount withheld is subject to the adjustment rules of this paragraph.

Example (2). Purchaser B, in the third calendar quarter of the year, ascertains that too little tax was withheld from payments for oil purchased in the preceding calendar quarter with respect to producer C. B must attempt to fully adjust the underwithholding by increasing the amount withheld from subsequent payments made to C to the full amount of windfall profit. If the adjustment has not been completed when B makes the final payment for oil removed during the calendar year, B should not continue the adjustments in payments for oil removed after the close of the calendar year. However, B is required to inform C of C's liability for the amount remaining unadjusted and to provide that information to the Internal Revenue Service in accordance with the rules of § 150.4997-2.

(d) *Interim withholding rule*—(1) *Effective date.* The rules of this paragraph apply to payments made after April 18, 1980, and before June 4, 1980, with respect to oil removed on or after March 1, 1980. These rules may, at the option of the purchaser, be applied with respect to payments made prior to the above period with respect to such oil.

(2) *General rule.* The purchaser of domestic crude oil shall deduct and withhold from amounts payable by that purchaser for the oil the amount specified in subparagraph (3) of this paragraph unless—

(i) The crude oil is removed from the premises (as defined in § 150.4996-1(d) before it is sold, or

(ii) The manufacture or conversion of crude oil into refined products begins before the oil is removed from the premises, or

(iii) The producer of the oil is an integrated oil company (as defined in § 150.4996-1(g)).

For purposes of section 4995(a)(1)(B), the amount specified in subparagraph (3) of this paragraph shall be considered the tax required to be withheld under section 4995(a)(1)(A).

(3) *Amount to be deducted and withheld; options of purchaser.* The amount to be deducted and withheld under paragraph (2) of this paragraph is, at the option of the purchaser, either—

(i) 70 percent of the excess, if any, of the purchase price per barrel of crude oil over $11.22 ($11.47 for oil removed after March 31, 1980), or

(ii) the amount that would be required to be withheld under paragraph (a) and (b) (or, at the purchaser's option, paragraphs (a), (b), and (c)) of this section if those paragraphs were in effect.

The purchaser may choose from among the above options with respect to each payment to which this paragraph applies.

(e) *Extent of purchaser's liability.* Every purchaser required to deduct and withhold tax under this section is liable for the tax required to be withheld, whether or not it is actually withheld by the purchaser. However, in no event shall the purchaser's liability for the tax required to be withheld exceed the producer's liability for the tax imposed by section 4986 (including the application of the net income limitation provided in section 4988(b) if all the data necessary for computing that limitation are available) with respect to oil sold to that purchaser, and the purchaser's liability shall abate to the extent that the producer's liability for the tax is paid (including payments by the producer or by the purchaser through adjustments in amounts later withheld). See paragraph (c) relating to adjustments in withholding. The producer from whom the correct amount was not withheld shall be liable to any purchaser for the amount of the producer's tax liability paid by the purchaser pursuant to this paragraph. The purchaser is relieved of liability to any other person for the amount of any tax withheld pursuant to this section and paid to the Internal Revenue Service or deposited with a duly designated depositary of the United States. See § 150.4995-3 relating to depositary requirements.

(f) *Effective date.* The rules of paragraphs (a), (b), and (c) of this section are effective with respect to payments made after June 3, 1980, for oil removed on or after March 1, 1980. However, for purposes of applying paragraph (c) to payments described in the preceding sentence, payments made before June 4, 1980, for oil removed on or after March 1, 1980, shall be treated as if paragraphs (a) and (b) applied to them.

§ 150.4995-2 Producer's certificate.

(a) *In general.* The producer of "exempt Indian oil", as defined in section 4994(d), or the holder of any interest in crude oil that is a "qualified governmental interest" as defined in section 4994(a) or is a "qualified charitable interest" as defined in section 4994(b), may furnish an exemption certificate with respect to such oil to the purchaser of the oil or to the operator of the property from which the oil is produced (or, if the producer is a partner, to the partnership (see paragraph (e) of this section)), in accordance with the rules of paragraph (b) of this section. Any producer of "independent producer oil", as defined in section 4992, may furnish a certificate with respect to such oil to the purchaser of the oil or to the operator of the property from which the oil is produced (or, if the producer is a partner, to the partnership (see paragraph (e) of this section)), in accordance with the rules of paragraph (c) of this section. Any certificate provided under this section must set forth the facts that establish entitlement to the exemption or lower rates claimed. The certificate (or any revocation of a certificate) shall identify the producer by name, address, and employer identification (or social security) number and shall be signed by the producer (under the penalties of perjury except in the case of a revocation). For the requirement that the operator of a property who has received such a certificate furnish a copy of the certificate, or certify as to its contents, to each purchaser of oil from that property, see § 150.6050C-1 (f). For the effect of the furnishing of such a certificate see § 150.4995-1(b) (3) (relating to the withholding requirement). For the criminal penalty applicable to the furnishing of a false statement, see section 7206.

(b) *Exemption certificate.* For purposes of this section, an exemption certificate is a written statement certifying that the producer's oil is exempt from the tax imposed by section 4986 because the oil constitutes exempt Indian oil or the oil is from a qualified governmental interest or a qualified charitable interest. Any producer who furnishes an exemption certificate to an operator, purchaser, or partnership shall also file an exemption certificate with the Internal Revenue Service Center for the region with which the producer's income tax return is filed. Only one such certificate need be filed even though the producer may furnish certificates to more than one operator or purchaser.

(c) *Independent producer's certificate.* An independent producer's certificate is a written statement certifying that the entire amount of the producer's oil expected to be sold to the purchaser is subject to the rates of tax provided in section 4987(b)(2) because the oil constitutes "independent producer oil" as defined in section 4992. No certificates may be furnished with respect to oil if it is reasonable to believe that the number of barrels to be affected by the certificate, taken together with all other oil with respect to which a certificate has been furnished by the producer to any operator, purchaser, or partnership, will exceed the producer's independent producer amount (see section 4992(c) and (e)).

(d) *Revocation of certificate.* If the producer has furnished a certificate with respect to oil, and the producer subsequently discovers that the oil is not, or has ceased to be, eligible for certification under the rules of paragraphs (a) through (c) of this section, the producer shall furnish notice within 10 days to the person to whom the certificate was furnished that the certificate is revoked.

(e) *Partnerships.* If payment for oil sold by a partnership is to be made to the partnership rather than to each partner individually, any certifications permitted by this section shall be furnished by the partnership. Each certification shall state the percentage of the oil that is certified as exempt from tax or subject to a lower rate of tax. The partnership certification may certify oil as exempt from tax or subject to a lower rate of tax only to the extent that the partnership has received certifications from its partners. Any partnership furnishing a certification shall retain in its records, for so long as material in the administration of any internal revenue law, each certification from a partner that was used as the basis for the certification furnished by the partnership under this section.

(f) *Substitution of operator for purchaser.* If a purchaser of crude oil and the operator of the property from which the crude oil is produced make the election described in § 150.4995-4, the purchaser shall forward to the operator, at the time of the election, any exemption certificate or any notice or revocation previously received by the purchaser. The purchaser shall immediately forward to the operator any exemption certificate or any notice of revocation received after the election. The operator shall treat any exemption certificate or any notice of revocation forwarded by a purchaser as an exemption certificate or notice of revocation from the producer.

§ 150.4995-3 Depositary requirements.

(a) *Deposits by integrated oil companies other than independent refiners*—(1) *In general.* Every integrated oil company (as defined in § 150.4996-1(g)) other than an independent refiner (as defined in § 150.4996-1(h)) that is either liable as a producer for the tax imposed by section 4986 or is required as a purchaser to deduct and withhold tax pursuant to § 150.4995-1 shall make deposits with respect to semimonthly periods (as defined in subparagraph (3)(i) of this paragraph). The amount to be deposited for each semimonthly period is the amount of tax imposed by section 4986 on oil removed from the premises during that semimonthly period for which the company is liable as a producer, plus the amount required to be withheld by the company as a purchaser pursuant to §150.4995-1 from payments that have been or will be made for oil removed from the premises during that semimonthly period. The deposits shall be made on or before the depositary date (as defined in subparagraph (3)(ii) of this paragraph) for the semimonthly period in which the oil was removed. These depositary requirements will be considered to have been met for a semimonthly period with respect to estimated deposits only if—

(i) (A) The company's deposit for such semimonthly period is not less than 90 percent of the total amount otherwise required by this section to be deposited by it for such period, and (B) if such period occurs in a month other than the last month in a taxable period, it deposits any underpayment for such month by the 9th day of the second month following such month; or

(ii) (A) Its deposit for each semimonthly period in the month is not less than 45 percent of the total amount otherwise required by this section to be deposited by it for the month, and (B) if such month is other than the last month in a taxable period, it deposits any underpayment for such month by the 9th day of the second month following such month; or

(iii) (A) Its deposit for each semimonthly period in the month is not less than 50 percent of the total amount required by this section to be deposited by it for the second preceding calendar month (determined without regard to subdivisions (i) through (iv) of this subparagraph), and (B) if such month is other than the last month in a calendar quarter, it deposits any underpayment for such month by the 9th day of the second month following such month; or

(iv) (A) The requirements of (i) (A), (ii) (A), or (iii) (A) are satisfied for the first semimonthly period of a calendar month, and (B) the company's deposit for the second semimonthly period of that calendar month is, when added to the deposit for the first semimonthly period, not less than 90 percent of the total amount otherwise required by this section to be deposited by it for that month, and (C) if such period occurs in a month other than the last month in a calendar quarter, the company deposits any underpayment for such month by the 9th day of the second month following such month.

However, subdivisions (ii) and (iii) of this subparagraph shall not apply to any company that normally incurs in the first semimonthly period in each month more than 75 percent of its total liability for deposit for the month (determined without regard to subdivisions (i) through (iv)).

(2) *Special requirement.* If the aggregate amount of deposit liability for a taxable period (determined without regard to subdivisions (i) through (iv) of subparagraph (1) of this paragraph) exceeds the total amount deposited by the company pursuant to subparagraph (1) of this paragraph for such taxable period, then the company shall, on or before the last day of the first month following the close of the taxable period, deposit an amount by which the deposit liability exceeds the total deposits made pursuant to subparagraph (1) of this paragraph for the taxable period.

(3) *Definitions.* For purposes of this part—

(i) *Semimonthly period.* A "semimonthly period" means the first 15 days of a calendar month or the portion of a calendar month following the 15th day of such month.

(ii) *Depositary date.* The depositary date for deposits for semimonthly periods is the 9th day of the semimonthly period following the semimonthly period in which the oil was removed.

(4) *Special rule for oil removed prior to April 4, 1980.* For purposes of this paragraph, oil removed after February 29, 1980, and before April 4, 1980 shall be considered to have been removed on April 4, 1980.

(b) *Independent refiners purchasing oil pursuant to a delayed payment contract.* Purchasers that are independent refiners (as defined in § 150.4996-1(h)) shall make deposits for each calendar month in accordance with the rules of paragraph (c) of this section except in the case of oil purchased under a contract therefor under which no payment is required to be made by the purchaser before the 46th day after the close of the month in which the oil is purchased. In the case of oil purchased under such a contract, the deposits shall be made for each calendar month not later than the last day of the second month which begins after the month in which the oil was removed. The amount to be deposited for each month is the amount required to be withheld pursuant to §150.4995-1 from payments that have been or will be made for oil removed during that month.

(c) *Deposits by other purchasers.* Except as provided in paragraph (a) or (b) of this section, purchasers shall make deposits for each calendar month not later than 45 days after the close of that month. The amount to be deposited for each month is the amount required to be withheld pursuant to § 150.4995-1 from payments that have been or will be made for oil removed from the premises during that month.

(d) *Special rule for determining operator's status.* See section 4995(a) (7)(A)(ii) for a special rule for determining the status of the operator when the election provided by § 150.4995-4 is made.

(e) *Payments by producers to correct underwithholding.* If the amount of tax withheld from a producer for a calendar year is less than the total liability of the producer for the tax imposed by section 4986 with respect to oil removed during the calendar year and subject to withholding under § 150.4995-1, the producer shall remit the difference with a timely return filed under § 150.4997-1 or shall, on or before the last day for filing a return under § 150.4997-1, deposit such difference.

(f) *Deposits by producers of tax due on oil not subject to withholding.* (1)

In general. Except as provided in paragraph (a) (relating to certain integrated oil companies), every producer shall deposit for each calendar month the tax imposed by section 4986 on the removal in that month of oil that is not subject to withholding under §150.4995-1. The deposits shall be made not later than 45 days after the close of the month in which the oil was removed (or deemed removed under section 4988(c)(4)) from the premises. These deposit requirements will be considered to have been met for a month with respect to estimated deposits only if—

(i)(A) The producer's aggregate deposit liability under this subparagraph (1) for the three months of a taxable period is less than $100 and (B) the producer deposits the amount of tax owed on or before the last day for filing the return required by § 150.4997-1 for that taxable period or remits the tax owed with that return; or

(ii)(A) The producer's deposit for the month is not less than 90 percent of the total amount otherwise required by this section to be deposited by it for the month, and (B) the producer complies with the requirements of subparagraph (2) of this paragraph; or

(iii)(A) The producer's deposit for each month of the taxable period is not less than 30 percent of the total amount otherwise required by this section to be deposited by it for the three months of the taxable period, and (B) the producer complies with the requirements of subparagraph (2) of this paragraph; or

(iv)(A) The producer's deposit for the month is not less than 100 percent of the amount required by this section to be deposited by it for the third preceding month (determined without regard to subdivisions (i) through (iv)), and (B) the producer complies with the requirements of subparagraph (2) of this paragraph.

However, subdivisions (iii) and (iv) of this subparagraph shall not apply to any producer that normally incurs in the first month in each taxable period more than 45 percent of its total liability for deposit for the taxable period (determined without regard to subdivisions (ii) through (iv)).

(2) *Special requirement.* If the total liability for the tax imposed by section 4986 for a taxable period exceeds the total amount deposited by the producer pursuant to subparagraph (1) of this paragraph for such taxable period, then the producer shall deposit the difference not later than 45 days after the close of the last month in the taxable period.

(g) *Government depositaries.* Deposits required by this section shall be made with a Federal Reserve bank or, at the depositor's election, with an authorized financial institution. See paragraph (h)(2) of this section.

(h) *Depositary forms*—(1) *In general.* A person may make one, or more than one, remittance of the amount required to be deposited. However, a deposit for one taxable period shall be made separately from any deposit for another taxable period.

(2) *Tax deposit forms.* Each remittance of amounts required to be deposited by this section shall be accompanied by an FTD (Federal Tax Deposit, Excise Taxes) Form (Form 504). Such form shall be prepared in accordance with the instructions applicable thereto. The remittance, together with FTD Form 504, shall be forwarded to a Federal Reserve bank or, at the election of the person remitting the tax, to a financial institution authorized in accordance with Treasury Department Circular No. 1079, 31 CFR Part 214, to accept remittances of the taxes for transmission to a Federal Reserve bank. The timeliness of the deposit will be determined by the date the deposit is received (or is deemed received under section 7502 (e)) by a Federal Reserve bank or by the authorized financial institution, whichever is earlier. Each person making deposits pursuant to this section shall report on the return for the period with respect to which such deposits are made information regarding such deposits in accordance with the instructions applicable to such return.

(3) *Procurement of prescribed forms.* Copies of the applicable deposit forms will so far as possible be furnished to purchasers and producers. Such a person will not be excused from making a deposit, however, by the fact that no form has been furnished to it. A person not supplied with the proper form should make application therefor in ample time to make the required deposits within the time prescribed. A person may secure the forms or additional forms by applying therefor and supplying its name, identification number, address, and the taxable period to which the deposits will relate. The address of the person as entered on such form should be the address to which the receipt should be returned following validation by the Federal Reserve bank. Copies of FTD Form 504 may be secured by application to a director of an Internal Revenue Service Center.

§ 150.4995-4 Election of purchaser and operator to have operator withhold, deposit tax, etc.

(a) *General rule.* Pursuant to section 4995(a)(7)(B), it has been determined that the substitution of the operator for the purchaser will make the administration of the windfall profit tax more practicable only when the operator is otherwise required by § 150.4995-3 to make deposits as a purchaser of oil produced from a different oil reservoir. Consequently, a purported election pursuant to section 4995(a)(7) is invalid except in that circumstance. In the allowed case, the operator of the property and a purchaser of crude oil produced from that property may make a joint election under this section with respect to oil produced from the entire property or any portion thereof. While the election is in effect, all the requirements otherwise imposed upon the purchaser by chapter 45 or subtitle F of the Code or by this part are imposed upon the operator. The purchaser shall not be held responsible for failing to meet those requirements. The operator shall promptly notify all producers of oil from that property (or portion) that a joint election has been made and that all information otherwise required to be sent to the purchaser should be sent to the operator. If the operator makes payment for oil produced from the property to a partnership rather than directly to the producers, the notice shall be sent to the partnership. The operator and the purchaser must agree to transfer to the operator responsibility for meeting all the requirements otherwise imposed upon the purchaser in order for the agreement to constitute an effective election.

(b) *Method of making election; termination of election.* The joint election shall be made by the execution of a document, signed and dated by both the purchaser and operator, that states that both parties have agreed that the operator of the property shall be responsible for all the requirements otherwise imposed upon the purchaser by chapter 45 (or related provisions of subtitle F) of the Code or by this part. The purchaser and operator shall, within 10 days of the execution of the document, each forward a copy of the document to the Internal Revenue Service Center for the region with which it files its income tax return. The election shall remain in effect from the date of its execution (or later effective date specified in the election document) until either of the parties executes a document, signed, dated, and delivered to the other party, that declares that the joint election is to be terminated. The termination shall not take effect for at least 60 days after the execution of the termination document unless both the operator and the purchaser agree on an earlier effective date. The party executing the termination document shall promptly notify all producers of oil from that property of the termination and the resulting changes in responsibilities and shall, within 10 days of executing the termination document, forward a copy to the Internal Revenue Service Center for the region with which its income tax return is filed. The party receiving the termination document shall, within 10 days of receipt, forward a copy to the Internal Revenue Service Center for the region with which its income tax return is filed. Both the purchaser and operator shall retain in their records, for so long as they may be material in the administration of any internal revenue law, a copy of the joint election and any subsequent termination.

§ 150.4996-1 Definitions.

For purposes of this part and chapter 45 of the Code—

(a) *Purchaser.* The term "purchaser" includes only the first person (as defined in section 7701(a)(1)) purchasing domestic crude oil.

(b) *Producer.* The term "producer" means the holder of the economic interest with respect to the crude oil in place in the ground. However, in the case of a partnership, the partnership's economic interest in the oil shall be allocated among the partners on the basis of each partner's proportionate share of the partnership's income from the crude oil, and the partner to whom the oil is allocated shall be treated as the producer of the oil. In the case of a trust or estate, the entity is the producer rather than the beneficiaries.

(c) *Operator.* The term "operator" means the person that holds an operating mineral interest in the property and bears more of the responsibility for the management and operation of crude oil production from the property than any other holder of such an interest. In the case of a business entity, the operator is the entity and not its employee or owner. However, under section 4996(a)(2)(B), another person may be designated as the operator, provided that the district director for the district in which the property is located issues a written statement that the district director is satisfied that the designation does not jeopardize the collection of the tax and related interests of the Federal Government. Such a designation must be made in writing and signed by all persons holding operating mineral interests in the property.

(d) *Removed from the premises; deemed removed.* Oil is removed from the premises when the oil is physically transported off the premises. The term "premises" means "a tract or parcel of land" as that term is defined in paragraph (a)(3) of § 1.614-1. Except as otherwise provided in this paragraph, if oil is used on the premises or if the manufacture or conversion of crude oil into refined products begins on the premises, the oil shall be treated as removed on the day the use, manufacture or conversion begins. However, oil that is produced and then reinjected into the reservoir or used on the same tract or parcel of land to power a production process or production equipment is not removed from the premises so long as the oil is at no time transported off the tract or parcel of land from which it was produced. Furthermore, oil used to power a production process or production equipment will not be considered removed from the premises if it is transported from one tract or parcel of land to a contiguous tract or parcel of land, provided that 100 percent of the economic interest in the oil produced from both tracts or parcels of land is held by the same persons.

(e) *Taxable period.* The term "taxable period" means March 1980 and each calendar quarter beginning after March 1980.

(f) *Energy regulations.* The term "energy regulations" means regulations prescribed under section 4(a) of the Emergency Petroleum Allocation Act of 1973 (15 U.S.C. 753(a)) as amended (crude oil price control regulations). See section 4996(b)(8).

(g) *Integrated oil company.* The term "integrated oil company" means a taxpayer that both produces oil and is either a "retailer" or a "refiner".

(1) *Retailer.* The term "retailer" means any taxpayer described in section 613A(d)(2), *i.e.*, one who directly, or through a related person. sells oil or natural gas (excluding bulk sales to commercial or industrial users) or any product derived from oil or natural gas—

(i) Through any retail outlet operated by the taxpayer or a related person, or

(ii) To any entity—

(A) Obligated under an agreement or contract with the taxpayer or related person to use a trademark, trade name, or service mark or name owned by such taxpayer or related person, in marketing or distributing oil or natural gas or any product derived from oil or natural gas, or

(B) Given authority, pursuant to an agreement or contract with the person or related person, to occupy any retail outlet owned, leased, or in any way controlled by the taxpayer or related person.

However, notwithstanding the preceding sentence, this subparagraph shall not apply in any case where the combined gross receipts from the sale of such oil, natural gas, or any product derived therefrom, for the taxable period of all retail outlets taken into account for purposes of this subparagraph do not exceed $1,250,000. For purposes of this subparagraph, sales of oil, natural gas, or any product derived from oil or natural gas shall not include sales made of such items outside the United States, if no domestic production of the person or a related person is exported during the calendar year or immediately preceding calendar year.

(2) *Refiner.* The term "refiner" means any taxpayer described in section 613A(d)(4), *i.e.*, one who is engaged in the refining of crude oil or is related to a person so engaged, provided that on any day during the taxable period the refinery runs of the person and any related person exceed 50,000 barrels.

For purposes of this paragraph, the term "related person" has the same meaning as in section 613A(d)(2) and (4).

(h) *Independent refiner.* The term "independent refiner" means a refiner who

(1) Obtained, directly or indirectly, in the second preceding calendar quarter, more than 70 percent of his refinery input of domestic crude oil (or 70 percent of his refinery input of domestic and imported crude oil) from producers who do not control, are not controlled by, and are not under common control with such refiner, and

(2) Marketed or distributed in such quarter and continues to market or distribute a substantial volume of gasoline refined by him through branded independent marketers or nonbranded independent marketers. The term "branded independent marketer" means a person who is engaged in the marketing or distributing of refined petroleum products pursuant to—

(i) An agreement or contract with a refiner (or a person who controls, is controlled by, or is under common control with such refiner) to use a trademark, trade name, service mark, or other identifying symbol or name owned by such refiner (or any such person), or

(ii) An agreement or contract under which any such person engaged in the marketing or distributing of refined petroleum products is granted authority to occupy premises owned, leased, or in any way controlled by a refiner (or person who controls, is controlled by, or is under common control with such refiner),

but who is not affiliated with, controlled by, or under common control with, any refiner (other than by means of a supply contract, or an agreement or contract described in subparagraph (1)(i) or (ii)) and who does not control such refiner. The term "nonbranded independent marketer" means a person who is engaged in the marketing or distributing of refined petroleum products, but who is not a refiner, is not a person who controls, is controlled by, is under common control with, or is affiliated with a refiner (other than by means of a supply contract), and is not a branded independent marketer.

(i) *Property.* Except as otherwise provided in section 4988(b) (relating to the net income limitation on windfall profit), the term "property" has the same meaning as that term is given by the energy regulations. See 10 C.F.R. § 212.72(a); FEA Rul. 1977-1, 42 F.R. 3628 (1977).

(j) *Other.* See section 4996(b) and (d) for definitions of "crude oil", "barrel", "domestic", "United States", "possession of the United States", "Indian tribe", and "Alaskan oil from Sadlerochit reservoir".

§ 150.4996-2 Severance tax adjustment.

(a) *In general.* The severance tax adjustment with respect to any barrel of crude oil is the amount by which any severance tax imposed with respect to that barrel exceeds the severance tax which would have been imposed if the barrel had been valued at its adjusted base price.

(b) *Severance tax defined.* For purposes of this section, the term "severance tax" means any tax imposed by a State (not including a political subdivision of a State) with respect to the extraction of oil that is determined on the basis of the gross value of the extracted oil. The term "severance tax" does not include a tax levied on the value of reserves in the ground or a tax levied on the basis of net proceeds from production. Furthermore, a tax on the removal of crude oil from the ground levied as a fixed fee per barrel is not a severance tax because the amount of that tax is not determined by reference to the gross value of the extracted oil.

(c) *Limitations*—(1) *15 percent limitation.* A severance tax shall not be taken into account to the extent that the total rate thereof exceeds 15 percent.

(2) *Increases after March 31, 1979.* The amount of a State's severance tax taken into account under paragraph (a) of this section shall not exceed the amount which would have been imposed under that State's severance tax, as in effect on March 31, 1979, unless that excess is attributable to an increase in the rate of the severance tax (or to the imposition of a severance tax) which applies equally to all portions of the gross value of each barrel of oil subject to that tax. For purposes of this subparagraph, the conversion of a tax levied at a fixed fee per barrel into a tax based on the gross value of oil removed constitutes an initial imposition of a severance tax.

§ 150.4996-3 Special rules for post-1978 transfers of property.

(a) *In general.* The rules of this section apply for all purposes of this part and chapter 45 of the Code, including the application of the June 1979 energy regulations for purposes of this part and chapter 45 of the Code.

(b) *Classification of oil from property transferred after 1978.* If a portion of a property (as defined in paragraph (i) of § 150.4996-1) is transferred after December 31, 1978, any crude oil produced from any portion of the property constitutes oil from a stripper well property, newly discovered oil, or heavy oil only if such oil would be so classified if there had not been a transfer. The term "transfer" means any sale, exchange, lease, sublease, gift, bequest, devise, or other disposition (including a distribution by an estate, or a contribution to or distribution by a corporation, partnership, or trust, whether or not a taxable event) of rights (including rights less than fee simple) with respect to the property. Thus, for example, a change in the identity of the holder of a lease, mineral rights, royalty rights, or fee simple ownership rights with respect to a portion of the property is a transfer, even if such change is the result of corporate reorganization, gift, devise, or inheritance.

§ 150.4997-1 Returns and recordkeeping.

(a) *Returns.* Returns with respect to windfall profit taxes imposed by section 4986 shall be made as provided in this section.

(1) *Quarterly return.* A return for each taxable period (on Form 720, with Form 6047 attached thereto, in accordance with the instructions on those forms) shall be made by the following:

(i) Each purchaser of crude oil required to deduct and withhold tax pursuant to § 150.4995-1;

(ii) Each operator of a property who, having made an election pursuant to § 150.4995-4, is required to deduct and withhold tax; and

(iii) Each producer of crude oil the tax with respect to which is excepted from the withholding requirement by a subparagraph of § 150.4995-1(a).

(2) *Annual return.* A return for each calendar year shall be made by each producer of crude oil whose liability for tax with respect to oil that was removed during the four taxable periods of the calendar year exceeds the amount of tax withheld with respect to that oil.

See § 150.6076-1 for the rules relating to the time for filing the returns required by this section.

(b) *Recordkeeping requirements.* Each taxpayer liable for tax under section 4986, each producer or purchaser of domestic crude oil, each operator of a property from which domestic crude oil was produced, and each partnership or other person receiving information on behalf of or providing information to producers under this part shall keep records of all documents, material, and information necessary to the determination of the windfall profit tax or that affect his or her administrative obligations under the Crude Oil Windfall Profit Tax Act of 1980 or the regulations in this part, including material furnished to other persons, as well as information received from other persons. The records shall be kept at all times available for inspection by authorized internal revenue officers or employees, and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.

§ 150.4997-2 Certain information to be furnished by purchaser and others.

(a) *In general.* If a purchaser is subject to the rules for collection and deposit of tax under §§ 150.4995-1 and 150.4995-3 with respect to any crude oil purchased (or would be subject to such rules in the absence of an exemption certificate given pursuant to § 150.4995-1(b)(3)), such purchaser shall furnish the monthly statement required by paragraph (b) of this section and the yearly statement required by paragraph (c) of this section to each producer of the crude oil purchased, except that, if payment for the oil purchased is made to the operator rather than to the producer or to a partnership rather than the partners, the statements shall be furnished to the operator or the partnership, as the case may be. Such purchaser shall also file the information return required by paragraph (c) of this section with the Internal Revenue Service (in the case of yearly statements). Any person who receives a statement with respect to oil of which such person is not the producer shall, within 15 days of receipt of the statement, furnish to each producer or partnership of producers (and the Internal Revenue Service in the case of a yearly statement) the information relating to that producer's or partnership's share of the oil purchased.

(b) *Monthly statement*—(1) *In general.* The purchaser shall furnish statements for each calendar month showing the total amount of windfall profit tax withheld by the purchaser from payments made to the producer, operator, or partnership with respect to oil removed during that month. If the purchaser did not withhold tax from payments to that person because of the receipt of an exemption certificate, the monthly statement need only state the reason for the absence of withholding.

(2) *Time for furnishing monthly statement.* Any statement required to be furnished by a purchaser under this paragraph for any calendar month shall be furnished before the first day of the second month which begins after the close of the month to which the statement applies.

(c) *Yearly statement of windfall profit tax liability and windfall profit tax deduction*—(1) *In general.* For each calendar year, the purchaser shall furnish statements and shall file information returns with the Internal Revenue Service. A separate statement shall be furnished to and a separate information return shall be filed for each producer, operator, or partnership to whom the purchaser made payments for oil purchased during the calendar year. Each statement and information return shall contain the following information with respect to oil for which that person received payment:

(i) The quantity, removal price, severance tax adjustment, TAPS adjustment (if any), adjusted base price, and windfall profit tax liability (computed without regard to the net income limitation) for oil in each tier that was removed during that calendar year;

(ii) The total quantity of the taxable crude oil that was removed during that year;

(iii) The total amount of the windfall profit tax liability with respect to the oil incurred during that year; and

(iv) The amount of windfall profit tax withheld by the purchaser with respect to the oil removed during each month of that year and the total tax withheld with respect to oil removed during the year. For purposes of the preceding sentence, each category of tier 3 oil, independent producer oil withheld upon at a 50 percent rate, and independent producer oil withheld upon at a 30 percent rate shall be treated as a separate tier. If the purchaser did not withhold tax from payments to that person because of the receipt of an exemption certificate, the yearly statement and information return shall state that fact and shall set forth the above information clearly identified as relevant to tax consequences that would have occurred had the exemption certificate not been received.

(2) *Additional information in the case of withholding adjustments.* In the case of withholding adjustments that were not completed during the course of the year under paragraph (c) of § 150.4995-1, the purchaser shall provide additional information in the yearly statement and information return with respect to the person subject to the adjustment. The statement and information return shall set forth the amount ascertained to have been underwithheld or overwithheld, the amount actually adjusted, and the amount remaining unadjusted. If the adjustment was due to underwithholding, the statement shall also inform the recipient that the producer is liable for the amount of the tax under section 4986 in excess of the amount of such tax withheld by the purchaser and that this information is being supplied to the Internal Revenue Service. If the withholding adjustment was due to overwithholding, the statement shall inform the recipient that the purchaser was unable to fully adjust the overpayment under paragraph (c) of § 150.4995-1 and that the producer is eligible for a credit or refund which he may claim in accordance with the rules provided in § 150.6402-1.

(3) *Statement of windfall profit tax deduction.* The statement and information return required by this paragraph shall also set forth as the amount deductible for income tax purposes the total amount of windfall profit tax withheld from payments made to the producer, operator, or partnership during the calendar year without regard to when the oil was removed.

(4) *Prescribed form.* The statement and information return required by this paragraph shall be furnished and filed on Form 6248. The statement and return shall also contain such other information as is required by the form or its instructions. If the statement includes the information required by subparagraph (2) of this paragraph, the statement shall be furnished in duplicate. The information return shall be filed in the place and in the manner provided in the instructions to Form 6248.

(5) *Time for furnishing yearly statement of windfall profit tax liability and filing yearly information returns.* Each yearly statement required to be furnished by a purchaser under this paragraph for any calendar year shall be furnished on or before January 31 of the year immediately following the calendar year to which the statement applies, and each yearly information return required to be filed by a purchaser shall be filed on or before the due date for the return of tax imposed by section 4986 for the last taxable period of the calendar year.

(d) *Cross reference.* For the requirement that the operator furnish the statements and file the returns required by this section in the event that the operator and purchaser elect to have the operator deduct and withhold tax, etc., see § 150.4995-4.

§ 150.6050C-1 Information furnished by operator for purposes of windfall profit tax.

(a) *In general.* The operator of any property from which domestic crude oil is removed during a calendar month shall furnish a monthly statement, signed under the penalties of perjury, certifying the information specified in paragraph (b) of this section to:

(1) The purchaser of the oil, if the purchaser is required to withhold tax from payments for the oil pursuant to § 150.4995-1, or

(2) The producer, in any other case, except that if the producer of oil is a partner in a partnership, this statement may be furnished to the partnership if the producer and the partnership so agree. In that case, the partnership shall furnish the information to the producer with respect to that producer's share of the oil within 15 days of receipt.

(b) *Information to be certified.* In the case of exempt Alaskan oil or exempt front-end oil, the statement shall certify that the oil is exempt from tax. If a producer of the oil is an integrated oil company, the statement shall state the portion of which the integrated oil company is the producer. In all statements not certifying exemption, the following information is to be certified in the statement required under paragraph (a) of this section:

(1) The tier, for purposes of the tax imposed by section 4986, of the oil removed during the month and, if the oil is tier 3 oil, whether the oil constitutes newly discovered oil, heavy oil, or incremental tertiary oil;

(2) The amount of the oil removed and, if the oil removed includes oil of different tiers or categories, the amount of oil removed of each tier or category;

(3) The adjusted base price (within the meaning of section 4989) for each tier of oil removed;

(4) The severance tax adjustment, if any, provided under section 4996(c) with respect to each tier of oil removed;

(5) The TAPS adjustment, if any, provided under section 4996(d), and the average removal price for the month, in the case of oil from the Sadlerochit Reservoir;

(6) The property from which the oil was removed.

In the case of a statement furnished to a purchaser, the operator shall provide the information with respect to the aggregate amount of oil sold to that purchaser removed during the month. In the case of a statement furnished to a producer or partnership, the operator shall provide the information with respect to that person's allocable share of all oil removed from the premises during the month (including any oil delivered in kind to that producer).

(c) *Time and manner of certifying information.* The operator shall furnish the statement required under paragraph (a) of this section to the purchaser or producer, as the case may be, no later than the fifteenth day of the month following the calendar month in which the oil was removed. However, the statement with respect to oil removed during March 1980 shall be furnished no later than April 25, 1980.

(d) *Agreement between operator and recipient of statement.* If the purchaser or producer agrees in a signed statement that the operator shall be relieved of the duty of furnishing to such purchaser or producer—

(1) The statement otherwise required under paragraph (a) of this section, or

(2) Some or all of the information required under paragraph (b) of this section,

the operator shall be relieved of such duty, provided that the purchaser or producer has the information necessary to comply with all of the requirements of this part without such statement or information. Such an agreement shall immediately cease to have effect when the operator, purchaser, or producer, by a written statement signed by an authorized person, notifies the other party that it is terminating the agreement.

(e) *Special rule.* If an agreement under §150.4995-4 is in effect between the operator and purchaser under which the operator assumes the obligations of the purchaser, the statement otherwise required by this section is not required with respect to oil subject to withholding pursuant to § 150.4995-1.

(f) *Producer's certificate.* If, pursuant to § 150.4995-2, the operator receives a producer's certificate certifying a share of production to be exempt or subject to a lower rate of tax, the operator shall either (1) furnish a copy of that certificate to each purchaser of oil from that property by the 15th day of the month following the month in which the certificate was received, or (2) if payment is to be received by the operator on behalf of the producers, furnish a certificate that summarizes the contents of the producers' certificates and states that the operator has received and has such certificates available for inspection.

(g) *Penalties.* See sections 6652(b), 7206, and 7241 (relating to civil and criminal penalties).

§150.6076-1 Time for filing return of windfall profit tax.

Each quarterly return required by paragraph (a)(1) of § 150.4997-1 shall be filed not later than the last day of the second month following the close of the taxable period. Each annual return required by paragraph (a)(2) of § 150.4997-1 shall be filed not later than the last day of the first February following the close of the calendar year in which the oil giving rise to the underpayment was removed.

§ 150.6402-1 Credit or refund of overpayment of windfall profit tax.

(a) *In general.* Any producer who pays, or is deemed to have paid under section 4995(a)(4), to the district director, director of the regional Internal Revenue Service Center, or the Director of the Office of International Operations more than the correct amount of the crude oil windfall profit tax imposed by chapter 45 for a taxable period may file a claim for refund of the overpayment or may claim credit for such overpayment, in the manner and subject to the conditions stated in this section and § 301.6402-2 of this chapter (Regulations on Procedure and Administration).

(b) *Overpayments not attributable to amounts deducted and withheld*—(1) *In general.* Except as provided in paragraph (b)(2) of this section, in the case of any overpayment of tax imposed by chapter 45 attributable solely to tax paid on crude oil not subject to withholding, the producer may file a claim for refund of the overpayment on or after the date for filing the return of such tax for such taxable period under section 6076, or may claim credit for such overpayment by making an adjustment on the return of windfall profit tax for the current or subsequent taxable periods in accordance with Form 720 and the instructions for such adjustments.

(2) *Net income limitation.* A producer who, due to the application of the net income limitation on windfall profit provided in section 4988(b), has overpaid the tax imposed by chapter 45 for any taxable period shall not file a claim for credit or refund of that overpayment until the income tax return is filed for the taxable year that includes the last day of the taxable period. The producer may file a claim for refund of the overpayment or claim credit for the overpayment against any liability for a tax imposed by chapter 1 in accordance with the form and instructions provided for that purpose.

(c) *Overpayment attributable to amounts deducted and withheld.* Under section 4995(a)(4), the producer of oil is treated as having paid any amount withheld on the last day of the first February after the calendar year in which the oil was removed from the premises. Therefore, if the sum of the producer's liability for the tax imposed by chapter 45 on oil subject to withholding under § 150.4995-1 for all taxable periods of a calendar year is less than the amount deducted and withheld from the producer under § 150.4995-1 with respect to oil removed during the calendar year, the producer may file a claim for credit or refund of the overpayment after such last day of February, except that, in the case of an overpayment due to the application of the net income limitation provided in section 4988(b), the claim for credit or refund shall not be filed until the income tax return is filed for the taxable year that includes the last day of the last taxable period of such calendar year. The producer may file a claim for refund of the overpayment or may claim credit for the overpayment against any liability in respect to a tax imposed by chapter 1 in accordance with the form and instructions provided for that purpose. The producer shall attach to the claim a copy of all Forms 6248 furnished to the prodcer pursuant to § 150.4997-2.

(d) *Special interim rule for exempt producers.* If a producer of any crude oil from a qualified governmental interest (as defined in section 4994(a)) or qualified charitable interest (as defined in section 4994(b)), or a producer of exempt Indian oil (as defined in section 4994(d)), has had tax withheld from payments made for oil removed before July 1, 1980, the producer may file a claim for refund on or after July 1, 1980. The claim shall be filed on Form 843 and shall have attached a copy of each monthly statement received pursuant to § 150.4997-2.

There is need for the immediate guidance provided by the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in sections 4992, 4993, 4995, 4996, 4997, 6050C, 6402, and 7805 of title 26 of the United States Code and section 101(i)(2) of the Crude Oil Windfall Profit Tax Act of 1980.

Jerome Kurtz,
Commissioner of Internal Revenue.

Approved April 2, 1980.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on April 3, 1980, 8:45 a.m., and published in the issue of the Federal Register for April 4, 1980, 45 F.R. 23384)

Section 4987.—Amount of Tax

26 CFR 150.4987-1: Amount of tax.

Temporary excise tax regulations relating to the windfall profit tax on domestic crude oil imposed by Title I of the Crude Oil Windfall Profit Tax Act of 1980. See T.D. 7690, page 11.

Section 4988.—Windfall Profit; Removal Price

26 CFR 150.4988-1: Windfall profit; removal price.

Temporary excise tax regulations relating to the windfall profit tax on domestic crude oil imposed by Title I of the Crude Oil Windfall Profit Tax Act of 1980. See T.D. 7690, page 11.

Section 4989.—Adjusted Base Price

26 CFR 150.4989-1: Adjusted base price.

Temporary excise tax regulations relating to the windfall profit tax on domestic crude oil imposed by Title I of the Crude Oil Windfall Profit Tax Act of 1980. See T.D. 7690, page 11.

Section 4991.—Taxable Crude Oil; Categories of Oil

26 CFR 150.4991-1: Taxable crude oil; tiers of oil.

Temporary excise tax regulations relating to the windfall profit tax on domestic crude oil imposed by Title I of the Crude Oil Windfall Profit Tax Act of 1980. See T.D. 7690, page 11.

Section 4992.—Independent Producer Oil

26 CFR 150.4992-1: Independent producer oil.

Temporary excise tax regulations relating to the windfall profit tax on domestic crude oil imposed by Title I of the Crude Oil Windfall Profit Tax Act of 1980. See T.D. 7690, page 11.

Section 4993.—Incremental Tertiary Oil

26 CFR 150.4993-1: Incremental tertiary oil.

Temporary excise tax regulations relating to the windfall profit tax on domestic crude oil imposed by Title I of the Crude Oil Windfall Profit Tax Act of 1980. See T.D. 7690, page 11.

Section 4994.—Definitions and Special Rules Relating to Exemptions

26 CFR 150.4994-1: Exemptions.

Temporary excise tax regulations relating to the windfall profit tax on domestic crude oil imposed by Title I of the Crude Oil Windfall Profit Tax Act of 1980. See T.D. 7690, page 11.

Section 4995.—Withholding; Depositary Requirements

26 CFR 150.4995-1: Requirement of withholding.

Temporary excise tax regulations relating to the windfall profit tax on domestic crude oil imposed by Title I of the Crude Oil Windfall Profit Tax Act of 1980. See T.D. 7690, page 11.

Section 4996.—Other Definitions and Special Rules

26 CFR 150.4996-1: Definitions.

Temporary excise tax regulations relating to the windfall profit tax on domestic crude oil imposed by Title I of the Crude Oil Windfall Profit Tax Act of 1980. See T.D. 7690, page 11.

Section 4997.—Records and Information; Regulations

26 CFR 150.4997-1: Returns and recordkeeping.

Temporary excise tax regulations relating to the windfall profit tax on domestic crude oil imposed by Title I of the Crude Oil Windfall Profit Tax Act of 1980. See T.D. 7690, page 11.

Section 6050C.—Information Regarding Windfall Profit Tax on Domestic Crude Oil

26 CFR 150.6050C-1: Information furnished by operator for purposes of windfall profit tax.

Temporary excise tax regulations relating to the windfall profit tax on domestic crude oil imposed by Title I of the Crude Oil Windfall Profit Tax Act of 1980. See T.D. 7690, page 11.

Section 6076.—Time for Filing Return of Windfall Profit Tax

26 CFR 150.6076-1: Time for filing return of windfall profit tax.

Temporary excise tax regulations relating to the windfall profit tax on domestic crude oil imposed by Title I of the Crude Oil Windfall Profit Tax Act of 1980. See T.D. 7690, page 11.

Section 6402.—Authority to Make Credits or Refunds

26 CFR 150.6402-1: Credit or refund of overpayment of windfall profit tax.

Temporary excise tax regulations relating to the windfall profit tax on domestic crude oil imposed by Title I of the Crude Oil Windfall Profit Tax Act of 1980. See T.D. 7690, page 11.

Section 6651.—Failure to File Tax Return or to Pay Tax

26 CFR 301.6651-1: Failure to file tax return or to pay tax.

An extension of the time in which contractors or subcontractors with contracts subject to the Vinson-Trammel Act must file Form 949 and 949-A. See Rev. Proc. 80-13, page 32.

Section 6871.—Claims for Income, Estate and Gift Taxes in Bankruptcy and Receivership Proceedings

26 CFR 301.6871(a)-2: Collection of assessed taxes in bankruptcy and receivership proceedings.

Bankruptcy and receiverships; priority; taxes. Claims against a decedent's estate for funeral and administrative expenses and a family allowance required to be paid by state law have priority over the tax claims of the government for which the government has no lien. However, such tax claims are superior to claims against the estate for doctor bills from the decedent's last illness and wages due a household employee.

Rev. Rul. 80-112

ISSUE

Do claims against a decedent's estate for funeral and administrative expenses, doctor's bills from the decedent's last illness, wages due a household employee, and a one-year family allowance provided under state law have priority over claims for federal taxes?

FACTS

An individual died in September 1978, leaving property insufficient to pay taxes owed the United States for which it had no lien and other debts including funeral and administrative expenses, doctor's bills from the decedent's last illness, and wages due a household employee.

The state in which the decedent resided provides that a reasonable one-year family allowance be paid out of a decedent's estate.

Under the laws of the state, claims against the estate of a deceased debtor are to be paid in the following order: administration expenses, funeral expenses, costs of last illness, family allowances, wages of household employees, and all other claims.

LAW AND ANALYSIS

Section 3466 of the Revised Statutes (31 U.S.C. section 191, 1970) provides that whenever any person indebted to the United States is insolvent, or whenever the estate of any deceased debtor, in the hands of the executors or administrators, is insufficient to pay all the debts due from the deceased, the debts due to the United States shall be first satisfied.

Funeral and administrative expenses and the one-year family allowance provided by state law are under state law not debts of the decedent, but are charges against the property of the decedent to be deducted before the payment of debts. Costs of the decedent's last illness and the wages of household servants are debts from the decedent.

HOLDING

The claims against the decedent's estate for funeral and administrative expenses and the family allowance have priority over federal tax claims of the government for which it has no lien. However, such federal tax claims are superior to claims against a decedent's estate for doctor's bills from the decedent's last illness and wages due a household employee.

Section 7805.—Rules and Regulations

26 CFR 301.7805-1: Rules and regulations.

Whether the taxpayer is entitled to deduct all of the intangible drilling and development costs incurred in developing two noncontiguous tracts. See Rev. Rul. 80-109, page 8.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.602: Forms and instructions.
(Also Part I, Section 6651; 301.6651-1.)

Rev. Proc. 80-13 [1]

SECTION 1. PURPOSE

The purpose of this revenue procedure is to further extend the time set forth in Rev. Proc. 77-47, 1977-2 C.B. 580, in which contractors and subcontractors with contracts subject to the Vinson-Trammell Act, 48 Stat. 503 (current version at 10 U.S.C. sections 2382 and 7300 (1970)) in taxable years that end after September 30, 1976 must file certain reports. This extension is being made to permit consideration of comments received on the notice of proposed rulemaking under the Vinson-Trammell Act that was published in the Federal Register on October 26, 1979 as well as the further comments presented at the hearing on such rulemaking that was held on March 12, 1980.

SEC. 2. EXTENSION AND EFFECT ON OTHER DOCUMENTS

Section 4.02 of Rev. Proc. 77-47, as modified by Rev. Proc. 78-38, 1978-2 C.B. 542, Rev. Proc. 79-25, 1979-1 C.B. 566 and Rev. Proc. 79-53, 1979-43 I.R.B. 26, is further modified by extending to October 15, 1980 the time for filing Forms 949 and 949-A for taxpayers with taxable years that end before January 31, 1980.

An extension of the time granted taxpayers for filing Forms 949 and 949-A does not extend the time for filing their federal income tax returns.

Interest on any excess profits will be charged from the due date of the report, without regard to any extensions, to the date of payment. However, taxpayers who repay excess profits by October 15, 1980 will not be subject to the penalty for failure to pay tax with respect to the excess profits under section 6651 of the Internal Revenue Code.

Rev. Proc. 79-53, 1979-43 I.R.B. 26, which provides that Rev. Proc. 77-47 is extended to April 15, 1980 for taxpayers with tax years that ended before July 31, 1979, is superseded.

Rev. Proc. 77-47 is further modified.

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26 CFR 601.201: Rulings and determination letters.
(Also Sections 351, 367; 1.351-1, 7.367 (a)-1.)

Rev. Proc. 80-14

SECTION 1. PURPOSE

The purpose of this Revenue Procedure is to set forth guidelines that will be used by the Internal Revenue Service in considering requests for rulings under section 367(a)(1) of the Internal Revenue Code where tangible property is transferred by a United States person to a foreign corporation in a transaction described in section 351 and the tangible property transferred is leased by the foreign corporation to other persons who will not use it in the United States.

SEC. 2. BACKGROUND

Rev. Proc. 68-23, 1968-1 C.B. 821, sets forth the guidelines used by the Internal Revenue Service in considering requests for rulings under section 367 of the Code in respect of certain types of transactions involving foreign corporations.

Section 3.02(1) of Rev. Proc. 68-23 provides that favorable consideration under section 367 of the Code will ordinarily be given to an exchange described in section 351 where property is transferred to a foreign corporation controlled by the transferor, and such property is devoted by the transferee foreign corporation to the active conduct, in any foreign country, of a trade or business. Section 3.02(1) further provides that it is contemplated that the transferee foreign corporation, in addition to the active conduct of a trade or business, will have need for a substantial investment in fixed assets in such business.

Section 3.02(1)(b)(ii) of Rev. Proc. 68-23 limits section 3.02(1) by providing that a favorable ruling under section 367 of the Code generally will not be issued for an exchange described in section 351 where the property to be transferred to the foreign corporation will be licensed or leased by the transferee foreign corporation after the transfer.

However, section 2.02 of Rev. Proc. 68-23 provides that notwithstanding a contrary statement or implication contained in the guidelines a taxpayer may establish that a favorable ruling under section 367 of the Code should be issued based on all the facts and circumstances of the case.

SEC. 3. GUIDELINES

Where tangible property is transferred to a foreign corporation by a United States person, in a transaction described in section 351 of the Code, and the tangible property transferred will be leased by the foreign corporation to other persons, who will not use it in the United States, a favorable ruling under section 367(a)(1) ordinarily will be issued if the taxpayer establishes, based on all the facts and circumstances, that the leasing of the tangible property by the foreign corporation will represent the active conduct of a trade or business in the foreign country, that the foreign corporation will have need for a substantial investment in fixed assets (the tangible property transferred) in such business, and that the lessee will not use the tangible property in the United States. The active conduct of a trade or business requires that the employees of the foreign corporation will perform substantial marketing, customer servicing, repair and maintenance and other substantial operational activities with respect to the leased tangible property.

SEC. 4. INQUIRIES

Inquiries in regard to this Revenue Procedure should refer to its number and should be addressed to the Assistant Commissioner (Technical), Attention: T:C:R, Internal Revenue Service, Washington, D.C. 20224.

SEC. 5. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 68-23 is amplified.

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[1] Also released in News Release IR-80-39, dated March 28, 1980.

Treasury Department Order No. 150-69

Delegation to Commissioner of Internal Revenue of Functions Relating to Delinquent Internal Revenue Officers and Employees

By virtue of the authority vested in the Secretary of the Treasury by Reorganization Plan No. 26 of 1950, there are transferred to the Commissioner of Internal Revenue the functions of the Secretary of the Treasury under subsection 7803(c) of the Internal Revenue Code of 1954, relating to any officer or employee of the Treasury who fails to account for and pay over any amounts of money or property collected or received in connection with the Internal Revenue laws.

The functions transferred to the Commissioner of Internal Revenue may be exercised by any officer or employee of the Internal Revenue Service who is so authorized by the Commissioner, under such rules as the Commissioner may prescribe.

This order supersedes Treasury Department Order No. 150-69 [1975-2 C.B. 606] dated March 14, 1969.

G. William Miller,
Secretary of the Treasury.

Part IV. Items of General Interest

Submission of Form W-4

Announcement 80-50

Recently published final regulations will help identify persons who reduce the income tax withheld from their pay by incorrectly claiming either exemption from withholding or too many withholding allowances. The final regulations were published in the March 11, 1980, T.D. 7682, Federal Register.

The new regulations require that employers send the Internal Revenue Service copies of all Forms W-4, Employee's Withholding Allowance Certificates, that show 10 or more withholding allowances. They must also send copies of all Forms W-4 showing exempt status, but only for employees usually earning wages of more than $200 per week.

The new rules apply to Forms W-4 received by employers from their employees on or after April 1, 1980, rather than October 9, 1979, as originally proposed. Therefore, employers should disregard the line provided on Forms 941, 941E, and 941-M (Revised January 1980) for the first quarter of 1980.

Employers will be required to transmit the W-4 copies quarterly with Forms 941, 941E, or 941-M. However, at their option, employers may send copies of Forms W-4 more often than quarterly. Each employer choosing to do this must include a statement showing the employer's name, address, employer identification number, and the number of Forms W-4 being sent.

Employers who want to transmit W-4 data to the Service on magnetic media should refer to the specifications in Rev. Proc. 80-8, 1980-10 I.R.B. 18.

Statistics from 1977 Business Income Tax Returns

Announcement 80-51

Publication 453, Preliminary Report, Statistics of Income—1977, Business Income Tax Returns, covering returns of sole proprietorships and partnerships, is now available and may be purchased for $2.50 from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

Treatment of Organization and Syndication Fees—Public Hearing

Announcement 80-56 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to the treatment of partnership organization and syndication fees.

DATES: The public hearing will be held on May 21, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by May 9, 1980.

ADDRESS: The public hearing will be held in the Chief Counsel's Conference Room, Room 4132, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-266-76), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles G. Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under sections 707 and 709 of the Internal Revenue Code of 1954. The proposed regulations appeared in the FEDERAL REGISTER for Friday, January 11, 1980, at page 2349 (45 FR 2349).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of the comments to be presented at the hearing and the time they wish to devote to each subject by May 9, 1980. Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building unitl 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive appearing in the FEDERAL REGISTER for Wednesday, November 8, 1978.

Correction of Publication 78

Announcement 80-57

Contributions to the American Institute for Economic Research, Inc., Great Barrington, Ma., continue to be deductible under section 170(c) of the Code with a 50% deductibility limitation. The subject organization was inadvertently deleted from our latest edition of Publication 78, Cumulative List of Organizations described in Section 170(c) of the Internal Revenue Code of 1954 (Rev. 1-80).

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[1] Filed by the Office of the Federal Register on April 8, 1980, 8:45 a.m., and published in the issue of the Federal Register for April 9, 1980, 45 F.R. 24200.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants and Enrolled Agents from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following persons have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
John E. Bishop	Greenville, SC	Attorney	Indefinite effective October 24, 1979
Raymond A. Carr	Roanoke, VA	Certified Public Accountant	Indefinite effective February 11, 1980
Philip R. Hedrick	Charlotte, NC	Attorney	One Year effective February 22, 1980
Edward J. Loughery	Succasunna, NJ	Enrolled Agent	Indefinite effective February 1, 1980
C. Rex Olson	Phoenix, AZ	Certified Public Accountant	Four months effective February 15, 1980
Julian S.H. Weiner	Beverly Hills, CA	Certified Public Accountant	Indefinite effective August 23, 1979
W. Frank Wolfenbarger	Irving, TX	Certified Public Accountant	Indefinite effective January 1, 1980
Stephen K. Easton	New York, NY	Certified Public Accountant	Indefinite from February 29, 1980

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants or enrolled agents to practice before the Internal Revenue Service.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify such disbarred or suspended

practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant or enrolled agent so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing, the following individuals were disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
John J. McBurney	College Park, MD	Attorney	October 22, 1979
Robert W. Tufts	St. Petersburg, FL	Certified Public Accountant	March 17, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.401-2, 1.403(b)-1, 1.405-1, amended; 1.401-8A redesignated 1.401-8 and as redesignated amended; 1.401-8 redesignated 1.401(f)-1 and as redesignated amended; 1.401(a)-1, 1.401(a)-2, 1.401(a)-16, 1.415-1 through 1.415-10 added.	Limitations on benefits and contributions under qualified plans.	Jan. 24, 1980	Apr. 23, 1980
26 CFR 1.861-8, 1.882-4, amended.	Allowance of deductions to foreign corporations doing business in the U.S.	Feb. 27, 1980	Apr. 28, 1980
26 CFR 1.37, 1.37-4, 1.37-5, deleted; 1.37-1, 1.37-2, 1.37-3, revised; 7.0, amended.	Credit for the elderly.	Feb. 27, 1980	Apr. 28, 1980
26 CFR 1.105-7, added.	Self-insured medical reimbursement plans.	Feb. 28, 1980	Apr. 28, 1980
26 CFR 1.175, deleted; 1.175-2, 1.175-4, amended; 1.175.7, added.	Definition of "land used in farming" for purposes of determining deductibility of soil and water conservation expenditures.	Feb. 27, 1980	Apr. 28, 1980
26 CFR 301.6103(j)(1)-1 added; 404.6103(j)(1)-1 deleted.	Disclosure of returns and return information to officers and employees of Bureaus of the Census and Economic Analysis of the Department of Commerce for certain statistical purposes.	Mar. 24, 1980	May 23, 1980
26 CFR 150.0 through 150.6402-1 added; published as temporary regulations in T.D. 7690, page 11, this Bulletin.	Crude Oil Windfall Profit Tax Act of 1980.	Apr. 4, 1980	June 3, 1980
26 CFR 1.166-9, 1.482-2, 1.1371-1, amended; 1.385-1 through 1.385-12, added.	Treatment of certain interests in corporations as stock or indebtedness.	Mar. 24, 1980	June 23, 1980
26 CFR 53.4942 revoked; 53.4942(a)-2 amended.	The use of blockage or similar factors in determining the value of private foundations' noncharitable assets consisting of listed securities for purposes of determining the amount foundations must distribute annually for charitable purposes.	Mar. 12, 1980	May 12, 1980
26 CFR 301.6103(a)-1 through 301.6103(c)-1, 301.6103(i)-1 through 301.6103(p)(2)(B)-1 added; 301.6103(h)(2)-1 amended; 404.6103(a)-1 through 404.6103(i)-1, 404.6103(j)(2)-1 through 404.6103(n)-1, 420.6103(1)(2)-1 through 420.6103(1)(2)-3 deleted.	Disclosure of returns and return information under certain circumstances.	Mar. 24, 1980	May 23, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified,* above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1, dated January 7, 1980.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1 I.R.B., dated January 7, 1980.

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______	*1927–2*	*2.95*
______	1928–1	6.95
______	1928–2	9.50
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______	*1929–2*	*3.15*
______	1930–1	7.30
______	1930–2	9.50
______	*1931–1*	*3.60*
______	*1931–2*	*3.25*
______	*1932–1*	*2.80*
______	1932–2	8.65
______	*1933–1*	*3.35*
______	*1933–2*	*3.45*
______	*1934–1*	*3.70*
______	*1934–2*	*4.10*
______	1935–1	6.90
______	*1935–2*	*4.00*
______	*1936–1*	*3.55*
______	*1936–2*	*3.90*
______	*1937–1*	*3.75*
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______	*1938–2*	*3.50*
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______	1939–2	9.40
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______	1940–2	14.00
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______	*1941–2*	*3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
______	*1944*(*)	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
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______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
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______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$10.10
______	1957–2	13.00
______	1958–1	9.60
______	1958–2	13.00
______	1958–3	15.00
______	1959–1	15.00
______	1959–2	9.60
______	1960–1	9.00
______	1960–2	11.50
______	1961–1	14.00
______	1961–2	10.00
______	1962–1	6.20
______	1962–2	7.15
______	1962–3	15.00
______	1963–1	9.00
______	1963–2	10.75
______	1964–1–1	10.00
______	1964–1–2	11.00
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______	1966–2	14.05
______	1967–1	10.00
______	1967–2	10.00
______	1968–1	14.00
______	1968–2	11.75
______	1969–1	7.50
______	1969–2	6.50
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______	1970–1	11.00
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______	1971–2	8.50
______	1972–1	13.50
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______	1976–2	10.25
______	1976–3–1	9.50
______	1976–3–2	16.00
______	1976–3–3	10.00
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______	1977–2	11.75
______	1978–1	11.75
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______	1978–3–2	9.00
______	1979–1	14.00

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April 28, 1980
Bulletin No. 1980-17

9258

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-115, page 12.
Life insurance companies; reserves; combined disability and life coverage; cancellable. Reserves held by a life insurance company for payment of disability benefits under one-year group term life insurance contracts, which provide both disability insurance and term life insurance coverage that may be terminated at any time by the insurance company, do not qualify as life insurance reserves within the meaning of section 801(b) of the Code; Rev. Rul. 70-190 clarified.

Rev. Rul. 80-116, page 13.
Life insurance companies; merger; revaluation of reserves. A life insurance company that had elected under section 818(c) of the Code to revalue its reserves on the approximate revaluation basis acquired, in a statutory merger, another life insurance company that had smaller reserves computed on a preliminary term basis. The acquiring company is not entitled to an adjustment under section 481 by reason of the required revaluation of the acquired reserves.

Rev. Rul. 80-117, page 15.
Life insurance companies; merger, revaluation of reserves. In a statutory merger, a life insurance company that computed its reserves on a preliminary term basis acquired another life insurance company that had smaller reserves, which it had elected under section 818(c) of the Code to revalue on the approximate revaluation basis. The revaluation of the acquired reserves on the preliminary term basis is a change in the basis for computing the reserves, and the resulting adjustment is subject to the 10-year spread rule of section 810(d)(1).

Rev. Proc. 80-15, page 27.
CLADR; clarification; addition; deletion. Asset guideline classes 57.0 and 57.1 are created to include those assets formerly included in classes 13.4, 50.0, 50.1, 70.2, and 70.21 used in distributive trades and services, including billboards, service station buildings, and petroleum marketing land improvements. The description of assets included in class 00.12 is clarified. Asset guideline classes 13.4, 50.0, 50.1, 70.2, and 70.21 are deleted. Rev. Proc. 77-10 modified.

T.D. 7683, page 6.
Amendments to the regulations under sections 43, 6012, and 6051 of the Code relate to the earned income credit.

Rev. Proc. 80-5 (Republication), page 23.
Accounting methods; change; inventory write-down. The procedure provided for taxpayers to change their method of accounting for "excess" inventory pursuant to the decision of the Supreme Court in **Thor Power Tool Co. v. Commissioner** is, as amended, republished.

Announcement 80-54, page 31.
Amendments are set forth to Rev. Proc. 80-5. Also, common errors being made by taxpayers in complying with this revenue procedure are listed.

(Continued on page 4)

Finding Lists begin on page 36.
Announcement of Disbarments and Suspensions on page 34.
Announcement Relating to Notice of Proposed Rulemaking on page 35.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part includes rulings and decisions based on Subpart A, Tax Conventions and related Treasury Decisions and Revenue Rulings; Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of Revenue Rulings, Revenue Procedures, and other published items, and (3) topical Indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

EXEMPT ORGANIZATIONS

Rev. Rul. 80-113, page 9.
Rulings; untimely notification; advance ruling period. An organization having no financial support filed the notice required by section 508(a) of the Code more than 15 months after the end of the month it was organized. The organization may obtain an advance ruling treating it as an organization described in sections 170(b)(1)(A)(vi) and 509(a)(1) for the period beginning on the date the notice was filed, which is the date the organization is recognized as exempt under section 501(c)(3).

Rev. Rul. 80-114, page 11.
Christian Science health care facility. An otherwise qualifying nonprofit organization that operates a health care facility for patients under the care of Christian Science practitioners receives its income principally from contributions, patients' fees, medicare, medicaid, and health insurance. The organization accepts patients who are unable to pay as funds permit. The organization qualifies for exemption under section 501(c)(3) of the Code. Rev. Rul. 78-427 superseded.

Rev. Rul. 80-118, page 20.
Private foundation; gross investment income; interest on U.S. savings bonds. A private foundation derived interest income upon redemption of Series E U.S. savings bonds that were received from the estate of the purchaser. The interest is includible in the computation of gross investment income under section 4940(c)(2) of the Code if neither the individual nor the estate elected to report as income the periodic increases in bond value.

EMPLOYMENT TAXES

T.D. 7682, page 17.
Amendments to the regulations under sections 3401 and 3402 of the Code relate to submission of copies of certain employee withholding exemption certificates to the Service.

T.D. 7683, page 6.
Amendments to the regulations under sections 43, 6012, and 6051 of the Code relate to the earned income credit.

EXCISE TAXES

T.D. 7681, page 19.
Amendments to the regulations relate to the availability of a refund or credit on certain articles described in section 4221(a)(1) of the Code.

Notice 80-3, page 23.
Windfall profit tax; inflation adjustment factor. For purposes of computing the windfall profit tax, the inflation adjustment for the quarter ending June 30, 1980, is .0422 for tier 1 or tier 2 oil and .0527 for tier 3 oil.

TAX CONVENTIONS

Rev. Proc. 80-16, page 29.
France; U.S. citizen resident in France; source of partnership income. A procedure to be followed by partnerships in making the election provided in Article 23(3)(c) of the U.S.-France Income Tax Convention as amended by the Protocol of November 24, 1978, is set forth. The application of this election to partnerships reporting income on the basis of taxable years begun before January 1, 1979, and ended after January 1, 1979, with the distributive shares of the partners being reported on the basis of taxable years begun on or after January 1, 1979, is clarified.

Announcement 80-59, page 33.
A correction is made to Rev. Rul. 80-98, which holds that amounts received from the National Institutes of Health under the Visiting Fellows Program by residents of certain countries are exempt from federal income tax.

ADMINISTRATION

Del. Order 57 (Rev. 4), page 22.
Additional inspection of books. Authority to sign, after investigation, a notice to a taxpayer that an additional inspection of such taxpayer's books of account is necessary is delegated to District Directors, Service Center Directors, and the Director of International Operations; Del. Order 57 (Rev. 3) superseded.

Del. Order 97 (Rev. 17), page 22.
Closing agreements. Authority to enter into closing agreements concerning tax liability is delegated to designated Service officers; Del. Order 97 (Rev. 16) superseded.

Highlights of this Issue—Continued

(Continued from page 4)

ADMINISTRATION—Cont'd

Announcement 80-52, page 31.
Certain sections of the regulations that contain cross-references to statutory sections removed by T.D. 7665 are corrected to refer to corresponding sections of the Code or appropriate regulation sections. In other instances the cross-references are deleted. These changes will be reflected in the April 1, 1980, edition of Title 26 of the Code of Federal Regulations.

Announcement 80-60, page 33.
A correction is made to the effective date of Rev. Proc. 80-11, which relates to reporting dividends on restricted stock that is not substantially vested within the meaning of section 83 of the Code when such dividends are reflected on both Forms 1099-DIV and W-2.

Announcement 80-61, page 33.
A new Form 6047, Windfall Profit Tax, has been developed for use generally by first purchasers of crude oil as an attachment to Form 720, Quarterly Federal Excise Tax Return.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 43.—Earned Income

26 CFR 1.43-1: Earned income credit for taxable years beginning before January 1, 1979.
(Also Sections 6012, 6051; 1.6012-1, 31.6051-1.)

T.D. 7683 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; SUBCHAPTER C, PART 31. — EMPLOYMENT TAXES, APPLICABLE ON AND AFTER JANUARY 1, 1955

Earned income credit

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the earned income credit but not, in general, to advance payment of the earned income credit. Changes to the applicable tax law were made by the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1]. The regulations provide necessary guidance to the public for compliance with the new law.

DATE: The regulations are effective for taxable years beginning after December 31, 1978, with the exception of the amendment to section 6051(a) which relates to reporting of advance payments of the earned income credit on Forms W-2 with respect to remuneration paid after June 30, 1979.

FOR FURTHER INFORMATION CONTACT: Barbara B. Coughlin of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-6618).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On July 6, 1979, the Federal Register proposed amendments to the Income Taxe Regulations (26 CFR Part 1) under sections 43 and 6012 of the Internal Revenue Code of 1954 and to the Employment Tax Regulations (26 CFR Part 31) under section 6051 of the Code (44 FR 39477). The amendments were proposed to conform the regulations to sections 103, 104 and 105(a), (c), and (d) of the Revenue Act of 1978 (92 Stat. 2771). Several comments were received with respect to the proposed amendments and taken into account in this Treasury decision. No public hearing was requested or held. A number of comments received with respect to this notice of proposed rulemaking which in fact relate to a separate notice of proposed rulemaking, published in the Federal Register on May 9, 1979 (44 F.R. 27089), involving the advance payment of the earned income credit under section 3507 of the Internal Revenue Code of 1954 have not been taken into account by this Treasury decision since they were not relevant to this Treasury decision. Those comments will be taken into account in the context of the regulation project involving advance payment of the earned income credit. This proposed Treasury decision adopts the rules contained in the notice of proposed rulemaking with three minor changes. One change is to clarify the rule that earned income includes compensation excluded from gross income and to state that earned income does not include unemployment compensation.

ALLOWANCE OF CREDIT

The regulations adopted by this Treasury decision provide rules reflecting the changes in the earned income credit as allowed by section 43. In the case of an individual eligible for the earned income credit, the credit is 10 percent of the first $5,000 of the individual's earned income for the taxable year. Prior to January 1, 1979, the credit allowed by section 43 was 10 percent of the first $4,000 of the individual's earned income for the taxable year.

LIMITATION ON AMOUNT OF CREDIT

The regulations adopted by this Treasury decision reflect the new rules for the limitation on the amount of the earned income credit. The amount of credit must not exceed the excess, if any, of $500 over 12.5 percent of that amount of adjusted gross income or, if greater, that amount of earned income of the taxpayer as exceeds $6,000 for the taxable year. Prior to January 1, 1979, the amount of credit allowed a taxpayer for a taxable year was reduced by an amount equal to 10 percent of so much of adjusted gross income or, if greater, earned income of the taxpayer for the taxable year as exceeded $4,000.

ELIGIBLE INDIVIDUAL

The regulations adopted by this Treasury decision provide rules reflecting the change in definition of the term "eligible individual." An eligible individual is either (1) an individual who is married, who is entitled to an exemption deduction for a child (within the meaning of section 151 (e)(3)), and who has the same principal place of abode as the child which place of abode is in the United States; (2) an individual who is a surviving spouse (as determined under section 2(a) of the Code) whose principal place of abode is in the United States; or (3) an individual who is a head of household (as determined under section 2(b) of the Code without regard to paragraphs (b)(1)(A)(ii) and (B)) whose principal place of abode is in the United States. This Treasury decision provides that the term "principal place of abode" is defined by reference to § 1.2-2(c). To qualify as an eligible individual, the individual must not have been entitled to exclude any gross income under section 911 or 931.

EARNED INCOME

The regulations adopted by this Treasury decision provide rules reflecting the change in definition of the term "earned income." Earned income means wages, salaries, tips, other employee compensation, and net earnings from self-employment (within the meaning of section 1402(a)). The determination of earned income is subject to certain special rules. This Treasury decision provides that unemployment compensation is not earned income.

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[1] This publication of the Treasury Decision contains the complete text of the amendments to the regulations. The instructions for modifying the notice of proposed rulemaking have been omitted.

MISCELLANEOUS

The regulations adopted by this Treasury decision provide rules for the coordination of the earned income credit with the advance payment of the earned income credit by employers under section 3507 of the Internal Revenue Code of 1954. This Treasury decision clarifies that the amount of any advance payment of the earned income credit is treated as an additional amount of tax imposed by chapter 1 of the Code. This Treasury decision also amends § 1.6012-1(a)(2) to conform to section 6012 of the Code, as amended, which requires individuals who receive advance payments of earned income credit to make a return of income. This Treasury decision also amends § 31.6051-1 to conform to section 6051, as amended, which requires employers to furnish on a written statement (Form W-2) to employees the total amount of advance payments of earned income credit paid to the employee under section 3507 of the Code for the calendar year.

The regulations adopted by this Treasury decision impose no new reporting burdens or recordkeeping requirements not already imposed by statute. The principal effect of the final regulations is to conform existing regulations under sections 43, 6012 and 6051 of the Code to changes made by the Revenue Act of 1978. The Treasury Department will review these regulations from time to time based upon comments received from offices within the Treasury, the Internal Revenue Service, and other governmental agencies, and comments received from the public.

DRAFTING INFORMATION

The principal author of these regulations is Barbara B. Coughlin of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing these regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to 26 CFR Part 1 and 26 CFR 31 are hereby adopted:

INCOME TAX REGULATIONS (26 CFR Part 1)

Paragraph 1. Section 1.43-1 is amended by revising the heading and paragraphs (a) and (e). These revised provisions read as follows:

§ 1.43-1 Earned income credit for taxable years beginning before January 1, 1979.

(a) *Allowance of credit.* For taxable years beginning before January 1, 1979 (and after December 31, 1974), subject to the limitations of paragraph (b) of this section, an eligible individual (as defined in paragraphs (c)(1) and (2) of this section) is allowed as a credit against the tax imposed by chapter 1 for the taxable year, an amount equal to 10 percent of the first $4,000 of earned income (as defined in paragraph (c)(3) of this section) for the taxable year. For later taxable years beginning after December 31, 1978, see § 1.43-2.

* * * * *

(e) *Effective dates.* The rules of this section apply only for taxable years beginning both after December 31, 1974, and before January 1, 1979. For later taxable years beginning after December 31, 1978, see § 1.43-2.

Par. 2. A new § 1.43-2 is added immediately after § 1.43-1. This new section reads as follows:

§ 1.43-2 Earned income credit for taxable years beginning after December 31, 1978.

(a) *Allowance of credit.* For taxable years beginning after December 31, 1978, subject to the limitations of paragraph (b) of this section, an eligible individual (as defined in paragraph (c)(1) of this section) is allowed as a credit against the tax imposed by subtitle A of the Code for the taxable year, an amount equal to 10 percent of the first $5,000 of earned income (as defined in paragraph (c)(2) of this section) for the taxable year. For earlier taxable years beginning before January 1, 1979, see § 1.43-1.

(b) *Limitations*—(1) *Amount of credit.* The amount of the credit allowed by section 43 and paragraph (a) of this section for the taxable year must not exceed the excess, if any, of $500 over 12.5 percent of that amount of the adjusted gross income (or, if greater, the earned income) of the taxpayer for the taxable year which exceeds $6,000. For the meaning of the term "earned income," see paragraph (c)(2) of this section. Adjusted gross income is determined under section 62 and the regulations thereunder. If an individual has adjusted gross income or earned income of $10,000 or more, the individual is not entitled to the credit.

(2) *Married individuals.* No credit is allowed by section 43 and paragraph (a) of this section in the case of an eligible individual who is married (within the meaning of section 143 and the regulations thereunder) unless the individual and spouse file a single return jointly (a joint return) for the taxable year (see section 6013 and the regulations thereunder relating to joint returns of income tax by husband and wife). The requirements of the preceding sentence do not apply to an eligible individual who is not considered as married under section 143(b) and the regulations thereunder (relating to certain married individuals living apart).

(3) *Length of taxable year.* No credit is allowed by section 43 and paragraph (a) of this section in the case of a taxable year covering a period of less than 12 months. However, the rule of the preceding sentence does not apply to a taxable year closed by reason of the death of the eligible individual.

(c) *Definitions*—(1) *Eligible individual.* For purposes of this section, an eligible individual is an individual who meets the following requirements of this paragraph (c)(1).

(i) For the taxable year the individual must meet any one of the following three requirements set forth, respectively, in (A), (B), and (C) of this subdivision (i).

(A) The individual must be married (within the meaning of section 143 and the regulations thereunder) and be entitled to a deduction under section 151 for a child (within the meaning of section 151(e)(3) and the regulations thereunder). The child must have the same principal place of abode (as defined in § 1.2-2(c)) as the individual and that principal place of abode must be in the United States for the entire taxable year.

(B) The individual must qualify as a surviving spouse (as determined under section 2(a) and the regulations thereunder). Thus, the spouse of the individual must have died within the period of the 2 taxable years immediately preceding the individual's taxable year. Also, the individual must have furnished over half the cost of maintaining as the individual's home a household in the United States for the entire taxable year which is the principal place of abode of a child of the individual who qualifies as a dependent for whom the individual is entitled to a deduction under section 151.

(C) The individual must qualify as a head of household (as determined under section 2(b) and the regulations thereunder but without regard to section 2(b)(1)(A)(ii) and (B) and the regulations thereunder). Thus, the individual cannot be married as of the close of the taxable year and cannot qualify as a surviving spouse under section 2(a). Also, the individual must have furnished over half the cost of maintaining as the individual's home a household in the United States for the entire taxable year which is the principal place of abode of a child or descendant of the individual who is unmarried or who qualifies as a dependent for whom the individual is entitled to a deduction under section 151.

(ii) For the entire taxable year, the individual must not be entitled to exclude any amount from gross income under section 911 (relating to earned income by individuals in certain camps outside the United States) or section 931 and the regulations thereunder (relating to income from sources within the possessions of the United States).

(iii) The rules of this paragraph (c)(1) are illustrated by the following examples:

Example (1). A, who is married and a member of the United States Armed Forces, maintains his household outside the United States for part of the taxable year. A is not an eligible individual. However, if A maintains his household inside the United States for the entire taxable year and is only temporarily absent therefrom by reason of military service and if the household is his principal place of abode and the principal place of abode of his child who receives over half of his support from the taxpayer for the calendar year in which the taxable year of the taxpayer begins and who either has less than $1,000 of gross income for the calendar year in which the individual's taxable year begins or who has not attained the age of 19 at the close of the calendar year in which the individual's taxable year begins or is a student, then the individual is an eligible individual if he meets the requirements of subdivision (ii) of this paragraph.

Example (2). B's wife died in 1975 and B has not remarried. For his entire taxable year beginning January 1, 1979, B maintains his household inside the United States. The household is, for the entire taxable year, B's principal place of abode and the principal place of abode of B's unmarried grandchild whose natural parents are deceased. Thus B qualifies as a head of household (as determined under section 2(b) without regard to subparagraphs (A)(ii) and (B) of section 2(b)(1)). In these circumstances, regardless of whether B provides sufficient support to claim the grandchild as a dependent, B is an eligible individual if he meets the requirements of subdivision (ii) of this paragraph.

Example (3). C is married and maintains his household inside the United States for the entire taxable year. The household is his principal place of abode and, for the entire year, is also the principal place of abode of a 12 year old child whose natural parents are deceased and who is placed with C by a State agency to provide the child with foster care. C receives compensation from the State agency to cover all of the cost of maintaining the child in his home. The child is in C's care and is cared for as C's own child. In these circumstances, the child is C's foster child, but C is not able to claim the child as a dependent since C did not provide half the child's support for the year. C is not eligible for the earned income credit.

Example (4). Assume the same facts as in example (3) except that C receives no compensation from the State agency, and C provides over half the child's support and is able to claim the child as a dependent. C is an eligible individual if he meets the requirements of subdivision (ii) of this paragraph.

Example (5). D's husband died in 1974 and D has not remarried. For the entire taxable year beginning January 1, 1979, D maintains her household inside the United States. The household is D's principal place of abode and, for the entire taxable year, is also the principal place of abode of D's unmarried son. D cares for her son in all respects except that her parents provide over half of the son's support. D qualifies as a head of household (as determined under section 2(b) without regard to subparagraph (A)(ii) and (B) of section 2(b)(1)). D is an eligible individual if D meets the requirements of subdivision (ii) of this paragraph.

Example (6). Assume the same facts as in example (5) except that D is married. Since D cannot qualify as a head of household, and D's son cannot be claimed as D's dependent, D is not an eligible individual.

(2) *Earned income.* For purposes of this section, earned income means—

(i) Wages, salaries, tips, other employee compensation, and

(ii) Net earnings from self-employment (within the meaning of section 1402(a) and the regulations thereunder).

Earned income includes compensation excluded from gross income, such as disability income excluded under section 105(d), the rental value of a parsonage excluded under section 107, and the value of meals and lodging furnished for the convenience of the employer excluded under section 119. Earned income is computed without regard to any community property laws which may otherwise be applicable. Earned income is reduced by any net loss in earnings from self-employment. Earned income does not include amounts received as a pension, an annuity, unemployment compensation, or workmen's compensation, or an amount to which section 871(a) and the regulations thereunder apply (relating to income of nonresident alien individuals not connected with United States business).

(d) *Examples.* The application of this section is illustrated by the following examples. For purposes of these examples, assume that the eligible individual does not receive a pension, an annuity, or an amount to which section 871(a), 911, or 931 applies.

Example (1). A and B (married individuals) maintain a household inside the United States which is their principal place of abode and the principal place of abode of their two children who are 12 and 14 years old. A and B are calendar year taxpayers and, for 1979, they file a joint return. A and B have a total earned income of $7,600 (computed without regard to any community property laws) and have adjusted gross income of less than $7,600. The earned income credit of $300 is determined as follows:

Basic credit (10 percent of $5,000 under paragraph (a) of this Section)			$500
Initial limitation amount		$500	
Less: Reduction under paragraph (b)(1) of this section:			
Earned income for taxable year	$7,600		
Less	$6,000		
Excess over $6,000	1,600		
12½ percent of excess ($1,600)		$200	
Maximum credit (if less than basic credit)			$300

Example (2). Assume the same facts as in example (1) except that A and B have earned income of $4,000 and adjusted gross income of $7,000. The earned income credit of $375 is determined as follows:

Basic credit (10 percent of $4,000 under paragraph (a) of this section)			$400
Initial limitation amount		$500	
Less: Reduction under paragraph (b)(1) of this section:			
Adjusted gross income for taxable year	$7,000		
Less	$6,000		
Excess over $6,000	$1,000		
12½ percent of excess ($1,000)		$125	
Maximum credit (if less than basic credit)			$375

(e) *Coordination of credit with advance payments*—(1) *Recapture of excess advance payments.* If any advance payment of earned income credit under section 3507 is made to an individual by an employer during any calendar year, then the total amount of these advance payments to the individual in that calendar year is treated as an additional amount of tax imposed (by chapter 1 of the Code) upon the individual on the tax return for the individual's last taxable year beginning in that calendar year.

(2) *Reconciliation of payments advanced and credit allowed.* Any additional amount of tax under paragraph (e)(1) of this section is not treated as a tax imposed by chapter 1 of the Code for purposes of determining the amount of any credit (other than the earned income credit) allowable under subpart A, part I, subchapter A, chapter 1 of the Code.

Par. 3. Paragraph (a)(2) of § 1.6012-1 is amended by adding a new subdivision (vii) immediately after subdivision (vi). This new subdivision reads as follows:

§ 1.6012-1 Individuals required to make returns of income.

(a) *Individual citizen or resident.* * * *

(2) * * *

(vii) For taxable years beginning after December 31, 1978, an individual who receives payments during the calendar year in which the taxable year begins under section 3507 (relating to advance payment of earned income credit) must file an income tax return.

* * * * *

EMPLOYMENT TAX REGULATIONS
(26 CFR Part 31)

Par. 4. Section 31.6051-1 is amended as follows:

1. Paragraph (a)(1)(i) is amended by striking out "and" at the end of inferior subdivision (*f*), by striking out the period at the end of inferior subdivision (*g*) and inserting in its place ", and" and by adding a new inferior subdivision (*h*) immediately after inferior subdivision (*g*). This new inferor subdivision (*h*) reads as set forth below.

2. Paragraph (b)(1) is amended by striking out "and" at the end of subdivision (iv), by striking out the period at the end of subdivision (v) and inserting in its place ", and" and by adding a new subdivision (vi) immediately after subdivision (v). This new subdivision (vi) reads as set forth below.

§ 31.6051.1 Statement for employees.

(a) *Requirement if wages are subject to withholding of income tax*—(1) *General rule.* (i) * * *

(*h*) The total amount paid to the employee under section 3507 (relating to advance payment of earned income credit).

* * * * *

(b) *Requirement if wages are not subject to withholding of income tax*—(1) *General rule.* * * *

(vi) The total amount paid to the employee under section 3507 (relating to advance payment of earned income credit).

* * * * *

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved March 5, 1980.

Donald C. Lubick,
Assistant Secretary of
the Treasury.

(Filed by the Office of the Federal Register on March 12, 1980; 8:45 a.m., and published in the issue of the Federal Register for March 13, 1980, 45 F.R. 16174)

Section 167.—Depreciation

26 CFR 1.167(a)-11: Depreciation based on class lives and asset depreciation ranges for property placed in service after December 31, 1970.

Net asset guideline classes 57.0, Distributive Trades and Services, and 57.1, Distributive Trades and Services—Billboards, Service Station Buildings and Petroleum Marketing Land Improvements. Clarification of asset guideline class description for asset guideline class 00.12, Information Systems. Deletions of asset guideline classes 13.4, Marketing of Petroleum and Petroleum Products; 50.0, Wholesale and Retail Trade; 50.1, Wholesale and Retail Trade Service Assets; 70.2, Personal and Professional Services; and 70.21, Personal and Professional Services Service Assets. See Rev. Proc. 80-15, page 27.

Section 170.—Charitable, Etc., Contributions and Gifts

26 CFR 1.170A-9: Definition of section 170(b)(1)(A) organization.
(Also Sections 508, 509; 1.508-1, 1.509 (a)-2.)

Rulings; untimely notification; advance ruling period. An organization having no financial support filed the notice required by section

508(a) of the Code more than 15 months after the end of the month it was organized. The organization may obtain an advance ruling treating it as an organization described in sections 170(b)(1)(A)(vi) and 509(a)(1) for the period beginning on the date the notice was filed, which is the date the organization is recognized as exempt under section 501(c)(3).

Rev. Rul. 80-113

ISSUE

May an organization having no financial support and filing its notice under section 508(a) of the Internal Revenue Code more than 15 months after the end of the month it was organized obtain an advance ruling treating it as described in sections 170(b)(1)(A)(vi) and 509(a)(1) during an advance ruling period beginning on the date it becomes exempt from federal income tax under section 501(c)(3)?

FACTS

The organization received no financial support from December 28, 1973, the date it was organized exclusively for purposes within section 501(c)(3) of the Code, through May 1, 1976, the date it applied to the Internal Revenue Service for recognition of exemption from federal income tax under section 501(c)(3). It requested an advance ruling under section 1.170A-9(e)(5) of the Income Tax Regulations in order to be treated as described in sections 170(b)(1)(A)(vi) and 509(a)(1) during an advance ruling period. Pursuant to section 1.170A-9(e)(5), it established that it could reasonably be expected to meet the requirements of section 1.170A-9(e)(2) or (3). It is not an organization described in section 508(c)(1)(A) or 508(c)(2) to which section 508(a) is not applicable. It is not an organization described in section 509(a)(3) or (4).

LAW AND ANALYSIS

Section 508(a) of the Code provides that an organization, other than one described in section 508(c), organized after October 9, 1969, shall not be treated as an organization described in section 501(c)(3) unless it has given notice to the Secretary, in such manner as the Secretary may by regulations prescribe, that it is applying for recognition of such status.

Section 1.508-1(a) of the regulations provides, in part, that an organization seeking exemption under section 501(c)(3) of the Code must, within fifteen months from the end of the month in which it was organized, give the Commissioner notice that it is applying for exemption. If it fails to give notice within this period, it will be treated as exempt, provided it otherwise qualifies, only from the date it files its application constituting such notice.

Section 508(c)(1)(B) of the Code provides that section 508(a) shall not apply to any organization which is not a private foundation under section 509 and whose gross receipts in each taxable year are normally not more than $5,000.

Section 509 of the Code provides that an organization described in section 501(c)(3) is not a private foundation if it is described in section 509(a)(1), (2), (3) or (4).

Rev. Rul. 77-207, 1977-1 C.B. 152, holds that if, pursuant to section 508(a) of the Code, an organization's exemption from federal income tax under section 501(c)(3) is effective only from the date it filed an application for recognition of exemption, such organization is neither described in section 501(c)(3) nor classifiable as a private foundation under section 509 prior to the date as of which, pursuant to section 508(a), it is recognized as exempt from federal income tax under section 501(c)(3).

Rev. Rul. 77-208, 1977-1 C.B. 153, holds that if, pursuant to section 508(a) of the Code, an organization is exempt from federal income tax under section 501(c)(3) effective only from the date it filed an application for recognition of exemption, it is considered a new organization as of that date and may obtain an advance ruling treating it as described within sections 170(b)(1)(A)(vi) and 509(a)(1), provided, pursuant to section 1.170A-9(e)(5) of the regulations, it can reasonably be expected to meet the requirements of section 1.170A-9(e)(2) or (3).

The organization in the present case received no financial support prior to May 1, 1976, the date it applied for recognition of exemption. For this reason, it was not described in section 170(b)(1)(A)(vi) of the Code on that date and, therefore, was not excepted by section 508(c)(1)(B) from the notice requirement of section 508(a). It follows that, pursuant to the holding in Rev. Rul. 77-207, the organization was neither exempt under section 501(c)(3) nor a private foundation as defined in section 509(a) prior to the date the notice was filed; and, pursuant to the holding in Rev. Rul. 77-208, it is treated as a new organization as of the date the notice was filed.

HOLDING

Since the organization has established that it can reasonably be expected to meet the requirements of section 1.170A-9(e)(2) or (3) of the regulations, it may obtain an advance ruling treating it as described in sections 170(b)(1)(A)(vi) and 509(a)(1) of the Code during an advance ruling period beginning on May 1, 1976, the date on which the section 508(a) notice was filed and the date as of which it is treated as a new organization and recognized as exempt under section 501(c)(3).

Section 381.—Carryovers in Certain Corporate Acquisitions

26 CFR 1.381(c)(4)-1: Method of accounting.

Merger of one life insurance company that had not previously made an election under section 818(c)(2) of the Code into another life insurance company that had made a previous election under section 818(c)(2). See Rev. Rul. 80-116, page 13.

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26 CFR 1.381(c)(4)-1: Method of accounting.

Merger of one life insurance company that elected to revalue its preliminary term life insurance reserves under section 818(c)(2) of the Code into another life insurance company that had not made a section 818(c) election. See Rev. Rul. 80-117, page 15.

Section 481.—Adjustments Required by Changes in Method of Accounting

26 CFR 1.481-1: Adjustments in general.

Whether the surviving life insurance company in a statutory merger of two life insurance companies must compute an adjustment under section 481 of the Code by reason of the revaluation of the preliminary term reserves acquired from the transferor life insurance company under section 818(c)(2). See Rev. Rul. 80-116, page 13.

Section 501.—Exception from Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Christian Science health care facility. An otherwise qualifying nonprofit organization that operates a health care facility for patients under the care of Christian Science practitioners receives its income principally from contributions, patients' fees, medicare, medicaid, and health insurance. The organization accepts patients who are unable to pay as funds permit. The organization qualifies for exemption under section 501(c)(3) of the Code. Rev. Rul. 78-427 superseded.

Rev. Rul. 80-114

ISSUE

Is an organization that operates a Christian Science health care facility qualified for exemption under section 501(c)(3) of the Internal Revenue Code?

FACTS

The organization, which otherwise qualifies for exemption under section 501(c)(3) of the Code, was formed for the purpose of providing health care, comfort, and maintenance to persons seeking health in a manner consistent with the teachings of the First Church of Christ, Scientist (Christian Science Church). The Church teaches that all forms of mental or physical illness and injury are merely symptoms of spiritual disorder, and that persons who are suffering from such illness or injury can be completely cured only by means of prayer and faith.

The organization's primary activity is the operation of a nonprofit health care facility for patients under the care of individuals who have been officially recognized by the board of directors of the Church as Christian Science practitioners. The organization follows a policy of strict compliance with state and local laws applicable to the licensing and operation of a Christian Science health care facility.

The organization's principal sources of income are contributions, fees paid by its patients, fees paid under medicare and medicaid programs, and fees paid by health insurers. The organization accepts patients who are unable to pay, as funds permit.

LAW

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and is not to be construed as limited by the separate enumeration in section 501(c)(3) of other tax exempt purposes which may fall within the broad outlines of charity as developed by judicial decisions.

Rev. Rul. 55-261, 1955-1 C.B. 307, holds that payments to Christian Science practitioners for services rendered are deductible as expenses for medical care within the meaning of section 23(x) of the 1939 Code, which corresponds to section 213 of the 1954 Code.

In the general law of charity, the promotion of health has traditionally been considered a charitable purpose. See *Restatement (Second) of Trusts*, 368, 372 (1959).

ANALYSIS AND HOLDING

By providing care under the circumstances described above, the organization is operating a health care facility that serves the charitable purpose of promoting health. Accordingly, the organization is operated exclusively for charitable purposes, and is exempt from Federal income tax under section 501(c)(3) of the Code.

APPLICATION INSTRUCTIONS

Even though an organization considers itself within the scope of this revenue ruling, it must file an application on Form 1023, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. See sections 1.501(a)-1 and 1.508-1(a) of the regulations. In accordance with the instructions to Form 1023, the application should be filed with the District Director of Internal Revenue for the key district indicated therein.

EFFECT ON OTHER REVENUE RULINGS

This Rev. Rul. more appropriately describes the activities of a Christian Science health care facility. Rev. Rul. 78-427, 1978-2 C.B. 176, is superseded.

Section 508.—Special Rules with Respect to Section 501(c)(3) Organizations

26 CFR 1.508-1: Notices.

Whether an organization having no financial support and applying for exemption under section 501(c)(3) of the Code more than 15 months after the end of the month it was organized may obtain an advance ruling treating it as described in sections 170(b)(1)(A)(vi) and 509(a)(1) during an advance ruling period. See Rev. Rul. 80-113, page 9.

Section 509.—Private Foundation Defined

26 CFR 1.509(a)-2: Exclusion for certain organizations described in section 170(b)(1)(A).

Whether an organization having no financial support and applying for exemption under section 501(c)(3) of the Code more than 15 months after the end of the month it was organized may obtain an advance ruling treating it as described in sections 170(b)(1)(A)(vi) and 509(a)(1) during an advance ruling period. See Rev. Rul. 80-113, page 9.

Section 702.—Income and Credits of Partner

26 CFR 1.702-1: Income and credits of partner.

A procedure for partnerships having a partner who is a United States citizen and resident of France to follow in making an election under Article 23(3)(c) of the United States-France Income Tax Convention, 1968-2 C.B. 691, as amended by the Protocol of November 24, 1978, 1979-51 I.R.B. 17, whereby a certain portion of such partner's United States-source income will be deemed to be French-source income. See Rev. Proc. 80-16, page 29.

Section 801.—Definition of Life Insurance Company

26 CFR 1.801-3: Definitions.

Life insurance companies; reserves; combined disability and life coverage; cancellable. Reserves held by a life insurance company for payment of disability benefits under one-year group term life insurance contracts, which provide both disability insurance and term life insurance coverage that may be terminated at any time by the insurance company, do not qualify as life insurance reserves within the meaning of section 801(b) of the Code; Rev. Rul. 70-190 clarified.

Rev. Rul. 80-115

ISSUE

Do reserves held by the taxpayer for payment of disability benefits under 1-year group term life insurance policies that provide both disability and term life insurance benefits qualify as life insurance reserves within the meaning of section 801(b) of the Internal Revenue Code?

FACTS

The taxpayer is a life insurance company taxable under section 802 of the Code. The taxpayer issues, among other types of insurance, 1-year group term life insurance contracts that provide, in addition to life insurance benefits, disability benefits. If the policy is renewed at the end of its 1-year term, the renewal premium will be recomputed based upon the accumulated experience of the group. The taxpayer may terminate the policies upon written notice to the named insured, but in no event shall a termination of policy adversely affect any claim incurred prior to the date of such termination.

When the policy is issued the taxpayer establishes two reserves, namely, a reserve for basic life insurance benefits and a reserve entitled Disability Benefits-Active Lives. The portion of the premiums received for the basic life insurance benefits funds the basic life reserve and the portion of the premiums received for the disability benefits funds the Disability Benefits-Active Lives reserve. When an insured employee becomes disabled and entitled to the monthly income payments specified in the contract, a third reserve, entitled Disability Benefits-Disabled Lives, is established. This reserve is funded out of the Disability Benefits-Active Lives reserve, and the disability income payments to the insured employee are paid out of this reserve.

The Disability Benefits-Active Lives reserve and Disability Benefits-Disabled Lives reserve established under the policy are computed on the basis of recognized mortality and morbidity tables, at assumed rates of interest, and are required by law. At the end of the policy term, whatever balance remains in the Disability Benefits-Active Lives reserve is released to the income of the taxpayer and the reserve is zero. The disabled employee's recovery or death terminates the taxpayer's obligation to pay disability benefits to that employee. Amounts in the Disability Benefits-Disabled Lives reserve that are attributable to the terminated obligation are then released to the income of the taxpayer. The question presented is whether both disability benefits reserves are life insurance reserves as that term is defined by section 801(b) of the Code.

LAW AND ANALYSIS

Section 801(b)(1) of the Code provides as follows:

> (b) Life Insurance Reserves Defined.—
>
> (1) In General.—For purposes of this part, the term "life insurance reserves" means amounts—
>
> (A) which are computed or estimated on the basis of recognized mortality or morbidity tables and assumed rates of interest, and
>
> (B) which are set aside to mature or liquidate, either by payment or reinsurance, future unaccrued claims arising from life insurance, annuity and noncancellable health and accident insurance contracts . . . involving, at the time with respect to which the reserve is computed, life, health, or accident contingencies.

Section 801(b)(2) of the Code provides that, with exceptions not here pertinent, life insurance reserves must also be required by law.

As early as 1942, Congress indicated that cancellable and noncancellable health and accident insurance were to be accorded different treatment for income tax purposes. Because cancellable health and accident insurance does not entail long-term risks but noncancellable health and accident insurance does, Congress recognized that the noncancellable long-term risk variety was more like life insurance and that a company issuing such contracts would have to have a reserve in addition to the unearned premiums in order to provide for the increasing actuarial risk under such contracts. It also provided for unearned premiums and unpaid losses on noncancellable health and accident insurance to be in the numerator of the qualification fraction under section 801(a) of the Code to insure that insurance companies engaged primarily in this type of business could qualify as life insurance companies for federal income tax purposes. S. Rep. No. 1631, 77th Cong., 2d Sess. 145-49 (1942), 1942-2 C.B. 504; H.R. Rep. No. 2333, 77th Cong., 2d Sess. 109-12 (1942), 1942-2 C.B. 372.

Section 1.801-2(c) of the Income Tax Regulations provides that:

> The term "noncancellable life, health, or accident insurance policy" means a health and accident contract, or a health and accident contract combined with a life insurance or annuity contract, which the insurance company is under an obligation to renew or continue at a specified premium and with respect to which a reserve in addition to the unearned premium (as defined in paragraph (e) of this section) must be carried to cover that obligation. Such a health and accident contract shall be considered noncancellable even though it states a termination date at a stipulated age, if, with respect to the health and accident contract, such age termination date is 60 or over.

Section 1.801-3(d) of the regulations describes a guaranteed renewable life, health, and accident insurance policy as a policy that is not cancellable by the company but under which the company reserves the right to adjust premium rates by classes in accordance with its experience under the type of policy involved and with respect to which a reserve in addition to the unearned premiums must be carried. In accordance with section 801(e) of the Code, guaranteed renewable policies are treated in the same manner as noncancellable life, health, and accident insurance policies.

In *United Benefit Life Insurance Company v. McCrory*, 414 F.2d 928 (8th Cir. 1969), the court held that reserves set aside by a taxpayer for the payment of claims for permanent and total disability under policies not arising from noncancellable health and accident insurance contracts cannot qualify as life insurance reserves.

The type of policy described in this revenue ruling may be terminated at any time by the insurance company upon written notice to the named insured. This policy is not, therefore, a noncancellable health and accident policy or guaranteed renewable policy within the meaning of sections 1.801-3(c) and (d) of the regulations because the taxpayer is not under an obligation to renew or continue the policy either at a specified premium or premium rates adjusted by classes and does not have to maintain a reserve in addition to the unearned premiums. *See Group Life & Health Ins. Co. v. United States*, 434 F.2d 115 (5th Cir. 1970).

HOLDING

The disability reserves set aside under 1-year group life insurance policies, which provide both disability and term life insurance benefits, do not qualify as life insurance reserves under section 801(b) of the Code.

EFFECT ON OTHER REVENUE RULINGS

In Rev. Rul. 70-190, 1970-1 C.B. 150, the Service concluded that a reserve for payment of disability benefits established after the disability claim has been incurred and approved qualifies as a life insurance reserve under section 801(b) of the Code. The facts in that ruling indicated that the disability reserve was established from premiums on contracts providing both ordinary life and disability benefits without specifying that the latter benefits were being provided under contracts that were noncancellable. Rev. Rul. 70-190 is clarified by stating that the health and accident benefits provided in combination with ordinary life insurance under the contracts described therein were, in effect, noncancellable.

Section 806.—Certain Changes in Reserves and Assets

26 CFR 1.806-4: Change in basis in computing reserves.

Proper tax treatment to be accorded life insurance reserves where a transferor life insurance company had previously elected to revalue such reserves under section 818(c)(2) of the Code when it merged into another life insurance company that had not made a section 818(c) election. See Rev. Rul. 80-117, page 15.

Section 810.—Rules for Certain Reserves

26 CFR 1.810-3: Adjustment for change in computing reserves.

Proper tax treatment to be accorded life insurance reserves where a transferor life insurance company had previously elected to revalue such reserves under section 818(c)(2) of the Code when it merged into another life insurance company that had not made a section 818(c) election. See Rev. Rul. 80-117, page 15.

Section 818.—Accounting Provisions

26 CFR 1.818-4: Election with respect to life insurance reserves computed on preliminary term basis.
(Also Sections 381, 481; 1.381(c)(4)-1, 1.481-1.)

Life insurance companies; merger; revaluation of reserves. A life insurance company that had elected under section 818(c) of the Code to revalue its reserves on the approximate revaluation basis acquired, in a statutory merger, another life insurance company that had smaller reserves computed on a preliminary term basis. The acquiring company is not entitled to an adjustment under section 481 by reason of the required revaluation of the acquired reserves.

Rev. Rul. 80-116

Advice has been requested whether *S*, a life insurance company, as the surviving company in a statutory merger of two stock life insurance companies, is entitled to an adjustment under section 481 of the Internal Revenue Code by reason of the revaluation of reserves of the acquired insurance company under the circumstances described below.

In its Federal income tax return for the taxable year 1961, *S*, a life insurance company taxable under section 802 of the Code, elected, pursuant to section 818(c), to revalue its life insurance reserves, previously computed on a preliminary term basis, using the approximate revaluation basis prescribed by section 818(c)(2). The taxpayer has computed its life insurance reserves on the approximate revaluation basis since 1961.

R, also a life insurance company taxable under section 802 of the Code, was incorporated and commenced business in 1958. *R* has made no election under section 818(c) to revalue its reserves that were computed on the preliminary term basis.

On July 1, 1976, *R* was merged into *S*, pursuant to the requirements of the state insurance code, in a statutory merger as defined in section 368(a)(1)(A) of the Code. The amount of life insurance reserves of *S*, computed on the approximate revaluation method, was substantially greater than the amount of life insurance reserves of *R*, computed on a preliminary term basis. At all times subsequent to the merger, *S*, the successor life insurance company, has continued to be taxable under section 802.

Section 381(c)(22) of the Code provides, in part, that in the case of a tax-free merger when the surviving corporation is a life insurance company, certain items of the distributor or transferor corporation are required to be taken into account by the transferee in accordance with the Commissioner's regulations. Section 1.381(c)(22)-1(a) of the Income Tax Regulations provides that the acquiring corporation shall take into account the reserves described in section 810(c) distributed or transferred to it as of the close of the date of distribution or transfer by the distributor or transferor corporation in accordance with the provisions of section 381(c)(4) and the regulations thereunder.

Section 810(c) of the Code lists certain items that are to be taken into account under section 810(a) or (b). Section 810(a) and (b) provide that the difference in the sum of section 810(c) items at the beginning of the year and the sum of 810(c) items at the close of the taxable year (reduced by the amount of investment yield not included in gain or loss from operations for the taxable year by reason of section 809(a)(1)) shall be taken into account as a net decrease under section 809(c)(2) or a net increase under section 809(d)(2), as the case may be.

Rev. Rul. 72-344, 1972-2 C.B. 218, holds that the acquiring life insurance company should, under section 381(c)(22) of the Code, add at the date of transfer from its subsidiary life insurance company that was liquidated under section 332, the dollar balances of the transferred section 810(c) items, as of the close of the day of transfer, to the opening balances of its own section 810(c) items. Further, the difference between that sum and the acquiring life insurance company's closing balances of all section 810(c) items shall be taken into account by the acquiring company under section 809(c)(2) or (d)(2), as the case may be, in computing its gain or loss for its first taxable year ending after the date of distribution or transfer.

Section 818(c) of the Code permits a life insurance company issuing contracts with respect to which the life insurance reserves are computed on one of the recognized preliminary term bases to elect to revalue such reserves, on a net level premium basis for the purposes of determining the amount that may be taken into account as life insurance reserves for purposes of Part I, Subchapter L, Chapter 1 of the Code, other than section 801. If such an election is made, the basis to be used in making this revaluation of reserves shall be made on either the exact revaluation basis under section 818(c)(1) or the approximate revaluation basis under section 818(c)(2). If an election is made to use either the exact or the approximate basis of revaluing the life insurance reserves, the basis adopted by a life insurance company shall be adhered to in making the computations under Part I, Subchapter L, Chapter 1 of the Code (other than section 801) for the taxable year and all subsequent taxable years unless a change in the basis of computing such reserves is approved by the Commissioner.

Section 1.818-4(d)(2) of the regulations states, in part, that for any taxable year other than the first taxable year for which the election is made under section 818(c) of the Code, a company making such election must revalue all its life insurance reserves held with respect to contracts, for which such reserves are computed on a preliminary term basis at the beginning of the taxable year, on the basis elected under section 818(c). Further, section 1.810-2(c)(3) provides that, for purposes of determining the increase or decrease in reserves under section 810(a) and (b), if a company that computes its life insurance reserves on a preliminary term basis elects to revalue such reserves on a net level premium basis under section 818(c), the sum of such reserves at the beginning and end of all taxable years (including the first taxable year) for which the election applies shall be the sum of such reserves computed on such net level premium basis.

Section 1.381(c)(4)-1 of the regulation provides, in part, that the acquiring corporation shall use the method of accounting used by the distributor or transferor corporation on the date of distribution or transfer unless different methods of accounting were used by the distributor or transferor corporation and the acquiring corporation. If different methods of accounting were used, the acquiring corporation shall use the principal method of accounting. The principal method of accounting can be determined by comparing the dollar balances in each corporation's reserve account. The method of accounting of the party having the largest amount is, under section 1.381(c)(4)-1(c)(2)(iv), deemed to be the principal method. Section 1.381(c)(4)-1(a)(1)(ii) provides, in part, that if adjustments are necessary to reflect a change in accounting method, pursuant to section 381 of the Code, the manner in which they are to be taken into account and the tax attributable thereto shall be determined and computed under section 481 of the Code and regulations thereunder subject to the rules provided in section 1.381(c)(4)-1(c) and (d).

Section 481(a) of the Code provides, in part, that in computing the taxpayer's taxable income for the taxable year, if the computation is under a method of accounting different from the method under which the taxpayer's taxable income for the preceding taxable year was computed, then there shall be taken into account those adjustments that are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted.

Since the amount of life insurance reserves of *S* computed on the approximate revaluation method at the time of the statutory merger was substantially greater than the life insurance reserves of *R*, *S*'s basis of computing life insurance reserves is considered the principal method of accounting for computing such reserves. Thus, *S* was correct to continue such basis with respect to its life insurance reserves and also to use such basis in computing the life insurance reserves acquired from *R* in the merger.

In view of the above, *S* is required to revalue, as of July 1, 1976, the preliminary term reserves acquired from *R* in the merger to the net level premium basis under section 818(c) of the Code, using the approximate method of valuation prescribed in section 818(c)(2). For purposes of its section 810(a) or (b) adjustments for the increase or decrease in section 810(c) items, *S* must add to its own opening reserves the revalued life insurance reserves attributable to those contracts acquired from *R* as of July 1. The difference between the sum of *S*'s opening life insurance reserve balance, which includes those reserves attributable to *R*'s contracts, and the opening balances of all other section 810(c) items, and *S*'s closing balances of all section 810(c) items shall be taken into account by *S* under section 809(c)(2) or (d)(2), as the case may be, in computing its gain or loss for the taxable year 1976, the first taxable year ending after the date of distribution or transfer.

Further, *S* is not allowed to make a section 481 adjustment because the duplication or omission section 481 of the Code is designed to correct is not present under a section 818(c) election. Section 810(d)(3) and section 1.810-3(e)(1) of the regulations specifically provide that an election pursuant to section 818(c) is not to be considered a change in basis within the meaning of section 810(d)(1) that would require a 10-year spread of any adjusting item, similar to the 10-year spread set forth in Rev. Proc. 70-27, 1970-2 C.B. 509. The only adjustment required by reason of an election under section 818(c) is that provided by section 1.810-2(c)(3), which provides that for purposes of determining the increase or decrease in reserves, all reserves at both the beginning and the end of the taxable year in which the election under section 818(c) is made shall be computed on the net level premium basis. The difference between the reserves at the end of the previous taxable year, which were valued on the preliminary term basis, and the reserves at the beginning of the taxable year of the election, which were revalued on the net level premium basis pursuant to the section 818(c) election, is not reflected as a deduction in the year of the election or any subsequent taxable year. See example (1) of section 1.813-3(f) of the regulations. Thus, by revaluing reserves acquired in the merger under section 818(c) election, there is no duplication or omission of income or deductions of the type that would require a section 481 adjustment.

Accordingly, *S* is not entitled to an adjustment under section 481 of the Code by reason of the revaluation of reserves of the acquired insurance company pursuant to an election under section 818(c).

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26 CFR 1.818-4: Election with respect to life insurance reserves computed on preliminary term basis.
(Also Sections 381, 806, 810; 1.381(c)(4)-1, 1.806-4, 1.810-3.)

Life insurance companies; merger; revaluation of reserves. In a statutory merger, a life insurance company that computed its reserves on a preliminary term basis acquired another life insurance company that had smaller reserves, which it had elected under section 818(c) of the Code to revalue on the approximate revaluation basis. The revaluation of the acquired reserves on the preliminary term basis is a change in the basis for computing the reserves, and the resulting adjustment is subject to the 10-year spread rule of section 810(d)(1).

Rev. Rul. 80-117

Advice has been requested concerning the proper tax treatment of life insurance reserves that a transferor life insurance company (*M*) had elected to revalue under section 818(c)(2) of the Internal Revenue Code prior to the company's merger into another life insurance company (*R*) that had not made a section 818(c) election for the same type of reserves.

Prior to its merger into *R*, *M* elected, for federal income tax purposes, to revalue its life insurance reserves that were computed on a preliminary term basis using the approximate revaluation method under section 818(c)(2) of the Code. The merger, which occurred on October 31, 1976, qualified as a reorganization under section 368(a)(1)(A). Both *M* and *R* qualified as a life insurance company taxable under section 802 at the time of the merger. As of October 31, 1976, the life insurance reserves of *R*, computed on a preliminary term basis, were greater than the life insurance reserves of *M*. *R* has never made an election to revalue its preliminary term reserves under section 818(c).

In reliance upon the "principal method of accounting" requirements of section 381(c)(4) of the Code and section 1.381(c)(4)-1 of the Income Tax Regulations, *R* changed the method used by *M* in computing its life insurance reserves to conform to *R*'s method of computing life insurance reserves on the preliminary term basis.

The specific issue is what is the proper manner to take into account the difference, as of the date of the merger, between *M*'s life insurance reserves determined on the approximate revaluation basis under section 818(c) of the Code and as computed on a preliminary term basis.

Section 381(c)(22) of the Code provides that if the acquiring corporation is an insurance company taxable under subchapter L, there shall be taken into account (to the extent proper to carry out the purposes of section 381 and of subchapter L, and under such regulations as may be prescribed by the Secretary) the items required to be taken into account for purposes of subchapter L in respect of the distributor or transferor corporation.

Section 1.381(c)(22)-1(a) of the regulations provides that among the items to be taken into account by the acquiring corporation are the reserves described in section 810(c) of the Code distributed or transferred to it as of the close of the date of distribution or transfer by the distributor or transferor corporation in accordance with the provisions of section 381(c)(4) and the regulations thereunder.

Section 810(c) of the Code lists certain items (including life insurance reserves) that are to be taken into account under section 810(a) or (b). Section 810(a) and (b) provide that the difference in the sum of the section 810(c) items at the beginning of the year and the sum of the section 810(c) items at the close of the taxable year (reduced by the amount of investment yield not included in gain or loss from operations for the taxable year by reason of section 809(a)(1)) shall be taken into account as a net decrease under section 809(c)(2) or a net increase under section 809(d)(2), as the case may be.

In Rev. Rul. 72-344, 1972-2 C.B. 218, a life insurance company, wholly owned by another life insurance company, was liquidated under section 332 of the Code. The issue there was how the parent should treat the section 810(c) items acquired from the subsidiary for purposes of section 381. Rev. Rul. 72-344 holds that the acquiring life insurance company should add, at the date of transfer, the dollar balances of the transferred section 810 (c) items, as of the close of the day of transfer, to the opening balance of its section 810(c) items. It further holds that the difference between the above described sum and the acquiring life insurance company's closing balances of all section 810(c) items shall be taken into account by the acquiring company under section 809(c)(2) or section 809(d)(2), as the case may be, in computing its gain or loss for the first taxable year ending after the date of distribution or transfer.

The principles stated in Rev. Rul. 72-344 are applicable in the instant revenue ruling. Thus, *R* must add the dollar balances of the section 810(c) items acquired from *M*, as of the close of the day of transfer, to the opening balances of *R*'s own section 810(c) items for purposes of section 810(a) or (b). A problem arises, however, because *R* valued its life insurance reserves on a preliminary term basis, but prior to the merger *M*, the acquired corporation, revalued its reserves on the approximate revaluation basis pursuant to a section 818(c)(2) election.

Section 806(b) of the Code provides that, for purposes of subpart B, if the basis for section 810(c) items at the end of the taxable year differs from the basis at the beginning of the taxable year, the old basis shall be used as of the close of the taxable year and the new basis shall be used as of the beginning of the next taxable year.

Thus, for purposes of determining taxable investment income, the old basis will continue to be used for the entire year in which the change in basis occurs. Section 806(b) is applicable in the instant situation because the basis for determining the life insurance reserves of *M* by *R* as of December 31, 1976, was preliminary term (as a result of conformance to the principal method of accounting of *R*), while the basis for determining the life insurance reserves as of January 1, 1976, was the approximate revaluation basis (pursuant to previous election by *M* under section 818(c)(2)).

In determining a life insurance company's gain from operations, section 809(d)(2) of the Code provides a deduction for the net increase in reserves required by section 810 to be taken into account in the determination of gain from operations. Section 810(b) requires that the excess of section 810(c) items at the close of the taxable year over section 810(c) items at the beginning of the taxable year shall be taken into account as a net increase referred to in section 801 (d)(2). Thus, together, section 809 (d)(2) and section 810(b) provide the general rule that a net increase in the life insurance reserves shall be taken into account in full in the year the increase occurs.

Section 810(d)(1) of the Code and section 1.810-3(a) of the regulations, however, provide an exception to this general rule. Section 810(d)(1) and section 1.810-3(a) provide that if the basis for determining any item referred to in section 810(c) at the end of the taxable year differs from the basis for such determination at the end of the preceding taxable year, then so much of the difference between the amount of the item at the end of the taxable year, computed on the new basis, and the amount of the item at the end of the taxable year, computed on the old basis, as is attributable to contracts issued before the taxable year, shall not be included in income or be deductible, as the case may be, under section 810(a) or (b), but rather shall be deductible or includible in income, as the case may be, at a rate of one-tenth for each of the 10 succeeding taxable years.

Section 810(d)(2) and (3) of the Code provides the only exceptions to the 10-year spread rule for the change in basis under section 810(d)(1). Section 810(d)(2) states that:

> Except as provided in section 381 (c)(22) (relating to carryovers in certain corporate readjustments), if for any taxable year the taxpayer is not a life insurance company, the balance of any readjustments under this paragraph shall be taken into account for the preceding taxable year.

Under section 810(d)(3) of the Code an election to revalue preliminary term reserves under section 818 (c), is not treated as a change in basis in computing reserves for purposes of section 810(d)(1).

In the instant situation, as a result of the merger and the application of the "principal method of accounting" concept in section 1.381(c)(4)-1 of the regulations, the section 818(c) election previously in effect is revoked. Revocation of the section 818(c) election requires a revaluation of life insurance reserves from the approximate revaluation basis to a preliminary term basis. Such a change in basis comes within the meaning of section 810(d) (1), and thus, is subject to the 10-year spread rule. The section 810(d) (2) exception cannot apply because the merger comes within the carryover provisions of section 381(c)(22). Similarly, section 810(d)(3) cannot apply because a section 818(c) election is no longer in effect. Thus, the revocation is a change in basis, and the adjustment created thereby is subject to a 10-year spread under section 810(d)(1).

The adjustment created by the change in basis in computing life insurance reserves is controlled by section 810(d)(1) of the Code because it is the result of a change in basis for determining a section 810(c) reserve. Thus, there is no need for section 481 to apply. The distortion that an allocation under section 481 seeks to avoid is likewise avoided under section 810(d). Compare Rev. Rul. 80-116, page , this Bulletin, holding that the surviving life insurance company in a statutory merger is not entitled to an adjustment under section 481 by reason of the revaluation of preliminary term reserves of the acquired life insurance company pursuant to an election under section 818(c).

Accordingly, the life insurance reserves acquired by *R* from *M* in the merger were properly revalued to a preliminary term basis pursuant to the principal method of accounting requirements of section 1.381(c)(4)-1 of the regulations. Such revaluation to a preliminary term method of computing life insurance reserves is a change in basis in computing reserves within the meaning of section 806(b) and section 810(d) of the Code.

Section 901.—Taxes of Foreign Countries and of Possessions of United States

26 CFR 1.901-1: Allowance of credit for taxes.

A procedure for partnerships having a partner who is a United States citizen and resident of France to follow in making an election under Article 23(3)(c) of the United States-France Income Tax Convention, 1968-2 C.B. 691, as amended by the Protocol of November 24, 1978, 1979-51 I.R.B. 17, whereby a certain portion of such partner's United States-source income will be deemed to be French-source income. See Rev. Proc. 80-16, page 29.

Section 904.—Limitation on Credit

26 CFR 1.904-1: Limitation of credit for foreign taxes.

A procedure for partnerships having a partner who is a United States citizen and resident of France to follow in making an election under Article 23(3)(c) of the United States-France Income Tax Convention, 1968-2 C.B. 691, as amended by the Protocol of November 24, 1978, 1979-51 I.R.B. 17, whereby a certain portion of such partner's United States-source income will be deemed to be French-source income. See Rev. Proc. 80-16, page 29.

Section 911.—Income Earned by Individuals in Certain Camps

26 CFR 5b.911-1: Individuals qualifying for exclusion.

A procedure for partnerships having a partner who is a United States citizen and resident of France to follow in making an election under Article 23(3)(c) of the United States-France Income Tax Convention, 1968-2 C.B. 691, as amended by the Protocol of November 24, 1978, 1979-51 I.R.B. 17, whereby a certain portion of such partner's United States-source income will be deemed to be French-source income. See Rev. Proc. 80-16, page 29.

Section 913.—Deduction for Certain Expenses of Living Abroad

26 CFR 5b.913-1: Deduction for certain expenses of living abroad.

A procedure for partnerships having a partner who is a United States citizen and resident of France to follow in making an election under Article 23(3)(c) of the United States-France Income Tax Convention, 1968-2 C.B. 691, as amended by the Protocol of November 24, 1978, 1979-51 I.R.B. 17, whereby a certain portion of such partner's United States-source income will be deemed to be French-source income. See Rev. Proc. 80-16, page 29.

Section 3402.—Submission of Copies of Certain Withholding Exemption Certificates to the Internal Revenue Service

26 CFR 31.3402(f)(2)-1: Withholding exemption certificates.

T.D 7682

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 31.—EMPLOYMENT TAXES; APPLICABLE ON AND AFTER JANUARY 1, 1955

Submission of copies of certain withholding exemption certificates to the Internal Revenue Service.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final Employment Tax Regulations which require employers to submit copies of certain employee withholding exemption certificates to the Internal Revenue Service. The final regulations reflect several changes in the position of the Internal Revenue Service with respect to required submission of copies of these certificates and provide the public with needed guidance.

DATES: The amendments are effective with respect to withholding exemption certificates received by an employer on or after April 1, 1980.

FOR FURTHER INFORMATION CONTACT: William E. Mantie of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3459.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On October 9, 1979, the Federal Register published proposed amendments to the Employment Tax Regulations (26 CFR Part 31) under sections 3401 and 3402 of the Internal Revenue Code of 1954 (44 FR 57940). The amendments were proposed in order to set forth the circumstances under which employers must submit copies of employee withholding exemption certificates to the Internal Revenue Service. After consideration of all comments received in response to the notice of proposed rulemaking and at a public hearing held on January 4, 1980, amendments to the regulations are adopted as set forth in this Treasury decision.

EXPLANATION OF PROVISIONS

The notice of proposed rulemaking provided for submission of a copy of a withholding exemption certificate if the total number of withholding exemptions claimed on the certificate exceeded 9 or if the certificate indicated that the employee was claiming a status exempting him from withholding. Some employers that employ part-time employees, such as students, which tend to have a high rate of turn-over and which often claim a status exempting them from withholding, expressed concern about the administrative burdens of submitting copies of all exempt status certificates as required by the proposed regulation. In response to this concern, the proposed requirement is modified by this Treasury decision to provide that a copy of the withholding exemption certificate that indicates the employee is claiming a status of exemption from withholding is not required to be submitted if, at the time the certificate is received, it is reasonably expected that the employee's wages from that employer will not then usually exceed $200 per week. It is felt that this change will alleviate some of the burdens that the proposed regulation would have imposed on employers.

A number of persons suggested that the proposed amendments be modified to require submission of certificates only when the number of withholding exemptions claimed on the certificate exceeded a specified number for the employee's wage bracket. The requirement that employers submit copies of certain withholding exemption certificates was proposed to improve the ability of the Internal Revenue Service to monitor compliance in the withholding area while keeping the burdens placed on employers as small as possible. It has been concluded that more sophisticated criteria, such as the graduated submission suggestion described in this paragraph, would impose an excessive burden on many employers and have therefore been rejected.

A number of persons submitting comments expressed concern about the recordkeeping burdens that would be imposed on employers under the requirement of the proposed regulation that copies of certificates received after October 9, 1979, be submitted.

In order to alleviate this burden, the proposed requirement is modified by this Treasury decision to provide for submission only of copies received on or after April 1, 1980.

Evaluation of the effectiveness of these regulations will be based on comments received from members of Congress, offices within Treasury and the Internal Revenue Service, other governmental agencies, State and local governments, and the public. These regulations will impose new reporting and recordkeeping requirements which are necessary for more effective administration and collection of income taxes withheld from an employee's wages on the basis of the withholding exemption certificate.

DRAFTING INFORMATION

The principal author of these regulations is William E. Mantle of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

The Employment Tax Regulations (26 CFR Part 31) are amended as follows:

Paragraph 1. Section 31.3401(e)-1(b) (relating to number of withholding exemptions claimed) is amended by deleting the last two sentences and inserting in lieu thereof the following new sentence:

§ 31.3401(e)-1 Number of withholding exemptions claimed.

* * * * *

(b) * * * For rules relating to invalid withholding exemption certificates, see § 31.3402(f)(2)-1(e), and for rules relating to required submission of copies of certain withholding exemption certificates to the Internal Revenue Service, see § 31.3402(f)(2)-1(g).

* * * * *

Par. 2. Section 31.3402(f)(2)-1 (relating to withholding exemption certificates) is amended by deleting the last two sentences of paragraph (e) and inserting in lieu thereof the following new sentence, and by adding the following new paragraph (g) immediately after paragraph (f):

§ 31.3402(f)(2)-1 Withholding exemption certificates.

* * * * *

(e) *Invalid withholding exemption certificates.* * * * This paragraph applies only with respect to withholding exemption certificates received by any employer after July 26, 1976.

* * * * *

(g) *Submission of certain withholding certificates*—(1) *General rule.* An employer shall submit, in accordance with paragraph (g)(3) of this section, a copy of any withholding exemption certificate which is received from the employee during the reporting period (without regard to the date it is effective) if the employee is employed by that employer on the last day of the reporting period and if—

(i) The total number of withholding exemptions (within the meaning of section 3402(f)(1) and the regulations thereunder) claimed on the certificate exceeds 9, or

(ii) The certificate indicates that the employee claims a status exempting the employee from withholding, and the exception provided by paragraph (g)(2) of this section does not apply.

(2) *Exception.* A copy of the certificate shall not be submitted under paragraph (g)(1)(ii) of this section if the employer reasonably expects, at the time the certificate is received, that the employee's wages (under chapter 24 of the Code) from that employer shall not then usually exceed $200 per week.

(3) *Rules for submission*—(i) *In general.* The reporting period is a calendar quarter. Copies required to be submitted under paragraph (g)(1) of this section shall be submitted at the time and place of filing Form 941 or 941E for the reporting period, or Form 941-M for the last month of the reporting period. Form 941, 941E, or 941-M shall be used, in accordance with the instructions for the form, to transmit the copies.

(ii) *Option.* At the choice of the employer, copies required to be submitted under paragraph (g)(1) of this section may be submitted earlier and for shorter reporting periods than a calendar quarter. In such case, the employer shall submit the copies to the service center where the employer would file a Form 941 or 941E and shall include with the submission a statement showing the employer's name, address, employer identification number, and the number of copies of withholding exemption certificates submitted. However, in no event shall a copy be submitted later than the time for filing the report required to be submitted for the calendar quarter reporting period under subdivision (i) of this paragraph (g)(3).

(iii) *First report.* The first submission of copies shall include a copy of any certificate required to be submitted under paragraph (g)(1) of this section which is received by the employer on or after April 1, 1980.

(4) *Other withholding exemption certificates.* An employer shall also submit a copy of any currently effective withholding exemption certificate (or make the original certificate available for inspection) upon written request of the Internal Revenue Service.

(5) *Computation of withholding.* Until receipt of written notice from the Internal Revenue Service that a certificate, a copy of which was submited under this section, is defective, that certificate is effective and the employer shall withhold on the basis of the statements made in that certificate. If the Internal Revenue Service finds that a copy of a withholding exemption certificate submitted con-

tains any materially incorrect statement or if, after written request to the employee for verification of the statements on the certificate, the Internal Revenue Service determines that it lacks sufficient information to determine if the certificate is correct, and in either event so notifies the employer in writing, the employer shall then consider the certificate to be defective for purposes of computing amounts of withholding. The employer shall promptly furnish the employee who filed the defective certificate, if still in his employ, with a copy of the written notice of the Internal Revenue Service with respect to the certificate and may request another withholding exemption certificate from the employee. The employer shall withhold amounts from the employee as if the employee were a single person claiming no exemptions (see § 31.3402(f)(2)-1(a)) until a new certificate is filed. If and when the employee does file a new certificate the employer shall withhold on the basis of that new certificate as currently effective, but must submit a copy of that new certificate if required by, and in accordance with, this paragraph (g).

(6) *Definition of employer.* For purposes of this paragraph (g), the term "employer" includes any individual authorized by the employer to receive withholding exemption certificates, to make withholding computations, or to make payroll distributions.

Par. 3. Section 31.3402(n)-1 (relating to employees incurring no income tax liability) is amended by deleting the last two sentences immediately before example (1) and inserting in lieu thereof the following new sentence:

§ 31.3402(n)-1 Employees incurring no income tax liability.

* * * For rules relating to invalid withholding exemption certificates, see § 31.3402(f)(2)-1(e), and for rules relating to submission to the Internal Revenue Service of withholding exemption certificates claiming a complete exemption from withholding, see § 31.3402(f)(2)-1(g). * * *

This Treasury decision is issued under the authority contained in sections 6001, 6011, and 7805 of the Internal Revenue Code of 1954 (68A Stat. 731; 26 U.S.C. 6001; 68A Stat. 732; 26 U.S.C. 6011; 68A Stat. 917; 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved February 28, 1980.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on March 10, 1980, 8:45 a.m., and published in the issue of the Federal Register for March 11, 1980, 45 F.R. 15525)

Section 4221.—Certain Tax-free Sales

26 CFR 48.4221-2: Tax-free sale of articles to be used for, or resold for, further manufacture.

T.D. 7681

TITLE 26.—INTERNAL REVENUE,—CHAPTER 1, SUBCHAPTER D, PART 48.—MANUFACTURERS AND RETAILERS EXCISE TAXES

Certain tax-free sales by manufacturers.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the availability of a refund or credit on certain articles described in section 4221(a)(1) of the Code. These regulations provide necessary guidance to the public for compliance with the law, and affect both original and subsequent manufacturers of these articles.

DATE: The regulations are effective for sales made after December 31, 1958.

FOR FURTHER INFORMATION CONTACT: Kyllikki Kusma of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention CC:LR:T:LR-116-79, 202-566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

The regulations at § 48.4221-2(c)(1) currently make a cross reference to section 6416(b)(3)(A). This is an erroneous cross reference which has led to confusion among manufacturers as to the availability of a refund or credit on certain articles described in section 4221(a)(1). These regulations delete the incorrect cross reference and clarify that a refund or credit is available to only one manufacturer with respect to taxes paid on an article. Because this regulation is non-substantive and essentially procedural, it is found unnecessary to issue this Treasury decision with notice and public procedure. For the same reasons, this regulation is not a significant regulation under paragraph 8 of the Treasury Directive appearing in the Federal Register for November 8, 1978 (43 F.R. 52120).

DRAFTING INFORMATION

The principal author of this regulation was Kyllikki Kusma of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations:

Accordingly, 26 CFR Part 48 is amended as follows:

Paragraph. Section 48.4221-2(c)(1) is revised to read as follows:

§ 48.4221-2 Tax-free sale of articles to be used for, or resold for, further manufacture.

* * * * *

(c) *Proof of resale for further manufacture*—(1) *Cessation of exemption.* The exemption provided in section 4221(a)(1) and described in paragraph (a) of this section in respect of an article sold by the manufacturer to a purchaser for resale to a second purchaser for use by the second purchaser in further manufacture shall cease to apply on the first day following the close of the 6-month period which begins on the date of the sale of such article by the manufacturer, or the date of shpiment of the article by the manufacturer, whichever is earlier, unless, within such 6-month period, the manufacturer receives proof, in the form prescribed by paragraph (c)(2) of this section, that the article was actually resold by the purchaser to a second purchaser for such use. If, on the first day following the close of the 6-month period, such proof has not been received, the manufacturer shall become liable for tax at that time at the rate in effect when the sale was made but otherwise in the same manner as if the article had been sold by it on such first day at a taxable price equivalent to that at which the article was actually sold. If the manufacturer later obtains such proof, it may file a claim for refund or credit of this tax. The payment of this tax by the manufacturer is not considered an overpayment by the subsequent manufacturer or producer for which the subsequent manufacturer or producer is entitled to a credit or refund under section 6416(b)(3). See section 4221(d)(6) and paragraph (b) of this section for the circumstances under which an article is considered to have been sold for use in further manufacture.

* * * * *

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved February 20, 1980.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on February 29, 1980, 8:45 a.m., and published in the issue of the Federal Register for March 3, 1980, 45 F.R. 13728)

Section 4940.—Excise Tax Based on Investment Income

26 CFR 53.4940-1: Excise tax on net investment income.

Private foundation; gross investment income; interest on U.S. savings bonds. A private foundation derived interest income upon redemption of Series E U.S. savings bonds that were received from the estate of the purchaser. The interest is includible in the computation of gross investment income under section 4940(c)(2) of the Code if neither the individual nor the estate elected to report as income the periodic increases in bond value.

Rev. Rul. 80-118

ISSUE

Under the circumstances described below, is the interest income derived by a private foundation upon redemption of Series E United States savings bonds received from an estate included in the computation of gross investment income under section 4940(c)(2) of the Internal Revenue Code?

FACTS

The Series E bonds were distributed to a private foundation described in section 509(a) of the Code from the estate of the individual who purchased the bonds. Neither the individual nor the estate elected under section 454 to report the periodic increase in value of the bonds as income.

LAW AND ANALYSIS

Section 4940(a) of the Code imposes on each private foundation exempt from taxation under section 501(a) a tax equal to 2 percent of the net investment income of such foundation for the taxable year.

Section 4940(c)(1) of the Code and section 53.4940-1(c) of the Foundation Excise Tax Regulations provide that net investment income is the amount by which the sum of the gross investment income and the net capital gain exceeds the deductions allowed by section 4940(c)(3). Unless inconsistent with the provisions of section 4940, net investment income shall be determined under the principles of subtitle A.

Section 4940(c)(2) of the Code and section 53.4940-1(d)(1) of the regulations provide that the term "gross investment income" means the gross amount of income from interest, dividends, rents, and royalties, but not including any such income to the extent included in computing the tax imposed by section 511.

Section 53.4940-1(d)(2) of the regulations provides, in part, that in the case of a distribution from an estate, such distribution shall not retain its character in the hands of the distributee for purposes of computing the tax under section 4940 of the Code.

Section 53.4940-1(d)(2) of the regulations generally allows income derived by an estate to be disregarded by a distibutee private foundation for purposes of section 4940 of the Code. Thus, investment income received by and taxed to an estate is not again taxed, by virtue of section 4940, when it is received by a private foundation. This section of the regulations, however, is applicable only to the income of an estate that is subsequently distributed to a private foundation.

In this case, no part of the periodic increase in the value of the Series E bonds was reported as income by the estate. When the private foundation received the bonds from the estate, it did not receive a distribution of income of the estate. What the estate received from the decedent and ultimately distributed to the foundation was the right to receive income upon redemption of the bonds. For income tax purposes, such income would be treated as income in respect of a decedent and taxed to the one who actually received it. *See* Rev. Rul. 64-104, 1964-1 (Part 1) C.B. 223. Here, the entire increase in the value of the bonds will be the interest income of the private foundation when it redeems the bonds.

HOLDING

Since the increase in the value of the Series E bonds is not income of an estate that was subsequently distributed to a private foundation, section 53.4940-1(d)(2) of the regulations is inapplicable under the circumstances described above. Accordingly, the interest income derived by the private foundation upon redemption of the Series E bonds received from the estate is included in the computation of gross investment income under section 4940(c)(2) of the Code. Further, all the interest income accrued on the Series E bonds from the date of purchase by the decedent until the date of redemption by the foundation must be included in the computation of gross investment income under section 4940(c)(2).

To determine how the interest accrued on Series E bonds would be treated for purposes of computing adjusted net income under section 4942(f) of the Code, see Rev. Rul. 75-442, 1975-2 C.B. 448.

Section 6012.—Persons Required to Make Returns of Income

26 CFR 1.6012-1: Individuals required to make returns of income.

Requirement that individuals who receive advance payments of earned income credit make a return of income. See T.D. 7683, page 6.

Section 6051.—Receipts for Employees [Information Regarding Wages Paid Employees]

26 CFR 31.6051-1: Statements for employees.

Requirement that employers furnish to employees on Form W-2 the total amount of advance earned income credit payments made to each employee for the calendar year. See T.D. 7683, page 6.

Part III. Administrative, Procedural, and Miscellaneous

Delegation Order No. 57 (Rev. 4) (Effective February 20, 1980)

Notice of Additional Inspection of Taxpayer's Book of Account Under Section 7605(b), Internal Revenue Code of 1954

Pursuant to the provisions of Section 7851(b)(3) of the Internal Revenue Code of 1954, there is hereby delegated to each District Director, Service Center Director, and to the Director of International Operations, the authority to sign in his/her name, after investigation, on the notice to a taxpayer, required by Section 7605(b) of the Internal Revenue Code of 1954, that an additional inspection of such taxpayer's books of account is necessary.

This authority may not be redelegated.

This order supersedes Delegation Order No. 57 (Rev. 3) [1972-2 C.B. 769] issued August 18, 1972.

Jerome Kurtz,
Commissioner.

(Filed by the Office of the Federal Register on February 21, 1980, 8:45 a.m., and published in the issue of the Federal Register for February 22, 1980, 45 F.R. 11972)

Delegation Order No. 97 (Rev. 17) (Effective February 19, 1980)

Closing Agreements Concerning Internal Revenue Tax Liability

Pursuant to authority granted to the Commissioner of Internal Revenue by 26 CFR 301.7121-1(a); Treasury Department Order No. 150-32; Treasury Department Order No. 150-36 [1954-2 C.B. 733]; and Treasury Department Order No. 150-83 [1973-2 C.B. 508], subject to the transfer of authority covered in Treasury Department Order No. 221, as modified by Treasury Department Order No. 221-3 (Rev. 2), as revised, this authority is hereinafter delegated.

1. The Assistant Commissioner (Technical) is hereby authorized in cases under his/her jurisdiction to enter into and approve a written agrement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) in respect to any prospective transactions or completed transactions if the request to the Assistant Commissioner (Technical) for determination or ruling was made before any affected returns have been filed.

2. The Assistant Commissioner (Compliance) is hereby authorized to enter into and approve a written agreement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) for a taxable period or periods ended prior to the date of agreement and related specific items affecting other taxable periods. The Assistant Commissioner (Compliance) is also authorized to enter into and approve a written agreement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) with respect to the performance of his/her functions as the competent authority in the administration of the operating provisions of the tax conventions of the United States.

3. The Assistant Commissioner (Employee Plans and Exempt Organizations) is hereby authorized to enter into and approve a written agreement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) in cases under his/her jurisdiction, that is, in respect of any transaction concerning employee plans or exempt organizations.

4. Regional Commissioners; Regional Directors of Appeals; Assistant Regional Commissioners (Examination); District Directors; Director of International Operations; Chiefs and Associate Chiefs of Appeals Offices, are hereby authorized in cases under their jurisdiction (but excluding cases docketed before the United States Tax Court) to enter into and approve a written agreement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) for a taxable period or periods ended prior to the date of agreement and related specific items affecting other taxable periods.

5. The Assistant Commissioner (Technical); the Assistant Commissioner (Employee Plans and Exempt Organizations); Regional Commissioners; Regional Directors of Appeals; Chiefs and Associate Chiefs of Appeals Offices are hereby authorized in cases under their jurisdiction docketed in the United States Tax Court and in other Tax Court cases upon the request of Chief Counsel or his/her delegate to enter into and approve a written agreement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) but only in respect to related specific items affecting other taxable periods.

6. The Director of International Operations is hereby authorized to enter into and approve a written agreement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) to provide for the mitigation of economic double taxation under section 3 of Revenue Procedure 64-54, C.B. 1964-2, 1008, under Revenue Procedure 72-22, C.B. 1972-1, 747, and under Revenue Procedure 69-13, C.B. 1969-1, 402, and to enter into and approve a written agreement providing the treatment available under Revenue Procedure 65-17, C.B. 1965-1, 833.

7. The authority delegated herein does not include the authority to set aside any closing agreement.

8. Authority delegated in this Order may not be redelegated, except that the Assistant Commissioner (Technical) may redelegate the authority contained in paragraph 1 to the Deputy Assistant Commissioner (Technical) and to the Technical Advisors on the Staff of the Assistant Commissioner (Technical) for cases that do not involve precedent issues, the Assistant Commissioner (Compliance) may redelegate the authority contained in paragraph 2 of this Order to the Deputy Assistant Commissioner (Compliance), and the Assistant Commissioner (Employee Plans and Exempt Organizations) may redelegate the authority

contained in paragraph 3 of this Order to the Deputy Assistant Commissioner (Employee Plans and Exempt Organizations) and to the Technical Advisors on the Staff of the Assistant Commissioner (Employee Plans and Exempt Organizations) for cases that do not involve precedent issues.

9. Delegation Order No. 97 (Rev. 16) [1978-2 C.B. 477], issued October 1, 1978, is hereby superseded.

JEROME KURTZ,
Commissioner.

(Filed by the Office of the Federal Register on February 21, 1980, 8:45 a.m., and published in the issue of the Federal Register for February 22, 1980, 45 F.R. 11973)

Inflation Adjustment for Computation of Windfall Profit Tax

Notice 80-3

Section 4989(b) of the Internal Revenue Code requires the determination of an inflation adjustment factor for use in computing the windfall profit tax.

The Service has determined that, for oil removed during the April-June quarter of 1980, the inflation adjustments are as follows:

Tier 1 or Tier 2 oil	0.0422
Tier 3 oil	0.0527

Worksheets for computation of the windfall profit tax are included in the Instructions for Form 6047, Windfall Profit Tax, and an explanation of the inflation adjustment may be found in the Specific Instructions for Line 4 of the worksheets.

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26 CFR 601.204: Changes in accounting periods and in methods of accounting.
(Also Part I, Sections 446, 471, 481; 1.446-1, 1.471-2, 1.481-1.)

Rev. Proc. 80-5 (Republication)[1]

SECTION 1. PURPOSE AND SCOPE

The purpose of this revenue procedure is to provide a procedure for taxpayers to change their method of accounting for "excess" inventory pursuant to the decision of the Supreme Court of the United States in *Thor Power Tool Co. v. Commissioner,* 439 U.S. 522 (1979), 1979-1 C.B. 167.

This procedure is mandatory for the first taxable year (calendar or fiscal) ending on or after December 25, 1979. See Rev. Rul. 80-60, 1980-10 I.R.B. 5.

SEC. 2. BACKGROUND

.01 In the *Thor Power* case, the taxpayer used the "lower of cost or market" method of valuing inventories for both financial accounting and for income tax purposes. See section 1.471-4 of the Income Tax Regulations. The taxpayer wrote down what it regarded as "excess" inventory to its net realizable value which, in most cases, was determined to be scrap value. The taxpayer determined that these articles were excess inventory because they were held in excess of any reasonably foreseeable future demand although such inventory was not scrapped or sold at reduced prices. The taxpayer retained the excess items in inventory and continued to sell them at original prices. The taxpayer contended that by writing down excess inventory to scrap value, it thereby reduced its inventory to "market" (net realizable value) in accord with its "lower of cost or market" method of accounting. The Commissioner of Internal Revenue disallowed this write-down. (The taxpayer also wrote down the cost of inventory that was either promptly scrapped or actually sold at reduced prices below cost. The Commissioner allowed these write-downs.)

The Supreme Court in *Thor Power* stated that sections 446 and 471 of the Internal Revenue Code vests the Commissioner with wide discretion in determining whether a particular method of inventory accounting should be disallowed as not clearly reflecting income. The Court affirmed the lower court's decision, sustaining the Commissioner, that although the taxpayer's write-down of excess inventory did conform to the best accounting practice in the trade or business and thus satisfied the first test of section 1.471-2(a) of the regulations, it failed to satisfy the second test of section 1.471-2(a), that it clearly reflect the taxpayer's income. The Court stated that where a taxpayer, under the "lower of cost or market" method of accounting, values its inventory for tax purposes at "market" (replacement cost), the taxpayer is permitted to depart from replacement cost only in specified situations described in sections 1.471-2(c) and 1.471-4(b) of the regulations. When such a departure to a lower inventory valuation is made, the regulations require that it be substantiated by objective evidence of actual offerings, sales, or contract cancellations and further require that records of actual dispositions be kept. The Court concluded that because the taxpayer provided no objective evidence of the reduced market value of its excess inventory, its write-down was plainly inconsistent with the regulations and was properly disallowed by the Commissioner. The taxpayer could not have properly taken advantage of any permitted write-downs since it did not scrap its "excess" inventory nor sell or offer it for sale at prices below replacement cost.

.02 The *Thor Power* case affirmed the method of accounting for inventory valuation established under the income tax regulations where the lower of cost or market method is applicable. In using the lower of cost or market method the regulations require a taxpayer having "excess" inventory to value such "excess" inventory at replacement cost (if lower than actual cost as defined in section 1.471-4 of the regulations) unless the goods have been scrapped, or they have been sold or offered for sale (at a lower price) within the meaning of the regulations under section 471 of the Code. (The "prescribed method.")

.03 Although the *Thor Power* case involved a method of inventory write-down that the taxpayer had initiated in the year in question, the Supreme Court's decision clearly applies to a taxpayer that has been consistently taking prohibited inventory write-downs described in the *Thor Power* decision. See *Will-Burt Co. v. Commissioner,* 38 T.C.M. 861 (1979).

.04 Section 446(e) of the Code and section 1.446-1(e)(2)(i) of the regulations state that, except as otherwise provided, a taxpayer must secure the consent of the Commissioner before changing a method of accounting for federal income tax purposes. Section 1.446-1(e)(3)(i) provides, in relevant part, that except as otherwise provided in subdivision (ii), in order to secure the Commissioner's consent, the taxpayer must file an application on Form 3115 with the National Office within 180 days after the beginning of the taxable year in which the taxpayer desires to make the change. Subdivision (ii) provides that notwithstanding subdivision (i), the Commissioner may prescribe administrative procedures, subject to such limitations, terms, and conditions as he deems necessary to obtain his consent, to permit taxpayers to change their accounting methods to an acceptable method consistent with applicable regulations.

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[1] This republication reflects amendments announced in News Release IR-80-48, dated April 8, 1980.

Section 481(a) of the Code provides, in part, that if a taxpayer's taxable income for any taxable year is computed under a method of accounting different from the method used for the preceding taxable year, then there shall be taken into account those adjustments which are determined to be necessary solely by reason of the change in order to prevent amounts from being duplicated or omitted. Section 481(c) provides that in the case of any change described in subsection (a), the taxpayer may, in such manner and subject to such conditions as the Secretary may by regulations prescribe, take the adjustments required by subsection (a)(2) into account in computing the tax for the taxable year or years permitted under such regulations.

SEC. 3. APPLICATION

.01 In accordance with section 1.446-1(e)(3)(ii) of the regulations the 180 day rule is waived and consent is hereby granted taxpayers to change from a method of accounting for inventory valuation of "excess" inventory, that is not in accordance with the "prescribed method," to such "prescribed method." See section 2.02 above. Such consent is granted for the first taxable year ending on or after December 25, 1979, and shall be made in accordance with the provisions of this revenue procedure, including the adjustment under section 481(a) described in section 3.03 below.

.02 Pursuant to the consent granted in section 3.01, a taxpayer that is using a method of accounting for inventory valuation by writing down "excess" inventory in a manner that is not in accordance with the "prescribed method" must change such method of accounting to the "prescribed method" on its federal income tax return for the first taxable year ending on or after December 25, 1979. See Rev. Rul. 80-60.

.03 An adjustment is required to prevent amounts of income from being duplicated or omitted within the meaning of section 481 of the Code and the regulations thereunder when the change in method of accounting is made pursuant to the provisions set forth in this revenue procedure. Such adjustment, whether positive or negative, referred to as the "net section 481(a) adjustment," shall be taken into account as provided in either section 3.04 or section 3.05 below.

.04 (1) The taxpayer may treat the change in method of accounting as a change initiated by the taxpayer. In such case, unless otherwise provided in this revenue procedure, the net section 481(a) adjustment shall be taken into account ratably over a period of taxable years equal to the number of taxable years the taxpayer used a method of accounting where inventory was written down using an impermissible method. This period may not exceed 10 taxable years. In addition, the rules described in sections 3.07, 3.08, and 3.09 apply.

(2) When the entire net amount of an adjustment is attributable to the taxable year immediately preceding the year of change (first preceding year), the total net adjustment will be taken into account in computing taxable income for the year of change. The amount attributable to the taxable year immediately preceding the year of change is the difference in the amount required under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the same change in accounting method had been made in such preceding year.

(3) When 67 percent or more of the net amount of an adjustment is attributable to the 1 taxable year period, 2 taxable year period, or 3 taxable year period immediately preceding the year of change, the highest percent attributable to such 1, 2, or 3 taxable year period will be taken into account ratably over a 3 taxable year period beginning with the year of change. An amount attributable to such 1, 2, or 3 taxable year period is the difference in the amount required under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the same change in accounting method had been made at the beginning of such preceding 1, 2, or 3 taxable year period. Any remaining balance will be taken into account ratably over an additional period equal to the remainder of the number of taxable years the taxpayer has used the accounting method that is being changed. However, the total adjustment period will not exceed 10 taxable years. This paragraph 3.04(3) only applies if the taxpayer has used the method being changed for at least 3 taxable years and the entire amount of the adjustment is not attributable to the taxable year immediately preceding the year of change.

(4) In all other situations the total net adjustment will be taken into account ratably over the number of taxable years (not to exceed 10) the taxpayer has used the accounting method that is being changed.

(5) See section 4 of this revenue procedure for an example of the computation of a net section 481(a) adjustment pursuant to this revenue procedure where the taxpayer elected to treat the change in accounting method as a change initiated by the taxpayer.

.05 The taxpayer may treat the change in method of accounting as a change *not* initiated by the taxpayer within the meaning of section 481(a)(2) of the Code. In such case, the net section 481(a) adjustment, as modified by the "pre-1954 Code years" adjustment described in section 1.481-3 of the regulations, shall be taken into account in the year of change in full; in addition, see section 481(b) for the limitation on tax. See section 4 of this revenue procedure for an example of the computation of a net section 481(a) adjustment where the taxpayer elected to treat the change in accounting method as a change not initiated by the taxpayer.

.06 This revenue procedure does not apply to a taxpayer that has used a method of accounting for inventory valuation of "excess goods" that is not in accordance with the "prescribed method" and the use of such impermissible method has been raised and is pending as an issue as of February 8, 1980, in connection with the examination of the taxpayer's federal income tax return. In such case, Rev. Proc. 70-27, 1970-2 C.B. 509, clarified by Rev. Proc. 75-18, 1975-1 C.B. 687, and as subsequently modified or superseded, is available.

.07 This revenue procedure does not apply to a method of accounting for inventory, where the taxpayer elects to use (or is using) the last-in first-out (LIFO) method of accounting for such inventory for the first taxable year ending on or after December 25, 1979. In the case of a taxpayer electing LIFO for the first taxable year ending on or after December 25, 1979, pursuant to section 472(d) of the Code and the regulations thereunder, the difference between the carrying value of such inventory under the taxpayer's method of accounting (if less than cost) and cost shall be included in income for the preceding taxable year by filing an amended return for such preceding year. For a taxpayer using the LIFO method, see Rev. Proc. 76-6, 1976-1 C.B. 545, Rev. Proc. 76-28, 1976-2 C.B. 645, and Rev. Rul. 76-282, 1976-2 C.B. 137. If a taxpayer elects the LIFO method of inventory valuation during the "spread period" referred to in section 3.04, other than in the first taxable year ending on or after December 25, 1979, the unamortized balance of the section 481(a) adjustment, referred to in section 3.03, must be taken into account in full as an item of ordinary income in the year for which such election is made.

.08 If, at the end of any taxable year during the "spread period" referred to in section 3.04, the value of the taxpayer's inventory to which the section 481(a) adjustment under section 3.03 relates, as of the last day of any taxable year, is reduced by more than 33⅓ percent of the inventory valued at the beginning of the first taxable year ending on or after December 25, 1979 (see section 3.03), the balance of the unamortized net section 481(a) adjustment, at such time, must be taken into account in full as an item of ordinary income in the year of such inventory reduction. This section shall not apply in the event such reduction is attributable to a strike or involuntary conversion.

.09 (a) With respect to a corporation.

If the taxpayer ceases to engage in the trade or business, to which this adjustment (section 3.03) relates, at any time prior to the expiration of the "spread period" referred to in section 3.04, the taxpayer will take into account in such year the balance of the adjustment not previously taken into account in computing taxable income. For purposes of this condition, the taxpayer is not considered to have ceased the trade or business if such cessation is the result of a transaction to which section 381 of the Code applies, but in such case the acquiring corporation shall continue to be subject to this revenue procedure as though it were the acquired corporation.

(b) With respect to a partnership:

In the event the partnership terminates or ceases to engage in the trade or business, to which this adjustment (section 3.03) relates, at any time prior to the expiration of the "spread period" referred to in section 3.04, the balance of the adjustment not previously taken into account in computing ordinary income shall be taken into account in such year. A partnership ceasing to engage in the trade or business includes the incorporation of such trade or business in a transaction to which section 351 of the Code applies; see Rev. Rul. 77-264, 1977-2 C.B. 187.

(c) With respect to a sole proprietor:

If the taxpayer ceases to engage in the trade or business, to which this adjustment (section 3.03) relates, at any time prior to the expiration of the "spread period" referred to in section 3.04, the balance of the adjustment not previously taken into account in computing taxable income shall be taken into account in such year. A sole proprietor ceasing to engage in the trade or business includes the incorporation of such trade or business in a transaction to which section 351 of the Code applies; see Rev. Rul. 77-264, 1977-2 C.B. 187.

.10 For purposes of the addition to tax for underpayment of estimated tax under section 6654(a) of the Code (applicable to individuals) or section 6655(a) (applicable to corporations), in applying the exceptions under sections 6654(d)(2), 6654(d)(3), and 6655(d)(3), the increase in taxable income in the year of change attributable to a change in method of accounting for inventory under this revenue procedure shall be considered to be taxable income for the last month of such taxable year. The increase in taxable income attributable to the change includes the difference in taxable income resulting from using the new method (the "prescribed method") to value beginning and ending inventory as well as the adjustment required by section 481(a) of the Code.

Furthermore, in determining the amount of income for the installment periods under sections 1.6554-2(d) and 1.6655-2(d) of the regulations (which provide for apportioning the cost of goods sold for the year on the basis of gross receipts for the year unless a more exact determination is available) any adjustment to the cost of goods sold for the first taxable year ending on or after December 25, 1979, resulting from the application of this revenue procedure shall be considered to be an adjustment in the last month of the taxable year.

.11 Section 1375(f) of the Code provides that certain distributions by corporations that qualify as electing small business corporations must be made within 2½ months after the close of the corporation's taxable year in order to be considered as distributions of the corporation's undistributed taxable income for such year. The Service will consider requests from electing small business corporations with taxable years ending on or after December 25, 1979, but before March

10, 1980, for a 1-year modification of the taxable year for which consent is granted in section 3.01. Such requests for modification must be made by July 28, 1980, and must be accompanied by a statement of justification, filed under penalty and perjury, and must include (1) a statement establishing (a) that there was insufficient time for reaching a fully informed decision with respect to making a distribution under section 1375(f) as a result of section 3.01, and (b) that the corporation has a history of making timely section 1375(f) distributions, and (2) a description of the change in method of accounting resulting from the application of this revenue procedure. The requests should be addressed to the Commissioner of Internal Revenue, Attention: T:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. In order to assist in the processing of these requests, reference to this paragraph should be made a part of the request by either typing or legibly printing at the top of the request the following statement:

"SUBMITTED UNDER SECTION 3.11 OF REV. PROC. 80-5."

.12 In applying sections 3.04(2) or (3), if a taxpayer's books and records do not contain sufficient information to compute the section 481(a) adjustment attributable to the 1, 2, or 3 taxable year period immediately preceding the year of change, the taxpayer may reasonably estimate such amounts and also attach the following statement to the Form 3115:

Under penalty of perjury, I hereby certify that:

(1) the books and records of (*name of the taxpayer*) do not contain sufficient information to permit a computation of the section 481(a) adjustment attributable to the 1 taxable year period, 2 taxable year period, or 3 taxable year period immediately preceding the year of change as required by section 3.04 of Rev. Proc. 80-5, and

(2) based on the information that is contained in such records, to the best of my information and belief, the entire amount of the section 481(a) adjustment for the year of change (*indicate either "is" or "is not", as the case may be*) attributable to the taxable year immediately preceding the year of change, and 67 percent or more of the section 481(a) adjustment for the year of change (*indicate either "is" or "is not", as the case may be*) attributable to the 1 taxable year period, 2 taxable year period, or 3 taxable year period immediately preceding the year of change.

SEC. 4 EXAMPLE (1)

X is a domestic corporation incorporated in 1950 and engaged in the business of manufacturing that reports its income on a calendar year basis. In the normal course of its business, *X* maintains an inventory of replacement parts for its products for sale to the public. *X* has consistently written down the value of excess inventory of replacement parts as a result of anticipated losses with respect to such inventory. As of December 31, 1978, *X* had on hand inventory items which it had written down to its estimate of scrap value by taking an inventory write-down for excess goods in the amount of $100,000. The write-down by *X* did not conform with the regulations under section 471 of the Code.

X filed a Form 3115 (Application for Change in Method of Accounting) with its tax return for taxable year 1979 in accordance with the provisions set forth in section 5 of this revenue procedure. Accordingly, *X* restored the write-down of $100,000 to its opening inventory for the taxable year 1979. As a result of such restoration, *X* will, in effect, receive a double deduction through the cost of goods sold in the amount of $100,000. Thus, under section 481(a) of the Code, an adjustment is necessary solely by reason of the change in method of accounting in order to prevent the $100.000 from being duplicated. Less than 67 percent of the adjustment is attributable to taxable years 1976, 1977, and 1978. If *X* had changed its method of accounting in 1954, the adjustment would have been $10,000.

If *X* elects to treat its change in method of accounting as a change initiated by the taxpayer pursuant to section 3.04 above, an adjustment in the amount of $100,000 shall be taken into account as an item of gross income ratably over 10 taxable years (1/10 each year).

If *X* elects to treat its change in method of accounting as a change not initiated by the taxpayer pursuant to section 3.05 above, an adjustment in the amount of $90,000 ($100,000 — $10,000) shall be taken into account as an item of gross income in taxable year 1979, the year of change. The tax for 1979 on the adjustment shall be limited as provided in section 481(b) of the Code.

EXAMPLE (2)

The facts are the same as presented in Example (1) with the exception that *X* has used the improper write-down method for 6 taxable years and the net section 481(a) adjustment if the year of change had been one of the 3 preceding taxable years, would have been $60,000 in 1976, $28,000 in 1977, and $50,000 in 1978. In this example, the difference between the net section 481(a) adjustment if the year of change had been 1977, and such adjustment in 1979, the year of change, is more than 67% ($100,000 — $28,000 = $72,000/ $100,000 = 72%) and represents the highest percent of the adjustment attributable to any one of the 1, 2, or 3 taxable year period preceding the year of change. Under the provisions of section 3.04 of this revenue procedure the adjustment for 1979 of $100,000, therefore, shall be taken into account in the amount of $24,000 in 1979, 1980, and 1981 ($72,000 spread ratably over 3 years) and $9,333 in 1982, 1983, and 1984 (the remainder of $28,000 from the $100,000 adjustment spread over 3 years, the remaining number of years that *X* used the accounting method that is being changed).

EXAMPLE (3)

The facts are the same as presented in example (1) with the additional fact that the value of *X*'s inventory as of December 31, 1978 (the *end* of the year *preceding* the year of change) was $800,000, which takes into account the write-downs for excess inventory (the *old* method). The value of the inventory as of January 1, 1979 (the *beginning* of the year of change), computed in accordance with a method of accounting permitted by the regulations (the *new* method), was $900,000. If *X* treats the change in method of accounting as a change initiated by the taxpayer, the net section 481(a) adjustment is $100,000 ($900,000 — $800,000). The taxable income for the year ended December 31, 1979, based on the foregoing and the amounts indicated below, should be computed as follows:

Sales		$1,600,000
Inventory at beginning of year (computed in accordance with the *new* method)	$ 900,000	
Manufacturing costs	1,170,000	
	2,070,000	
Inventory at end of year (computed in accordance with *new method*)	970,000	
		1,100,000
Gross Profit		$ 500,000
Deductions		200,000
		300,000
Section 481(a) adjustment (1/10 × $100,000)		10,000
Taxable income		$ 310,000

If *X* elects to treat the change in method of accounting as a change not initiated by the taxpayer, an adjustment in the amount of $90,000 ($100,000 — $10,000 attributable to pre-1954 years) shall be taken into account as an item of gross income in 1979 and taxable income in the above example for 1979 would be $390,000. In such case, the tax for 1979 on the adjustment shall be limited as provided in section 481(b) of the Code.

Sec. 5. Manner of Effecting the Change

.01 Taxpayers to which this revenue procedure applies must effect the change in their methods of accounting for their first taxable year ending on or after December 25, 1979, pursuant to the provisions set forth in this revenue procedure by filing a Form 3115 in duplicate. The original shall be attached to the taxpayer's timely filed federal income tax return for such year or to an amended return for such year filed no later than the extended time period prescribed in section 6081 of the Code and the regulations thereunder whether or not the taxpayer has, in fact, been granted an extension of time for filing its income tax return for the first taxable year ending on or after December 25, 1979. For example, a domestic corporation whose taxable year ends December 31, 1979, must effect the change described in this revenue procedure on an original timely filed return, or on an amended return filed no later than September 15, 1980. At the same time a copy of the Form 3115 shall be filed with the National Office addressed to the Commissioner of Internal Revenue, Attention: T:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. In addition to the information required on Form 3115, the taxpayer must state whether section 3.04 or section 3.05 has been applied and must provide (1) a computation of the net section 481(a) adjustment, (2) the pre-1954 Code year adjustment, if applicable, and (3) the period over which the net section 481(a) adjustment will be taken into account and the basis for such conclusion. The National Office will sample the Form 3115's to determine whether the requirements of this revenue procedure have been followed. The National Office or the District Director may advise the taxpayer of required adjustments to the change in method of inventory valuation. Any adjustment made by the National Office will be limited to those necessary to properly comply with this revenue procedure.

.02 In order to assist in the processing of these changes in methods of accounting and to insure proper handling, reference to this revenue procedure shall be made a part of the Form 3115 by either typing or legibly printing the following statement: "FILED UNDER REV. PROC. 80-5."

.03 If a taxpayer applies the provisions of this revenue procedure to change a method of accounting with respect to a method of accounting for inventory write-downs not in accordance with the regulations under section 471 of the Code, and if it is subsequently determined that such change in method is not within the scope of this revenue procedure, the taxpayer will be deemed to have properly filed a timely application for a change in such method of accounting at the time that and for the taxable year in which the Form 3115 is filed pursuant to sections 5.01 and 5.02.

Sec. 6. Inquiries

Inquiries regarding this revenue procedure may be addressed to the Commissioner of Internal Revenue, Attention: T:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

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26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability. (Also Part I, Section 167; 1.167(a)-11.)

Rev. Proc. 80-15

Section 1. Purpose

In this revenue procedure, the Assistant Secretary (Tax Policy) of the Treasury prescribes certain changes with respect to the Class Life Asset Depreciation Range System. One purpose of this Revenue Procedure is to establish under section 1.167(a)-11 of the Income Tax Regulations a new class 57.0, Distributive Trades and Services, and a new class 57.1, Distributive Trades and Services—Billboards, Service Station Buildings and Petroleum Marketing Land Improvements. A further purpose is to clarify the description of assets included in class 00.12, Information Systems.

Class 57.0 includes assets formerly included in classes 13.4, Marketing of Petroleum and Petroleum Products (section 1245 property), 50.0, Wholesale and Retail Trade, 70.2, Personal and Professional Services, and 50.1 and 70.21 (Service Assets). Class 57.1 includes assets formerly included in class 13.4, Marketing of Petroleum and Petroleum Products (Section 1250 property, including service station buildings and all depreciable land improvements).

The new and clarified asset guideline classes, and associated asset guideline depreciation periods, asset depreciation ranges, and annual asset guideline repair allowance percentages are set forth in Section 2 of this Revenue Procedure.

Sec. 2. Asset Guideline Classes, Asset Guideline Periods, Asset Depreciation Ranges, and Annual Asset Guideline Repair Allowance Percentages

The asset guideline classes, asset guideline periods, asset depreciation ranges, and annual asset guideline repair allowance percentages are prescribed as set forth below.

Asset Guideline Class	Description of Assets Included	Asset Depreciation Range (in years)			Annual Asset Guideline Repair Allowance Percentage
		Lower Limit	Asset Guideline Period	Upper Limit	
00.12	Information Systems: Includes computers and their peripheral equipment used in administering normal business transactions and the maintenance				

Asset Guideline Class	Description of Assets Included	Asset Depreciation Range (in years)			Annual Asset Guideline Repair Allowance Percentage
		Lower Limit	Asset Guideline Period	Upper Limit	
	of business records, their retrieval and analysis. Information systems are defined as: 1) Computers: A computer is an electronically activated device capable of accepting information, applying prescribed processes to the information, and supplying the results of these processes with or without human intervention. It usually consists of a central processing unit containing extensive storage, logic, arithmetic, and control capabilities. Excluded from this category are adding machines, electronic desk calculators, etc. 2) Peripheral equipment consists of the auxiliary machines that may be placed under control of the central processing unit. Nonlimiting examples are: Card readers, card punches, magnetic tape feeds, high speed printers, optical character readers, tape cassettes, mass storage units, paper tape equipment, keypunches, data entry devices, teleprinters, terminals, tape drives, disc drives, disc files, disc packs, visual image projector tubes, card sorters, plotters, and collators. Peripheral equipment may be used on-line or off-line. Does not include equipment that is an integral part of other capital equipment that is included in other CLADR classes of economic activity, i.e., computers used primarily for process or production control, switching, channeling, and automating distributive trades and services such as point of sale (POS) computer systems	5	6	7	7.5
57.0	Distributive Trades and Services: Includes assets used in wholesale and retail trade, and personal and professional services. Includes Section 1245 assets used in marketing petroleum and petroleum products	7	9	11	8
57.1	Disrtibutive Trades and Services—Billboard, Service Station Buildings and Petroleum Marketing Land Improvements: Includes section 1250 assets, including service station buildings and depreciable land improvements, whether section 1245 property or section 1250 property, used in the marketing of petroleum and petroleum products, but not including any of these facilities related to petroleum and natural gas trunk pipelines. Includes car wash buildings and related land improvements. Includes billboards, whether such assets are section 1245 property or section 1250 property. Excludes all other land improvements, buildings and structural components as defined in section 1.48-1(e) of the regulations	16	20	24	5

SEC. 3. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 77-10, 1977-1 C.B. 548, as modified, is further modified by the deletion of classes 13.4, Marketing of Petroleum and Petroleum Products; 50.0, Wholesale and Retail Trade; 50.1, Wholesale and Retail Trade Service Assets; 70.2, Personal and Professional Services; and 70.21, Personal and Professional Services Service Assets.

Rev. Proc. 77-10, as subsequently modified, is revised by the prescription of new classes 57.0, Distributive

Trades and Services, and 57.1, Distributive Trades and Services—Billboards, Service Station Buildings and Petroleum Marketing Land Improvements, and the clarification of class 00.12, Information Systems.

SEC. 4. EFFECTIVE DATE

This revenue procedure is effective for assets placed in service in taxable years ending on or after April 28, 1980. For taxable years ending prior to April 28, 1980, distributive trades and services automated equipment such as POS computer systems described herein are properly classified in asset guideline class 00.12, 50.0, or 70.2, depending upon which class was selected by the taxpayer on its original return.

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26 CFR 601.701: Publicity of information. (Also Part I, Sections 702, 901, 904, 911, 913; 1.702-1, 1.901-1, 1.904-1, 5b.911-1, 5b.913-1; Part II, United States-France Income Tax Convention, 1968-2 C.B. 691.)

Rev. Proc. 80-16

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide a procedure for partnerships to follow in making the election provided in Article 23(3)(c) of the United States-France Income Tax Convention (the "Treaty"), 1968-2 C.B. 691, as amended by the Protocol of November 24, 1978 (the "Protocol"), 1979-51 I.R.B. 17. This revenue procedure also clarifies the application of this election to partnerships reporting income on the basis of taxable years begun before January 1, 1979, and ended after January 1, 1979, with the distributive shares of the partners being reported on the basis of taxable years begun on or after January 1, 1979.

SEC. 2. BACKGROUND

.01 Article 23(3)(c) of the Treaty provides special rules for sourcing income applicable to United States citizens who are residents of France and members of a partnership. It provides that a partnership of which an individual member is both a resident of France and a citizen of the United States may elect for any taxable year to treat the income from United States sources that is taxable by France solely by reason of Article 14 (4), as income from sources within France. This increases the member's foreign tax credit limitation provided in section 904(a) of the Internal Revenue Code.

If the election is made, the partnership share of the foreign-source income of each of the other partners not resident in France is correspondingly reduced by the amount deemed to be from sources within France and thus a corresponding amount of their foreign-source income is treated as having a United States source for United States tax purposes. Such reduction is first applied to the French-source income of those other partners and when that is exhausted, to their other foreign-source income. This reduction may not exceed the foreign-source income that would otherwise be allocated to those other partners for the taxable year. In the event that the amount of the French resident partner's United States-source income that is deemed to be from French sources exceeds the entire amount of the other partner's foreign-source income (including the French-source income), the excess is first applied to reduce the French-source income and then other foreign-source income of the other partners in each of the succeeding taxable years until the deemed-French-source income of the French resident partner is fully offset by the deemed-United States-source income of the other partners, whether or not an election for such succeeding years is in effect. See Treasury Department Technical Explanation of the Protocol, 1979-51 I.R.B. 33.

If the election is made, it is made for all the members of the partnership. The effects of this election, therefore, are binding on all the members having a United States income tax liability. With respect to members who are citizens of the United States and residents of France, Article 23 of the Treaty provides that, if the election is made, such members are denied any benefits of the exclusion or deduction provided by sections 911 and 913 of the Code for income earned abroad. Such denial of section 911 and section 913 benefits does not affect the applicability of these benefits to the income earned abroad by the members' spouses.

.02 Article 6(4) of the Treaty, with respect to the taxation of partnership income generally provides that a partner's distributive share of partnership income, loss, and other items is to have the same character and source in the partner's hands as those items have in the hands of the partnership. This provision is intended to reduce the double taxation of partnership income that would result due to the inconsistency between the source rules applied by the United States and those applied by France. This provision is a restatement of the normal sourcing rules applied to partnership income under section 702(b) of the Internal Revenue Code.

.03 Article 14(4) of the Treaty provides that the special partnership source rules of Article 6(4) shall apply to income from independent personal services by analogy but such application may not result in the exemption from French tax under Article 23(2) of more than 50 percent of the earned income from a partnership of a United States citizen who is a resident of France.

.04 Section 904(a) of the Code limits the amount of foreign tax credit that may be applied against United States tax liability on a taxpayer's worldwide income to the same proportion of such amount that the taxable income from foreign sources bears to the taxpayer's taxable income from all sources (worldwide) for the same taxable year.

.05 Article 2 of the Protocol provides that the Protocol shall have effect retroactively with respect to tax years beginning on or after January 1, 1979.

SEC. 3. SCOPE AND OBJECTIVE

This revenue procedure applies to all partnerships seeking to make the election provided in Article 23(3)(c) of the Treaty, including partnerships reporting their income for United States tax purposes on a fiscal year basis with the year begun before January 1, 1979, and ended after January 1, 1979, and seeking to make such election with respect to the United States-source income of a partner resident in France who is a United States citizen but whose distributive share is reported on a calendar or fiscal year basis, with the year beginning on or after January 1, 1979. In furtherance of the underlying purpose of this election provision, which is to minimize the effect of any double taxation that may exist because of the differences between United States and French tax laws, a procedure is provided whereby such partnerships may avail themselves of this election. This election was provided in the Treaty for the benefit of the French resident partner and the beginning date of such partner's taxable year is controlling vis-a-vis the effective date of the Protocol rather than the beginning date of the partnership's taxable year.

SEC. 4. MANNER OF MAKING THE ELECTION UNDER ARTICLE 23(3)(c).

.01 The election provided in Article 23(3)(c) of the Treaty under which the United States-source income of its parners(s) resident in France that cannot be treated as exempt under Article 23 because of the 50-percent limitation of Article 14(4) will be deemed to be French-source income for United States tax purposes, including the foreign tax credit limitation of section 904(a) of the Code, shall be effected by a partnership's filing of a Form 1065, U.S. Partnership Return of Income, along with a Schedule K-1 (Form 1065), Partner's Share of Income, Credits, Deduction, etc.—1979, in duplicate on or before the appropriate due date for the Form 1065 or within 90 days of the publication of this revenue procedure, whichever is later. Each member of the partnership shall file a Form 1040, U.S. Individual Income Tax Return, along with a Form 1116, Computation of Foreign Tax Credit—Individual, Fiduciary, or Nonresident Alien Individual, making the appropriate adjustments necessitated by the election, also in duplicate, on or before the appropriate due date for the Form 1040 or within 90 days of the publication of this revenue procedure, whichever is later. The originals of all these returns shall be filed with the appropriate Service Center as provided on page 1 of the Instructions for Form 1065. At the same time, copies of these returns shall be filed with the Director, Office of International Operations, Attention: Chief, Tax Treaty and Technical Services Division, CP:OIO:3, Room 820, 1325 K Street, NW, Washington, DC 20224. This election is not valid unless the partnership return is accompanied by all affected individual returns. If this is not possible because of different due dates, the partnership return shall be accompanied by a list of all the affected partners (their names and social security numbers) that will later file appropriate returns pursuant to this procedure.

.02 In order to assist in the processing of these returns and to insure proper handling, reference to this revenue procedure shall be made a part of the returns by indicating at the top of the copies of Form 1065, Schedule K-1, Form 1040 and Form 1116 by either typing or legibly printing the following statement: "FILED UNDER REV. PROC. 80-16."

.03 Such election may also be effected by the filing of the appropriate amended returns by a partnership and its members, provided the amended returns are filed within the applicable statutory period provided by law. The appropriate amended returns of the partnership and those of its members must be filed simultaneously and in the same manner as indicated in sections 4.01 and 4.02 above. This election will not be valid unless the amended partnership return is accompanied by all affected amended individual returns.

.04 The election made under the provisions of this revenue procedure pursuant to Article 23(3)(c) of the Treaty shall apply to the first taxable year for which such election was made and for each taxable year thereafter until such election is revoked by the partnership. The election may be revoked for any taxable year. Such revocation shall be effected by the simultaneous filing of the appropriate amended returns by the partnership and its members within 3 years from the time the original returns of the members were filed or 2 years from the time the federal tax was paid for the taxable year for which the election is sought to be revoked, whichever of such periods expires later. The amended returns are to be filed in the same manner as indicated in sections 4.01 and 4.02 above. This revocation will not be valid unless the amended partnership return is accompanied by all affected amended individual returns.

SEC. 5. INQUIRIES

Inquiries regarding this revenue procedure may be addressed to the Commissioner of Internal Revenue, Attention: T:C:C:3, 1111 Constitution Avenue, NW, Washington, DC 20224.

SEC. 6. EFFECTIVE DATE

This revenue procedure is effective April 28, 1980, the date of its publication in the Internal Revenue Bulletin.

Part IV. Items of General Interest

Removal of Statutory Sections from Title 26 of the Code of Federal Regulations—Amendment

Announcement 80-52 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Editorial changes.

SUMMARY: This document announces editorial changes to Title 26 of the Code of Federal Regulations, made necessary by the previous deletion of statutory sections from the regulations. Cross-references to the deleted material have been changed to the corresponding sections of the Internal Revenue Code of 1954 or to the appropriate regulations sections. However, when either such change would have produced a redundancy, the cross-reference has been deleted.

EFFECTIVE DATE: This announcement is effective March 31, 1980.

FOR FURTHER INFORMATION CONTACT: George H. Bradley of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3486, not a toll-free call.

Announcement

On January 25, 1980, Treasury Decision 7665 was published in the Federal Register (43 FR 6088) [1980-8 I.R.B. 17]. That Treasury decision removed from Title 26 of the Code of Federal Regulations those regulation sections that recite verbatim provisions of the Internal Revenue Code of 1954.

A number of existing regulation sections in Title 26 of the Code of Federal Regulations contain cross-references to certain of those regulation sections which were removed. The next publication of Title 26 will correct these cross-references to refer to corresponding sections of the Internal Revenue Code of 1954 or to the appropriate regulation sections, and no longer to statutory sections as formerly recited in Title 26.

Certain of the regulation sections that referred to deleted statutory sections also referred to the corresponding Code section and regulations section. In those instances, cross-references to the deleted statutory sections were deleted.

These changes will be made as a part of the April 1, 1980, edition of Title 26 of the Code of Federal Regulations.

Amendment of Rev. Proc. 80-5

Announcement 80-54 [1]

In response to questions, Rev. Proc. 80-9, 1980-10 I.R.B. 19, dealing with the change in method of accounting for "excess" inventory pursuant to the decision of the Supreme Court of the United States in *Thor Power Tool Co. v. Commissioner* is amended.

Rev. Proc. 80-5 was announced in IRS News Release IR-80-19 on Feb. 8, 1980.

The amendments add provisions to Rev. Proc. 80-5 that concern the following:

1. The election of the last-in, first-out method of accounting (LIFO) in the same taxable year that a change is made under Rev. Proc. 80-5;

2. The treatment of the Internal Revenue Code section 481(a) adjustment in the event that the value of the inventory to which the adjustment relates is reduced by more than 33⅓ percent;

3. The application of certain exceptions to the addition to tax for underpayment of estimated tax;

4. Electing small business corporations with taxable years ending before Mar. 10, 1980, seeking to comply with the rules provided in section 1375(f) of the Code with respect to their distributions;

5. The computation of the section 481(a) adjustment attributable to periods prior to the year of change for purposes of determining the proper spread period;

6. An example of the computation of the section 481(a) adjustment;

7. Compliance with Rev. Proc. 80-5 by an amended return; and

8. A change of accounting method made under the provisions of Rev. Proc. 80-5 that is subsequently determined not to be within its scope.

Sample copies of Form 3115, Application for Change in Accounting Method, filed under the provisions of Rev. Proc. 80-5 and have indicated the following common errors being made by taxpayers:

a. Failure to indicate whether the change in method of accounting will be treated as a change initiated by the taxpayer as described in section 3.04 (1) of the procedure or as a change in method of accounting not initiated by the taxpayer as described in section 3.05; if section 3.04 is applicable, failure to indicate the period over which the section 481(a) adjustment will be taken into account;

b. Failure to indicate the number of years of use of the method of accounting for inventory valuation of "excess" inventory that was not in accordance with the "prescribed method" (section 3.04(1));

c. Failure to compute the section 481(a) adjustment properly, particularly the failure to redetermine the *opening* inventory for the year of change under a method of accounting that is in accordance with the regulations; and

d. Failure to indicate on the top of the Form 3115 that it is being "Filed Under Rev. Proc. 80-5."

As revised, Rev. Proc. 80-5 is republished on page 23 of this Bulletin. The amendments to Rev. Proc. 80-5 are as follows:

1. To clarify the applicability of the revenue procedure to taxpayers electing the last-in, first-out (LIFO) method of inventory valuation, section 3.07 is modified to read as follows:

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[1] Filed by the Office of the Federal Register on March 28, 1980, 8:45 a.m., and published in the issue of the Federal Register for March 31, 1980, 45 F.R. 20795.

[1] Based on News Release IR-80-48 dated April 8, 1980.

This revenue procedure does not apply to a method of accounting for inventory, where the taxpayer elects to use (or is using) the last-in first-out (LIFO) method of accounting for such inventory for the first taxable year ending on or after December 25, 1979. In the case of a taxpayer electing LIFO for the first taxable year ending on or after December 25, 1979, pursuant to section 472(d) of the Code and the regulations thereunder, the difference between the carrying value of such inventory under the taxpayer's method of accounting (if less than cost) and cost shall be included in income for the preceding taxable year by filing an amended return for such preceding year. For a taxpayer using the LIFO method, see Rev. Proc. 76-6, 1976-1 C.B. 545, Rev. Proc. 76-28, 1976-2 C.B. 645, and Rev. Rul. 76-282, 1976-2 C.B. 137. If a taxpayer elects the LIFO method of inventory valuation during the "spread period" referred to in section 3.04, other than in the first taxable year ending on or after December 25, 1979, the unamortized balance of the section 481(a) adjustment, referred to in section 3.03, must be taken into account in full as an item of ordinary income in the year for which such election is made.

2. To clarify the applicability of the 33⅓ percent rule, section 3.08 is modified to read as follows:

If, at the end of any taxable year during the "spread period" referred to in section 3.04, the value of the taxpayer's inventory to which the section 481(a) adjustment under section 3.03 relates, as of the last day of any taxable year, is reduced by more than 33⅓ percent of the inventory valued at the beginning of the first taxable year ending on or after December 25, 1979 (see section 3.03), the balance of the unamortized net section 481(a) adjustment, at such time, must be taken into account in full as an item of ordinary income in the year of such inventory reduction. This section shall not apply in the event such reduction is attributable to a strike or involuntary conversion.

3. To provide coordination between the revenue procedure and the determination of the addition to tax for underpayment of estimated tax, the following paragraph is added to section 3:

.10 For purposes of the addition to tax for underpayment of estimated tax under section 6654(a) of the Code (applicable to individuals) or section 6655(a) (applicable to corporations), in applying the exceptions under sections 6654(d)(2), 6654(d)(3), and 6655(d)(3), the increase in taxable income in the year of change attributable to a change in method of accounting for inventory under this revenue procedure shall be considered to be taxable income for the last month of such taxable year. The increase in taxable income attributable to the change includes the difference in taxable income resulting from using the new method (the "prescribed method") to value beginning and ending inventory as well as the adjustment required by section 481(a) of the Code.

Furthermore, in determining the amount of income for the installment periods under sections 1.6654-2(d) and 1.6655-2(d) of the regulations (which provide for apportioning the cost of goods sold for the year on the basis of gross receipts for the year unless a more exact determination is available) any adjustment to the cost of goods sold for the first taxable year ending on or after December 25, 1979, resulting from the application of this revenue procedure shall be considered to be an adjustment in the last month of the taxable year.

4. To provide a special procedure for small business corporations seeking to comply with the provisions of section 1375(f) of the Code, the following paragraph is added to section 3:

.11 Section 1375(f) of the Code provides that certain distributions by corporations that qualify as electing small business corporations must be made within 2½ months after the close of the corporation's taxable year in order to be considered as distributions of the corporation's undistributed taxable income for such year. The Service will consider requests from electing small business corporations with taxable years ending on or after December 25, 1979, but before March 10, 1980, for a 1-year modification of the taxable year for which consent is granted in section 3.01. Such requests for modification must be made by July 28, 1980, and must be accompanied by a statement of justification, filed under penalty and perjury, and must include (1) a statement establishing (a) that there was insufficient time for reaching a fully informed decision with respect to making a distribution under section 1375(f) as a result of section 3.01, and (b) that the corporation has a history of making timely section 1375(f) distributions, and (2) a description of the change in method of accounting resulting from the application of this revenue procedure. The requests should be addressed to the Commissioner of Internal Revenue, Attention: T:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. In order to assist in the processing of these requests, reference to this paragraph should be made a part of the request by either typing or legibly printing at the top of the request the following statement:

"SUBMITTED UNDER SECTION 3.11 OF REV. PROC. 80-5."

5. To provide a procedure for submitting certain required information in order to comply with the rules for allowing a spread of the section 481(a) adjustment when all information is not otherwise available, the following paragraph is added to section 3:

.12 In applying section 3.04(2) or (3), if a taxpayer's books and records do not contain sufficient information to compute the section 481(a) adjustment attributable to the 1, 2, or 3 taxable year period immediately preceding the year of change, the taxpayer may reasonably estimate such amounts and also attach the following statement to the Form 3115:

Under penalty of perjury, I hereby certify that:

(1) the books and records of (*name of the taxpayer*) do not contain sufficient information to permit a computation of the section 481(a)

adjustment atrtibutable to the 1 taxable year period, 2 taxable year period, or 3 taxable year period immediately preceding the year of change as required by section 3.04 of Rev. Proc. 80-5, and

(2) based on the information that is contained in such records, to the best of my information and belief, the entire amount of the section 481(a) adjustment for the year of change (*indicate either "is" or "is not", as the case may be*) attributable to the taxable year immediately preceding the year of change, and 67 percent or more of the section 481(a) adjustment for the year of change (*indicate either "is" or "is not", as the case may be*) attributable to the 1 taxable year period, 2 taxable year period, or 3 taxable year period immediately preceding the year of change.

6. To provide an example to illustrate the computation of the section 481(a) adjustment, referred to in section 3.03, the following example is added to section 4:

EXAMPLE (3)

The facts are the same as presented in example (1) with the additional fact that the value of *X*'s inventory as of December 31, 1978 (the *end* of the year *preceding* the year of change) was $800,000, which takes into account the write-downs for excess inventory (the *old* method). The value of the inventory as of January 1, 1979 (the *beginning* of the year of change, computed in accordance with a method of accounting permitted by the regulations (the *new* method), was $900,000. If *X* treats the change in method of accounting as a change initiated by the taxpayer, the net section 481(a) adjustment is $100,000 ($900,000 — $800,000). The taxable income for the year ended December 31, 1979, based on the foregoing and the amounts indicated below, should be computed as follows:

Sales		$1,600,000
Inventory at beginning of year (computed in accordance with the *new* method)	$ 900,000	
Manufacturing costs	1,170,000	
	2,070,000	
Inventory at end of year (computed in accordance with the *new* method)	970,000	
		1,100,000
Gross Profit		$ 500,000
Deductions		200,000
		300,000
Section 481(a) adjustment (1/10 × $100,000)		10,000
Taxable income		$ 310,000

If *X* elects to treat the change in method of accounting as a change not initiated by the taxpayer, an adjustment in the amount of $90,000 ($100,000 — $10,000 attributable to pre-1954 years) shall be taken into account as an item of gross income in 1979 and taxable income in the above example for 1979 would be $390,000. In such case, the tax for 1979 on the adjustment shall be limited as provided in section 481(b) of the Code.

7. To clarify that the granting of an extension of time to file the tax return is not otherwise required, the second sentence of section 5.01 is modified to read as follows:

The original shall be attached to the taxpayer's timely filed federal income tax return for such year or to an amended return for such year filed no later than the extended time period prescribed in section 6081 of the Code and the regulations thereunder whether or not the taxpayer has, in fact, been granted an extension of time for filing its income tax return for the first taxable year ending on or after December 25, 1979.

8. To clarify the effect when the method being changed is not within the scope of this revenue procedure, the following paragraph is added to section 5:

.03 If a taxpayer applies the provisions of this revenue procedure to change a method of accounting with respect to a method of accounting for inventory write-downs not in accordance with the regulations under section 471 of the Code, and if it is subsequently determined that such change in method is not within the scope of this revenue procedure, the taxpayer will be deemed to have properly filed a timely application for a change in such method of accounting at the time that and for the taxable year in which the Form 3115 is filed pursuant to sections 5.01 and 5.02.

Correction of Rev. Rul. 80-98

Announcement 80-59

The last sentence of Rev. Rul. 80-98 1980-14 I.R.B. 25 is corrected to read as follows:

Rev. Rul. 80-36 1980-6 I.R.B. 11 is amplified.

This correction will be reflected in Rev. Rul. 80-98 when it is published in 1980-1 C.B.

Correction of Rev. Proc. 80-11

Announcement 80-60 [1]

Section 4 of Rev. Proc. 80-11, 1980-14 I.R.B. 28, is corrected to read as follows:

"This revenue procedure is effective March 27, 1980, the date of its publication."

This publication date reflects the date this revenue procedure was published as News Release, IR-80-38. This date will be corrected when Rev. Proc. 80-11 is republished in 1980-1 C.B.

New Form 6047, Windfall Profit Tax

Announcement 80-61 [1]

A new Form 6047, Windfall Profit Tax, has been developed and will be used to report the excise tax due under the Crude Oil Windfall Profit Tax Act of 1980, which is retroactive to March 1, 1980. The form and instructions are available at Internal Revenue Service offices.

Generally, first purchasers of crude oil are required to file Form 6047 as an attachment to Form 720, Quarterly Federal Excise Tax Return. The IRS will mail Form 6047 and instructions to all first purchasers who have filed a Domestic Crude Oil First Purchase Report with the Department of Energy.

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[1] Based on News Release IR-80-51, dated April 15, 1980.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants and Enrolled Agents from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following person has been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Stephen K. Easton	New York, NY	Certified Public Accountant	Indefinite from February 29, 1980

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants or enrolled agents to practice before the Internal Revenue Service.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant or enrolled agent so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing, the following individuals were disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
John J. McBurney	College Park, MD	Attorney	October 22, 1979
Robert W. Tufts	St. Petersburg, FL	Certified Public Accountant	March 17, 1980
William A. Cartaugh	Greenville, SC	Enrolled Agent	March 21, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 301.6103(j)(1)-1 added; 404.6103(j)(1)-1 deleted.	Disclosure of returns and return information to officers and employees of Bureaus of the Census and Economic Analysis of the Department of Commerce for certain statistical purposes.	Mar. 24, 1980	May 23, 1980
26 CFR 150.0 through 150.6402-1 added; published as temporary regulations in T.D. 7690, 1980-16 I.R.B. 11.	Crude Oil Windfall Profit Tax Act of 1980.	Apr. 4, 1980	June 3, 1980
26 CFR 1.166-9, 1.482-2, 1.1371-1, amended; 1.385-1 through 1.385-12, added.	Treatment of certain interests in corporations as stock or indebtedness.	Mar. 24, 1980	June 23, 1980
26 CFR 53.4942 revoked; 53.4942(a)-2 amended.	The use of blockage or similar factors in determining the value of private foundations' noncharitable assets consisting of listed securities for purposes of determining the amount foundations must distribute annually for charitable purposes.	Mar. 12, 1980	May 12, 1980
26 CFR 301.6103(a)-1 through 301.6103(c)-1, 301.6103(i)-1 through 301.6103(p)(2)(B)-1 added; 301.6103(h)(2)-1 amended; 404.6103(a)-1 through 404.6103(i)-1, 404.6103(j)(2)-1 through 404.6103(n)-1, 420.6103(1)(2)-1 through 420.6103(1)(2)-3 deleted.	Disclosure of returns and return information under certain circumstances.	Mar. 24, 1980	May 23, 1980
26 CFR 1.170A-1, 1.170A-4, 1.170A-11, amended; 1.170A-4A, added.	Deduction of certain charitable contributions of inventory and other property.	Mar. 20, 1980	May 19, 1980
26 CFR 1.6050-1, 301.6050-1, deleted; 53.4942(b)-1, revised.	Treatment of Certain Elderly Care Facilities.	Mar. 24, 1980	May 23, 1980
26 CFR 1.46-4, 1.316-1, 1.852-4, 1.857-4, amended; 1.852, 1.857, deleted; 1.381(c)(25)-1, 1.860-1 through 1.860-5, added.	Deficiency dividends paid by certain regulated investment companies and real estate investment trusts.	March 31, 1980	May 27, 1980

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[1] See footnote at end of list.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1, dated January 7, 1980.

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* Denotes entry since last publication

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1 I.R.B., dated January 7, 1980.

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______	*1927–2*	*2.95*
______	1928–1	6.95
______	1928–2	9.50
______	*1929–1*	*2.50*
______	*1929–2*	*3.15*
______	1930–1	7.30
______	1930–2	9.50
______	*1931–1*	*3.60*
______	*1931–2*	*3.25*
______	*1932–1*	*2.80*
______	1932–2	8.65
______	*1933–1*	*3.35*
______	*1933–2*	*3.45*
______	*1934–1*	*3.70*
______	*1934–2*	*4.10*
______	1935–1	6.90
______	*1935–2*	*4.00*
______	*1936–1*	*3.55*
______	*1936–2*	*3.90*
______	*1937–1*	*3.75*
______	1937–2	7.70
______	*1938–1*	*4.05*
______	*1938–2*	*3.50*
______	1939–1–1	8.25
______	1939–1–2	10.90
______	1939–2	9.40
______	1940–1	5.55
______	1940–2	14.00
______	1941–1	*$6.95*
______	*1941–2*	*3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
______	*1944*(*)	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*2.65*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
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______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$10.10
______	1957–2	13.00
______	1958–1	9.60
______	1958–2	13.00
______	1958–3	15.00
______	1959–1	15.00
______	1959–2	9.60
______	1960–1	9.00
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May 5, 1980
Bulletin No. 1980-18

9258

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-119, page 5.

Out-of-court settlement; actual and threatened claims; acquisition of stock. The entire amount of an out-of-court payment made by an individual, a shareholder and director of a domestic corporation, in settlement of both an actual claim against the individual under section 10(b) of the Securities Exchange Act of 1934 and various threatened claims, all relating to the individual's acquisition of the stock of the corporation, is a capital expenditure, not a business expense deductible under section 162(a) of the Code.

Rev. Rul. 80-120, page 6.

Insurance premiums paid to physician-owned mutual insurance company. Payments made as professional liability insurance premiums by a medical service corporation with 25 employees to a physician-owned mutual insurance company that provides non-assessable professional liability insurance to over 5,000 doctors and several professional corporations are deductible under section 162 of the Code.

Rev. Rul. 80-121, page 7.

Land gains tax; Vermont. The tax imposed by sections 10001 through 10010, title 32, of the Vermont Statutes Annotated (Supp. 1979), on gain from the sale or exchange of certain land in Vermont is a transfer tax and is deductible under section 164(a) of the Code only to the extent that it is paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212.

T.D. 7685, page 9.

Temporary regulations under section 1502 of the Code relate to the effect of the at risk limitations of section 465 on affiliated corporations that file consolidated returns.

Notice 80-4, page 19.

Foreign life insurance companies shall use a percentage of 13.9 in determining the "minimum figure" under section 819 of the Code for purposes of computing income tax liability for the taxable year 1979 and estimated tax liability and installments for the taxable year 1980.

EMPLOYEE PLANS

Rev. Rul. 80-122, page 8.

Qualification; benefits suspended during reemployment after retirement. Benefits provided under a pension plan will not fail to be definitely determinable merely because the plan provides that pension benefits shall be suspended for any period of time during which primary insurance benefits under the Social Security Act are discontinued because of employment after retirement date; Rev. Rul. 82 superseded.

EXEMPT ORGANIZATIONS

Announcement 80-55, page 20.

A listing is given of organizations now classified as private foundations.

ESTATE TAX

Rev. Rul. 80-123, page 10.

Charitable remainder trusts; governing instru-

(Continued on page 4)

Finding Lists begin on page 24.
Announcement of Disbarments and Suspensions on page 22.
Announcementof Notice of Proposed Rulemaking on page 23.
Monthly Index for April begins on page 27.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part includes rulings and decisions based on Subpart A, Tax Conventions and related Treasury Decisions and Revenue Rulings; Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of Revenue Rulings, Revenue Procedures, and other published items, and (3) topical Indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

ESTATE TAX—Cont'd

ment. In order for the charitable interest in a testamentary charitable remainder trust to qualify for an estate tax charitable deduction, the governing instrument of the trust must provide that the obligation to pay the unitrust or annuity amount begins on the date of death, and for corrective payments in the case of an underpayment or overpayment of the amount determined to be payable; Rev. Rul. 72-395 modified.

EMPLOYMENT TAXES

Rev. Rul. 80-124, page 12.

Payments to employees under preretirement leave plan. Payments made by a company to eligible employees under a negotiated preretirement leave benefit plan that (1) was adopted to offset layoffs resulting from periodic slack seasons, (2) provides benefits whether or not an actual need for a layoff ever occurs, and (3) guarantees benefits at the time leave is scheduled are wages under sections 3121(a), 3306(b), and 3401(a) of the Code; Rev. Ruls. 56-249 and 60-330 distinguished and Rev. Rul. 75-461 amplified.

T.D. 7684, page 13.

Final regulations under section 3401 of the Code relate to wage withholding on remuneration for which a corresponding deduction is allowable under section 913.

EXCISE TAXES

Rev. Rul. 80-125, page 16.

Coal; surface-mined coal mixed with underground-mined coal. Computation of the manufacturers tax on coal is illustrated for sales by the producer of surface-mined coal and underground-mined coal that are blended together during cleaning.

T.D. 7686, page 17.

Amendments to the regulations under sections 4041, 4073, 4083, 4091, 4093, and 4221 of the Code relate to an extension of the maximum duration period of blanket exemption certificates for purchases of various items otherwise subject to tax.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 162.—Trade or Business Expenses

26 CFR 1.162-1: Business expenses.
(Also Section 263; 1.263(a)-1.)

Out-of-court settlement; actual and threatened claims; acquisition of stock. The entire amount of an out-of-court payment made by an individual, a shareholder and director of a domestic corporation, in settlement of both an actual claim against the individual under section 10(b) of the Securities Exchange Act of 1934 and various threatened claims, all relating to the individual's acquisition of the stock of the corporation, is a capital expenditure, not a business expense deductible under section 162(a) of the Code.

Rev. Rul. 80-119

ISSUE

Is all or any portion of a payment made by a taxpayer in settlement of a suit brought against the taxpayer deductible under section 162(a) of the Internal Revenue Code under the circumstances described below?

FACTS

The taxpayer, *A*, a shareholder and director of *X*, a domestic corporation, purchased additional shares of *X* stock from *B*, an individual unrelated to *A* or *X*. Subsequent to the purchase, *Y* was organized as a holding company by the management and controlling shareholders of *X*, and *Y* acquired *X* as a controlled subsidiary with the controlling shareholders of *X* exchanging their stock for stock of *Y*. Following the corporate acquisition, an offer to the remaining shareholders of *X* to exchange their shares for shares of *Y*, and a public offering by *Y* of its stock, *B* filed a complaint with a federal district court alleging that *A* had violated section 10(b) of the Securities Exchange Act of 1934 (Act) by withholding certain information from *B* when *A* purchased the *X* stock from *B*. The complaint alleged that, at the time of the purchase, *A* concealed the pending organization of *Y*, as well as the planned exchange of stock by the controlling shareholders, the planned offer to the remaining shareholders to exchange their stock, and the planned public offering by *Y*. The complaint further alleged that, at the time the complaint was filed the fair market value of the *Y* stock *A* received in exchange for the *X* stock purchased from *B* was several times greater than the amount for which *B* sold the *X* stock to *A*. *B* asked that judgment be entered against *A* in the amount of the damages sustained by *B*, plus interest and costs of the suit.

Subsequent to the filing of the complaint, *A*'s counsel informed *A* of the threats of *B* to convert the complaint into a class action that would include other purchases of *X* stock by *A* and other controlling shareholders of *X* and to amend the complaint to allege common law fraud. *A*'s counsel also informed *A* that, while the existing complaint would permit the award of only actual damages, common law fraud would permit the award of both actual and punitive damages.

A negotiated with *B* an out-of-court cash settlement of the suit. The amount of the settlement, however, exceeded the amount of damages that *B* could have been awarded, based on the applicable circuit court's method of computing damages in actions involving section 10(b) of the Act, had the suit been tried. *A* was a prominent member of the business community. *A* paid *B* more than the court could have awarded *B* under the section 10(b) action because *A* wanted to avoid a trial on the various present and threatened suits. *A* also believed that litigation would affect *A*'s standing in the business community, and *A* desired to preserve *A*'s business reputation. In exchange for the cash payment, *B* settled the suit and agreed not to take any of the threatened actions.

LAW AND ANALYSIS

Section 162(a) of the Code allows as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 1.162-1 of the Income Tax Regulations provides, in part, that business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business. This section contains a cross reference to sections 261-276 of the Code for items not deductible. Among these sections is section 263(a), which prohibits deductions for capital expenditures. Under section 1.263(a) the cost of acquisition of a capital asset is considered a capital expenditure.

The origin-of-the-claim test is the proper method of determining whether the entire settlement payment is a capital expenditure or whether only that portion of the payment made for actual damages resulting from the stock purchase transaction is a capital expenditure and the remainder of the payment is a deductible business expense. In *United States v. Gilmore,* 372 U.S. 39, 49 (1973), the Supreme Court of the United States held that it could be determined whether costs of litigation were nondeductible personal expenses or deductible business expenses by considering the "origin and character of the claim with respect to which an expense was incurred."

In *Anchor Coupling Company v. United States,* 427 F. 2d 429, 433 (7th Cir. 1970), *cert. denied,* 401 U.S. 908 (1971), the United States Court of Appeals for the Seventh Circuit concluded that the examination of the origin and character of the claim with respect to which a settlement is made, rather than the estimation of the potential consequences of the claim upon the business operations of a taxpayer, is the controlling test in determining whether a settlement payment constituted a deductible busines expense or a nondeductible capital outlay.

Under the origin-of-the-claim test it may be proper for a settlement payment to be allocated to claims that were only threatened as well as to those that were actually made. See *DeMink v. United States,* 448 F. 2d 867 (9th Cir. 1971); *Eisler v. Commissioner,* 59 T.C. 634 (1973), *acq.* 1973-2 C.B. 1. In *Boagni v. Commissioner,* 59 T.C. 708 (1973), the United States Tax Court recognized that legal expenses incurred can be characterized as both deductible and nondeductible when the litigation is rooted in situations giving rise to both types of expenditures. In discussing the application of the origin-of-the-claim test, the court, at page 713, stated:

> [T]he "origin of the claim" rule does not contemplate a mechanical search for the first in the chain of events which led to the litigation but, rather, requires an examination of all the facts. The inquiry is directed to the ascertainment of the "kind of transaction" out of which the litigation arose. Consideration must be given to the issues involved, the nature and objectives of the litigation, the defenses asserted, the purpose for which the claimed deductions were expended, the background of the litigation, and all facts pertaining to the controversy. [citations omitted]

In the present case, in return for the cash payment, *B* settled the original claim and agreed not to take any of the threatened actions. The origin-of-the-claim test should be applied to each settled claim, actual and threatened, to determine whether the settlement payment is a deductible business expense, a non-deductible capital outlay or a combination of the two types of expenditures. This determination is made by examining each claim to discover if it originated in the course of the conduct of a trade or business as an ordinary and necessary business expense or if it originated in a transaction giving rise to a nondeductible expenditure, such as the acquisition of a capital asset.

Each of the settled claims, actual and threatened, originated in the stock purchase transaction. All these claims are various forms of relief sought for the harm allegedly done by the taxpayer in this transaction.

HOLDING

The entire amount of the out-of-court settlement payment is a capital expenditure because all the claims it settled arose from the acquisition of a capital asset. No portion of the payment is deductible under section 162 (a) of the Code.

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26 CFR 1.162-1: Business expenses.

Insurance premiums paid to physician-owned mutual insurance company. Payments made as professional liability insurance premiums by a medical service corporation with 25 employees to a physician-owned mutual insurance company that provides non-assessable professional liability insurance to over 5,000 doctors and several professional corporations are deductible under section 162 of the Code.

Rev. Rul. 80-120

ISSUE

Are payments made by a professional corporation to a mutual insurance company as professional liability insurance premiums deductible as ordinary and necessary business expenses under section 162 of the Internal Revenue Code?

FACTS

The taxpayer is a professional corporation that has a contract with a hospital to provide professional medical services. The taxpayer employs 10 doctors and 15 registered nurses.

M, a mutual insurance exchange, was formed and qualified pursuant to state law to provide medical professional liability insurance, which includes malpractice insurance. It is a physician-owned carrier offering non-assessable professional liability insurance policies to all physicians and medical professional corporations, including the taxpayer, licensed to practice in the state who maintain at least 50 percent of their practice in the state. *M* is managed by a board of directors consisting of member-policyholders. Its sole business purpose is to supply insurance coverage to the policyholders at the lowest possible cost. Over 5,000 doctors and several professional corporations are insured by the exchange. *M* is subject to tax as a mutual insurance company under section 821(a) of the Code.

During the taxable year, premium payments to the exchange in the amount of 1000x dollars for professional liability insurance were made by the taxpayer. These premium payments are established according to customary rating formulas dependent upon the hazard and expense differences among the insured doctors.

LAW AND ANALYSIS

Section 162(a) of the Code provides a deduction for all ordinary and necessary expenses paid or incurred in carrying on any trade or business.

Section 1.162-1(a) of the Income Tax Regulations provides that among the items included in business expenses are insurance premiums against accident, or other similar losses in the case of a business.

Essential to the concept of insurance is a sharing and distribution of the insurance risk by all the parties insured. See *Helvering v. LeGierse*, 312 U.S. 531 (1941), 1941-1 C.B. 430. When there is no economic shift or distribution of the risk "insured," the contract is not one of insurance. See Rev. Rul. 77-316, 1977-2 C.B. 53, which sets forth examples in which payments denominated insurance premiums are not deductible under section 162 of the Code because there is no economic shifting or distributing of risks of loss where the alleged insureds are all economically interrelated and the risks are carried or retained by a foreign corporation that is wholly-owned by one of the alleged insureds.

Rev. Rul. 78-338, 1978-2 C.B. 107, deals with a group of 31 unrelated corporations all owning shares of a foreign insurance company. No shareholder in Rev. Rul. 78-338 owned a controlling interest in the insurance company. The insurance company provides insurance only to its shareholders and their subsidiaries and affiliates, and no shareholder's individual risk coverage was permitted to exceed 5 percent of the total risks insured by the company. Premium rates are established according to customary industry rating formulas, dependent upon the hazard and expense differences among the insureds. Rev. Rul. 78-338, in distinguishing Rev. Rul. 77-316, holds that the requisite risk-shifting and risk-distribution necessary to constitute insurance are present, therefore the amounts paid as premiums are deductible under section 162 of the Code.

In the instant situation, as in Rev. Rul. 78-338, the requisite risk-shifting and risk-distribution necessary to constitute insurance are present. There is a sufficient number of policyholders; no one policyholder owns a controlling interest in the exchange, and the policies are non-assessable.

HOLDING

Payments made by the professional corporation to a physician-owned mutual insurance company as professional liability insurance premiums are deductible as ordinary and necessary expenses under section 162 of the Code.

Section 164.—Taxes

26 CFR 1.164-1: Deduction for taxes.

Land gains tax; Vermont. The tax imposed by sections 10001 through 10010, title 32, of the Vermont Statutes Annotated (Supp. 1979), on gain from the sale or exchange of certain land in Vermont is a transfer tax and is deductible under section 164(a) of the Code only to the extent that it is paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212.

Rev. Rul. 80-121

ISSUE

Is the tax imposed by sections 10001 through 10010, title 32, of the Vermont Statutes Annotated (Supp. 1979), on gain from the sale or exchange of certain land in Vermont deductible under section 164 of the Internal Revenue Code?

FACTS

Section 10001 of the Vermont Statutes levies a tax (land gains tax) on gain from the sale or exchange of land in Vermont. However, gain allocable to any improvements on the land, gain attributable to land held for more than six years, or gain attributable to land necessary for the use of a dwelling used by the taxpayer as the taxpayer's principal residence and not exceeding 10 acres is not subject to the land gains tax. The rate of land gains tax (from 5 to 60 percent) varies, directly according to the percentage of the taxpayer's basis in the land that is equal to the gain, and inversely according to the length of time the taxpayer has held the land, abating completely after six years.

Under the Vermont statute, a sale or exchange of land is any transfer of title to land for a consideration, and a taxable gain is the amount realized from a sale or exchange of land, less the transferor's basis in the land as determined under the federal Internal Revenue Code. In computing the amount of gain subject to tax, the taxpayer cannot reduce taxable gain from one sale or exchange of land during the taxable year by losses from other sales or exchanges of land, including those incurred in a trade or business or in any transaction entered into for profit though not connected with a trade or business. The amount realized from a sale or exchange of land is the full actual consideration paid or to be paid therefor, including the amount of any liens or encumbrances on the land existing before the sale or exchange and not removed thereby, minus any expenses of sale, any commissions, and any portion of the amount realized that is allocable to buildings or other structures on the land, if any.

Under the Vermont statute, liability for the land gains tax is imposed on the owner-seller of the land with exceptions not here relevant. The buyer of any land held by the seller for less than six years is required to withhold and remit to the Vermont Commissioner of Taxes ten percent of all consideration paid to the seller. Within 30 days of the sale or exchange of the land, the seller must file a tax return and pay any land gains tax that may be due in excess of the amount withheld.

Any tax required to be paid or withheld is a personal debt of the person liable to pay or withhold. When the notification or assessment of the land gains tax liability is made by the Vermont Commissioner of Taxes, an amount equal to the tax required to be paid or withheld becomes a lien upon all property and rights to property, whether real or personal, belonging to the person liable for the tax or for the withholding. To be valid, the lien must be recorded in the office of the clerk of the county where the property subject to the lien is situated.

Because notification or assessment occurs well after the date of the sale or exchange, the buyer has title to the transferred land when the notification or assessment takes place. Thus, because the seller no longer has title to the land, no lien to secure payment of the land gains tax can arise against the land by virtue of the seller's former ownership therein. A lien can arise against the land by virtue of the buyer's ownership, but only to assure that the buyer withholds and remits the required amount to the Vermont Commissioner of Taxes. Thus, if the buyer fulfills the obligation to withhold and remit, but the seller fails to pay any additional land gains tax owed in excess of the amount withheld, the State has no recourse against either the buyer's land or the buyer personally.

The collections from the land gains tax are used exclusively for public purposes.

LAW AND ANALYSIS

Section 164(a) of the Code describes various types of taxes that are allowed as a deduction for the taxable year within which paid or accrued. Specifically, these taxes are: (1) state and local, and foreign, real property taxes, (2) state and local personal property taxes, (3) state and local, and foreign, income, war profits, and excess profits taxes, and (4) state and local general sales taxes.

Section 164(a) of the Code also allows, as a deduction, state and local, and foreign, taxes not specifically described that are paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212 (relating to expenses for the production of income).

The only section 164 specific deduction provisions possibly applicable to the Vermont land gains tax are the state real property tax deduction provision and the state income tax deduction provision.

Section 1.164-3(b) of the Income Tax Regulations provides that the term "real property taxes" means taxes imposed on interests in real property and levied for the general public welfare by the proper taxing authorities of a state at a like rate against all property in the territory over which such authorities have jurisdiction.

Some of the characteristics of a tax imposed on real property or on an interest in real property are: (1) the tax is generally imposed or triggered by the ownership of real property and not the exercise of one or more of the incidents of property ownership, such as use or disposition, (2) the tax is measured by the value of real property, and (3) liability for the tax is not solely personal. See Rev. Rul. 75-558, 1975-2 C.B. 67, and Rev. Rul. 73-600, 1973-2 C.B. 47.

The Vermont land gains tax is not imposed or triggered by the ownership of real property, but rather, by the exercise of one of the incidents of property ownership, the transfer of real property at a gain. The land gains tax is not measured by the value of the real property, but rather, by the gain derived from the transfer of that property. Liability for the tax is personal because Vermont has no recourse against the buyer's land to satisfy any land gains tax owed by the seller in excess of the amount withheld and paid over to the state by the buyer. Thus, the land gains tax is not a real property tax within the meaning of section 164(a)(1) of the Code.

With respect to the Vermont land gains tax qualifying under the section 164 state income tax deduction provision, such tax, unlike federal income tax law, is not structured to fall on net gain, because the taxpayer cannot reduce taxable gain from sales or exchanges of land during the taxable year by any losses from other sales or exchanges of land during that year. Under federal income tax law, taxpayers are allowed to reduce gains from sales or exchanges of land (or other property) by losses from sales or exchanges of land (or other property). See sections 165, 1211, 1212, 1222, and 1231 of the Code and section 1.165-1(c)(3) of the regulations. A taxpayer could be required to pay the land gains tax even though under federal income tax law the taxpayer actually had a net loss from sales or exchanges of land for the taxable year. Thus, the land gains tax is not an income tax within the meaning of section 164(a)(3).

HOLDING

The Vermont land gains tax is a transfer tax and, therefore, is deductible under section 164(a) of the Code only to the extent that it is paid or accrued within a taxable year in carrying on a trade or business or in connection with an activity described in section 212 (relating to expenses for the production of income). See Rev. Rul. 65-313, 1965-2 C.B. 47, which also provides guidelines for the federal income tax treatment of transfer taxes imposed by state or local governments.

Section 263.—Capital Expenditures

26 CFR 1.263(a)-1: Capital expenditures; in general.

Whether an out-of-court settlement payment is a nondeductible capital expenditure. See Rev. Rul. 80-119, page 5.

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401-1: Qualified pension, profit-sharing and stock bonus plans.

Qualification; benefits suspended during reemployment after retirement. Benefits provided under a pension plan will not fail to be definitely determinable merely because the plan provides that pension benefits shall be suspended for any period of time during which primary insurance benefits under the Social Security Act are discontinued because of employment after retirement date; Rev. Rul. 82 superseded.

Rev. Rul. 80-122

The purpose of this revenue ruling is to restate the position of Rev. Rul. 82, 1953-1 C.B. 288, in view of the amendment of section 401(a) of the Internal Revenue Code by the Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 1974-3 C.B. 1.

The issue in Rev. Rul. 82 is whether a defined benefit plan which provides that pension benefits will be suspended for any period of time during which primary insurance payments under the Federal Social Security Act are discontinued because of reemployment with the employer after retirement will fail to satisfy the "definitely determinable benefits" requirement of section 1.401-1(b)(1)(i) of the Income Tax Regulations.

Section 1.401-1(b)(1)(i) of the regulations generally defines a pension plan, within the meaning of section 401(a) of the Code, as a plan established and maintained by an employer to provide definitely determinable benefits to its employees after retirement.

Pension benefits will not fail to be definitely determinable because a factor or condition, determinable only after retirement, is used to compute benefits in accordance with an express provision contained in the plan, if the factor or condition is not subject to the discretion of the employer.

In this case, the suspension of Social Security payments and thus, the suspension of pension benefits, is not within the discretion of the employer.

Accordingly, the pension benefits provided under the plan will not fail to be definitely determinable as required by section 1.401-1(b)(1)(i) of the regulations merely because of this suspension.

This revenue ruling considers only whether plan benefits are definitely determinable. It does not consider whether the plan provisions will result in a permissible forfeiture under section 411(a)(3)(B) of the Code or section 203(a)(3)(B) of the Employee Retirement Income Security Act.

Rev. Rul. 82 is superseded because the position stated therein is restated under current law in this revenue ruling.

Section 664.—Charitable Remainder Trusts

26 CFR 1.664-1: Charitable remainder trusts.

Whether the governing instrument of a testamentary charitable remainder trust must contain mandatory provisions conforming to section 1.664-1(a)(5) of the regulations in order for the charitable interest to qualify for an estate tax charitable deduction. See Rev. Rul. 80-125, page 10.

Section 819.—Foreign Life Insurance Companies

26 CFR 1.819-2: Foreign life insurance companies.

Percentage to be used in computing income tax for taxable year 1979 and estimated tax for taxable year 1980. See Notice 80-4, page 19.

Section 1502.—Regulations [Consolidated Returns]

26 CFR 5.1502-45: Limitation on losses to amount at risk.

T.D. 7685

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 5.—TEMPORARY INCOME TAX REGULATIONS UNDER THE REVENUE ACT OF 1978

Corporations filing consolidated returns subject to at risk limitations under section 465

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document contains temporary regulations relating to the at risk limitations as they affect an affiliated group that files a consolidated return. Changes to the applicable law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol 1) 1] and the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1]. The regulations would provide the public with the guidance needed to comply with the Acts and would affect certain closely-held corporations that join with their subsidiaries in filing a consolidated return.

DATES: The amendments are effective for taxable years for which the due date (without extensions) for filing returns is after March 14, 1980.

FOR FURTHER INFORMATION CONTACT: Lawrence M. Axelrod of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention CC:LR:T (202-566-3458, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains temporary regulations relating to the at risk limitations under section 465, as amended by section 202 of the Revenue Act of 1978 with respect to the effect of those limitations on corporations that join with their subsidiaries in filing a consolidated return. The temporary regulations provided by this document will remain in effect until superseded by final regulations on this subject.

Under section 465, as amended by the Revenue Act of 1978, a corporation which meets the stock ownership test for a personal holding company may deduct losses attributable to any of its activities (other than the holding of real estate and equipment leasing) only to the extent that it has amounts at risk in the activity. In general, the stock ownership test is met if 50 percent in value of a corporation's outstanding stock is owned, directly or indirectly, by not more than five individuals. Prior to the Revenue Act of 1978, section 465, as enacted by the Tax Reform Act of 1976, applied the at risk limitations only to corporations that were either personal holding companies or Subchapter S corporations. Under section 542, a corporation is a personal holding company if it satisfies two requirements, an adjusted ordinary gross income requirement and a stock ownership requirement. Section 202 of the Revenue Act of 1978 amended section 465 to apply the at risk limitations to all corporations that satisfy the stock ownership test, regardless of whether the adjusted gross income test is met. The Report of the House Ways and Means Committee states that, in the case of an affiliated group, revised section 465 is to apply to all corporations in the group if it applies to the common parent. H.R. Rep. No. 95-1445, 95th Cong., 2d Sess. 69 (1978) [1978-3 C.B. (Vol. 1) 181].

The Treasury Department understands that taxpayers are actively considering a transaction or plan to avoid the at risk limitations. Under the plan, a corporation forms a subsidiary with a nominal capital investment, the subsidiary goes at risk in some activity, and the corporation uses losses of the subsidiary through the filing of a consolidated return. It is claimed that since the subsidiary is technically "at risk" in the activity, deductions are not barred by section 465.

If an activity is conducted directly by the parent without risk, section 465 disallows the corporation from deducting any loss from the activity. To permit a corporation to receive the tax benefit of such a loss, in a case in which the activity is conducted by a subsidiary (without any true economic risk) and the corporation and subsidiary file a consolidated return, would frustrate the congressional mandate embodied in section 465.

Under section 1502, the Secretary is delegated broad power to prescribe regulations in order that the tax liability of any affiliated group of corporations making a consolidated return may be clearly reflected and in order to prevent avoidance of such tax liability. Under the temporary regulations, if a parent meets the stock ownership test for a personal holding company, a subsidiary's loss from an activity to which section 465 applies will be allowed as a deduction on a consolidated return only to the extent that the parent is at risk in the activity of a subsidiary, under the principles of section 465, as of the close of the subsidiary's taxable year.

Under section 1503(a), consolidated return regulations must be adopted before the due date of the return for a taxable year, to be effective for that year. Therefore, to be effective for taxable years ending on or after December 31, 1979, it is impracticable to issue the regulations under the usual notice procedures. The temporary regulations will be effective for taxable years for which the due date (without extensions) for filing returns is after March 14, 1980.

DRAFTING INFORMATION

The principal author of this regulation is Lawrence M. Axelrod of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations both on matters of substance and style.

Adoption of amendments to the regulations.

Part 5 of Title 26 of the Code of Federal Regulations is amended by adding a new § 5.1502-45 to read as follows:

§ 5.1502-45 Limitation on losses to amount at risk.

(a) *In general.*—(1) *Scope.* This section applies to a loss of any subsidiary if the common parent's stock meets the stock ownership requirement described in section 465(a)(1)(C).

(2) *Limitation on use of losses.* Except as provided in paragraph (a)(4) of this section, a loss from an activity of a subsidiary during a consolidated return year is includible in the computation of consolidated taxable income (or consolidated net operating loss) and consolidated capital gain net income (or consolidated net capital loss) only to the extent the loss does not exceed the amount that the parent is at risk in the activity at the close of that subsidiary's taxable year. In addition, the sum of a subsidiary's losses from all its activities is includible only to the extent that the parent is at risk in the subsidiary at the close of that year. Any excess may not be taken into account for the consolidated return year but will be treated as a deduction allocable to that activity of the subsidiary in the first succeeding taxable year.

(3) *Amount parent is at risk in subsidiary's activity.* The amount the parent is at risk in an activity of a subsidiary is the lesser of (i) the amount the parent is at risk in the subsidiary or (ii) the amount the subsidiary is at risk in the activity. These amounts are determined under paragraph (b) of this section and the principles of section 465. See section 465 and the regulations thereunder and the examples in paragraph (e) of this section.

(4) *Excluded activities.* The limitation on the use of losses in paragraph (a)(2) of this section does not apply to a loss attributable to an activity described in section 465(c)(3)(D).

(5) *Substance over form.* Any transaction or arrangement between members (or between a member and a person that is not a member) which does not cause the parent to be economically at risk in an activity of a subsidiary will be treated in accordance with the substance of the transaction or arrangement notwithstanding any other provision of this section.

(b) *Rules for determining amount at risk*—(1) *Excluded amounts.* The amount a parent is at risk in an activity of a subsidiary at the close of the subsidiary's taxable year does not include any amount which would not be taken into account under section 465 were the subsidiary not a separate corporation. Thus, for example, if the amount a parent is at risk in the activity of a subsidiary is attributable to nonrecourse financing, the amount at risk is not more than the fair market value of the property (other than the subsidiary's stock or debt or assets) pledged as security.

(2) *Guarantees.* If a parent guarantees a loan by a person other than a member to a subsidiary, the loan increases the amount the parent is at risk in the activity of the subsidiary.

(c) *Application of section 465.* This section applies in a manner consistent with the provisions of section 465. Thus, for example, the recapture of losses provided in section 465(e) applies if the amount the parent is at risk in the activity of a subsidiary is reduced below zero.

(d) *Other consolidated return provisions unaffected.* This section limits only the extent to which losses of a subsidiary may be used in a consolidated return year. This section does not apply for other purposes, such as § 1.1502-32 and § 1.1502-19, relating to investment in stock of a subsidiary and excess loss accounts, respectively. Thus, a loss which reduces a subsidiary's earnings and profits in a consolidated return year, but is disallowed as a deduction for the year by reason of this section, may nonetheless result in a negative adjustment to the basis of an owning member's stock in the subsidiary or create (or increase) an excess loss account.

(e) *Examples.* The provisions of this section may be illustrated by the examples in this paragraph (e). In each example, the stock ownership requirement of section 465(a)(1)(C) is met for the stock of the parent (P), and each affiliated group files a consolidated return on a calendar year basis and comprises only the members described.

Example (1). In 1979, P forms S with a contribution of $200 in exchange for all of S's stock. During the year, S borrows $400 from a commercial lender and P guarantees $100 of the loan. S uses $500 of its funds to acquire a motion picture film. S incurs a loss of $120 for the year with respect to the film. At the close of 1979, the amount P is at risk in S's activity is $300. If S has no gain or loss in 1980, and there are no contributions from or distributions to P, at the close of 1980 P's amount at risk in S's activity will be $180.

Example (2). P forms S-1 with a capital contribution of $1 on January 1, 1980. On February 1, 1980, S-1 borrows $100 with full recourse and contributes all $101 to its newly formed subsidiary S-2. S-2 uses the proceeds to explore for natural oil and gas resources. S-2 incurs neither gain nor loss from its explorations during the taxable year. As of December 31, 1980, P is at risk in the exploration activity of S-2 only to the extent of $1.

(f) *Effective date.* This section applies to consolidated return years ending on or after December 31, 1979.

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in sections 1502 and 7805 of the Internal Revenue Code of 1954 (68A Stat. 637, 917; 26 U.S.C. 1502, 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved March 11, 1980.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on March 12, 1980, 12:16 p.m., and published in the issue of the Federal Register for March 14, 1980, 45 F.R. 16483)

Section 2055.—Transfers for Public, Charitable, and Religious Uses

26 CFR 20.2055-2: Transfers not exclusively for charitable purposes.
(Also Sections 664, 7805; 1.664-1, 301.7805-1.)

Charitable remainder trusts; governing instrument. In order for the charitable interest in a testamentary charitable remainder trust to

qualify for an estate tax charitable deduction, the governing instrument of the trust must provide that the obligation to pay the unitrust or annuity amount begins on the date of death, and for corrective payments in the case of an underpayment or overpayment of the amount determined to be payable; Rev. Rul. 72-395 modified.

Rev. Rul. 80-123

ISSUE

Must the governing instrument of a testamentary charitable remainder trust contain mandatory provisions conforming to section 1.664-1(a)(5) of the Income Tax Regulations in order for the charitable interest to qualify for an estate tax charitable deduction?

LAW AND ANALYSIS

Section 2055(e)(2)(A) of the Internal Revenue Code provides that if a remainder interest in property passes for a charitable purpose and an interest in the same property passes for a private purpose then, with certain limited exceptions, no charitable deduction is allowed for the charitable remainder interest unless the interest is in a trust which is a charitable remainder annuity trust or unitrust (described in section 664 of the Code) for a pooled income fund (described in section 642(c)(5)).

The transfer of a remainder interest in trust will qualify for an estate tax charitable deduction only if the interest is in a trust which is a charitable remainder trust at the date of death of the decedent and the charitable interest is susceptible of valuation on the date of the decedent's death. Section 20.2055-2(a) of the Estate Tax Regulations. Valuation of the charitable interest is based on the assumption that a specified unitrust or annuity amount will be distributed over a specified period of time determinable and beginning as of the date of death.

Section 1.664-1(a)(4) of the regulations provides that in order for a trust to qualify as a charitable remainder trust, it must satisfy the definition of and function exclusively as a charitable remainder trust from the creation of the trust. For purposes of section 664 the trust is deemed created at the earliest time that neither the grantor nor any other person is treated as owner of the trust corpus for income tax purposes, but in no event prior to the time that the trust is funded.

Notwithstanding the rule that for the tax exemption purposes of section 664 charitable remainder trusts are not deemed to be created until they are funded, section 1.664-1(a)(5) provides a special rule regarding the deemed creation date for federal estate tax purposes. This rule provides that for purposes of section 2055, the charitable remainder trusts are deemed to be created as of the date of death of the grantor, even though the trust is not yet funded and even though no payments will be made by the trust until the end of a reasonable period of estate administration at which time the trust will be funded. The rule allows a deferral in commencement of the annuity or unitrust payments provided the obligation to pay begins as of the date of death and local law or the governing instrument authorizes the delay. When the trust is fully funded, the trustee is required to pay out or receive whichever is appropriate, the difference between what, if anything, has been paid out and what should have been paid out during the interim between death and full funding.

The remainder of the section prescribes the method for retroactively determining the proper amounts payable, in the event the unitrust or annuity amount is deferred.

Rev. Rul. 72-395, 1972-2 C.B. 340, explains the requirements for charitable remainder trusts and sets forth sample provisions for drafting trust instruments. The requirements of section 1.664-1(a)(5) of the regulations are treated as an optional provision in sections 5.02 and 7.02 of Rev. Rul. 72-395.

The amount of the deduction allowed for charitable remainder trusts under section 2055(a) is computed as of the date of death. The computation assumes the trust is operative, and making payouts as of this date, and that any accretions to or invasions of trust corpus are being made as necessitated by the difference in the required payout and the actual income earned during this period.

In reality, these events do not occur until a later date when the trust is funded. State law governing the administration of trusts and estates normally would determine who is entitled to the income earned, during the period of administration of the estate, by the assets that will eventually fund the trusts. However, it is unlikely that application of state law will produce the same distributions, accretions and invasions presumed in the deduction computation.

In order to overcome these practical difficulties involved with testamentary trusts, the regulations created a special rule for estate tax purposes.

The provisions for corrective payments contained in section 1.664-1(a)(5) require, in effect, that the proper amount payable during the period of administration will be distributed, or any excess payment will be recovered. Thus, the provision ensures that the trust disbursements will be based on the same premises applied in the computation of the deduction. Applying these corrective payment rules makes the value of the charitable interest ascertainable and assures consistency in computing the amount of the deduction and the actual payments of the annuity or unitrust amounts. Deeming the trust to be created on the date of death satisfies the requirement of section 2055 that the trust be qualified as of the date of death.

Not only must a testamentary trust contain a deferral provision for purposes of section 2055 of the Code, but it also must contain a deferral provision for purposes of qualification as a charitable remainder trust under section 664 of the Code. If the deferral provision of section 1.664-1(a)(5) of the regulations is not included in the governing instrument of the trust, then, as explained above, no charitable deduction will be allowable, and, under section 1.664-1(a)(1)(iii)(a) of the regulations, the trust will not meet the definition of a charitable remainder trust.

HOLDING

A governing instrument of a testamentary charitable remainder trust must contain mandatory provisions conforming to section 1.664-1(a)(5) of the regulations in order for the charitable interest to qualify for an estate tax charitable deduction; that is, the governing instrument must provide that the obligation to pay the unitrust or annuity amount begins on the date of death, and for corrective payments in the case of an underpayment or overpayment of the annuity or unitrust amount determined to be payable.

Rev. Rul. 72-395 is hereby modified to the extent that it implies that the provisions contained in section 1.664-1(a)(5) of the regulations are optional for testamentary charitable remainder trusts.

Pursuant to the authority contained in section 7805(b), the principles of this revenue ruling apply only in the case of transfers to testamentary charitable remainder trusts by decedents dying after May 5, 1980 (the date this revenue ruling appeared in the I.R.B.) except that they do not apply in the case of transfers under the terms of wills executed on or before May 5, 1980: (a) If the decedent dies after May 5, 1980, but before May 5, 1981, without having amended any dispositive provision of this will after May 5, 1980, by codicil or otherwise; (b) If the decedent dies after May 5, 1980, and at no time after that date had the right to change the portions of the will which pertain to the passing of the property to, or for the use of an organization described in section 2055(a); or (c) If no dispositive provision of the will is amended by the decedent, by codicil or otherwise, after May 5, 1980, and before May 5, 1981, and the decedent is on May 5, 1981, and at all times thereafter under a mental disability (as defined in section 1.642(c)-2(b)(3)(ii) of the Income Tax Regulations) to amend the will by codicil or otherwise.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 72-395 is modified.

Section 3121.—Definitions [Federal Insurance Contributions Act]

26 CFR 31.3121(a)-1: Wages.
(Also Sections 3306, 3401; 31.3306(b)-1, 31.3401(a)-1.)

Payments to employees under preretirement leave plan. Payments made by a company to eligible employees under a negotiated preretirement leave benefit plan that (1) was adopted to offset layoffs resulting from periodic slack seasons, (2) provides benefits whether or not an actual need for a layoff ever occurs, and (3) guarantees benefits at the time leave is scheduled are wages under sections 3121(a), 3306(b), and 3401(a) of the Code; Rev. Ruls. 56-249 and 60-330 distinguished and Rev. Rul. 75-461 amplified.

Rev. Rul. 80-124

ISSUE

Are payments made by a company to its eligible employees under its preretirement leave benefit plan wages under sections 3121(a), 3306(b), and 3401(a) of the Internal Revenue Code?

FACTS

The company's preretirement leave benefit plan, which arose from a collective bargaining agreement with its employees' union, was adopted to offset layoffs that ordinarily resulted from the periodic slack seasons incurred by the company. By scheduling its older more experienced employees on leave at times when there is a reduced need for employees, the company is able to retain the services of short service employees who might otherwise be laid off. An additional purpose of the plan is to introduce and accustom eligible employees to permanent retirement status on a gradual basis.

To be entitled to benefits under the plan, an employee must have 30 years of service with the company. Eligible employees are entitled to 1 to 4 weeks of benefits per year, according to their age. The leave must be taken in full, consecutive weeks and any unused portion may not be accrued.

Eligible employees who desire to use the leave must apply by a prescribed date each year. The company schedules the leave after taking into account the employees' preferences, the need for their services at the times requested, and the seniority of other employees making similar applications. The leave is guaranteed whether or not the actual need for a layoff ever occurs, and if any employee dies before or while taking preretirement leave that has been scheduled, the benefits are paid to the estate. Benefits paid to employees under the plan equal about two-thirds of their regular salaries.

The union agreed to an offset of the preretirement leave plan payments against contributions required to be made by the company to its supplemental unemployment benefit plan trust account under its collective bargaining agreement with the union. The company uses that account to pay supplemental unemployment benefits to its employees who are laid off. The preretirement leave benefit plan is not a part of the supplemental unemployment benefit plan. Supplemental unemployment benefits are not wages under sections 3121(a) and 3306(b) of the Code. They are, however, treated as wages for purposes of federal income tax withholding under section 3402(o).

LAW AND ANALYSIS

Sections 3121(a) and 3306(b) of the Code provide that "wages" means all remuneration for employment. Section 3401(a) contains a similar definition.

Rev. Rul. 75-461, 1975-2 C.B. 394, holds that payments to employees under a negotiated preretirement leave benefit plan based on years of employee service and age, and established to introduce and accustom eligible employees to permanent retirement gradually, are wages under sections 3121(a), 3306(b), and 3401(a) of the Code. Benefits were about two-thirds of the employee's regular weekly wages. The payments were not made on account of retirement or sickness or accident disability and employees were permitted to choose whether to return to active status or retire permanently at the end of the leave period. The revenue ruling does not state the effect of the plan's funding on the company's supplemental unemployment benefit plan.

Rev. Rul. 57-37, 1957-1 C.B. 18, holds that contributions conveying fully vested and nonforfeitable interests made by an employer into separate and independently controlled trusts for each employee, where each trust is created pursuant to a collective bargaining agreement for the purpose of furnishing unemployment and certain other benefits to eligible employees and paying over the balance due of such benefits to the employee upon termination of employment or retirement or to the employee's estate upon death, are wages under sections 3121(a), 3306(b), and 3401(a) of the Code.

Rev. Rul. 56-249, 1956-1 C.B. 488, holds that benefits paid to individuals by trustees of a trust created pursuant to the provisions of a supplemental unemployment benefit plan are not wages under sections 3121(a), 3306(b), and 3401(a) of the Code. The benefits are paid only to unemployed former employees of the company who are on layoff and no employee has any right, title, or interest in or to any asset of the fund or any company contributions to the fund until such time as the employee is on layoff by reason of a reduction in force or the discontinuance of a plant or operation.

Rev. Rul. 60-330, 1960-2 C.B. 46, which amplifies Rev. Rul. 56-249, holds that supplemental unemployment benefit payments made by an employer directly to qualifying former employees pursuant to the provisions of a supplemental unemployment benefit plan, but in all other material respects similar to the plan described in Rev. Rul. 56-249, are not wages under sections 3121(a), 3306(b), and 3401(a) of the Code.

In order for a payment to qualify as a supplemental unemployment benefit payment under Rev. Rul. 56-249 and Rev. Rul. 60-330, the employee must have no right, title, or interest in the payment or the company contribution to provide the payment until the employee is laid off, and the payment must be made for a layoff that is involuntary on the part of the employee. See section 3402(o)(2)(A) of the Code, which defines supplemental unemployment compensation benefits for the purpose of treating them as wages subject to income tax withholding, and section 501(c)(17)(D)(i), which defines the benefits for purposes of the exemption from federal income tax of trusts paying them. Both Code sections provide that the payment must be based on the involuntary separation of an employee from the employment of the employer only when such separation is one resulting directly from a reduction in force, the discontinuance of a plant or operation, or other similar condition.

In this case, the preretirement leave benefits do not constitute supplemental unemployment compensation benefits since benefits are provided even where there has been no layoff because of periodic slack seasons, and the benefits are guaranteed at the time the leave is scheduled. The fact that funding of the preretirement leave plan reduced the company's supplemental unemployment benefit plan contribution does not convert the preretirement leave payments to supplemental unemployment benefit payments.

HOLDING

Payments made to eligible employees under the company's preretirement leave benefit plan are wages under sections 3121(a), 3306(b), and 3401(a) of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 56-249 and Rev. Rul. 60-330 are distinguished and Rev. Rul. 75-461 is amplified.

Section 3306.—Definitions [Federal Unemployment Tax Act]

26 CFR 31.3306(b)-1: Wages.

Whether payments made by a company to its eligible employees under its preretirement leave benefit plan are wages. See Rev. Rul. 80-124, page 12.

Section 3401.—Definitions [Collection of Income Tax at Source on Wages]

26 CFR 31.3401(a)-1: Wages.

Whether payments made by a company to its eligible employees under its preretirement leave benefit plan are wages. See Rev. Rul. 80-124, page 12.

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26 CFR 31.3401(a)(18)-1: Remuneration for which a corresponding deduction is allowed under section 913.

T.D. 7684

TITLE 26.—INTERNAL REVENUE, CHAPTER I, SUBTITLE C, PART 31.—EMPLOYMENT TAXES APPLICABLE ON AND AFTER JANUARY 1, 1955; PART 37.—TEMPORARY EMPLOYMENT TAX REGULATIONS UNDER THE FOREIGN EARNED INCOME ACT OF 1978

Wage withholding on remuneration for which a corresponding deduction is allowable under section 913

AGENCY: Internal Revenue Service, Treasury.

ACTION: Adoption of final regulations and deletion of temporary regulations.

SUMMARY: This document provides final Employment Tax Regulations and deletes temporary regulations, relating to wage withholding on remuneration for which a corresponding deduction is allowable under section 913 of the Internal Revenue Code of 1954. Changes to the applicable tax law were made by the Foreign Earned Income Act of 1978 [Pub. L. 95-615, 1978-2 C.B. 415]. These regulations provide necessary guidance to employers of persons living abroad for compliance with the law.

DATE: This Treasury decision is effective on April 14, 1980. However, if an employer has determined wages of employees and withheld on a basis consistent with the rules contained in this Treasury decision for some period between January 1, 1979 and this effective date, that practice for that period will not be questioned by the Internal Revenue Service.

FOR FURTHER INFORMATION CONTACT: Mary E. Dean of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3289, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On January 4, 1979, the Federal Register published proposed amendments to the Employment Tax Regulations (26 CFR Part 31) under section 3401(a)(18) of the Internal Revenue Code of 1954 (44 FR 1110). The amendments were proposed to conform the regulations to section 207(a) of the Foreign Earned Income Act of 1978 (92 Stat. 3097, 3108). A public hearing was held on August 28, 1979. After consideration of all comments regarding the proposed amendments, this Treasury decision adopts amendments, as set forth in full below, to the Employment Tax Regulations.

In addition, on January 4, 1979, the Federal Register published Temporary Employment Tax Regulations under the Foreign Earned Income Act of 1978 (26 CFR Part 37) relating to section 3401(a)(18) of the Internal Revenue Code of 1954 (44 FR 1110). These temporary regulations, which contained the same rules as the proposed amendments to the Employment Tax Regulations, are deleted by this Treasury decision.

EXPLANATION OF PROVISION

Section 3401(a)(18) of the Code provides, for purposes of income tax withholding, that the term "wages" does not include remuneration paid to, or on behalf of, an employee if at the time of the payment it is reasonable to believe that a corresponding deduction is allowable under section 913 of the Code (relating to deduction for certain expenses of living abroad).

Several comments received from employers requested that the manner and timing of payments of certain forms of remuneration be considered in the further development of the regulation. Specifically, it was requested that payments of remuneration not regularly made with respect to payroll periods be exempted from the proration requirement of § 31.3401(a)(18)-1(a)(2). That provision has been accordingly revised to provide that these payments (for which a corresponding deduction must be allowable under section 913) do not constitute wages and are not subject to (or included in) the application of the proration requirement. With respect to other payments, however, the proration formula of § 31.3401(a)(18)-1(a)(2) applies in determining the portion of each payment which does not constitute wages. Section 31.3401(a)(18)-1(b) provides acceptable forms for written statements which employees may furnish to employers and upon which employers may rely in determining whether the employee will meet the bona fide foreign residency or physical presence tests of section 913. Finally, § 31.3401(a)(18)-1(c) provides an acceptable form for a written statement by the employee relating to the anticipated amount of the employee's deduction under section 913 for the year.

DRAFTING INFORMATION

The principal author of these regulations is Mary E. Dean of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 31 is amended by adding immediately after § 31.3401(a)(16)-1 a new § 31.3401(a)(18)-1 to read as follows and 26 CFR Part 37 is deleted.

§ 31.3401(a)(18)-1 Remuneration for which a corresponding deduction is allowable under section 913.

(a) *General rule*—(1) *In general.* Remuneration paid for services performed outside the United States for an employer (other than the United States or any agency thereof) by a citizen or resident of the United States does not constitute wages and hence is not subject to withholding to the extent that, at the time of the payment, it is reasonable to believe that a corresponding deduction is allowable under section 913, relating to the deduction for certain expenses of living abroad. The part of a payment of remuneration which does not constitute wages subject to withholding under this section is determined under paragraph (a)(2) of this section. The reasonable belief may be based upon information derived from the employee or from other sources which is reasonably sufficient to induce this belief, even though the information may ultimately be insufficient to establish that a corresponding deduction is allowable under section 913. For rules relating to reasonable belief of an employer as to the availability to an employee of a section 913 deduction, see paragraph (b) of this section. For rules relating to reasonable belief of an employer as to the anticipated amount of section 913 deduction allowable to an employee, see paragraph (c) of this section.

(2) *Amount of reduction in wages subject to withholding*—(i) *Irregular payments.* Any portion of a payment of remuneration to or on the behalf of an employee which is not regularly made with respect to payroll periods does not constitute wages to the extent that, at the time of the payment, it is reasonable to believe that a corresponding deduction is allowable to the employee under section 913. Examples of payments of remuneration which may be subject to this paragraph (a)(2)(i) include lump sum payments to a school for qualified schooling expenses and reimbursement in a lump sum to the employee of amounts paid by the employee for qualified home leave travel expenses.

(ii) *Other payments.* In addition to any reduction in wages determined under paragraph (a)(2)(i) of this section, a payment of remuneration made in a period during which the employee is expected to qualify for the section 913 deduction is further reduced by the following amount:

$$\frac{\text{Amount of sec. 913 deduction} \quad \text{(anticipated for the taxable year and not subject to paragraph (a)(2)(i))}}{\text{Total payment of remuneration} \quad \text{(anticipated for the portion of the year during which the taxpayer is expected to qualify for the section 913 deduction and not excluded from wages under paragraph (a)(2)(i))}} \times \text{The subject payment of remuneration (after reduction in wages provided in paragraph (a)(2)(i))}$$

The remaining part of the payment of remuneration is wages and hence is subject to withholding, unless excluded under another provision of section 3401(a). For the purpose of applying this proration under this paragraph (a)(2)(ii), an employer is not required to ascertain or take account of information with respect to amounts of remuneration received by the employee from any other source. The proration provided by this paragraph (a)(2)(ii) may be illustrated by the following examples:

Example (1). Employee A, a calendar year taxpayer, reasonably expects to receive remuneration of $48,000 from employer B during 1980. A expects to qualify for the section 913 deduction for the entire year. No reduction in wages is allowed pursuant to paragraph (a)(2)(i). A anticipates that A's section 913 deduction for 1980 will be $12,000. A's remuneration for January 1980 is $4,000. The amount of this payment of remuneration which does not constitute wages is $1,000, *i.e.*, ($12,000/$48,000 × $4,000). The remaining part of the remuneration, $3,000, is wages and is subject to withholding, unless excluded under another provision of section 3401(a).

Example (2). Employee A, a calendar year taxpayer, reasonably expected on January 1, 1980, to receive remuneration of $48,000 from employer B during 1980. A anticipated that A's section 913 deduction for 1980 would amount to $12,000. No reduction in wages is allowed pursuant to paragraph (a)(2)(i). For each of the first 6 months of 1980, A's remuneration was $4,000, and $1,000 of this remuneration did not constitute wages. On July 1, 1980, A first realizes that the anticipation of a $12,000 deduction under section 913 for 1980 was incorrect, and that instead A may reasonably expect that the section 913 deduction for 1980 will be $6,000. A's remuneration for July, 1980, is $4,000. The amount of this payment of remuneration which does not constitute wages is $500, *i.e.*, ($6,000/$48,000 × $4,000). The remaining part of the remuneration, $3,500, is wages and is subject to withholding, unless excluded under another provision of section 3401(a).

Example (3). Assume the same facts as in Example (1) except that on July 1, 1980, A's employer first decides to reimburse employee A for one-half of A's deduction anticipated under section 913 for 1980. The employer immediately makes an irregular payment of $6,000 to A which represents one-half of A's $12,000 of deduction anticipated under section 913 for 1980. Pursuant to paragraph (a)(2)(i) the full amount ($6,000) of the irregular payment by the employer does not constitute wages. A's other remuneration for July, 1980, of $4,000 consists of $500 which do not constitute wages and $3,500 which do constitute wages. This determination is made in the manner set forth in example (2).

(b) *Availability of section 913 deduction*—(1) *In general.* A deduction is allowable under section 913 only if an employee satisfies the requirements of section 913(a)(1) or (2), relating, respectively, to bona fide residence of a United States citizen in a foreign country and to physical presence of a United States citizen or resident in a foreign country. All or a portion of a payment of remuneration may be excluded from wages under this section only if the employer reasonably believes that the employee-recipient of the payment will meet the residence requirement of section 913(a)(1) or the presence requirement of section 913(a)(2).

(2) *Statement of residence in a foreign country.* (i) In the absence of cause for a reasonable belief to the contrary, the employer may presume that an employee will satisfy the residence requirement of section 913(a)(1) during the taxable year, or applicable portion thereof, for which the employee properly furnishes the employer the following statement or a statement with substantially the same information:

Statement for claiming benefits of section 913(a)(1) for calendar year ________ or fiscal year beginning ____________________ and ending ____________________.

I am a citizen of the United States. I have been a bona fide resident of the following foreign country or countries namely, ____________________, for an uninterrupted period which began on ____________________, 19____. I expect to remain a bona fide resident of a foreign country until the end of the taxable year 19____ or, if not until the end of the taxable year, until ____________ ____________, 19____.

On the basis of the facts in my case, I have good reason to believe that, with respect to the above period of foreign residence falling within the taxable year, I will satisfy the bona fide foreign residence requirement prescribed by section 913(a)(1) of the Internal Revenue Code of 1954 and qualify for the deduction allowed by section 913.

In the event I become disqualified for the deduction provided by section 913(a) for all or part of the above period of foreign residence falling within the taxable year, I will immediately notify my employer, and indicate the portion of the taxable year for which I qualify for the deduction under section 913.

I declare under the penalties of perjury that this statement has been examined by me and to the best of my knowledge and belief is true and correct.

____
(Signature of taxpayer)
Date: ____________________, 19____.

(ii) If the employer was entitled to presume for the taxable year immediately preceding an employee's current taxable year that the employee was a bona fide resident of a foreign country or countries during the entire preceding taxable year and the employee is residing in a foreign country on the first day of the current taxable year, in the absence of cause for a reasonable belief to the contrary and without obtaining from the employee the statement prescribed in paragraph (b)(2)(i), the employer may presume that the employee will be a bona fide resident of a foreign country or countries in the current taxable year.

(3) *Statement of presence in a foreign country.* In the absence of cause for a reasonable belief to the contrary, the employer may presume that an employee will satisfy the presence requirement of section 913(a)(2) with respect to the taxable year, or applicable portion thereof, for which the employee furnishes the following statement or a statement with substantially the same information:

Statement for claiming benefits of section 913(a)(2) for calendar year ________ or fiscal year beginning ____________________ and ending ____________________.

I am a citizen or resident of the United States.

Except for occasional absences not disqualifying me for the benefit of section 913(a)(2), I expect to be present in the following foreign countries, namely, ________ ____________, for an 18 month period which includes the entire taxable year ________ or, if not the entire year, the portion of the taxable year beginning on ____________________, 19____, and ending on ____________________, 19____.

On the basis of the facts in my case I have good reason to believe that, during the above period of presence in a foreign country falling within the taxable year, I will satisfy the 510 full-day requirement prescribed by section 913(a)(2).

In the event I become disqualified for the deduction provided by section 913(a)(2) for all or part of the above period of presence in a foreign country or countries falling within the taxable year, I will immediately notify my employer, indicating the portion, if any, of the taxable year for which I qualify for the deduction under section 913.

I declare under the penalties of perjury that this statement has been examined by me and to the best of my knowledge and belief is true and correct.

____
(Signature of taxpayer)
Date: ____________________, 19____.

(c) *Amount of section 913 deduction*—(1) *In general.* Section 913(a) allows a deduction for certain expenses of living abroad which is the sum of the amounts qualifying under section 913(b). Remuneration will be excluded from wages under this section only if the employer has reasonable evidence that the amount excluded does not exceed the anticipated amount of the employee's deduction allowable under section 913 for the taxable year.

(2) *Statement of amount of section 913 deduction.* In the absence of cause for a reasonable belief to the contrary, the employer may presume that the anticipated deduction allowable under section 913 for a taxable year is correctly determined when the employee furnishes his employer a statement, prepared by the employee or on behalf of the employee by the employer or another person, in substantially the following form:

Statement of anticipated deduction under section 913 for calendar year ________ or fiscal year beginning ________________
and ending ________________.

I anticipate that I will qualify for a deduction under section 913 of the following amounts:

(1) Qualified cost-of-living differential ________________ _____
(2) Qualified housing expenses ___ _____
(3) Qualified schooling expenses _ _____
(4) Qualified home leave travel expenses ____________ _____
(5) Qualified hardship area deduction ________________ _____

Total section 913 deduction anticipated ________________ _____

I understand that the total entered above plus the total reported on any other statements outstanding with other employers should not exceed my anticipated deduction under section 913 for the year.

I understand that the deduction allowed by section 913 shall not exceed my earned income from sources outside the United States for the portion of the taxable year in which my tax home is in a foreign country, reduced by the sum of—

(a) Any portion of that earned income which is excluded as compensation for meals and lodging under section 119, and

(b) Deductions properly allocable to that earned income other than the deduction allowed by section 913.

I declare under the penalties of perjury that this statement has been examined by me and to the best of my knowledge and belief is true and correct.

____
(Signature of taxpayer)
Date: ________________, 19___.

(3) *New statement.* The employee may furnish a new statement at any time during the taxable year when the employee reasonably anticipates that the amount of the deduction which will be allowable under section 913 has changed from the previous statement.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of Internal Revenue.

Approved March 5, 1980.

DONALD C. LUBICK,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on March 12, 1980, 8:45 a.m., and published in the issue of the Federal Register for March 13, 1980, 45 F.R. 16177)

Section 4041.—Imposition of Tax [Special Fuels]

26 CFR 48.4041-9: Exemption for use as supplies for vessels or aircraft.

Extension of maximum duration period of blanket exemption certificates. See T.D. 7686, page 17.

Section 4073.—Exemptions [Tire and Tubes]

26 CFR 48.4073-3: Exemption of tread rubber used for nonhighway tires.

Extension of maximum duration period of blanket exemption certificates. See T.D. 7686, page 17.

Section 4083.—Exemption of Sales to Producer [Petroleum Products]

26 CFR 48.4083-1: Exemption; sales to producers of gasoline.

Extension of maximum duration period of blanket exemption certificates. See T.D. 7686, page 17.

Section 4091.—Imposition of Tax [Lubricating Oil]

26 CFR 48.4091-3: Sales of cutting oil.

Extension of maximum duration period of blanket exemption certificates. See T.D. 7686, page 17.

Section 4093.—Exemptions [Lubricating Oil]

26 CFR 48.4093-1: Tax-free sales to manufacturers for resale.

Extension of maximum duration period of blanket exemption certificates. See T.D. 7686, page 17.

Section 4121.—Imposition of Tax [Coal]

26 CFR 139.4121-1: Questions and answers relating to the excise tax on coal.

Coal; surface-mined coal mixed with underground-mined coal. Computation of the manufacturers tax on coal is illustrated for sales by the producer of surface-mined coal and underground-mined coal that are blended together during cleaning.

Rev. Rul. 80-125

ISSUE

How should the manufacturers excise tax on coal be computed where coal from a surface mine is blended during cleaning with coal from an underground mine and the resulting product is sold by the producer?

FACTS

Situation 1. A producer mines and during the cleaning operation blends two tons of surface mined coal with two tons of underground mined coal to produce two tons of clean coal which is marketable. The clean coal is composed of 50 percent surface mined coal and 50 percent underground mined coal because the percentage of waste material in each type was 50 percent. The cleaned coal is sold for $30 per ton. If the surface mined coal and underground mined coal had been cleaned and sold separately, the fair market prices per ton would have been $20 and $25 respectively.

Situation 2. A producer mines and blends during the cleaning operation three tons of surface mined coal with one ton of underground mined coal to produce three tons of clean coal that is marketable. The clean coal product sells for $40 per ton. It is not routinely determinable as to what portion of the end product is surface mined coal and what portion is underground mined coal because the quality of each is constantly changing.

LAW AND ANALYSIS

Section 4121 of the Internal Revenue Code imposes a tax on coal sold by the producer at the rate of 50 cents per ton for underground mined coal and 25 cents per ton for surface mined coal, but in each case limited to 2 percent of the sale price per ton. Section 139.4121-1 of the Temporary Regulations provides that the sales price and tonnage determination is made at the point of sale, namely f.o.b. mine, or f.o.b. cleaning plant if cleaned before sale. The regulations further provide that if a sale includes a portion of a ton, the tax is applied proportionately.

The tax imposed by section 4121 of the Code is based on the amount of coal sold by the producer. Thus, if two tons of coal are actually sold by the producer in *Situation 1* or three tons of coal are actually sold by the producer in *Situation 2*, then the tax is computed on the amount sold regardless of the amount that could have been sold if there been no blending and cleaning process. If the amounts of underground mined and surface mined coal found in the clean coal cannot be determined by use of waste factors or recovery factors then the amount of each type of coal can be estimated on the ratio of the original tonnage input of each type of coal.

Under the temporary regulations, the amount of blended cleaned coal subject to tax and the sales price for such coal is determined at the point of sale of the blended cleaned coal. The computation of tax on such sale is determined without regard to the fair market values of the coals that were used to produce the blend.

HOLDING

Situation 1. Because the proportion of surface mined coal and underground mined coal in the blended, cleaned product is determinable, the tax is based on the proportion of each type of coal contained in the end product and the selling price of the coal sold is taken into account for purposes of the 2 percent limitation. Thus, the two tons of cleaned coal sold consist of one ton of surface coal and one ton of underground coal. The tax is computed as follows:

Surface coal—1 ton at
25 cents per ton = $0.25
Underground coal—1 ton at
50 cents per ton = $0.50
Tax on 2 tons $0.75

The tax is limited by statute to 2 percent of the selling price. In this situation, however, 2 percent of the sale price of $60.00 for 2 tons (at $30 per ton) is $1.20, which is more than the tax computed above at the tonnage rate. Therefore, the tax payable is $0.75.

Situation 2. Because the proportion of surface mined coal and underground mined coal in the blended product is not determinable, the ratio of the surface mined coal and underground mined coal in the original input is used to compute the tax. Thus, ¾ of the three tons of clean coal sold (2¼ tons) is treated as surface mined coal and ¼ of three tons (¾ ton) is treated as underground mined coal. Based on these figures, the tax is computed as follows:

Surface coal—2¼ tons
at 25 cents per ton = $0.5625
Underground coal—¾ ton
at 50 cents per ton = $0.3750
Tax on 3 tons $0.9375

In this situation, 2 percent of the sales price of $120.00 for 3 tons (at $40 per ton) is $2.40. Therefore, as in *Situation 1*, the 2 percent statutory limitation does not apply, and the tax payable is $0.9375.

Section 4221.—Certain Tax-free Sales

26 CFR 48.4221-6: Tax-free sales of articles to nonprofit educational organizations. (Also Sections 4041, 4073, 4083, 4091, 4093; 48.4041-9, 48.4073-3, 48.4083-1, 48.4091-3, 48.4091-4, 48.4091-6, 48.4093-1, 154.1-1.)

T.D. 7686

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 48.—MANUFACTURERS AND RETAILERS EXCISE TAXES; PART 154.—TEMPORARY REGULATIONS IN CONNECTION WITH THE AIRPORT AND AIRWAY REVENUE ACT OF 1970

Uniform maximum period for exemption certificates

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final Regulations.

SUMMARY: This document provides final regulations relating to an extension of the maximum duration period of blanket exemption certificates for purchases of various items otherwise subject to tax. These regulations provide necessary guidance to the public for compliance with the law, and they affect all persons required to pay retailers or manufacturers excise taxes.

DATE: The regulations are effective for sales made after December 31, 1958.

FOR FURTHER INFORMATION CONTACT: Annie R. Alexander of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T: LR-56-79, 202-566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

This Treasury decision amends §§ 48.4041-9, 48.4073-3, 48.4083-1, 48.4091-3-4, 6, 48.4093-1, and 154.1-1 of the regulations to extend the maximum duration of blanket exemption certificates from 4 calendar quarters to 12 calendar quarters. The certificates are used by purchasers buying otherwise taxable items for exempt purposes and on a regular basis from a single supplier. The certificates are required before a tax-free purchase can be made. Treasury Decision 7536, 1978-1 C.B. 317, extended the maximum period from 4 to 12 calendar quarters for some, but not all, exemption certificates. These regulations will create a uniform period for all such certificates. For similar reasons, § 48.4221-6(c) is amended to permit notification for a period not to exceed 12 calendar quarters. Because this regulation is nonsubstantive and liberalizes a procedural requirement in favor of taxpayers, it is found unnecessary to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section. For the same reasons, this regulation is not a significant regulation under paragraph 8 of the Treasury Directive appearing in the Federal Register for November 8, 1978 (43 FR 52120).

DRAFTING INFORMATION

The principal author of these regulations is Annie R. Alexander of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Amendments to the regulations

The following amendments to 26 CFR Parts 48 and 154 are adopted:

§ 48.4041-9

Paragraph 1. Paragraph (b)(2) of § 48.4041-9 is amended by substituting "12 calendar quarters" for "4 calendar quarters" in the second sentence.

§ 48.4073-3

Par. 2. Paragraph (c)(2) of § 48.4073-3 is amended by substituting "12 calendar quarters" for "4 calendar quarters" in the second sentence.

§ 48.4083-1

Par. 3. Paragraph (a) of § 48.4083-1 is amended by substituting "twelve successive calendar quarters" for "four successive calendar quarters" in the first sentence immediately following (a)(2)(ii).

§ 48.4091-3

Par. 4. Paragraph (a)(2)(ii) of § 48.4091-3 is amended by substituting "12 calendar quarters" for "4 calendar quarters" in the second sentence.

§ 48.4091-4

Par. 5. Paragraph (a)(2)(ii) of § 48.4091-4 is amended by substituting "12 calendar quarters" for "4 calendar quarters" in the second sentence.

§ 48.4091-6

Par. 6. Paragraph (b)(2) of § 48.4091-6 is amended by substituting "12 calendar quarters" for "4 calendar quarters" in the second sentence.

§ 48.4093-1

Par. 7. Paragraph (a)(2)(i) of § 48.4093-1 is amended by substituting "12 calendar quarters" for "4 calendar quarters".

§ 48.4221-6(c)

Par. 8. Section 48.4221-6(c) is amended by deleting the period at the end of the next to the last sentence and inserting in lieu thereof the following: "except that a single notification containing the information described in this paragraph may cover all sales by the seller to the purchaser made during a designated period not to exceed 12 successive calendar quarters.".

§ 154.1-1

Par. 9. Paragraph (d)(4) of § 154.1-1 is amended by substituting "12 calendar quarters" for "4 calendar quarters" in the first sentence.

* * * * *

This Treasury decision is issued under the authority contained in Section 7805 of the Code (68A Stat. 917, 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved February 26, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on March 18, 1980; 8:45 a.m., and published in the issue of the Federal Register for March 19, 1980, 45 F.R. 17573)

Section 7805.—Rules and Regulations

26 CFR 301.7805-1: Rules and regulations.

Circumstances in which the governing instrument of a testamentary charitable remainder trust must contain mandatory provisions conforming to section 1.664-1 (a)(5) of the regulations in order for the charitable interest to qualify for an estate tax charitable deduction. See Rev. Rul. 80-123, page 10.

Part III. Administrative, Procedural, and Miscellaneous

Notice 80-4

(Also Part I, Section 819; 1.819-2.)

Income Tax: Taxable Years Beginning After Dec. 31, 1953; Percentage To Be Used by Foreign Life Insurance Companies in Computing Income Tax for the Taxable Year 1979 and Estimated Tax for the Taxable Year 1980

AGENCY: Department of the Treasury.

ACTION: Proclamation.

SUMMARY: This proclamation announces the percentage to be used to compute the income tax liability of foreign corporations carrying on life insurance business in the United States.

EFFECTIVE DATE: March 15, 1980.

FOR FURTHER INFORMATION CONTACT: Mr. Hudson Milner, Office of Tax Analysis, U.S. Treasury Department, Washington, D.C. 20220, (202-566-2705), not a toll free call.

SUPPLEMENTARY INFORMATION: This proclamation, issued each year by the Secretary of the Treasury, announces the percentage to be used to compute the income tax liability of foreign corporations carrying on life insurance business in the United States.

Proclamation

For purposes of computing the 1979 income tax of foreign corporations carrying on a life insurance business, a percentage of 13.9 shall be used in determining the "minimum figure" under section 819. The same percentage shall be used for purposes of computing the estimated tax and the installment payments of estimated tax for the taxable year 1980. No additions to tax shall be made because of any underpayment of estimated tax for the taxable year 1980 which results solely from the use of this percentage.

This proclamation is issued without notice and public procedure because the public cannot effectively participate in the determination of the percentage. It is computed from information contained in income tax returns that are not open to the public. The proclamation was not published prior to its effective date because the percentage is computed on the basis of data which was not then available.

DONALD C. LUBICK,
Assistant Secretary
(Tax Policy).

(Filed by the Office of the Federal Register on March 25, 1980, 8:45 a.m., and published in the issue of the Federal Register for March 26, 1980, 45 F.R. 19546)

Part IV. Items of General Interest

Foundation Status of Certain Organizations

Announcement 80-55

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3) of the Code, eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Alcoholism Council Sacramento Area, Sacramento, CA
Analysis West, Palo Alto, CA
Baler Band Booster Club, Hollister, CA
Baroque Sinfonia of Santa Rosa, Santa Rosa, CA
Bay Area Energy Action, Inc., San Francisco, CA
Beethovens Exchange, Inc., San Francisco, CA
Berkeley One Act Theatre Company, Inc., San Francisco, CA
Broome County Family Day Care Association, Johnson City, NY
Broward Gridiron Club, Inc., Ft. Lauderdale, FL
Butte-Glenn Medical Society Auxiliary, Chico, CA
Carty Development Foundation, Inc., Pompano Beach, FL
Chester High Booster Club, Chester, CA
Childhood Production Ltd. of California, Oakland, CA
Community Urban Redevelopment of Lima and Allen County, Inc., Lima, OH
Concilio De Padres De Tulare County, Visalia, CA
Contact-Youth, Inc., San Rafael, CA
Cuban Refugee Assistance Fund, Inc., Coral Gables, FL
District of Columbia Integral Yoga Institute, Inc., Washington, DC
Drum and Bugle Corps of Columbus, Ohio, Delaware, OH
Everybody's Creative Arts Center, Inc., Oakland, CA
Extended Hand, Inc., The, Hyde Park, MA
Food and Land Resource Center, Minneapolis, MN
Foundation Center for Phenomenological Research, Sacramento, CA
Foundation for Applied Research, Washington, DC
Foundation for Humanistic Medicine and Psychology, San Anselmo, CA
Friends of Hong Kong Shue Yan College, Inc., San Francisco, CA
Frisella Memorial Physical Education Fund, The Dan, San Mateo, CA
Girls Club of Erie County, New York, Inc., Buffalo, NY
Gospel Teachers Publications Foundation, Inc., Dallas, TX
Greater Las Vegas Urban League, Las Vegas, NV
Hale Mental Health Service, Inc., John, San Francisco, CA
Here's Life Rochester, Inc., Rochester, NY
Hope for Hemophilia Research, Carmichael, CA
Housing Task Force, Inc., Davis, CA
Human Service Alternatives, Palo Alto, CA
Humboldt Youth Services, Arcata, CA
Huntsville Area Assn. for Pastoral Care, Huntsville, AL
Industrial Home for the Blind Foundation, Inc., Miami, FL
Ingalls Foundation for the Benefit of the Cumberland School of Law, Robert I., Birmingham, AL
Jacksonville Metropolitan Foundation, Inc., Jacksonville, FL
Jerome Consortium of Musical Arts, Mesa, AZ
Johnson Evangelistic Ministries, Inc., Charlie, Longview, TX
Ka' U Research Institute, Inc., Naalehu, HI
Kauai Foundation for Hearing Impaired Children, Lihue, HI
Kensington Repeater Association, Inc., Albany, CA
Kids of the Kingdom, Inc., Birmingham, AL
Korean-American Youth Foundation, Inc., Los Angeles, CA
Krazenpo Karate Club, Gilroy, CA
L'Opera de Florida, Inc., Tampa, FL
La Familia Center of Marin County, Inc., San Rafael, CA
La Ross, Inc., Compton, CA
Larita, Inc., Tucson, AZ
Last Hope, Santa Ana, CA
Lauderdale County Episcopal Charities, The Meridian, MS
Learning Resources of Northern New Mexico, Chimayo, NM
Legal Assistance for the Developmentally Disabled, Inc., Bismarck, ND
Lemon Grove Alano Club, Inc., Lemon Grove, CA
Life Line, Inc., Chatsworth, CA
Lifeline for Children, Inc., Pompano Beach, FL
Linden Buy High—Sell Low, Inc., Linden, CA
Local Indians for Education, Redding, CA
Longshoreman's Christian Fellowship, Wilmington, CA
Longview Symphony Foundation, The, Longview, TX
Mayfield Heights Community Center, Inc., Mayfield Heights, OH
Mendocino-Lake Counties Tribal and Economic Development District, Ukiah, CA
Military Historical Society of Minnesota, Inc., The, Camp Ripley, MN
Modesto Rotary Club Foundation, Modesto, CA
Montclair After-School Day Care Center, Inc., Oakland, CA
Montgomery Performing Arts Co., Montgomery, AL
Mothers' Emergency Stress Service, Inc., Sacramento, CA
Nevada Education & Training Organization for Health, Inc., Carson City, NV
Nevada Symphonic Association, Reno, NV
New Careers in Human Services, Eureka, CA

Oprahz Oprahz, San Francisco, CA
Pacific Management Institute, San Francisco, CA
Pathways Youth Services, Inc., Sparks, NV
People's Self-Help, San Francisco, CA
Poppy Day Care Center, Portola Valley, CA
Pro Per Legal Education Project, The, Berkeley, CA
Repertory Dance Theatre, Salt Lake City, UT
Saints, Inc., The, Tampa, FL
San Francisco Center for the Visual Studies, San Francisco, CA
San Francisco Juneteenth Society, San Francisco, CA
San Joaquin Suzski Music Club, Stockton, CA
Second Wind Inc., St. Augustine, FL
Silver Wheels Football, Inc., Buffalo, NY
Site, Cite, Sight, Inc., San Francisco, CA
Studio 7—Education Through Art, Inc., West Palm Beach, FL
Sullivan Çounty Health Advisory Council, Inc., Monticello, NY
Sunrise Children's Treatment Center for the Emotionally Disturbed, Concord, CA
Transitional Learning Concepts, Walnut Creek, CA
Tucker Ministries, Inc., Ron, Creve Coeur, MO
Volunteers in Parole, Sacramento, CA
Wakonda Supervised Living Facility, Inc., Wakonda, SD
Wintu Chapter of the National Audubon Society, Redding, CA
Wolf Foundation, Inc., Michael Alan, Miami, FL
Women for Christ, Jacksonville, AL
Wooster Art Center, Wooster, OH
Young Friends of North America Corp., Richmond, IN
Yuey Foundation, The Joe, San Francisco, CA
504 Committee, Inc., The, Oakland, CA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants and Enrolled Agents from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following person has been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Stephen K. Easton	New York, NY	Certified Public Accountant	Indefinite from February 29, 1980

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants or enrolled agents to practice before the Internal Revenue Service.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant or enrolled agent so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing, the following individuals were disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
Robert W. Tufts	St. Petersburg, FL	Certified Public Accountant	March 17, 1980
William A. Carbaugh	Greenville, SC	Enrolled Agent	March 21, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 301.6103(j)(1)-1 added; 404.6103(j)(1)-1 deleted.	Disclosure of returns and return information to officers and employees of Bureaus of the Census and Economic Analysis of the Department of Commerce for certain statistical purposes.	Mar. 24, 1980	May 23, 1980
26 CFR 150.0 through 150.6402-1 added; published as temporary regulations in T.D. 7690, 1980-16 I.R.B. 11.	Crude Oil Windfall Profit Tax Act of 1980.	Apr. 4, 1980	June 3, 1980
26 CFR 1.166-9, 1.482-2, 1.1371-1, amended; 1.385-1 through 1.385-12, added.	Treatment of certain interests in corporations as stock or indebtedness.	Mar. 24, 1980	June 23, 1980
26 CFR 53.4942 revoked; 53.4942(a)-2 amended.	The use of blockage or similar factors in determining the value of private foundations' noncharitable assets consisting of listed securities for purposes of determining the amount foundations must distribute annually for charitable purposes.	Mar. 12, 1980	May 12, 1980
26 CFR 301.6103(a)-1 through 301.6103(c)-1, 301.6103(i)-1 through 301.6103(p)(2)(B)-1 added; 301.6103(h)(2)-1 amended; 404.6103(a)-1 through 404.6103(i)-1, 404.6103(j)(2)-1 through 404.6103(n)-1, 420.6103(1)(2)-1 through 420.6103(1)(2)-3 deleted.	Disclosure of returns and return information under certain circumstances.	Mar. 24, 1980	May 23, 1980
26 CFR 1.170A-1, 1.170A-4, 1.170A-11, amended; 1.170A-4A, added.	Deduction of certain charitable contributions of inventory and other property.	Mar. 20, 1980	May 19, 1980
26 CFR 1.6050-1, 301.6050-1, deleted; 53.4942(b)-1, revised.	Treatment of Certain Elderly Care Facilities.	Mar. 24, 1980	May 23, 1980
26 CFR 1.46-4, 1.316-1, 1.852-4, 1.857-4, amended; 1.852, 1.857, deleted; 1.381(c)(25)-1, 1.860-1 through 1.860-5, added.	Deficiency dividends paid by certain regulated investment companies and real estate investment trusts.	Mar. 31, 1980	May 27, 1980
26 CFR 1.411(d)-1 added.	Coordination of vesting and discrimination requirements for qualified plans.	April 9, 1980	June 9, 1980
26 CFR 1.1502-12, amended; 1.1502-44, added.	Consolidated returns for percentage depletion for independent producers and royalty owners.	April 9, 1980	June 9, 1980

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[1] **See footnote at end of list.**

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1, dated January 7, 1980.

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Key to Abbreviations:

RR	Revenue Ruling
RP	Revenue Procedure
TD	Treasury Decision
CD	Court Decision
PL	Public Law
EO	Executive Order
DO	Delegation Order
TDO	Treasury Department Order
TC	Tax Convention
SPR	Statement of Procedural Rules
PTE	Prohibited Transaction Exemption

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May 12, 1980
Bulletin No. 1980-19

Internal Revenue bulletin

9258

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENTS

Announcement 80-62, page 19.
A public hearing will be held on June 4, 1980, concerning proposed regulations relating to the allowance of deductions to foreign corporations doing business in the U.S.

Announcement 80-65, page 19.
Public Law 96-223, Crude Oil Windfall Profit Tax Act of 1980, and related Committee Reports will be published in a special edition of the Cumulative Bulletin, 1980-3.

INCOME TAX

Rev. Rul. 80-126, page 5.
Annuities; civil service; disability; survivors' benefits; refund factor. The "approximate method" set forth in Rev. Rul. 60-325 may be used in determining the refund factor to be applied in computing the adjusted investment, under section 72(c)(2) of the Code, for annuities payable to the spouse and child of a federal employee who died while in a disability retirement status before having elected to report annuity payments under section 72(b) or (d) and before otherwise having attained such employee's annuity starting date for purposes of section 72; Rev. Rul. 71-89 superseded.

Rev. Rul. 80-127, page 5.
Depreciation; CLADR; shipping containers. Shipping containers that are designed and regularly used to transport cargo on the highway on specially designed trailers and to transport cargo by water on specially designed cargo ships are included in CLADR asset guideline class 00.27.

Rev. Rul. 80-134, page 10.
Warrants; extension of expiration date. The unilateral extension of the expiration date of warrants issued by a qualified real estate investment trust or any other corporation has the effect of the grant of new warrants, and the issuer recognizes gain on the date the original unexercised warrants lapse. This holding shall not apply to warrants issued on or before April 24, 1972, or warrants issued pursuant to a binding contract under which the issuer was obligated on April 24, 1972, to issue the warrants. Rev. Rul. 77-40 amplified.

Notice 80-5, page 16.
Countries that may require participation in, or cooperation with, an international boycott are listed.

EMPLOYEE PLANS

Rev. Rul. 80-128, page 6.
Distribution; two employers; single trust. An employee of two corporate employers, whose separate qualified pension plans were funded by contributions to a single trust, terminated employment with one of the employers. A distribution representing the balance to the employee's credit under the pension plan of the ex-employer was a lump-sum distribution within the meaning of section 402(e)(4)(A) of the Code. Rev. Rul. 66-16 superseded.

(Continued on page 4)

Finding Lists begin on page 23.
Announcement of Notice of Proposed Rulemaking on page 21.
Announcement of Disbarments and Suspensions on page 20.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part includes rulings and decisions based on Subpart A, Tax Conventions and related Treasury Decisions and Revenue Rulings; Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of Revenue Rulings, Revenue Procedures, and other published items, and (3) topical Indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

EMPLOYEE PLANS—Cont'd

Rev. Rul. 80-129, page 7.

Distribution; employing entity terminated. When the business of a partnership or corporation is terminated along with its qualfied plan and a partnership is formed to continue the business, a distribution from the exempt employees' trust will not be treated as a distribution on account of separation from service if the employee continues on the same job for the successor employer; Rev. Ruls. 73-17 and 73-413 superseded.

Rev. Proc. 80-17, page 17.

Rulings and opinion letters; simplified employee pension (SEP). Procedures that a plan sponsor may follow to obtain a ruling or opinion letter from the National Office as to the acceptability of a prototype simplified employee pension (SEP) are set forth; Rev. Procs. 75-6 and 77-15 modified.

Announcement 80-58, page 19.

A new Form 5306-SEP, Application for Approval of Prototype Simplified Employee Pension-SEP, that is to be used to request an opinion letter for a prototype SEP will be available after May 16, 1980.

T.D. 7688, page 7.

Amendments to the regulations under section 414(e) of the Code relate to the definition of the term "church plan."

EXEMPT ORGANIZATIONS

Rev. Rul. 80-130, page 10.

Social clubs; fees paid to members. An exempt social club may pay a reasonable fixed fee to members who bring in new members to the club without disqualifying the club from exemption.

Rev. Rul. 80-132, page 12.

Private foundation; self-dealing; donation of life insurance policy. A disqualified person donated a life insurance policy to a private foundation. The policy was subject to an outstanding loan made to the donor within the 10-year period ending on the date of the donation that was not insignificant in relation to the value of the policy. The donation was an act of self-dealing.

Rev. Rul. 80-133, page 13.

Private foundation; jeopardizing investment; donation of life insurance policy. A whole-life insurance policy that was subject to a loan to the donor-insured was donated to a private foundation. The face value of the policy, less any outstanding loan principal or interest, was payable to the donee upon the donor's death. The combined interest and premium payments made by the donee over the life expectancy of the donor would exceed the amount it would receive under the policy and were, therefore, jeopardizing investments.

EXCISE TAXES

Rev. Rul. 80-131, page 11.

Fiberglass bulk containers. Molded fiberglass open-top containers designed to be secured to the flatbed of taxable trailers and semitrailers, towed by a farm tractor through the farm fields, loaded with tomatoes by a mechanical tomato harvester, and used in transporting tomatoes from the farm fields over the highway to a cannery are taxable trailer and semitrailer bodies; Rev. Rul. 79-309 distinguished.

TAX CONVENTIONS

Announcement 80-68, page 19.

A change is made to Rev. Rul. 80-98, which holds that amounts received from the National Institutes of Health under the Visiting Fellows Program by residents of certain countries are exempt from federal income tax.

ADMINISTRATIVE

Del. Order Nos. 35(Rev. 11), 77(Rev. 14), 93 (Rev. 7), and 97(Rev. 18); pages 15 & 16.

Appeals team chiefs. Appeals team chiefs are added to the lists of officials to whom authority is granted to enter into agreements pursuant to section 1313(a)(4) of the Code, issue statutory notices of deficiency, consent to certain treatment of aggregations, and enter into closing agreements. Del. Order Nos. 35(Rev. 10), 77 (Rev. 13), 93(Rev. 6), and 97(Rev. 17) superseded.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 72.—Annuities; Certain Proceeds of Endowment and Life Insurance Contracts

26 CFR 1.72-7: Adjustment in investment where a contract contains a refund feature.

Annuities; civil service; disability; survivors' benefits; refund factor. The "approximate method" set forth in Rev. Rul. 60-325 may be used in determining the refund factor to be applied in computing the adjusted investment, under section 72(c)(2) of the Code, for annuities payable to the spouse and child of a federal employee who died while in a disability retirement status before having elected to report annuity payments under section 72 (b) or (d) and before otherwise having attained such employee's annuity starting date for purposes of section 72; Rev. Rul. 71-89 superseded.

Rev. Rul. 80-126

The purpose of this revenue ruling is to restate, under current law, Rev. Rul. 71-89, 1971-1 C.B. 33.

The issue presented in Rev. Rul. 71-89 is whether the "approximate method" set forth in Rev. Rul. 60-325 may be used to compute the adjusted investment under section 72(c)(2) of the Internal Revenue Code for annuities paid to survivors of a Federal employee who died while in a disability retirement status before reaching voluntary retirement age, which was such an employee's annuity starting date under prior law.

Section 72(c)(2) of the Code provides, in part, that if (a) the expected return under the contract depends in whole or in part on the life expectancy of one or more individuals, (b) the contract provides for payments to be made to a beneficiary (or to the estate of an annuitant) on or after the death of the annuitant or annuitants; and (c) such payments are in the nature of a refund of the consideration paid, then the value (computed without discount for interest) of such payments on the annuity starting date shall be subtracted from the investment in the contract. Such value is to be computed in accordance with actuarial tables prescribed by the Secretary.

Rev. Rul. 60-325, 1960-2 C.B. 23, involves the determination of the refund factor in a case in which the widow and child of a Federal employee are receiving benefits from the United States Civil Service Retirement and Disability Fund as a result of the employee's death while still in the service. That revenue ruling states that the determination of the adjustment for the refund feature, using the same method as that used in computing the multiple factors shown in Table III of section 1.72-9 of the Income Tax Regulations, requires a complicated actuarial calculation that cannot be made by using only the tables published in the regulations. However, Rev. Rul. 60-325 provides for the use of an acceptable approximate method that would produce reasonable results in such cases.

Under current law, if a federal employee dies while in a disability retirement status before having elected to report his or her annuity payments under section 72(b) or (d) of the Code and before otherwise having attained such employee's annuity starting date for purposes of section 72, the approximate method set forth in Rev. Rul. 60-325 may be used in determining the refund factor to be applied in computing the adjusted investment, under section 72(c)(2), for the annuities payable to the spouse and child of the federal employee. The employee's annuity starting date is determined under sections 72 and 105 and the regulations thereunder.

Rev. Rul. 71-89 is superseded because the position stated therein is updated and restated, under current law, in this revenue ruling.

Section 167.—Depreciation

26 CFR 1.167(a)-11: Depreciation based on class lives and asset depreciation ranges for property placed in service after December 31, 1970.

Depreciation; CLADR; shipping containers. Shipping containers that are designed and regularly used to transport cargo on the highway on specially designed trailers and to transport cargo by water on specially designed cargo ships are included in CLADR asset guideline class 00.27.

Rev. Rul. 80-127

ISSUE

What is the proper classification under the Class Life Asset Depreciation Range (CLADR) System of the shipping containers described below?

FACTS

The taxpayer is engaged in the business of leasing various types of equipment. The taxpayer entered into a lease agreement with a domestic steamship line for the rental of shipping containers to be used in the lessee's business. The primary business of the lessee is the operation of a fleet of vessels that provide water transportation of freight between the United States and various international ports.

The containers are designed for the transport of cargo by, and interchange between, two modes of transport. These modes are highway, on specially designed trailers, and marine, in the holds of specially designed container ships.

The lessee's customers load the containers at their own facilities, mount the containers on specially designed trailers, and haul them over the road to the lessee's docks. At the docks, the containers are removed from the trailer, loaded on a ship, and carried to a foreign port. From there, the containers may be remounted on a trailer and hauled over the road to their destinations or unloaded on the pier.

The containers are specifically designed to be used with trailers. Although the containers are carried on oceangoing vessels for the majority of their useful lives, they are regularly used in conjunction with special trailers.

The taxpayer elected to adopt the CLADR System under section 1.167(a)-11 of the Income Tax Regulations for the years in which the containers were placed in service.

LAW AND ANALYSIS

Section 1.167(a)-11(a)(1) of the regulations provides an asset depreciation range and class life system for determining the reasonable allowance for depreciation of designated classes of assets placed in service after December 31, 1970.

Section 1.167(a)-11(b)(4)(ii) of the regulations provides that the asset guideline classes and the asset guideline periods, and the asset depreciation ranges determined from such periods, in effect for taxable years ending before the effective date of the first supplemental asset guideline classes, asset guideline periods, the asset depreciation ranges, established pursuant to this section are set forth in Rev. Proc. 72-10, 1972-1 C.B. 721. Rev. Proc. 72-10 has been superseded by Rev. Proc. 77-10, 1977-1 C.B. 548.

Section 1.167(a)-11(e)(3)(iii) of the regulations provides that, in the case of leased property, unless there is an asset guideline class in effect for lessors of that property, the asset guideline class for that property shall be determined as if the property were owned by the lessee. However, in the case of an asset guideline class based upon the type of property (such as trucks or railroad cars) as distinguished from the activity in which used, the property shall be classified without regard to the activity of the lessee.

Rev. Proc. 77-10 provides asset depreciation periods for various guideline classes of assets. Classes with a 00 prefix prescribe asset guideline periods and asset guideline ranges for specific depreciable assets regardless of the business activity in which they are used. Class 00.27 prescribes the period and range for trailers and trailer-mounted containers.

Class 44.0, Water Transportation, prescribes the period and range for assets used in the commercial and contract carrying of freight and passengers by water. However, transportation assets included in classes with a 00.2 prefix are specifically excluded from class 44.0.

Pursuant to section 1.167(a)-11(b)(4)(iii)(b) of the regulations, the containers would be includable in class 44.0 unless they are properly includable in class 00.27. The exception occurs because class 00.27 is for depreciable assets regardless of the business activity in which they are used, and they are specifically excluded from class 44.0. The question is, therefore, whether the containers may be properly classified as trailer-mounted containers included in class 00.27.

The containers are mounted on the trailers as a regular part of their normal use and are specially designed to be used with the trailers. Therefore, the containers fall directly within the "trailer-mounted container" language of class 00.27, notwithstanding that the containers are used, for the majority of their useful lives, in the holds of container ships.

However, class 00.27 does not include carrier-container semi-trailers or trailer mounted containers such as those described in Rev. Rul. 73-231, 1973-1 C.B. 427, which are normally used only within the confines of railroad yards, port areas, or similar facilities. Although containers of this type are capable of being used on the highway, such use is incidental since the single-axle design combined with the heavy weight of these containers results in an axle weight that is illegal on the public highways in most states.

HOLDING

The leased shipping containers, designed for use over the road on specially designed trailers and in the holds of container ships, are properly included in CLADR asset guideline class 00.27. The result would be the same if the containers were owned by the shipping company.

Section 219.—Retirement Savings

Procedures relating to processing of opinion letters issued by the National Office on simplified employee pension agreements. See Rev. Proc. 80-17, page 17.

Section 402.—Taxability of Beneficiary of Employees' Trust

26 CFR 1.402(a)-1: Taxability of beneficiary under a trust which meets the requirements of section 401(a).

Distribution; two employers; single trust. An employee of two corporate employers, whose separate qualified pension plans were funded by contributions to a single trust, terminated employment with one of the employers. A distribution representing the balance to the employee's credit under the pension plan of the ex-employer was a lump-sum distribution within the meaning of section 402(e)(4)(A) of the Code. Rev. Rul. 66-16 superseded.

Rev. Rul. 80-128

The purpose of this revenue ruling is to restate the position in Rev. Rul. 66-16, 1966-1 C.B. 88, in view of the enactment of the Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 1974-3 C.B. 1.

The issue presented in Rev. Rul. 66-16 is whether the distribution described below is a lump-sum distribution within the meaning of section 402(e)(4)(A) of the Internal Revenue Code.

An employee, on account of separation from the service of one of two corporate employers whose separate qualified employee benefit plans are funded by contributions to a single trust, received a distribution representing the balance to the employee's credit from the plan of the one employer while continuing employment with the second employer. Each plan provides a separate accrued benefit for the employee.

A lump-sum distribution, within the meaning of section 402(e)(4)(A) of the Code, is accorded special tax treatment. A distribution will be a lump-sum distribution within the meaning of section 402(e)(4)(A) of the Code, provided the balance to the credit of an employee becomes payable within one taxable year of the recipient upon the occurrence of certain events. One of the events is an employee's separation from service.

Accordingly, the distribution received by the employee upon separation from the service of one employer representing the balance to the credit of the participant under the employee benefit plan of such employer while continuing employment with the other employer is a lump-sum distribution and may be accorded special tax treatment.

For purposes of this holding it is immaterial whether the individual continues in employment with the second employer or whether the individual receives any distributions from the plan of the second employer. Moreover, the taxability of the distribution from the second plan will be based upon the character of that distribution, generally without regard to the distribution made from the first plan.

Rev. Rul. 66-16 is superseded because the position set forth therein is restated under current law in this revenue ruling.

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26 CFR 1.402(a)-1: Taxability of beneficiary under a trust which meets the requirements of section 401(a).

Distribution; employing entity terminated. When the business of a partnership or corporation is terminated along with its qualified plan and a partnership is formed to continue the business, a distribution from the exempt employees' trust will not be treated as a distribution on account of separation from service if the employee continues on the same job for the successor employer; Rev. Ruls. 73-17 and 73-413 superseded.

Rev. Rul. 80-129

The purpose of this revenue ruling is to restate Rev. Ruls. 73-17, 1973-1 C.B. 197, and 73-413, 1973-2 C.B. 143, in view of the enactment of the Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 1974-3 C.B. 1.

The issue raised by both revenue rulings is whether a distribution from an exempt employees' trust is made on account of an employee's separation from the service, within the meaning of section 402(e)(4)(A) of the Internal Revenue Code, if the distribution is made when the original employing entity along with its qualified profit-sharing plan is terminated and a successor partnership is formed to continue the business.

The major difference in the two revenue rulings is that in Rev. Rul. 73-413 a corporation was liquidated, whereas in Rev. Rul. 73-17 a partnership was terminated under local law. However, in each case, the business was continued by a successor partnership, and the employees of the original employing entity continued on the same jobs for the successor partnership.

Section 402(a)(1) of the Code provides, in general, that the amount actually distributed or made available to any distributee by an employees' trust described in section 401(a), which is exempt from tax under section 501(a), shall be taxable to the distributee, in the year in which so distributed or made available, under section 72 (relating to annuities).

However, a lump-sum distribution, within the meaning of section 402(e)(4)(A) of the Code, is accorded special tax treatment. Section 402(e)(4)(A) provides, in pertinent part, that a distribution will be a lump-sum distribution, provided the balance to the credit of an employee becomes payable within one taxable year of the recipient on account of an employee's separation from the service of the employer.

Rev. Rul. 79-336, 1979-43 I.R.B. 15, which deals with a reorganization of a corporation, states that an employee is separated from the service of the employer, for purposes of section 402(e)(4)(A) of the Code, only upon death, retirement, resignation, or discharge, and not when the employee continues on the same job for a different employer as a result of liquidation, merger, consolidation, etc., of the former employer.

The rationale of Rev. Rul. 79-336 is equally applicable to situations in which, for whatever purpose, an employer terminates its business and a successor employer is formed to continue the business. That the successor employer operates its business under a form different from that of the predecessor employer does not require a different result.

Consequently, the termination of the employing entity did not result in a separation from the service, since the employees did not die, retire, or resign; nor were any of the employees discharged from employment. Rather, the employees continued on the same job for the successor partnership.

Accordingly, the distributions from the exempt employees' trusts may not be treated as distributions on account of separation from the service within the meaning of section 402(e)(4)(A) of the Code. However, even though the distributions will not qualify for special tax treatment since no lump-sum distribution occurred, the distributions from both plans may be eligible for tax-free rollover treatment, provided the specific requirements of sections 402(a)(5) and 402(a)(6)(A) of the Code, to the extent applicable, are met.

Rev. Ruls. 73-17 and 73-413 are superseded because the positions stated therein are restated under current law in this revenue ruling.

Section 404.—Deduction for Contributions of an Employer to an Employees' Trust or Annuity Plan and Compensation Under a Deferred-Payment Plan

Procedures relating to processing of opinion letters issued by the National Office on simplified employee pension agreements. See Rev. Proc. 80-17, page 17.

Section 408.—Individual Retirement Accounts

26 CFR 1.408-1: General rules.

Procedures relating to processing of opinion letters issued by the National Office on simplified employee pension agreements. See Rev. Proc. 80-17, page 17.

Section 414.—Definitions and Special Rules [Pension, Profit-Sharing, Stock Bonus Plans, Etc.]

26 CFR 1.414(e)-1: Definition of church plan.

T.D. 7688 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Definition of the term "church plan"

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

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[1] This publication of the Treasury Decision contains the complete text of the amendments to the regulations. The instructions for modifying the notice of proposed rulemaking have been omitted.

SUMMARY: This document provides final regulations relating to the definition of the term "church plan." Changes to the applicable tax law were made by the Employee Retirement Income Security Act of 1974 (ERISA) [Pub. L. 93-406, 1974-3 C.B. 1]. These regulations provide necessary guidance for determining whether a retirement plan is a church plan. If a plan is a church plan, it may obtain qualified status without meeting certain requirements required of plans which are not church plans. A retirement plan which does not meet the provisions required of a church plan may still obtain qualified status by meeting all the requirements applicable to retirement plans generally.

EFFECTIVE DATE: September 2, 1974.

FOR FURTHER INFORMATION CONTACT: Phoebe Mix of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3671, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On April 8, 1977, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 414(e) of the Internal Revenue Code of 1954 (42 FR 18621). The amendments were proposed under ERISA section 1015 (88 Stat. 925). A public hearing was held on October 6, 1977. After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision.

INDEPENDENT ADMINISTRATORS

A number of commentators requested guidance with respect to whether a plan which is administered by a separately incorporated organization such as a pension board or a bank, can still qualify as a church plan. The final regulations provide that such plans can qualify as church plans.

SINGLE CHURCH DISQUALIFICATION PROBLEM

A number of persons commented that the provision in the notice of proposed rulemaking which would cause a plan to lose its church plan status if one of the churches maintaining the plan fails to meet all the requirements was too harsh. The Treasury Department agrees. Therefore the final regulations permit such a plan to retain its church plan status if the church which does not meet the requirements disassociates itself from the plan after notice from the Internal Revenue Service of its failure. § 1.414(e)-1(c).

ONCE DISQUALIFIED, FOREVER DISQUALIFIED

A number of commentators requested that the Service reverse the position taken in the proposed regulations which provided that once a plan ceases or fails to be a church plan, it can thereafter never become one. This position was taken in order to be consistent with section 410(d) of the Code, which permits church plans to make an irrevocable election not to be treated as a church plan. The position taken in the regulations prevents plans from avoiding the irrevocable election simply by failing the substantive requirements for church plans for a few years, and then meeting them a few years later. In addition, at the hearing it was brought out that substantial administrative problems could result if plans were permitted to enter and leave church plan status. Accordingly, the position taken in the proposed regulations is unchanged in the final regulations. § 1.414(e)-1(a).

FORMER EMPLOYEES

The Service was also requested to add to the regulations special provisions for church personnel who leave the employment of the church. The final regulations do not cover this issue because it is beyond the scope of section 414(e). The rules relating to coverage of former employees are the same for all qualified plans, regardless of whether or not they are church plans. There are no provisions which treat former employees covered by church plans differently from former employees covered by other qualified plans.

ADDITIONAL CHANGES

The final regulations delete proposed § 1.414(e) (statutory provisions). This action complies with Treasury Department policy to avoid placing in the Code of Federal Regulations material that serves little or no useful purpose. The statutory language is readily available elsewhere. Other minor clerical and clarifying changes were also made.

ADDITIONAL CONSIDERATIONS

These regulations are needed in order to provide guidance to the public as well as government employees responsible for the implementation of section 414(e) of the Internal Revenue Code of 1954. Considering both the direct and indirect effects of these regulations, it is believed they satisfactorily implement section 414(e) of the Code.

Evaluation of the effectiveness of the regulations after issuance will be based upon comments received from offices within the Internal Revenue Service and the Treasury Department, other governmental agencies, State and local governments, and the public.

DRAFTING INFORMATION

The principal author in these regulations is Phoebe Mix of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

AUTHORITY

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

Adoption of amendments to the regulations

After careful consideration of all comments received, the following amendments to the regulations are hereby adopted:

§ 1.414(e)-1 Definition of church plan.

(a) *General rule.* For the purposes of part I of subchapter D of chapter 1 of the Code and the regulations thereunder, the term "church plan" means a plan established and at all times maintained for its employees by a church or by a convention or association of churches (hereinafter included within the term "church") which is exempt from tax under section 501(a), provided that such plan meets the requirements of paragraphs (b) and (if applicable) (c) of this section. If at any time during its existence a plan is not a church plan because of a failure to meet the requirements set forth in this section, it cannot thereafter become a church plan.

(b) *Unrelated businesses*—(1) *In general.* A plan is not a church plan unless it is established and maintained primarily for the benefit of employees (or their beneficiaries) who are not employed in connection with one or more unrelated trades or businesses (within the meaning of section 513).

(2) *Establishment or maintenance of a plan primarily for persons not employed in connection with one or more unrelated trades or businesses.* (i)(A) A plan, other than a plan in existence on September 2, 1974, is established primarily for the benefit of employees (or their beneficiaries) who are not employed in connection with one or more unrelated trades or businesses if on the date the plan is established the number of employees employed in connection with the unrelated trades or businesses eligible to participate in the plan is less than 50 percent of the total number of employees of the church eligible to participate in the plan.

(B) A plan in existence on September 2, 1974, is to be considered established as a plan primarily for the benefit of employees (or their beneficiaries) who are not employed in connection with one or more unrelated trades or businesses if it meets the requirements of both paragraphs (b)(2)(ii)(A) and (B) (if applicable) in either of its first 2 plan years ending after September 2, 1974.

(ii) For plan years ending after September 2, 1974, a plan will be considered maintained primarily for the benefit of employees of a church who are not employed in connection with one or more unrelated trades or businesses if in 4 out of 5 of its most recently completed plan years—

(A) Less than 50 percent of the persons participating in the plan (at any time during the plan year) consist of, and in the same year

(B) Less than 50 percent of the total compensation paid by the employer during the plan year (if benefits or contributions are a function of compensation) to employees participating in the plan is paid to,

employees employed in connection with an unrelated trade or business. The determination that the plan is not a church plan will apply to the second year (within a 5 year period) for which the plan fails to meet paragraph (b)(2)(ii)(A) or (B) (if applicable) and to all plan years thereafter unless, taking into consideration all of the facts and circumstances as described in paragraph (b)(2)(iii) of this section, the plan is still considered to be a church plan. A plan that has not completed 5 plan years ending after September 2, 1974, shall be considered maintained primarily for the benefit of employees not employed in connection with an unrelated trade or business unless it fails to meet paragraphs (b)(2)(ii)(A) and (B) in at least 2 such plan years.

(iii) Even though a plan does not meet the provisions of paragraph (b)(2)(ii) of this section, it nonetheless will be considered maintained primarily for the benefit of employees who are not employed in connection with one or more unrelated trades or businesses if the church maintaining the plan can demonstrate that based on all of the facts and circumstances such is the case. Among the facts and circumstances to be considered in evaluating each case are:

(A) The margin by which the plan fails to meet the provisions of paragraph (b)(2)(ii) of this section, and

(B) Whether the failure to meet such provisions was due to a reasonable mistake as to what constituted an unrelated trade or business or whether a particular person or group of persons were employed in connection with one or more unrelated trades or businesses.

(iv) For purposes of this section, an employee will be considered eligible to participate in a plan if such employee is a participant in the plan or could be a participant in the plan upon making mandatory employee contributions to the plan.

(3) *Employment in connection with one or more unrelated trades or businesses.* An employee is employed in connection with one or more unrelated trades or businesses of a church if a majority of such employee's duties and responsibilities in the employ of the church are directly or indirectly related to the carrying on of such trades or businesses. Although an employee's duties and responsibilities may be insignificant with respect to any one unrelated trade or business, such employee will nonetheless be considered as employed in connection with one or more unrelated trades or businesses if such employee's duties and responsibilities with respect to all of the unrelated trades or businesses of the church represent a majority of the total of such person's duties and responsibilities in the employ of the church.

(c) *Plans of two or more employers.* The term "church plan" does not include a plan which, during the plan year, is maintained by two or more employers unless—

(1) Each of the employers is a church that is exempt from tax under section 501(a), and

(2) With respect to the employees of each employer, the plan meets the provisions of paragraph (b)(2)(ii) of this section or would be determined to be a church plan based on all the facts and circumstances described in paragraph (b)(2)(iii) of this section.

Thus, if with respect to a single employer the plan fails to meet any provision of this paragraph, the entire plan ceases to be a church plan unless that employer ceases maintaining the plan for all plan years beginning after the plan year in which it receives a final notification from the Internal Revenue Service that it does not meet the provisions of this paragraph. If the employer does cease maintaining the plan in accordance with this paragraph, the fact that the employer formerly did maintain the plan will not prevent the plan from being a church plan for prior years.

(d) *Special rule.* (1) Notwithstanding paragraph (c)(1) of this section, a plan maintained by a church and one or more agencies of such church for the employees of such church and of such agency or agencies, that is in existence on January 1, 1974, shall be treated as a church plan for plan years ending after September 2, 1974, and beginning before January 1, 1983, provided that the plan is described in paragraph (c) of this section without regard to paragraph (c)(1) of this section, and the plan is not maintained by an agency which did not maintain the plan on January 1, 1974.

(2) For the purposes of section 414(e) and this section, an agency of a church means an organization which is exempt from tax under section 501 and which is either controlled by, or associated with, a church. For example, an organization, a majority of whose officers or directors are appointed by a church's governing board or by officials of a church, is controlled by a church within the meaning of this paragraph. An organization is associated with a church if it shares common religious bonds and convictions with that church.

(e) *Religious orders and religious organizations.* For the purpose of this section the term "church" includes a religious order or a religious organization if such order or organization (1) is an integral part of a church, and (2) is engaged in carrying out the functions of a church, whether as a civil law corporation or otherwise.

(f) *Separately incorporated fiduciaries.* A plan which otherwise meets the provisions of this section shall not lose its status as a church plan because of the fact that it is administered by a separately incorporated fiduciary such as a pension board or a bank.

(g) *Cross reference.* (1) For rules relating to treatment of church plans, see sections 410(c), 411(e), 412(h), 4975(g), and the regulations thereunder.

(2) For rules relating to church plan elections, see section 410(d) and the regulations thereunder.

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved March 12, 1980.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on March 28, 1980, 8:45 a.m., and published in the issue of the Federal Register for March 31, 1980, 45 F.R. 20796)

Section 415.—Limitation on Benefits and Contributions Under Qualified Plans

Procedures relating to processing of opinion letters issued by the National Office on simplified employee pension agreements. See Rev. Proc. 80-17, page 17.

Section 501.—Exemption from Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(c)(7)-1: Social clubs.

Rev. Rul. 80-130

ISSUE AND FACTS

A social club exempt from federal income tax under section 501(c)(7) of the Internal Revenue Code pays a fixed fee to each club member who brings a new member into the club.

HOLDING

Such fixed fee payments to members, if they are reasonable compensation for performance of a necessary administrative service, do not result in inurement of the club's net earnings so as to disqualify the club from exemption under section 501(c)(7) of the Code.

Section 856.—Definition of Real Estate Investment Trust

26 CFR 1.856-1: Definition of real estate investment trust.

Federal income tax consequences of extending the exercise date of warrants to acquire shares of a real estate investment trust. See Rev. Rul. 80-134, this page.

Section 1234.—Options to Buy or Sell

26 CFR 1.1234-1: Options to buy or sell. (Also Section 856; 1.856-1.)

Warrants; extension of expiration date. The unilateral extension of the expiration date of warrants issued by a qualified real estate investment trust or any other corporation has the effect of the grant of new warrants, and the issuer recognize gain on the date the original unexercised warrants lapse. This holding shall not apply to warrants issued on or before April 24, 1972, or warrants issued pursuant to a binding contract under which the issuer was obligated on April 24, 1972, to issue the warrants. Rev. Rul. 77-40 amplified.

Rev. Rul. 80-134

ISSUE

What are the federal income tax consequences to an issuer of certain warrants when the time within which such warrants can be exercised is extended?

FACTS

In connection with a public offering of its securities, an unicorporated trust that otherwise qualifies as a real estate investment trust ("REIT") under section 856 of the Internal Revenue Code issued warrants to purchase shares of beneficial interest of the trust. The warrants were issued on January 2, 1973, with an expiration date of December 31, 1979.

The REIT allocated 5*x* dollars to each warrant, the amount received from the purchasers, and credited such amount to the warrant-outstanding account pending exercise or lapse of the warrants.

On December 1, 1979, the REIT unilaterally "extended" the time during which the warrants could be exercised until December 31, 1983. The extension was accomplished prior to the expiration of the original exercise period. At the time of the extension, the shares of the REIT were trading at an amount substantially below the exercise price in the warrants, and the warrants, therefore, had only nominal value.

LAW AND ANALYSIS

Rev. Rul. 72-198, 1972-1 C.B. 223, provides, in part, that a warrant is considered an option for purposes of section 1234 of the Code if the holder has the right to purchase the stock to which it relates.

Effective September 1, 1976, section 1234(b)(1) of the Code, as amended by section 2136(a) of the Tax Reform Act of 1976, 1976-3 (Vol. 1) C.B. 405, provides, in part, that in the case of the grantor of an option granted after that date, gain or loss from any closing transaction with respect to, and gain on lapse of, an option in property shall be treated as a short-term capital gain or loss.

With respect to warrants issued on or before September 1, 1976, section 1.1234-1(b) of the Income Tax Regulations provides, in part, that any gain to the grantor of an option arising from the failure of the holder to exercise it is ordinary income.

On April 24, 1972, the Service published Rev. Rul. 72-198, a ruling holding that an issuer of stock-purchase warrants recognizes income to the extent of the net proceeds received on the sale of the warrants if and when the warrants expire unexercised. Rev. Rul. 77-40, 1977-1 C.B. 248, holds that if on or before April 24, 1972, a corporation issued warrants to purchase its stock, no tax consequences will result to the issuing corporation as a result of the expiration of these warrants. Rev. Rul. 78-73, 1978-1 C.B. 265, provides that a corporation that issued warrants after April 24, 1972, pursuant to a legally enforceable contract under which the corporation was obligated on April 24, 1972, and at all times thereafter, to issue the warrants, will have no tax consequences as a result of the expiration of the warrants.

In these circumstances, for purposes of section 1234 of the Code, the original warrants lapsed on December 31, 1979. At the time the REIT extended the date for exercise, the warrants had only a nominal value. Moreover, the REIT received no new or additional consideration from the warrant holders. Therefore, the extension was of the same nature and had the same effect as a gratuitous grant of new warrants to the holders. Accordingly, the original warrants lapsed on December 31, 1979. The result is the same whether or not the extended warrants are subsequently exercised.

HOLDING

Upon the lapse of the original warrants, the REIT must recognize ordinary income of 5*x* dollars, the premium received for each warrant. See section 1.1234-1(b) of the regulations.

The holding of this revenue ruling applies not merely to warrants issued by a real estate investment trust, but also to those issued by any other corporation.

EFFECT ON OTHER REVENUE RULINGS

A warrant issuer that issued warrants on or before April 24, 1972 (the date of publication of Rev. Rul. 72-198), or entered into a written legally enforceable contract under which the issuer was obligated on April 24, 1972, and at all times thereafter, to issue the warrants, and extended the warrants for no new or additional consideration, will not have income with respect to its issuance of warrants when the extended warrants lapse.

Rev. Rul. 77-40, as amplified by Rev. Rul. 78-73, is further amplified.

Section 4061.—Imposition of Tax [Motor Vehicles]

26 CFR 48.4061(a)-1: Imposition of tax; exclusion for light-duty trucks, etc.

Fiberglass bulk containers. Molded fiberglass open-top containers designed to be secured to the flatbed of taxable trailers and semitrailers, towed by a farm tractor through the farm fields, loaded with tomatoes by a mechanical tomato harvester, and used in transporting tomatoes from the farm fields over the highway to a cannery are taxable trailer and semitrailer bodies; Rev. Rul. 79-309 distinguished.

Rev. Rul. 80-131

ISSUE

Are the fiberglass bulk containers described below automotive bodies subject to the manufacturers excise tax imposed by section 4061(a)(1) of the Internal Revenue Code?

FACTS

A company manufactures molded fiberglass open-top containers designed for use on the flatbed of taxable trailers and semitrailers. Each container is 3 feet high, 8 feet wide, and is available in lengths of 18, 24, or 26 feet depending upon the capacity desired and the size of the flatbed trailer. Clamps are molded on each corner of the container enabling it to be secured with cables to the flatbed of the trailer (or semitrailer). When so equipped, the trailer is towed by a farm tractor through the farm fields and loaded with tomatoes by a mechanical tomato harvester.

The trailer is then towed by a highway truck from the farm over the highway to a cannery. The tomatoes are unloaded by pumping water into the container and allowing the water along with the tomatoes to flow out through doors located on the side of the container. The container is not removed from the trailer during the unloading process. At the close of the harvest season the container is removed and the flatbed vehicle is used for general hauling.

LAW AND ANALYSIS

Section 4061(a)(1) of the Code imposes a tax on the sale of truck trailer and semitrailer bodies by the manufacturer.

Section 4061(b)(1) of the Code imposes a tax on sales by a manufacturer of parts and accessories for any of the articles enumerated in section 4061(a)(1).

Under section 48.4061(a)-1(e)(1) of the Manufacturers and Retailers Excise Tax Regulations, as amended by T.D. 7461, 1977-1 C.B. 317, the sale of a trailer body is subject to the tax imposed by section 4061(a)(1) of the Code, if such body is, in any sense, reasonably suitable for use as a component part of a taxable highway truck trailer or semitrailer.

Under section 48.4061(a)-1(d)(1) of the regulations, the term "highway vehicle" includes any trailer or semitrailer that is designed to perform a function of transporting a load over public highways. Under section 48.4061(a)-1(d)(2)(ii) of the regulations, however, a trailer or semitrailer is not a highway vehicle if it is specially designed for the primary function of transporting a load other than over the public highway in connection with a farming operation and by reason of such special design the use of the trailer or semitrailer to transport the load over the public highways is substantially limited or impaired.

When the fiberglass bulk container in this case is mounted on the flatbed of a taxable highway trailer or semitrailer, a vehicle results that has as its function that of transporting tomatoes over the highway from the farm to the cannery. Since this vehicle is not specially designed for the primary function of offhighway transportation as provided in section 48.4061(a)-1(d)(2)(ii) of the regulations, this vehicle does not come within the scope of that section, and is therefore a highway vehicle within the meaning of section 48.4061(a)-1(d)(1) of the regulations. Moreover, since the container provides the entire load-carrying capacity of this vehicle, it is a body within the meaning of section 4061(a)(1) of the Code rather than a part or accessory within the meaning of section 4061(b)(1), despite the fact that the trailer or semitrailer constitutes an independent hauling unit in the absence of the container. *See*, Rev. Rul. 75-326, 1975-2 C.B. 428. The container therefore comes within the scope of section 48.4061(a)-1(e)(1) of the regulations.

In Rev. Rul. 79-309, 1979-2 C.B. 374, which deals with the applicability of the manufacturers excise tax to portable fuel tanks, the Internal Revenue Service indicated it would follow the result reached in ***Fargo Foundry Steel & Mfg. Co. v. United States***, 415 F. Supp. 1362 (D.N.D. 1976), aff'd No. 76-1786 (8th Cir. March 17, 1977) in all cases involving substantially similar portable fuel tanks. Thus, Rev. Rul. 79-309 concludes that such tanks are not taxable parts or accessories under section 4061(b) of the Code.

The tanks described in Rev. Rul. 79-309 are designed to be placed unattached on the bed of a pick-up truck to haul fuel for farm equipment in the field. They range in capacity from 70 gallons to 200 gallons, and are equipped with handles to facilitate portability. The tanks may also be used as "on-the-farm" storage tanks.

The tomato containers are distinguishable from the tanks involved in Rev. Rul. 79-309 in that the containers here are used only to transport tomatoes from the farm to the cannery and are not used for storage purposes. Therefore the fact that the containers involved in Rev. Rul. 79-309 were held to be nontaxable does not affect the holding in this revenue ruling.

HOLDING

The fiberglass bulk containers are trailer and semitrailer bodies taxable under section 4061(a)(1) of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 79-309 is distinguished.

Section 4941.—Taxes on Self-Dealing

26 CFR 53.4941(d)-2: Specific acts of self-dealing.

Private foundation; self-dealing; donation of life insurance policy. A disqualified person donated a life insurance policy to a private foundation. The policy was subject to an outstanding loan made to the donor within the 10-year period ending on the date of the donation that was not insignificant in relation to the value of the policy. The donation was an act of self-dealing.

Rev. Rul. 80-132

ISSUE

Under the circumstances described below, is the donation to a private foundation by a disqualified person of a life insurance policy subject to a policy loan an act of self-dealing within the meaning of section 4941(d)(1)(A) of the Internal Revenue Code?

FACTS

The organization is exempt from federal income tax under section 501(c)(3) of the Code, and is a private foundation under section 509(a).

A disqualified person, as defined in section 4946(a) of the Code, donated a life insurance policy to the foundation. The policy, which has a face value of $100x, is subject to an outstanding loan of $46x that was previously made to the disqualified person by the insurer within a 10-year period ending on the date of donation, at which time the cash surrender value of the policy was $50x. Under the terms of the policy, failure to repay the principal or interest on the policy loan reduces the proceeds that are payable to the beneficiary upon voluntary surrender of the policy or upon the death of the insured.

LAW

Section 4941 of the Code imposes a tax on each act of self-dealing between a disqualified person and a private foundation.

Section 4941(d)(1)(A) of the Code provides that the term "self-dealing" means any direct or indirect sale or exchange, or leasing, of property between a private foundation and a disqualified person.

For purposes of section 4941(d)(1) of the Code, section 4941(d)(2)(A) provides that a transfer of real or personal property by a disqualified person to a private foundation shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the foundation assumes or if it is subject to a mortgage or similar lien which a disqualified person placed upon the property within the 10-year period ending on the date of transfer.

Section 53.4941(d)-2(a)(2) of the Foundation Excise Tax Regulations provides that the transfer of real or personal property by a disqualified person to a private foundation shall be treated as a sale or exchange if the foundation takes the property subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of transfer. The regulation further provides that the term "similar lien" shall include, but is not limited to, deeds of trust and vendors' liens, but shall not include any other lien if such lien is insignificant in relation to the fair market value of the property transferred.

ANALYSIS

A loan on a life insurance policy is sometimes characterized as an advance of the proceeds of the policy. The insurer will not demand repayment of the loan, but a failure to repay the loan will reduce the cash surrender value of the policy and the amount payable on the death of the insured. Similarly, the insurer will not demand payment of interest on the loan as it accrues, but a failure to pay the interest will further reduce the cash surrender value of the policy and the amount payable on the death of the insured. Thus, the loan constitutes a charge against the policy. Compare *J. Simpson Dean*, 35 T.C. 1083 (1961), *nonacq.* 1973-2 C.B. 4 (nonacquiescence on another issue).

The fact that the insurer will not demand repayment of the loan or payment of interest as it accrues does not mean that the loan is not a "mortgage or other lien" within the meaning of section 53.4941(d)-2(a)(2) of the regulations. The transfer of the policy in the instant case relieves the donor of the obligation to either repay the loan, pay interest on the loan as it accrues, or suffer continued diminution in the value of the policy. Thus, the effect of the transfer is essentially the same as the transfer of property subject to a mortgage or similar lien. In addition, the amount of the loan is not insignificant in relation to the value of the policy.

HOLDING

The donation of the life insurance policy described above, which is subject to an outstanding policy loan, is a transfer of real or personal property by a disqualified person to a private foundation and is an act of self-dealing under section 4941(d)(1)(A) of the Code.

See Rev. Rul. 80-133, this page, this Bulletin, for the application of section 4944 of the Code to a similar transaction where the donor is not a disqualified person.

Section 4944.—Taxes on Investments Which Jeopardize Charitable Purpose

26 CFR 53.4944-1: Initial taxes.

Private foundation; jeopardizing investment; donation of life insurance policy. A whole-life insurance policy that was subject to a loan to the donor-insured was donated to a private foundation. The face value of the policy, less any outstanding loan principal or interest, was payable to the donee upon the donor's death. The combined interest and premium payments made by the donee over the life expectancy of the donor would exceed the amount it would receive under the policy and were, therefore, jeopardizing investments.

Rev. Rul. 80-133

ISSUE

Under the circumstances described below, are the payments by a private foundation of premiums on a life insurance policy and the interest on a loan secured by the policy jeopardizing investments under section 4944 of the Internal Revenue Code?

FACTS

The organization is exempt from federal income tax under section 501(c)(3) of the Code and is a private foundation under section 509(a) of the Code. A whole-life insurance policy was donated to the foundation. At the time of the donation, the policy was subject to a policy loan that the insurer had made to the donor. The policy provided that, upon the death of the insured, the foundation would receive insurance proceeds in an amount equal to the face value of the policy reduced by the sum of the outstanding principal of the loan and any unpaid interest thereon.

At the time of the donation of the policy, the life expectancy of the insured-donor was 10 years. Instead of immediately surrendering the policy to the insurer for its cash surrender value, the foundation retained the policy as an investment and annually pays the premiums and interest due on the policy and the policy loan, respectively. The combined premium and interest payments are of such an amount that, by the end of eight years, the foundation will have invested a greater amount in premiums and interest than it could receive as a return on this investment, *i.e.*, in the form of insurance proceeds upon the death of the insured.

LAW AND ANALYSIS

Section 4944 of the Code imposes a tax on private foundations and, under certain conditions, foundation managers for investing any amount in such a manner as to jeopardize the carrying out of any of the foundation's exempt purposes.

Section 53.4944-1(a)(2)(i) of the Foundation Excise Tax Regulations provides that an investment shall be considered to jeopardize the carrying out of the exempt purposes of a private foundation if it is determined that the foundation managers, in making such investment, have failed to exercise ordinary business care and prudence, under the facts and circumstances prevailing at the time of making the investment, in providing for the long-term and short-term financial needs of the foundation to carry out its exempt purposes. In the exercise of the requisite standard of care and prudence the foundation managers may take into account the expected return on an investment and the need for diversification within the investment portfolio. The determination whether the investment of a particular amount jeopardizes the carrying out of the exempt purposes of a foundation shall be made on an investment by investment basis, in each case taking into account the foundation's portfolio as a whole.

The foundation managers in the present case invested in a life insurance policy of an insured who has a life expectancy of ten years. The foundation pays combined premium and interest payments that will produce a financial loss to the foundation at the end of eight years. The period of time the payments could reasonably be expected to last is ten years. Under the facts and circumstances, the foundation managers, by investing at the projected rate of return prevailing at the time of the investment failed to exercise ordinary business care and prudence in providing for the long-term and short-term financial needs of the foundation in carrying out its exempt purposes.

See Rev. Rul. 80-132, page 12, this Bulletin, for the application of section 4941 of the Code to a similar transaction where the donor is a disqualified person.

HOLDING

Under the circumstances described above, each payment made by the private foundation for a premium on the insurance policy and the interest on the policy loan is a jeopardizing investment under section 4944 of the Code.

Part III. Administrative, Procedural, and Miscellaneous

Delegation Order No. 35 (Rev. 11) (Effective February 28, 1980)

Agreements as Determinations Under Section 1313(a)(4) of the Internal Revenue Code of 1954

1. Pursuant to the authority granted to the Commissioner of Internal Revenue and District Directors by 26 CFR 301.7701-9 and 26 CFR 1.1313(a)-4, the authority to enter into agreements pursuant to section 1313(a)(4), Internal Revenue Code of 1954, relating to agreements treated as determinations, is hereby delegated to the following officials:

a. Regional Directors of Appeals;

b. Chiefs and Associate Chiefs of Appeals Offices;

c. Appeals Team Chiefs as to their respective cases;

d. Director of International Operations;

e. Assistant District Directors;

f. Chiefs of Examination Divisions; and

g. Chiefs of Employee Plans and Exempt Organizations Divisions.

2. In other than streamlined districts this authority may be redelegated only by District Directors and the Director of International Operations, who may rededelegate to the Chief of Review Staff; to Revenue Agents and Tax Law Specialists (Reviewers) not lower than GS-11 for field examination cases; and to Revenue Agents and Tax Technicians (Reviewers) not lower than GS-9 for office examination cases. In streamlined districts, this authority may be redelegated by the District Director no lower than to GS-11 Revenue Agents.

3. This Order supersedes Delegation Order No. 35 (Rev. 10), 1979-1 C.B. 474, issued January 29, 1979.

JEROME KURTZ,
Commissioner.

(Filed by the Office of the Federal Register on March 4, 1980, 8:45 a.m., and published in the issue of the Federal Register for March 5, 1980, 45 F.R. 14357)

Delegation Order No. 77 (Rev. 14) (Effective February 28, 1980)

Authority to Issue Statutory Notices of Deficiency

1. The authority granted to the Commissioner of Internal Revenue and District Directors, by 26 CFR 301.7701-9, 26 CFR 301.6212-1, and 26 CFR 301.6861-1 to sign and send to the taxpayer by registered or certified mail any statutory notice of deficiency is hereby delegated to the following officials:

a. Regional Directors of Appeals;

b. Chiefs and Associate Chiefs of Appeals Offices;

c. Appeals Team Chiefs as to their respective cases;

d. Director of International Operations;

e. Service Center Directors;

f. Assistant District Directors;

g. Assistant Service Center Directors;

h. Chiefs of Examination Divisions;

i. Chiefs of Correspondence and Processing Sections; and

j. Chiefs of Employee Plans and Exempt Organizations Divisions.

2. This authority may be redelegated only by District Directors, Service Center Directors and the Director of International Operations, but not lower than Reviewers, Grade GS-9 in the Examination Division, Revenue Agents (GS-11) in streamlined district Examination Sections and/or groups, Examination Tax Examiners (Reviewers, GS-6) in Service Center Compliance Divisions, and Reviewers, Grade GS-12, in Employee Plans and Exempt Organizations Divisions.

3. This Order supersedes Delegation Order No. 77 (Rev. 13), 1979-2 C.B. 484, issued May 24, 1979.

JEROME KURTZ,
Commissioner.

(Filed by the Office of the Federal Register on March 4, 1980, 8:45 a.m., and published in the issue of the Federal Register for March 5, 1980, 45 F.R. 14358)

Delegation Order No. 93 (Rev. 7) (Effective February 28, 1980)

Authority to Consent to a Redetermination of Aggregations by a Taxpayer in the Case of Invalid Basic Aggregations or Invalid Additions

1. The authority vested in the Commissioner of Internal Revenue as prescribed in 26 CFR 1.614-2(d)(5) and 26 CFR 1.614-3(f)(8) and described below is hereby delegated to Regional Directors of Appeals, Chiefs and Associate Chiefs of Appeals Offices, Appeals Team Chiefs as to their respective cases, District Directors, and in other than streamlined districts, Chiefs, District Examination Divisions. In streamlined districts, this authority is not delegated below the District Director.

Consent to the reforming of aggregations by a taxpayer where the taxpayer has formed invalid basic aggregations or made invalid additions to valid or invalid basic aggregations, and

Consent, in the case of oil and gas wells where an invalid aggregation has been formed under section 614(b), to the treatment by a taxpayer of all the properties included in the aggregation, which fall within a single operating unit, under the provisions of section 614(d) rather than section 614(b) of the 1954 Code if so requested by the taxpayer.

2. In the case of oil and gas wells this delegation order shall apply only to taxable years subject to the 1954 Code beginning before January 1, 1964.

3. The authority delegated herein may not be redelegated.

4. This Order supersedes Delegation Order No. 93 (Rev. 6), 1979-1 C.B. 476, issued January 29, 1979.

JEROME KURTZ,
Commissioner.

(Filed by the Office of the Federal Register on March 4, 1980, 8:45 a.m., and published in the issue of the Federal Register for March 5, 1980, 45 F.R. 14359)

Delegation Order No. 97 (Rev. 18) (Effective February 28, 1980)

Closing Agreements Concerning Internal Revenue Tax Liability

Pursuant to authority granted to the Commissioner of Internal Revenue by 26 CFR 301.7121-1(a); Treasury Department Order No. 150-32; Treasury Department Order No. 150-36; and Treasury Department Order No. 150-83, subject to the transfer of authority covered in Treasury Department Order No. 221, as modified by Treasury Department Order No. 221-3 (Rev. 2), as revised, this authority is hereinafter delegated.

1. The Assistant Commissioner (Technical) is hereby authorized in cases under his/her jurisdiction to enter into and approve a written agreement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) in respect to any prospective transactions or completed transactions if the request to the Assistant Commissioner (Technical) for determination or ruling was made before any affected returns have been filed.

2. The Assistant Commissioner (Compliance) is hereby authorized to enter into and approve a written agreement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) for a taxable period or periods ended prior to the date of agreement and related specific items affecting other taxable periods. The Assistant Commissioner (Compliance) is also authorized to enter into and approve a written agreement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) with respect to the performance of his/her functions as the competent authority in the administration of the operating provisions of the tax conventions of the United States.

3. The Assistant Commissioner (Employee Plans and Exempt Organizations) is hereby authorized to enter into and approve a written agreement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) in cases under his/her jurisdiction, that is, in respect of any transaction concerning employee plans or exempt organizations.

4. Regional Commissioners; Regional Directors of Appeals; Assistant Regional Commissioners (Examination); District Directors; Director of International Operations; Chiefs and Associate Chiefs of Appeals Offices; and Appeals Team Chiefs with respect to his/her team cases, are hereby authorized in cases under their jurisdiction (but excluding cases docketed before the United States Tax Court) to enter into and approve a written agreement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) for a taxable period or periods ended prior to the date of agreement and related specific items affecting other taxable periods.

5. The Assistant Commissioner (Technical); the Assistant Commissioner (Employee Plans and Exempt Organizations); Regional Commissioners; Regional Directors of Appeals; Chiefs and Associate Chiefs of Appeals Offices; and Appeals Team Chiefs with respect to his/her team cases, are hereby authorized in cases under their jurisdiction docketed in the United States Tax Court and in other Tax Court cases upon the request of Chief Counsel or his/her delegate to enter into and approve a written agreement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) but only in respect to related specific items affecting other taxable periods.

6. The Director of International Operations is hereby authorized to enter into and approve a written agreement with any person relating to the Internal Revenue tax liability of such person (or of the person or estate for whom he/she acts) to provide for the mitigation of economic double taxation under section 3 of Revenue Procedure 64-54, C.B. 1964-2, 1008, under Revenue Procedure 72-22, C.B. 1972-1, 747, and under Revenue Procedure 69-13, C.B. 1969-1, 402, and to enter into and approve a written agreement providing the treatment available under Revenue Procedure 65-17, C.B. 1965-1, 833.

7. The authority delegated herein does not include the authority to set aside any closing agreement.

8. Authority delegated in this Order may not be redelegated, except that the Assistant Commissioner (Technical) may redelegate the authority contained in paragraph 1 to the Deputy Assistant Commissioner (Technical) and to the Technical Advisors on the Staff of the Assistant Commissioner (Technical) for cases that do not involve precedent issues, the Assistant Commissioner (Compliance) may redelegate the authority contained in paragraph 2 of this Order to the Deputy Assistant Commissioner (Compliance), and the Assistant Commissioner (Employee Plans and Exempt Organizations) may redelegate the authority contained in paragraph 3 of this Order to the Deputy Assistant Commissioner (Employee Plans and Exempt Organizations) and to the Technical Advisors on the Staff of the Assistant Commissioner (Employee Plans and Exempt Organizations) for cases that do not involve precedent issues.

9. Delegation Order No. 97 (Rev. 17), 1980-17 I.R.B. 22, issued February 19, 1980, is hereby superseded.

JEROME KURTZ,
Commissioner.

(Filed by the Office of the Federal Register on March 4, 1980, 8:45 a.m., and published in the issue of the Federal Register for March 5, 1980, 45 F.R. 14357)

List of Countries Requiring Cooperation with an International Boycott

Notice 80-5

In order to comply with the mandate of section 999(a)(3) of the Internal Revenue Code of 1954, the Department of the Treasury is publishing a current list of countries which may require participation in, or cooperation with, an international boycott (within the meaning of section 999(b)(3) of the Internal Revenue Code of 1954). Egypt has been deleted from this list in response to the fact that Egypt's participation in the Arab economic boycott of Israel was formally terminated on January 25, 1980, in accordance with Article 2, Annex III of the Peace Treaty between Egypt and Israel. Accordingly, the deletion of Egypt from the list of countries requiring cooperation with an international boycott is retroactively effective to January 26, 1980.

Taxpayers are reminded of the reporting requirements of section 999 (a)(1)(B), which are relevant to all countries not included on the Secretary's list.

On the basis of the best information currently available to the Department of the Treasury, the following countries may require participation in, or cooperation with, an international boycott (within the meaning of section 999(b)(3) of the Internal Revenue Code of 1954).

Bahrain, Iraq, Jordan, Kuwait, Lebanon, Libya, Oman, Qatar, Saudi Arabia, Syria, United Arab Emirates, Yemen Arab Republic, Yemen, Peoples Democratic Republic of.

Dated: April 1, 1980.

(Filed by the Office of the Federal Register on April 4, 1980, 8:45 a.m., and published in the issue of the Federal Register for April 7, 1980, 45 F.R. 23574)

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 219, 404, 408, 415; 1.408-1.)

Rev. Proc. 80-17

Section 1. Purpose

This revenue procedure sets forth the procedures for the issuance of rulings and opinion letters by the National Office of the Internal Revenue Service as to the acceptability of the form of any prototype simplified employee pension (SEP) agreement under sections 408(k) and 415 of the Internal Revenue Code.

Sec. 2. Background and General Information

.01 The Revenue Act of 1978, Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, created new rules that permit simplified employee pensions for tax years beginning after December 31, 1978.

.02 The general procedures of the Service relating to the issuance of rulings, determination letters, and opinion letters for employee plans matters are set forth in section 601.201 of the Statement of Procedural Rules.

.03 Procedures relating to the issuance of rulings, determination letters, and opinion letters pertaining to the establishment of individual retirement accounts and individual retirement annuities (IRAs) are set forth in Rev. Proc. 75-6, 1975-1 C.B. 646, as modified by Rev. Procs. 76-32, 1976-2 C.B. 654, and 77-24, 1977-2 C.B. 532.

.04 The Service has developed a model SEP agreement that meets the requirements of section 408(k) of the Code for those employers who wish to adopt such a program. Form 5305-SEP, Simplified Employee Pension-Individual Retirement Accounts Contribution Agreement, is used for this purpose. Eligible employers who adopt the model SEP agreement and follow its terms are assured that the model SEP meets the requirements of section 408(k). Because automatic approval has been granted with respect to model SEPs, no ruling, opinion, or determination letter from the Service is necessary.

.05 Receipt of a favorable opinion letter on a SEP is not required as a condition of receiving favorable tax treatment.

.06 The Service will only issue opinion letters on prototype SEP agreements. The Service will not issue opinion letters with respect to prototype SEP-IRAs that consolidate the SEP and IRA in one document. Nor will an opinion letter issued on a prototype SEP provide reliance as to the status of any IRA.

Sec. 3. Opinion Letters

.01 The National Office of the Service will furnish, on request, a written opinion as to whether the prototype SEP submitted by a sponsor satisfies the requirements of section 408(k) of the Code. For this purpose, a sponsor is a trade or professional association (other than an employee association), a bank (including credit unions, savings and loan associations, etc.), a regulated investment company, an insurance company, or a person who under regulations may act as a trustee or custodian of an IRA.

.02 Each opinion letter will contain an identifying serial number and a file-folder number. A copy of the opinion letter should be furnished to employers using the approved SEP agreement.

.03 If a particular employer adopts a prototype SEP in accordance with the form approved by the Service and observes the provisions thereof, the affected taxpayers may rely on the opinion letter provided (a) SEP contributions are made to an Internal Revenue Service model IRA or a Service approved master or prototype IRA and (b) contributions under the SEP do not (in combination with another SEP or any terminated, qualified defined benefit plan of the employer) fail to satisfy the requirements of section 415 of the Code.

Sec. 4. Instructions to Sponsoring Organizations and Employers

.01 A sponsoring organization, of the type referred to in section 3.01 above, that desires a written opinion as to the acceptability of the form of a prototype SEP should submit its request to the National Office. A single copy of all applicable documents, including the SEP agreement, must be submitted with the request.

.02 The request should be addressed to:

Commissioner of Internal Revenue
1111 Constitution Ave., N.W.
Washington, D.C. 20224
ATTENTION: E:EP:T

.03 Form 5306-SEP, Simplified Employee Pension (SEP) Application for Approval of Prototype SEP Agreement, is to be used for SEP agreements being submitted to the Service.

.04 Any amendment to an IRA, the sole effect of which is to permit or facilitate SEP contributions of up to $7,500, will not affect the status of the IRA to which it relates and should not be submitted to the Service for review.

.05 If an amendment is made to the form of a previously approved prototype SEP agreement, the following procedure will apply:

(1) Amendments to SEPs by sponsors will require submission of Form

5306-SEP and documentation as described under section 4.01 above, together with the amendments.

(2) Upon approval by the Service, an opinion letter will be issued to the applicant, and the sponsor should send a copy of the amended SEP and opinion letter to every affected employer.

SEC. 5. EFFECT ON OTHER PLANS

.01 Under section 415(e), (f), and (g) of the Code, a SEP is combined with other plans maintained by an employer for purposes of determining whether the limitations on benefits and contributions in section 415 are exceeded.

.02 Service model profit-sharing plans (Form 5612 or 5613) and money purchase plans (Form 5614 or 5615) specify that they cannot be used with any other qualified plan maintained by the employer. If such model plans are not used with any other qualified plan, the employer and affected employees may rely on the assurance of the Service that the terms of the model plan meet the qualification requirements of the Code. A SEP agreement is not a qualified plan, but it will be treated as such, for the purpose of applying the above restriction, if the employer concurrently maintains a SEP and a model profit-sharing, or money purchase pension plan. The effect of this treatment is that the affected taxpayers may no longer rely on the qualified status of the model plan if a SEP is also maintained.

.03 If an employer maintains a master or prototype defined contribution plan, the plan currently contains language which will coordinate contributions under that plan with any other master or prototype defined contribution plan maintained by the same employer. However, such a plan does not contain language to coordinate with a SEP and may, as a consequence, not satisfy section 415 of the Code if it is maintained with a SEP.

.04 If an employer maintains any combination of defined contribution or defined benefit plans including those enumerated in section 5.02 and 5.03 or, in addition to any defined contribution or defined benefit plan, has ever maintained a defined benefit plan which is now terminated, and wants a determination as to whether that plan, or those plans, in combination with a SEP agreement satisfy the requirements of section 415 of the Code, the employer may apply to the District Office for a determination letter on the plan under the procedures prescribed in section 601.201 of the S.R.R., and Rev. Procs. 72-6, 1972-1 C.B. 710 (as modied by Rev. Procs. 75-47, 1975-2 C.B. 581, and 77-25, 1977-2 C.B. 534), 72-7, 1972-1 C.B. 715, 75-52, 1975-2 C.B. 592, 76-38, 1976-2 C.B. 661, and 77-22, 1977-2 C.B. 529, as appropriate.

SEC. 6. RULING LETTERS

.01 If an adopting employer maintains more than one SEP, or has ever maintained a qualified defined benefit plan (which is now terminated), covering any of the same employees as does the SEP, the employer may request a ruling letter as to whether the SEP (in combination with the other SEP or plans) satisfies the requirements of section 415 of the Code.

.02 The employer should submit the request for a ruling letter to the National Office and include a single copy of each SEP and qualified plan.

.03 The ruling request should be addressed to:

Commissioner of Internal Revenue
1111 Constitution Ave., N.W.
Washington, D.C. 20224
ATTENTION: E:EP:T

SEC. 7. EFFECT ON OTHER DOCUMENTS

.01 The general instructions of section 601.201 of the S.P.R. are applicable to the extent that the matter is not covered by the specific procedures and instructions contained in this revenue procedure.

.02 Rev. Proc. 75-6, concerning the issuance of Service rulings, determination letters, and opinion letters for IRAs, is modified to allow existing IRAs on which a favorable ruling, determination letter, or opinion letter has been issued, to be amended to accept SEP contributions up to $7,500 without affecting their tax-qualified status.

.03 Rev. Proc. 77-15, 1977-1 C.B. 572, concerning Service model money purchase and profit-sharing plans is modified to treat SEP agreements as a qualified plan for the purpose of applying the conditions for full reliance.

SEC. 8. EFFECTIVE DATE

This revenue procedure is effective May 12, 1980, the date of its publication in the Internal Revenue Bulletin, and only applications received after this date will be considered.

Part IV. Items of General Interest

New Application Form for Prototype Simplified Employee Pension

Announcement 80-58

A new Form 5306-SEP, Application for Approval of Prototype Simplified Employee Pension-SEP, will be available after May 16, 1980. This application should be used to request a favorable opinion letter for a prototype simplified employee pension agreement to be used by more than one employer. Sponsors who may file this application are banks, federally insured credit unions, insurance companies, regulated investment companies, and trade or professional societies or associations (other than employee associations).

Allowance of Deductions to Foreign Corporations—Public Hearing

Announcement 80-62 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations:

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to the allowance of deductions to foreign corporations doing business in the United States.

DATES: The public hearing will be held on June 4, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by May 21, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-86-79), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-6870, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under sections 861 and 882 of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Wednesday, February 27, 1980, at page 12844 (45 FR 12844).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of oral comments to be presented at the hearing and the time they wish to devote to each subject by May 21, 1980.

Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive appearing in the Federal Register for Wednesday, November 8, 1978.

Publication of the Crude Oil Windfall Profit Tax Act of 1980

Announcement 80-65

Public Law 96-223, Crude Oil Windfall Profit Tax Act of 1980, and the related Committee Reports will be published in 1980-3 Cumulative Bulletin.

The volume of material involved makes it impractical to publish the law and related material in the weekly Internal Revenue Bulletin.

The special edition of the Cumulative Bulletin should be available in June.

Amendment of Rev. Rul. 80-98

Announcement 80-68

The final paragraph in the LAW AND ANALYSIS section of Rev. Rul. 80-98, 1980-14 I.R.B. 25, is amended to read as follows:

In Rev. Rul. 80-36, 1980-6 I.R.B. 11, examples are set forth in which amounts paid to a citizen of Japan for performing research at a heart research foundation in the United States are either compensation for services rendered or payments made under a grant, allowance, or award within the meaning of Article 20(1) of the Treaty. Rev. Rul. 80-36 also superseded Rev. Rul. 76-567, 1976-2 C.B. 491, in which the taxpayer a citizen and resident of Japan, received funds from a charitable organization paid in connection with the taxpayer's research work at an institute located in the United States. Rev. Rul. 76-567 concluded that the amount paid to the taxpayer for the research work was a grant, allowance, or award within the meaning of Article 20(1)(a)(iii) of the Treaty and, thus, is exempt from federal income tax. However, the revenue ruling did not distinguish between an amount paid under a grant for research and an amount paid as compensation for services rendered in performing research.

This amendment will be reflected in Rev. Rul. 80-98 when it is published in 1980-1 C.B.

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[1] Filed by the Office of the Federal Register on April 21, 1980, 8:45 a.m., and published in the issue of the Federal Register for April 22, 1980, 45 F.R. 26981.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants and Enrolled Agents from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant or enrolled agent, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, or enrolled agent in accordance with the consent offered.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant or enrolled agent so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following person has been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Stephen K. Easton	New York, NY	Certified Public Accountant	Indefinite from February 29, 1980

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants or enrolled agents to practice before the Internal Revenue Service.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants and enrolled agents to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant or enrolled agent, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant or enrolled agent so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing, the following individuals were disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
Robert W. Tufts	St. Petersburg, FL	Certified Public Accountant	March 17, 1980
William A. Carbaugh	Greenville, SC	Enrolled Agent	March 21, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 301.6103(j)(1)-1 added; 404.6103(j)(1)-1 deleted.	Disclosure of returns and return information to officers and employees of Bureaus of the Census and Economic Analysis of the Department of Commerce for certain statistical purposes.	Mar. 24, 1980	May 23, 1980
26 CFR 150.0 through 150.6402-1 added; published as temporary regulations in T.D. 7690, 1980-16 I.R.B. 11.	Crude Oil Windfall Profit Tax Act of 1980.	Apr. 4, 1980	June 3, 1980
26 CFR 1.166-9, 1.482-2, 1.1371-1, amended; 1.385-1 through 1.385-12, added.	Treatment of certain interests in corporations as stock or indebtedness.	Mar. 24, 1980	June 23, 1980
26 CFR 301.6103(a)-1 through 301.6103(c)-1, 301.6103(i)-1 through 301.6103(p)(2)(B)-1 added; 301.6103(h)(2)-1 amended; 404.6103(a)-1 through 404.6103(i)-1, 404.6103(j)(2)-1 through 404.6103(n)-1, 420.6103(1)(2)-1 through 420.6103(1)(2)-3 deleted.	Disclosure of returns and return information under certain circumstances.	Mar. 24, 1980	May 23, 1980
26 CFR 1.170A-1, 1.170A-4, 1.170A-11, amended; 1.170A-4A, added.	Deduction of certain charitable contributions of inventory and other property.	Mar. 20, 1980	May 19, 1980
26 CFR 1.6050-1, 301.6050-1, deleted; 53.4942(b)-1, revised.	Treatment of Certain Elderly Care Facilities.	Mar. 24, 1980	May 23, 1980
26 CFR 1.46-4, 1.316-1, 1.852-4, 1.857-4, amended; 1.852, 1.857, deleted; 1.381(c)(25)-1, 1.860-1 through 1.860-5, added.	Deficiency dividends paid by certain regulated investment companies and real estate investment trusts.	Mar. 31, 1980	May 27, 1980
26 CFR 1.411(d)-1 added.	Coordination of vesting and discrimination requirements for qualified plans.	April 9, 1980	June 9, 1980
26 CFR 1.1502-12, amended; 1.1502-44, added.	Consolidated returns for percentage depletion for independent producers and royalty owners.	April 9, 1980	June 9, 1980
26 CFR 1.21-1—53.4940-1 and intermediate sections amended.	Changes in the holding period required for gains or losses on transactions in capital assets to be treated as long-term capital gains or losses and changes in certain terms relating to transactions in capital assets.	April 9, 1980	June 9, 1980
26 CFR 1.1402(c)-3, 301.6652-1, amended; 1.6050A-1, 31.3121(b)(20)-1, 31.3401(a)(17)-1, 301.605 A-1 added.	Treatment of certain crewmen on boats engaged in catching fish as self-employed rather than as employees.	April 9, 1980	June 9, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified,* above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

Numerical Finding List[1]

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80-37, 1980-12 I.R.B. **16**
80-38, 1980-14 I.R.B. **30**
80-39, 1980-14 I.R.B. **30**
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80-41, 1980-14 I.R.B. **32**
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80-44, 1980-15 I.R.B. **17**
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80-47, 1980-15 I.R.B. **18**
80-48, 1980-13 I.R.B. **37**
80-49, 1980-13 I.R.B. **37**
80-50, 1980-16 I.R.B. **34**
80-51, 1980-16 I.R.B. **34**
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80-67, 1980-10 I.R.B. **11**
80-68, 1980-10 I.R.B. **12**
80-69, 1980-11 I.R.B. **5**
80-70, 1980-11 I.R.B. **5**
80-71, 1980-11 I.R.B. **7**
80-72, 1980-11 I.R.B. **9**
80-73, 1980-11 I.R.B. **10**
80-74, 1980-11 I.R.B. **13**
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80-81, 1980-12 I.R.B. **12**
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80-86, 1980-13 I.R.B. **9**
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80-92, 1980-14 I.R.B. **7**
80-93, 1980-14 I.R.B. **9**
80-94, 1980-14 I.R.B. **10**
80-95, 1980-14 I.R.B. **15**
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80-103, 1980-15 I.R.B. **12**
80-104, 1980-15 I.R.B. **13**
80-105, 1980-16 I.R.B. **5**
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[1] See footnote at end of list.

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7659, 1980-3 I.R.B. **8**
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7661, 1980-5 I.R.B. **6**
7662, 1980-5 I.R.B. **9**
7663, 1980-6 I.R.B. **6**
7664, 1980-7 I.R.B. **10**
7665, 1980-8 I.R.B. **17**
7666, 1980-8 I.R.B. **15**
7667, 1980-9 I.R.B. **7**
7668, 1980-10 I.R.B. **8**
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7671, 1980-12 I.R.B. **7**
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7673, 1980-13 I.R.B. **7**
7674, 1980-11 I.R.B. **22**
7675, 1980-14 I.R.B. **21**
7676, 1980-14 I.R.B. **18**
7677, 1980-14 I.R.B. **16**
7678, 1980-15 I.R.B. **14**
7679, 1980-15 I.R.B. **7**
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7684, 1980-18 I.R.B. **13**
7685, 1980-18 I.R.B. **9**
7686, 1980-18 I.R.B. **17**
7687, 1980-14 I.R.B. **11**
7690, 1980-16 I.R.B. **11**

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1, dated January 7, 1980.

Finding List of Current Action on Previously Published Rulings[1]

Bulletins 1980-1 through 1980-18

* Denotes entry since last publication

Delegation Orders:

4 (Rev. 9)
Superseded by
4 (Rev. 10), 1980-10 I.R.B. **13**

42 (Rev. 12)
Superseded by
42 (Rev. 13), 1980-4 I.R.B. **40**

57 (Rev. 3)
Superseded by
57 (Rev. 4), 1980-17 I.R.B. **22**

66 (Rev. 9)
Superseded by
66 (Rev. 10), 1980-14 I.R.B. **27**

97 (Rev. 16)
Superseded by
97 (Rev. 17), 1980-17 I.R.B. **22**

152
Superseded by
152 (Rev. 1), 1980-10 I.R.B. **14**

Revenue Procedures:

64-44
Superseded by
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66-53
Superseded by
Rev. Proc. 80-6, 1980-7 I.R.B. **16**

68-23
Amplified by
Rev. Proc. 80-14, 1980-16 I.R.B. **32**

70-6
Amplified by
Rev. Proc. 80-4, 1980-6 I.R.B. **17**

74-23
Superseded by
Rev. Proc. 80-7, 1980-8 I.R.B. **24**

74-24
Superseded by
Rev. Proc. 80-7, 1980-8 I.R.B. **24**

74-25
Superseded by
Rev. Proc. 80-7, 1980-8 I.R.B. **24**

75-3
Superseded by
Rev. Proc. 80-7, 1980-8 I.R.B. **24**

77-10
Modified by
Rev. Proc. 80-15, 1980-17 I.R.B. **27**

77-36
Superseded by
Rev. Proc. 80-7, 1980-8 I.R.B. **24**

77-40
Superseded by
Rev. Proc. 80-7, 1980-8 I.R.B. **24**

77-47
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Rev. Proc. 80-13, 1980-16 I.R.B. **32**

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78-32
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79-12
Amplified by
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79-21
Superseded by
Rev. Proc. 80-10, 1980-13 I.R.B. **20**

79-53
Superseded by
Rev. Proc. 80-13, 1980-16 I.R.B. **32**

80-5
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54-193
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56-249
Distinguished by
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56-252
Superseded by
80-49, 1980-8 I.R.B. **13**

56-432
Obsoleted by
80-27, 1980-4 I.R.B. **8**

56-497
Obsoleted by
80-16, 1980-3 I.R.B. **6**

60-330
Distinguished by
80-124, 1980-18 I.R.B. **12***

62-197
Distinguished by
80-17, 1980-3 I.R.B. **5**

63-180
Obsoleted by
80-16, 1980-3 I.R.B. **6**

64-149
Distinguished by
80-17, 1980-3 I.R.B. **5**

64-264
Clarified & Superseded by
80-20, 1980-3 I.R.B. **10**

65-16
Amplified by
80-4, 1980-1 I.R.B. **14**

66-307
Clarified by
80-80, 1980-12 I.R.B. **10**

67-25
Superseded by
80-49, 1980-8 I.R.B. **13**

Rev. Ruls.—Continued

67-431
Amplified by
80-7, 1980-1 I.R.B. **17**

68-89
Obsoleted by
80-16, 1980-3 I.R.B. **6**

68-382
Distinguished by
80-30, 1980-5 I.R.B. **7**

68-608
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80-78, 1980-12 I.R.B. **8**

69-368
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80-76, 1980-12 I.R.B. **6**

69-369
Obsoleted after 6/30/69 by
80-76, 1980-12 I.R.B. **6**

70-190
Clarified by
80-115, 1980-17 I.R.B. **12**

70-336
Modified by
80-109, 1980-16 I.R.B. **8**

71-252
Distinguished by
80-71, 1980-11 I.R.B. **7**

71-312
Modified & Superseded by
80-47, 1980-8 I.R.B. **11**

71-399
Further amplified by
80-96, 1980-14 I.R.B. **22**

72-395
Modified by
80-123, 1980-18 I.R.B. **10***

73-198
Amplified by
80-89, 1980-13 I.R.B. **10**

74-96
Superseded by
80-47, 1980-8 I.R.B. **11**

74-99
Clarified by
80-63, 1980-10 I.R.B. **7**

74-206
Amplified & Clarified by
80-65, 1980-10 I.R.B. **10**

74-433
Superseded by
80-62, 1980-8 I.R.B. **9**

74-512
Revoked by
80-53, 1980-8 I.R.B. **15**

75-296
Distinguished by
80-34, 1980-6 I.R.B. **9**

75-368
Modified by
80-6, 1980-1 I.R.B. **16**

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[1] See footnote at end of list.

Finding List of Current Action on Previously Published Rulings[1]—Continued

Bulletins 1980-1 through 1980-18

Rev. Ruls.—Continued

75-461
Amplified by
80-124, 1980-18 I.R.B. **12***

76-415
Clarified by
80-59, 1980-9 I.R.B. **18**

76-439
Revoked by
80-85, 1980-13 I.R.B. **6**

76-567
Superseded by
80-36, 1980-6 I.R.B. **11**

77-392
Revoked by
80-31, 1980-5 I.R.B. **8**

77-410
Superseded by
80-62, 1980-8 I.R.B. **9**

77-489
Amplified by
80-70, 1980-11 I.R.B. **5**

78-110
Clarified by
80-22, 1980-3 I.R.B. **15**

78-181
Distinguished by
80-9, 1980-2 I.R.B. **5**

78-427
Superseded by
80-114, 1980-17 I.R.B. **11**

80-36
Amplified by
90-98, 980-14, I.R.B. **25**

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1 I.R.B., dated January 7, 1980.

INTERNAL REVENUE CUMULATIVE BULLETINS

______	1927–1	$6.90
______	*1927–2*	*2.95*
______	1928–1	6.95
______	1928–2	9.50
______	*1929–1*	*2.50*
______	*1929–2*	*3.15*
______	1930–1	7.30
______	1930–2	9.50
______	*1931–1*	*3.60*
______	*1931–2*	*3.25*
______	*1932–1*	*2.80*
______	1932–2	8.65
______	*1933–1*	*3.35*
______	*1933–2*	*3.45*
______	*1934–1*	*3.70*
______	*1934–2*	*4.10*
______	1935–1	6.90
______	*1935–2*	*4.00*
______	*1936–1*	*3.55*
______	*1936–2*	*3.90*
______	*1937–1*	*3.75*
______	1937–2	7.70
______	*1938–1*	*4.05*
______	*1938–2*	*3.50*
______	1939–1–1	8.25
______	1939–1–2	10.90
______	1939–2	9.40
______	1940–1	5.55
______	1940–2	14.00
______	*1941–1*	*$6.95*
______	*1941–2*	*3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943(*)*	*9.55*
______	*1944(*)*	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*2.65*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$10.10
______	1957–2	13.00
______	1958–1	9.60
______	1958–2	13.00
______	1958–3	15.00
______	1959–1	15.00
______	1959–2	9.60
______	1960–1	9.00
______	1960–2	11.50
______	1961–1	14.00
______	1961–2	10.00
______	1962–1	6.20
______	1962–2	7.15
______	1962–3	15.00
______	1963–1	9.00
______	1963–2	10.75
______	1964–1–1	10.00
______	1964–1–2	11.00
______	1964–2	9.80
______	1965–1	10.70
______	1965–2	12.25
______	1966–1	9.25
______	1966–2	14.05
______	1967–1	10.00
______	1967–2	10.00
______	1968–1	14.00
______	1968–2	11.75
______	1969–1	7.50
______	1969–2	6.50
______	1969–3	$12.50
______	1970–1	11.00
______	1970–2	14.00
______	1971–1	10.55
______	1971–2	8.50
______	1972–1	13.50
______	1972–2	13.70
______	1973–1	13.20
______	1973–2	8.30
______	1974–1	11.00
______	1974–2	9.95
______	*1974–3*	*8.20*
______	1974–3 Supp.	10.00
______	1975–1	13.25
______	1975–2	13.00
______	1976–1	11.00
______	1976–2	10.25
______	1976–3–1	9.50
______	1976–3–2	16.00
______	1976–3–3	10.00
______	1977–1	10.75
______	1977–2	11.75
______	1978–1	11.75
______	1978–2	13.00
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May 19, 1980
Bulletin No. 1980-20

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Announcement 80-63, page 69.
New Form 5970-A, Election of Carryover Basis, for use by the personal representatives of certain decedents to elect application of the carryover basis rules, is available at Service offices.

ADMINISTRATIVE

Pub. L. 96-222, page 5.
The Technical Corrections Act of 1979 contains technical, clerical, conforming, and clarifying amendments to provisions enacted by the Revenue Act of 1978, the Foreign Earned Income Act of 1978, the Black Lung Benefits Revenue Act, the Energy Tax Act of 1978, and other 1978 tax legislation.

Announcement 80-64, page 69.
Publication 16, Statistics of Income—1975, Corporation Income Tax Returns, is now available and may be purchased from the Superintendent of Documents, Washington, D.C.

Announcement 80-79, page 69.
Corrections are made to Rev. Proc. 80-10, which provides specifications for private printing of Forms W-2, W-2P, and W-3.

Finding Lists begin on page 75.
Announcement Relating to Decisions of the Tax Court on page 4.
Announcement of Disbarments & Suspensions begin on page 70.
Announcement Relating to Notice of Proposed Rulemaking begins on page 72.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Announcement Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issue or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the tax court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner does NOT ACQUIESCE in the following decision:

Taxpayer	Docket No.	Report	
		Volume	Page
Hoover Co.[1] [2]	2697-77 9646-77	72	206

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[1] Republished.

[2] Nonacquiescence relating to whether petitioner's purported sale of a "future sell contract" for foreign currency shortly before the time set for performance but subsequent to the devaluation of the currency resulted in short-term or long-term capital gain.

Part II. Treaties and Tax Legislation

Subpart B. Legislation and Related Committee Reports

Public Law 96-222
96th Congress, H.R. 2797 [1]
April 1, 1980

An act to make technical corrections related to the Revenue Act of 1978.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

Section 1. Short Title, Etc.

(a) Short Title.—This Act may be cited as the "Technical Corrections Act of 1979".

(b) Amendment of 1954 Code.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954.

Sec. 2. Coordination of Enactment Dates of Revenue Acts of 1978 and Energy Tax Act of 1978.

The Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1] is amended by inserting after section 3 the following new section:

"Sec. 4. Coordination of Enactment Dates with Energy Tax Act of 1978.

"For purposes of applying the amendments made by this Act to sections 46 and 48 of the Internal Revenue Code of 1954, the Energy Tax Act of 1978 [Pub. L. 95-618, 1978-3 C.B. (Vol. 2) 1] shall be deemed to have been enacted immediately before this Act."

TITLE I—AMENDMENTS RELATED TO REVENUE ACT OF 1978

Sec. 101. Amendments Related to Title I.

(a) General Rule.—

(1) Amendment related to section 104 of the act.—Subparagraph (C) of section 43(c)(1) (relating to individual entitled to exclude income under section 911 not eligible individual) is amended to read as follows:

"(C) Individual who claims benefits of section 911, 913, or 931 not eligible individual.—The term 'eligible individual' does not include an individual who, for the taxable year, claims the benefits of—

"(i) section 911 (relating to income earned by individuals in certain camps outside the United States),

"(ii) section 913 (relating to deduction for certain expenses of living abroad), or

"(iii) section 931 (relating to income from sources within possessions of the United States)."

(2) Amendments related to section 105 of the act.—

(A) Payments treated as earned income for afdc.—Section 402 of the Social Security Act is amended by adding at the end thereof the following new subsection:

"(d)(1) For purposes of paragraphs (7) and (8) of subsection (a), any refund of Federal income taxes made by reason of section 43 of the Internal Revenue Code of 1954 (relating to earned income credit) and any payment made by an employer under section 3507 of such Code (relating to advance payment of earned income credit) shall be considered earned income.

"(2) In any case in which such advance payments for a taxable year made by all employers to an individual under section 3507 of such Code exceed the amount of such individual's earned income credit allowable under section 43 of such Code for such year, so that such individual is liable under section 43(g) of such Code for a tax equal to such excess, such individual's benefit amount must be appropriately adjusted so as to provide payment to such individual of an amount equal to the amount of the benefits lost by such individual on account of such excess advance payments."

(B) Payment treated as earned income for ssi.—Section 1612(a)(1) of the Social Secuirty Act is amended—

(i) by striking out "and" at the end of subparagraph (A); and

(ii) by adding after subparagraph (B) the following new subparagraph:

"(C) any refund of Federal income taxes made by reason of section 43 of the Internal Revenue Code of 1954 (relating to earned income credit) and any payment made by an employer under section 3507 of such Code (relating to advance payment of earned income credit); and".

(C) Treatment of excess payments under ssi.—Section 1631(b) of the Social Security Act is amended by inserting "(1)" after "(b)" and by adding at the end thereof the following new paragraph:

"(2) In any case in which advance payments for a taxable year made by all employers to an individual under section 3507 of the Internal Revenue Code of 1954 (relating to advance payment of earned income credit) exceed the amount of such individual's earned income credit allowable under section 43 of such Code for such year, so that such individual is liable under section 43(g) of such Code for a tax equal to such excess, the Secretary shall provide for an appropriate adjustment of such individual's benefit amount under this title so as to provide payment to such individual of an amount equal to the amount of such benefits lost by such individual on account of such excess advance payments."

(D) Effective date for advance payment of earned income credit.—Paragraph (2) of section 105(g) of the Revenue Act of 1978 (relating to effective date for advance payment of earned income credit) is amended by striking out "June 30, 1978" and inserting in lieu thereof "June 30, 1979".

(E) Clerical amendment.—Subsection (h) of section 43 (relating to coordination with advance payments of earned income credit) is redesignated as subsection (g).

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[1] Senate Report No. 96-498, page 22; House Report No. 96-250 is not published.

(3) Amendment related to section 112 of the act.—Paragraph (8) of section 128(a) (relating to cross references) is amended by striking out "benefits, see" and inserting in lieu thereof "benefits which are not includible in gross income under section 85,".

(4) Amendment related to section 131 of the act.—Subparagraph (B) of section 457(d)(9) (relating to application to rural electric cooperatives of rules for eligible State deferred compensation plans) is amended to read as follows:

"(B) Rural electric cooperative defined.—For purposes of subparagraph (A), the term 'rural electric cooperative' means—

"(i) any organization which is exempt from tax under section 501(a) and which is engaged primarily in providing electric service on a mutual or cooperative basis, and

"(ii) any organization described in paragraph (4) or (6) of section 501(c) which is exempt from tax under section 501(a) and at least 80 percent of the members of which are organizations described in clause (i)."

(5) Amendment related to section 133 of the act.—Subsection (c) of section 133 of the Revenue Act of 1978 (relating to effective date for clarification of deductibility of payments of deferred compensation, etc., to independent contractors) is amended to read as follows:

"(c) Effective Dates.—

"(1) In general.—Except as provided in paragraph (2), the amendments made by this section shall apply to deductions for taxable years beginning after December 31, 1978.

"(2) Special rule for certain title insurance companies.—

"(A) In general.—In the case of a qualified title insurance company plan, the amendment made by subsection (a)shall apply to deductions for taxable years beginning after December 31, 1979.

"(B) Qualified title insurance company plan.—For purposes of subparagraph (A), the term 'qualified title insurance company plan' means a plan of a qualified title insurance company—

"(i) which defers the payment of amounts credited by such company to separate accounts for members of such company in consideration of their issuance of policies of title insurance, and

"(ii) under which no part of such amounts is payable to or withdrawable by the members until after the period for the adverse possession of real property under applicable State law.

"(C) Qualified title insurance company.—For purposes of subparagraph (B), the term 'qualified title insurance company' means an unincorporated title insurance company organized as a business trust—

"(i) which is engaged in the business of providing title insurance coverage on interests in and liens upon real property obtained by clients of the members of such company, and

"(ii) which is subject to tax under section 831 of the Internal Revenue Code of 1954."

(6) Amendments related to section 134 of the act.—

(A) Employment requirement.—Subparagraph (B) of section 125(g)(3) (relating to certain participation eligibility rules not treated as discriminatory) is amended by striking out "service requirement" each place it appears and inserting in lieu thereof "employment requirement".

(B) Effective date.—Subsection (c) of section 134 of the Revenue Act of 1978 is amended by striking out "taxable years" and inserting in lieu thereof "plan years".

(7) Amendments related to section 141 of the act.—

(A) Amendment to anti-flow-through rules.—Paragraph (9) of section 46(f) (relating to special rule for additional credit) is amended—

(i) by striking out "subparagraph (B) of subsection (a)(2)" each place is appears and inserting in lieu thereof "subparagraph (E) of subsection (a)(2)", and

(ii) by striking out "an employee stock ownership plan which meets the requirements of section 301(d) of the Tax Reduction Act of 1975" in subparagraph (A) and inserting in lieu thereof "a tax credit employee stock ownership plan which meets the requirements of section 409A".

(B) Clarification of effective date.—Section 141 of the Revenue Act of 1978 (relating to ESOPS) is amended by striking out subsection (g) and inserting in lieu thereof the following new subsections:

"(g) Effective Dates for Tax Credit Stock Ownership Plans.—

"(1) In general. — Except as otherwise provided in this subsection and subsection (h), the amendments made by this section shall apply with respect to qualified investment for taxable years beginning after December 31, 1978.

"(2) Election to have amendments apply during 1978.—At the election of the taxpayer, paragraph (1) shall be applied by substituting 'December 31, 1977' for 'December 31, 1978'; except that in the case of a plan in existence before December 31, 1978, any such election shall not affect the required allocation of employer securities attributable to qualified investment for taxable years beginning before January 1, 1979. An election under the preceding sentence shall be made at such time and in such manner as the Secretary of the Treasury or his delegate shall prescribe. Such an election, once made, shall be irrevocable.

"(3) Voting right provisions.—Section 409A(e) of the Internal Revenue Code of 1954 (as added by subsection (a)) shall apply to plans to which section 409A of such Code applies, beginning with the first day of such application.

"(4) Right to demand employer securities, etc.—Paragraphs (1)(A) and (2) of section 409A(h) of the Internal Revenue Code of 1954 (as added by subsection (a)) shall apply to distributions after December 31, 1978, made by a plan to which section 409A of such Code applies.

"(5) Subsection (f)(7). — The amendment made by subsection (f)(7) shall apply to years beginning after December 31, 1978.

"(6) Retroactive application of amendment made by subsection (d).—In determining the regular tax deduction under section 56(c) of the Internal Revenue Code of 1954 for any taxable year beginning before

January 1, 1979, the amount of the credit allowable under section 38 of such Code shall be determined without regard to section 46(a)(2)(B) of such Code (as in effect before the enactment of the Energy Tax Act of 1978).

"(h) Effective Dates for Section 4975 Employee Stock Ownership Plans.—Paragraphs (5) and (6) of subsection (f) shall apply—

"(1) insofar as they make the requirements of subsections (e) and (h)(1)(B) of section 409A of the Internal Revenue Code of 1954 applicable to section 4975 of such Code, to stock acquired after December 31, 1979, and

"(2) insofar as they make paragraphs (1)(A) and (2) of section 409A(h) of such Code applicable to such section 4975, to distributions after December 31, 1978."

(C) Definition of qualifying employer security for employee stock ownership plan.—The first sentence of paragraph (8) of section 4975(e) (defining qualifying employer security) is amended to read as follows:

"The term 'qualifying employer security' means any employer security within the meaning of section 409A(l)."

(D) Nonrecognition of gain on contribution to tax credit employee stock ownership plan.—Subsection (m) of section 409A (relating to contributions of stock of controlling corporation) is amended to read as follows:

"(m) Nonrecognition of Gain or Loss on Contribution of Employer Securities to Tax Credit Employee Stock Ownership Plan.—No gain or loss shall be recognized to the taxpayer with respect to the transfer of employer securities to a tax credit employee stock ownership plan maintained by the taxpayer to the extent that such transfer is required under subparagraph (A) or (B) of section 48(n)(1)."

(E) Section 4975 employee stock ownership plans may distribute cash in certain cases.—Paragraph (2) of section 409A(h) (relating to allowing plan to distribute cash in certain cases) is amended by inserting "or of section 4975(e)(7)" after "the requirements of this section".

(F) Matched employer and employee contributions must stay in plan.—Subsection (d) of section 409A (relating to employer securities must stay in plan) is amended by inserting "(or allocated to a participant's account in connection with matched employer and employee contributions)" after "under subsection (b)".

(G) Limitation on required transfers for matching employees plan percentage.—Clause (i) of section 48(n)(1)(B) (relating to matching percentage) is amended to read as follows:

"(i) to make transfers of employer securities to a tax credit employee stock ownership plan maintained by the employer having an aggregate value equal to the lesser of—

"(I) the sum of the qualified matching employee contributions made to such plan for the taxable year, or

"(II) one-half of 1 percent of the amount of the qualified investment (as determined under subsections (c) and (d) of section 46) for the taxable year, and".

(H) Time for making transfers attributable to qualified matching employee contributions.—The last sentence of section 48(n)(1)(C) (relating to times for making transfers) is amended by inserting before the period at the end thereof the following: "(including where such excess is attributable to qualified matching employee contributions made after the close of the taxable year)".

(I) Date for establishing plan.—

(i) Paragraph (1) of section 409A(f) (relating to plan must be established before employer's due date) is amended to read as follows:

"(1) In general.—A plan meets the requirements of this subsection only if it is established on or before the due date (including any extension of such date) for the filing of the employer's tax return for the first taxable year of the employer for which an employee plan credit is claimed by the employer with respect to the plan."

(ii) Paragraph (2) of section 409A(f) is amended by inserting before the period at the end thereof the following: "with respect to the plan".

(J) Definition of employer securities.—

(i) Subparagraph (B) of section 409A(l)(2) (relating to special rule where there is no readily tradable common stock) is amended by striking out "class of stock" and inserting in lieu thereof "class of common stock".

(ii) Paragraph (3) of section 409A(l) is amended to read as follows:

"(3) Preferred stock may be issued in certain cases.—Noncallable preferred stock shall be treated as employer securities if such stock is convertible at any time into stock which meets the requirements of paragraph (1) or (2) (whichever is applicable) and if such conversion is at a conversion price which (as of the date of the acquisition by the ESOP) is reasonable. For purposes of the preceding sentence, under regulations prescribed by the Secretary, preferred stock shall be treated as noncallable if after the call there will be a reasonable opportunity for a conversion which meets the requirements of the preceding sentence."

(K) Voting rights requirements.—Paragraph (7) of section 4975(e) (defining leveraged employee stock ownership plan) is amended by striking out the last sentence and inserting in lieu thereof the following:

"A plan shall not be treated as an employee stock ownership plan unless it meets the requirements of section 409A(h) and, if the employer has a registration-type class of securities (as defined in section 409A(e)(4)), it meets the requirements of section 409A(e)."

(L) Name changes.—

(i) The following provisions are each amended by striking out "an ESOP" each place it appears (other than in any heading) and inserting in lieu thereof "a tax credit employee stock ownership plan":

(I) Section 48(n)(1)(A)(i).
(II) Section 48(n)(2).
(III) Section 48(n)(2)(A).
(IV) Section 48(n)(5).
(V) Section 401(a)(21).

(VI) Section 409A(m).

(VII) Section 415(c)(6)(B)(i).

(VIII) The last sentence of section 1504(a).

(ii) The following provisions are each amended by striking out "ESOP" each place it appears and inserting in lieu thereof "tax credit employee stock ownership plan":

(I) Section 409A(a) (other than in the subsection heading).

(II) Section 409A(l)(3).

(III) Section 48(n)(1)(B)(i) (as amended by clause (i)).

(IV) Section 48(n)(2).

(V) Section 48(n)(3).

(VI) Section 48(n)(4)(A).

(iii) The following provisions are each amended by striking out "ESOP" each place it appears (other than in any heading) and inserting in lieu thereof "employee plan":

(I) Section 46(a)(2).

(II) Section 48(n) (as amended by clauses (i) and (ii)).

(III) Section 48(o).

(IV) Section 56(c).

(V) Section 409A (as amended by subparagraph (I) and clauses (i) and (ii)).

(VI) Section 6699.

(iv) The following provisions are each amended by striking out "leveraged employee" each place it appears and inserting in lieu thereof "employee":

(I) Section 415(c)(6)(B)(i).

(II) The last sentence of section 1504(a).

(III) Section 4975(e)(7) (other than in the paragraph heading).

(v)(I) The heading of subparagraph (E) of section 46(a)(2) is amended by striking out "ESOP" and inserting in lieu thereof "EMPLOYEE PLAN".

(II) The subsection heading for section 48(n) is amended by striking out "ESOP" and inserting in lieu thereof "EMPLOYEE PLAN".

(III) The subparagraph headings for subparagraphs (A) and (B) of section 48(n)(1) are each amended by striking out "ESOP" and inserting in lieu thereof "EMPLOYEE PLAN".

(IV) The paragraph headings for paragraph (4) of section 48(n) and paragraphs (4), (5), (6), and (7) of section 48(o) are each amended by striking out "ESOP" and inserting in lieu thereof "EMPLOYEE PLAN".

(V) The paragraph heading for section 48(o)(3) is amended by striking out "ESOP" and inserting in lieu thereof "EMPLOYEE PLAN".

(VI) The subsection heading for subsection (a) of section 409A is amended by striking out "ESOP" and inserting in lieu thereof "TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLAN".

(VII) The section heading for section 409A is amended by striking out "ESOPS" and inserting in lieu thereof "TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLANS".

(VIII) The table of sections for subpart A of part I of subchapter D of chapter 1 is amended by striking out "ESOPS" in the item relating to section 409A and inserting in lieu thereof "tax credit employee stock ownership plans".

(IX) The section heading of section 6699 is amended by striking out "ESOP" and inserting in lieu thereof "TAX CREDIT EMPLOYEE STOCK OWNERSHIP PLAN".

(X) The table of sections for subchapter B of chapter 68 is amended by striking out "ESOP" in the item relating to section 6699 and inserting in lieu thereof "tax credit employee stock ownership plan".

(XI) The paragraph heading for paragraph (7) of section 4975(e) is amended by striking out "LEVERAGED EMPLOYEE" and inserting in lieu thereof "EMPLOYEE".

(M) Clerical amendments.—

(i) Subparagraph (E) of section 46(a)(2) is amended by inserting "and ending on" before "December 31, 1983" each place it appears.

(ii) Subparagraph (B) of section 48(n)(2) is amended by adding "and" at the end of clause (i), by striking out clause (ii), and by redesignating clause (iii) as clause (ii).

(iii) Paragraph (5) of section 48(o) (as amended by subparagraph (L)) is amended by inserting "percentage" after "attributable to the maching employee plan".

(8) Amendments related to section 142 of the act.—

(A) Subsection (c) of section 691 (relating to deduction for estate tax) is amended by adding at the end thereof the following new paragraph:

"(5) Coordination with section 402(e).—For purposes of section 402(e) (other than paragraph (1)(D) thereof), the total taxable amount of any lump sum distribution shall be reduced by the amount of the deduction allowable under paragraph (1) of this subsection which is attributable to the total taxable amount (determined without regard to this paragraph)."

(B) Paragraph (2) of section 2039(f) (relating to lump sum distributions) is amended by striking out "without the application of paragraph (2) thereof" and inserting in lieu thereof "(without the application of paragraph (2) thereof), except to the extent that section 402(e)(4)(J) applies to such distribution".

(9) Amendment related to section 143 of the act.—Subparagraph (B) of section 401(a)(22) is amended by striking "as securities" and inserting in lieu thereof "are securities".

(10) Amendments related to section 152 of the act.—

(A) Certain employees may be excluded.—Paragraph (2) of section 408(k) (relating to participation requirements for simplified employee pensions) is amended by adding at the end thereof the following new sentence:

"For purposes of this paragraph, there shall be excluded from consideration employees described in subparagraph (A) or (C) of section 410(b)(2)."

(B) Contributions under simplified employee pension not subject to FICA or FUTA taxes.—

(i) FICA tax.—Paragraph (5) of section 3121(a) (defining wages) is amended by striking out "or" at the end of subparagraph (B), by striking out the semicolon at the end of subparagraph (C) and inserting in lieu thereof ", or", and by adding at the end thereof the following new subparagraph:

"(D) under a simplified employee pension if, at the time of the payment, it is reasonable to believe that the employee will be entitled to a deduction under section 219 for such payment:".

(ii) FUTA tax.—Paragraph (5) of section 3306(b) (defining wages) is amended by striking out "or" at the end of subparagraph (B), by striking out the semicolon at the end of subparagraph (C) and inserting in lieu thereof ", or", and by adding at the end thereof the following new subparagraph:

"(D) under a simplified employee pension if, at the time of the payment, it is reasonable to believe that the employee will be entitled to a deduction under section 219 for such payment;".

(C) Correction of certain excess contributions.—Subparagraph (A) of section 408(d)(5) (relating to certain distributions of excess contributions after due date for taxable year) is amended by adding at the end thereof the following new sentence:

"If employer contributions on behalf of the individual are paid for the taxable year to a simplified employee pension, the dollar limitation of the preceding sentence shall be increased by the lesser of the amount of such contributions or $7,500."

(D) Clarification of section 219(b)(7).—Paragraph (7) of section 219(b) (relating to simplified employee pensions) is amended to read as follows:

"(7) Special rules in case of simplified employee pensions.—

"(A) Limitation.—If there is an employer contribution on behalf of the employee to a simplified employee pension, the limitation under paragraph (1) shall be the lesser of—

"(i) 15 percent of the compensation includible in the employee's gross income for the taxable year (determined without regard to the employer contribution to the simplified employee pension), or

"(ii) the sum of—

"(I) the amount contributed by the employer to the simplified employee pension and included in gross income (but not in excess of $7,500), and

"(II) $1,500, reduced (but not below zero) by the amount described in subclause (I).

"(B) Certain limitations do not apply to employee contribution.—Paragraphs (2) and (3) shall not apply with respect to the employer contribution to a simplified employee pension.

"(C) Special rule for applying subparagraph (A)(ii).—In the case of an employee who is an officer, shareholder, or owner-employee described in section 408(k)(3), the $7,500 amount specified in subparagraph (A)(ii)(I) shall be reduced by the amount of tax taken into account with respect to such individual under subparagraph (D) of section 408(k)(3)."

(E) Coordination with plan for shareholder-employees. — Paragraph (4) of section 404(h) (relating to effect on self-employed individuals) is amended—

(i) by inserting "or described in section 1379(b)(1)" after "of subsection (e)",

(ii) by inserting "or a shareholder-employee (as defined in section 1379 (d))" after "section 401(c)(1)", and

(iii) by striking out "self-employed individuals" in the paragraph heading and inserting in lieu thereof "self-employed individuals or shareholder-employees".

(F) Coordination with section 401(j).—Subsection (k) of section 408 (defining simplified employee pension) is amended—

(i) by striking out "and (5)" in paragraph (1) and inserting in lieu thereof "(5), and (6)",

(ii) by redesignating paragraph (6) as paragraph (7), and

(iii) by inserting after paragraph (5) the following new paragraph:

"(6) Employer may not maintain plan to which section 401(j) applies.—The requirements of this paragraph are met with respect to a simplified employee pension for a calendar year unless the employer maintains during any part of such year a plan—

"(A) some or all of the active participants in which are employees (within the meaning of section 401 (c)(1)) or shareholder-employees (as defined in section 1379(d)), and

"(B) to which section 401(j) applies."

(G) Employer may not maintain integrated plan.—

(i) The second sentence of section 408(k)(3)(D) (relating to treatment of certain contributions and taxes) is amended by striking out "Taxes paid" and inserting in lieu thereof "If the employer does not maintain an integrated plan at any time during the taxable year, taxes paid".

(ii) Paragraph (3) of section 408 (k) is amended by adding at the end thereof the following new subparagraph:

"(E) Integrated plan defined.—For purposes of subparagraph (D), the term 'integrated plan' means a plan which meets the requirements of section 401(a), 403(a), or 405(a) but would not meet such requirements if contributions or benefits under chapter 2 (relating to tax on self-employment income), chapter 21 (relating to Federal Insurance Contributions Act), title II of the Social Security Act, or any other Federal or State law were not taken into account."

(H) Penalty for failure to file reports.—Subsection (a) of section 6693 (relating to failure to provide reports on individual retirement accounts or annuities) is amended—

(i) by striking out "section 408(i)" the first place it appears and inserting in lieu thereof "subsection (i) or (l) of section 408", and

(ii) by striking out "section 408(i)" the second place it appears and inserting in lieu thereof "such subsection".

(I) Application with section 415.—Paragraph (5) of section 415(e) is amended—

(i) by striking out "any simplified employee pension" in the first sentence, and

(ii) by inserting after the first sentence the following new sentence: "For purposes of this section, any contribution by an employer to a simplified employee pension for an individual for a taxable year shall be treated as an employer contribution to a defined contribution plan for such individual for such year."

(J) Clerical amendments.—

(i) Subsection (j) of section 408 is amended by inserting "and" at the end of paragraph (1), by striking out

", and" at the end of paragraph (2) and inserting in lieu thereof a period, and by striking out paragraph (3).

(ii) Paragraphs (2), (3), and (4) of section 404(h) are each amended by striking out "subparagraph (1)" each place it appears and inserting in lieu thereof "paragraph (1)".

(iii) Paragraph (2) of section 152(g) of the Revenue Act of 1978 is amended by striking out "section 415(b)(2)" and inserting in lieu thereof "section 415(a)(2)".

(11) AMENDMENTS RELATED TO SECTION 153 OF THE ACT.—

(A) WAIVER OF SECTION 415(b)(1)(B) LIMITATION DOES NOT APPLY WHERE PARTICIPANT IS ALSO A PARTICIPANT OF ANOTHER QUALIFIED PLAN.—Paragraph (7) of section 415(b) (relating to benefits under certain collectively bargained plans) is amended by inserting after the second sentence the following new sentence: "This paragraph shall not apply to a participant for any period for which he is a participant under another plan to which this section applies which is maintained by an employer maintaining this plan."

(B) FORMULA FOR DETERMINING BENEFITS IN THE CASE OF SECTION 415(b)(7) PLANS.—Subparagraph (C) of section 415(b)(7) is amended to read as follows:

"(C) under which benefits are determined solely by reference to length of service, the particular years during which service was rendered, age at retirement, and date of retirement,".

(12) AMENDMENT RELATED TO SECTION 154 OF THE ACT.—Subparagraph (A) of section 403(b)(7) is amended by striking out "which satisfied" and inserting in lieu thereof "which satisfies".

(13) AMENDMENT RELATED TO SECTION 156 OF THE ACT.—

(A) EFFECTIVE DATE.—Subsection (d) of section 156 of the Revenue Act of 1978 (relating to effective date for provision allowing rollover of section 403(b) annuities) is amended by striking out "December 31, 1978" and inserting in lieu thereof "December 31, 1977".

(B) TRANSITIONAL RULE FOR MAKING SECTION 403(b)(8) ROLLOVER IN THE CASE OF PAYMENTS DURING 1978.—In the case of any payment made during 1978 in a qualifying distribution described in section 403(b)(8) of the Internal Revenue Code of 1954, the applicable period specified in section 402(a)(5)(C) of such Code shall not expire before the close of December 31, 1980.

(C) CLERICAL AMENDMENTS.—Sections 403(b)(1) and 4973(c)(1) are each amended by striking out "409(d)(3)(C)", and inserting in lieu thereof "409(b)(3)(C)".

(14) AMENDMENTS RELATED TO SECTION 157 OF THE ACT.—

(A) EFFECTIVE DATE FOR REMOVAL OF CERTAIN REQUIREMENTS.—Paragraph (3) of section 157(h) of the Revenue Act of 1978 is amended by striking out "the amendments made by this section" each place it appears and inserting in lieu thereof "the amendments made by this subsection".

(B) CONFORMING AMENDMENTS FOR SPOUSAL ROLLOVERS.—Sections 219(b)(4), 220(b)(5), 408(a)(1), 409(a)(4), and 4973(b)(1)(A) are each amended by inserting "402(a)(7)," after "section 402(a)(5),".

(C) SPOUSAL ROLLOVERS.—Clause (i) of section 402(a)(7)(A) is amended to read as follows:

"(i) any portion of a qualifying rollover distribution attributable to an employee is paid to the spouse of the employee after the employee's death,".

(D) EXTENSION OF TRANSITIONAL RULE.—Subparagraph (B) of section 157(h)(3) of the Revenue Act of 1978 (relating to transitional rule for removal of certain requirements) is amended—

(i) by striking out "any payment" and inserting in lieu thereof "any payment made during 1978", and

(ii) by striking out "December 31, 1978" and inserting in lieu thereof "December 31, 1980".

(E) CLERICAL AMENDMENTS.—

(i) Clause (iii) of section 402(a)(6)(D) (relating to sales of distributed property) is amended by striking out "many designate" and inserting in lieu thereof "may designate".

(ii) Subparagraph (B) of section 408(d)(5) is amended by striking out all that follows clause (i) and inserting in lieu thereof the following:

"(ii) the information was erroneous,

subparagraph (A) shall be applied by increasing the dollar limit set forth therein by that portion of the excess contribution which was attributable to such information."

(iii) Paragraph (20) of section 401(a)(1) is amended by striking out "makes a payment or distribution described in section 402(a)(5)(i) or 403(a)(4)(i)" and inserting in lieu thereof "makes a qualifying rollover distribution (determined as if section 402(a)(5)(D)(i) did not contain subclause (II) thereof) described in section 402(a)(5)(A)(i) or 403(a)(4)(A)(i)".

(b) EFFECTIVE DATES.—

(1) SPECIAL EFFECTIVE DATES.—

(A) SUBSECTION (a)(1).—The amendment made by subsection (a)(1) shall apply to taxable years beginning after December 31, 1977.

(B) SUBSECTION (a)(2).—The amendments made by subparagraphs (A) and (B) of subsection (a)(2) shall apply to payments for months beginning after December 31, 1979.

(C) DEFINITION OF QUALIFYING EMPLOYER SECURITIES.—The amendment made by subparagraph (C) of subsection (a)(6) shall apply to stock acquired after December 31, 1979.

(D) COORDINATION WITH SECTION 691.—The amendment made by subsection (a)(7) shall apply with respect to the estates of decedents dying after the date of the enactment of this Act.

(E) CONTRIBUTIONS UNDER SIMPLIFIED EMPLOYEE PENSION.—The amendments made by subparagraph (B) of subsection (a)(10) shall apply to payments made on or after January 1, 1979.

(F) PENALTY FOR FAILURE TO FURNISH REPORTS.—The amendment made by subparagraph (I) of subsection (a)(10) shall apply with respect to failures occurring after the date of the enactment of this Act.

(G) COORDINATION WITH SECTION 415.—The amendment made by subparagraph (I) of subsection (a)(10) shall apply to taxable years beginning after the date of the enactment of this Act.

(2) GENERAL EFFECTIVE DATE.—

For general effective date, see section 201.

Sec. 102. Amendments Related to Title II.

(a) General Rule.—

(1) Amenments related to subtitle a of title ii of the act.—

(A) Stock ownership rules.—Subsection (a) of section 465 (relating to deductions limited to amount at risk) is amended—

(i) by striking out "(determined by reference to the rules contained in section 318 rather than under section 544)" in paragraph (1)(C), and

(ii) by adding at the end thereof the following new paragraph:

"(3) Special rules for applying paragraph (1)(C).—For purposes of paragraph (1)(C)—

"(A) section 544(a)(2) shall be applied as if such section did not contain the phrase 'or by or for his partner'; and

"(B) sections 544(a)(4)(A) and 544(b)(1) shall be applied by substituting 'the corporation meet the stock ownership requirements of section 542(a)(2)' for 'the corporation a personal holding company'."

(B) Clarification of rules for recapture of losses where amount at risk is less than zero.—Subsection (d) of section 465 (defining loss) is amended by inserting before the period at the end thereof the following: "(determined without regard to subsection (e)(1)(A))".

(C) Clarification of limitation on recapture of losses.—Subparagraph (A) of section 465(e)(2) (relating to limitation on recapture of losses where amount at risk is less than zero) is amended by inserting "by reason of losses" after "with respect to the activity".

(D) Exclusion for certain equipment leasing by closely-held corporations.—

(i) Subsection (c) of section 465 (relating to deductions limited to amount at risk) is amended by adding at the end thereof the following new paragraphs:

"(4) Exclusion for certain equipment leasing by closely-held corporations.—

"(A) In general.—In the case of a corporation described in subsection (a)(1)(C) actively engaged in equipment leasing—

"(i) the activity of equipment leasing shall be treated as a separate activity, and

"(ii) subsection (a) shall not apply to losses from such activity.

"(B) 50-percent gross receipts test.—For purposes of subparagraph (A), a corporation shall not be considered to be actively engaged in equipment leasing unless 50 percent or more of the gross receipts of the corporation for the taxable year is attributable, under regulations prescribed by the Secretary, to equipment leasing.

"(C) Component members of controlled group treated as a single corporation.—For purposes of subparagraph (A), the component members of a controlled group of corporations shall be treated as a single corporation.

"(5) Waiver of controlled group rule where there is substantial leasing activity.—

"(A) In general.—In the case of the component members of a qualified leasing group, paragraph (4) shall be applied—

"(i) by substituting '80 percent' for '50 percent' in subparagraph (B) thereof, and

"(ii) as if paragraph (4) did not include subparagraph (C) thereof.

"(B) Qualified leasing group.—For purposes of this paragraph, the term 'qualified leasing group' means a controlled group of corporations which, for the taxable year and each of the 2 immediately preceding taxable years, satisfied each of the following 3 requirements:

"(i) At least 3 employees.—During the entire year, the group had at least 3 full-time employees substantially all of the services of whom were services directly related to the equipment leasing activity of the qualified leasing members.

"(ii) At least 5 separate leasing transactions.—During the year, the qualified leasing members in the aggregate entered into at least 5 separate equipment leasing transactions.

"(iii) At least $1,000,000 equipment leasing receipts.—During the year, the qualified leasing members in the aggregate had at least $1,000,000 in gross receipts from equipment leasing.

The term 'qualified leasing group' does not include any controlled group of corporations to which, without regard to this paragraph, paragraph (4) applies.

"(C) Qualified leasing member.—For purposes of this paragraph, a corporation shall be treated as a qualified leasing member for the taxable year only if for each of the taxable years referred to in subparagraph (B)—

"(i) it is a component member of the controlled group of corporations, and

"(ii) it meets the requirements of paragraph (4)(B) (as modified by subparagraph (A)(i) of this paragraph).

"(6) Definitions relating to paragraphs (4) and (5).—For purposes of paragraphs (4) and (5)—

"(A) Equipment leasing.—The term 'equipment leasing' means—

"(i) the leasing of equipment which is section 1245 property, and

"(ii) the purchasing, servicing, and selling of such equipment.

"(B) Leasing of master sound recordings, etc., excluded.—The term 'equipment leasing' does not include the leasing of master sound recordings, and other similar contractual arrangements with respect to tangible or intangible assets associated with literary, artistic, or musical properties.

"(C) Controlled group of corporations; component member.—The terms 'controlled group of corporations' and 'component member' have the same meanings as when used in section 1563. The determination of the taxable years taken into account with respect to any controlled group of corporations shall be made in a manner consistent with the manner set forth in section 1563."

(ii) Subparagraph (D) of section 465(c)(3) is amended to read as follows:

"(D) Exclusion for real property.—In the case of activities described in subparagraph (A), the holding of real property (other than mineral property) shall be treated as a separate activity, and subsection (a) shall not apply to losses from such activity. For purposes of the preceding sentence, personal property and services which are incidental to making real property available as living accommodations shall be treated as part of the activity of holding such real property."

(iii) Paragraph (5) of section 465 (b) is amended by striking out "to which this section applies" and inserting in lieu thereof "to which subsection (a) applies".

(E) Clerical amendment to effective date.—Subparagraph (A) of section 204(b)(2) of the Revenue Act of 1978 (relating to special transitional rules for leasing activities) is amended by striking out "this section" and inserting in lieu thereof "this subtitle".

(2) Amendments related to subtitle b of Title II of the act.—

(A) Amendment of section 6501—Section 6501 (relating to limitations on assessment and collection) is amended by redesignating the subsection added by section 212(a) of the Revenue Act of 1978 as subsection (o).

(B) Amendment of section 6511 (g)(2).—Paragraph (2) of section 6511(g) (relating to special rule for partnership items of federally registered partnerships) is amended by striking out "6501(q)" and inserting in lieu thereof "6501(o)".

(C) Amendment of section 761.—Subsection (a) of section 761 (defining partnership) is amended by striking out "or" at the end of paragraph (1), by inserting "or" at the end of paragraph (2), and by inserting after paragraph (2) the following new paragraph:

"(3) by dealers in securities for a short period for the purpose of underwriting, selling, or distributing a particular issue of securities,".

(b) Effective Date.—

For general effective date, see section 201.

Sec. 103. Amendments Related to Title III.

(a) General Rule.—

(1) Amendment related to section 301 of the act.—Subparagraph (A) of section 857(b)(4) (relating to imposition of tax on income from foreclosure property) is amended to read as follows:

"(A) Imposition of tax.—A tax is hereby imposed for each taxable year on the net income from foreclosure property of every real estate investment trust. Such tax shall be computed by multiplying the net income from foreclosure property by the highest rate of tax specified in section 11(b)."

(2) Amendments related to section 312 of the act.—

(A) Clarification of flow-through provisions. — Paragraph (2) of section 312(c) of the Revenue Act of 1978 (relating to repeal of certain obsolete provisions) is amended to read as follows:

"(2) Paragraphs (1) and (2) of section 46(f) and subparagraph (B) of section 48(a)(7) are each amended by striking out 'described in section 50' and inserting in lieu thereof 'described in section 50 (as in effect before its repeal by the Revenue Act of 1978)'."

(B) Clerical amendments to special rules for energy property.—

(i) Subsection (a) of section 46 (relating to amount of investment credit) is amended by redesignating paragraph (10) as paragraph (9).

(ii) Clause (i) of section 46(a) (9)(B) (as redesignated by clause (i)) is amended to read as follows:

"(i) paragraph (3)(B) shall be applied by substituting '100 percent' for the percentage determined under the table contained in such paragraph,".

(iii) Clause (ii) of section 46(a) (9)(B) (as so redesignated) is amended by striking out "(7), (8), and (9)" and inserting in lieu thereof "(7) and (8)".

(iv) Subsection (d) of section 6401 is amended by striking out "46(a)(10) (C)" and inserting in lieu thereof "46 (a)(9)(C)".

(3) Amendment related to section 313 of the act.—Subparagraph (B) of section 46(c)(5) (relating to applicable percentage in the case of certain pollution control facilities) is amended by adding at the end thereof the following new sentence: "This subparagraph shall not apply for purposes of applying the energy percentage."

(4) Amendments related to section 315 of the act.—

(A) Credit allowed to noncorporate lessors.—Paragraph (3) of section 46(e) (relating to special rule for noncorporate lessors) is amended by adding at the end thereof the following new sentence: "This paragraph shall not apply with respect to any property which is treated as section 38 property by reason of section 48(a) (1)(E)."

(B) Coordination with energy property.—Clause (i) of section 48 (g)(2)(B) is amended by striking out "subsection (a)(1)(E)" and inserting in lieu thereof "subsections (a)(1)(E) and (l))".

(5) Amendment related to section 316 of the act.—Sections 50B (f) and 52(f) (and the predecessor of section 52(f), section 52(h)) are each amended by striking out "section 46(e)" and inserting in lieu thereof "subsections (e) and (h) of section 46".

(6) Amendment related to section 321 of the act.—

(A) Extension of termination date.—Paragraph (4) of section 51(c) (relating to termination) is amended by striking out "December 31, 1980" and inserting in lieu thereof "December 31, 1981".

(B) Effective date for provision making new jobs credit elective.—Subsection (d) of section 321 of the Revenue Act of 1978 (relating to effective dates) is amended by adding at the end thereof the following new paragraph:

"(5) Subsection (b). — The amendments made by subsection (b) shall apply to taxable years beginning after December 31, 1976."

(C) Clarification of effective date.—Subparagraph (A) of section 321(d)(2) of the Revenue Act of 1978 (relating to special rules for newly targeted groups) is amended by inserting ", for purposes of applying the amendments made by this section" after "newly targeted group".

(D) Clarification of transitional rule.—Paragraph (3) of section 321(d) of the Revenue Act of 1978 (relating to trasitional rule) is amended to read as follows:

"(3) Transitsonal rule.—In the case of a taxable year which begins in

1978 and ends after December 31, 1978, the amount of the credit determined under section 51 of the Internal Revenue Code of 1954 shall be the sum of—

"(A) the amount of the credit which would be so determined without regard to the amendments made by this section, plus

"(B) the amount of the credit which would be so determined by reason of the amendments made by this section."

(E) FUTA WAGES TO BE TREATED AS INCLUDING REMUNERATION OF YOUTH PARTICIPATING IN A COOPERATIVE EDUCATION PROGRAM.—

(i) Subparagraph (D) of section 51(d)(8) (relating to members of targeted groups) is amended to read as follows:

"(D) WAGES.—In the case of remuneration attributable to services performed while the individual meets the requirements of subpargraph (A), wages, and unemployment insurance wages, shall be determined without regard to section 3306(c)(10)(C)."

(ii) Paragraph (1) of section 51(c) (defining wages) is amended by striking out "and subsection (h)(2)," and inserting in lieu thereof ", subsection (d)(8)(D), and subsection (h)(2),".

(F) AGE REQUIREMENT FOR QUALIFIED COOPERATIVE EDUCATION PROGRAMS.—Clause (i) of section 51(d)(8)(A) (defining youth participating in a qualified cooperative education program) is amended by striking out "(19)" and inserting in lieu thereof "20".

(G) CLERICAL AMENDMENTS.—

(i) Subsection (a) of section 44B is amended by striking out "at the taxpayer" and inserting in lieu thereof "of the taxpayer".

(ii) Paragraph (2) of section 44B (c) is amended by striking out "may be" and inserting in lieu thereof "may by".

(iii) Paragraph (2) of section 51 (c) is amended by striking out "amounts paid" and inserting in lieu thereof "amounts paid or incurred".

(iv) Paragraph (1) of section 51 (d) is amended by striking out "or" at the end of subparagraph (E).

(v) Clause (i) of section 51(d)(4)(A) is amended by striking out "active day" and inserting in lieu thereof "active duty".

(vi) Subparagraph (B) of section 51(d)(4) is amended by striking out "premployment" and inserting in lieu thereof "preemployment".

(vii) Paragraph (5) of section 51 (d) is amended by striking out "preemployment" and inserting in lieu thereof "preemployment".

(viii) Paragraph (12) of section 51(d) is amended by striking out "employer" and inserting in lieu thereof "employers".

(ix) The last sentence of section 51(e) is amended by inserting "except as provided in subsection (h)(1)," after "the preceding sentence,".

(x) Section 6501 is amended by redesignating the subsection added by section 321(b)(2) of the Revenue Act of 1978 as subsection (p).

(xi) Subparagraph (B) of section 321(d)(2) of the Revenue Act of 1978 is amended by striking out clauses (i) and (ii) and inserting in lieu thereof the following:

"(i) such individual meets the requirements of paragraph (1) of section 51(d) of such Code, and

"(ii) in the case of an individual meeting the requirements of subparagraph (A) of such paragraph (1), a credit was not claimed for such individual by the taxpayer for a taxable year beginning before January 1, 1979."

(xii) Paragraph (4) of section 321 (d) of the Revenue Act of 1978 is amended by striking out "subsection (u)(2)" and inserting in lieu thereof "subsection (c)(2)".

(xiii) Section 383 and subsection (a) of section 6411 are each amended by striking out "section 53(c)" and inserting in lieu thereof "section 53 (b)".

(7) AMENDMENTS RELATED TO SECTION 322 OF THE ACT.—

(A) CLARIFICATION OF EFFECTIVE DATE.—Paragraph (1) of section 322 (e) of the Revenue Act of 1978 (relating to effective date) is amended by adding at the end thereof the following new sentence: "For purposes of applying section 50A(a)(2) of the Internal Revenue Code of 1954 with respect to a taxable year beginning before January 1, 1979, the rules of sections 50A(a)(4), 50A(a)(5), and 50B(e)(3) of such Codes (as in effect on the day before the date of the enactment of this Act) shall apply."

(B) TRANSITIONAL RULE FOR EMPLOYEES HIRED AFTER SEPTEMBER 26, 1978.—Subparagraph (B) of section 322(e)(2) of the Revenue Act of 1978 (relating to eligible employees hired after September 26, 1978) is amended —

(i) by striking out "September 27, 1978," and inserting in lieu thereof "September 26, 1978, for purposes of applying the amendments made by this section,"; and

(ii) by striking out "January 1, 1979." and inserting in lieu thereof "January 1, 1979, and any wages paid or incurred after December 31, 1978, with respect to such individual shall be considered to be attributable to services rendered after that date."

(C) FEDERAL WELFARE RECIPIENT EMPLOYMENT INCENTIVE EXPENSES.—Effective with respect to wages paid or incurred after September 30, 1978, and before January 1, 1979, subparagraph (B) of section 50B(a)(2) (relating to work incentive program expenses), as in effect before the amendments made by section 322 of the Revenue Act of 1978, is amended by striking out "October 1, 1978" and inserting in lieu thereof "January 1, 1979".

(D) CLERICAL AMENDMENTS.—

(i) Subparagraph (C) of section 50A(a)(4) (relating to limitation with respect to nonbusiness eligible employees) is amended by striking out " '$6,000' and" and inserting in lieu thereof " '$6,000' for".

(ii) Subparagraph (B) of section 50B(g)(2) is amended by striking out "giving to such credit" and inserting in lieu thereof "giving rise to such credit".

(iii) Clause (i) of section 50B(h)(1)(A) is amended by striking out "9-day" and inserting in lieu thereof "90-day".

(iv) The second subsection designated as subsection (d) of section 322 of the Revenue Act of 1978 is amended by striking out "our" in paragraph (1)(A) thereof and inserting in lieu thereof "out".

(8) Amendment related to section 337 of the act.—Subsection (a) of section 337 of the Revenue Act of 1978 (relating to disposition of amounts generated by advance refunding of certain governmental obligations) is amended by striking out "or a refund profit" and inserting in lieu thereof "of a refund profit".

(9) Amendment relating to section 345 of the act.—Subsection (e) of section 345 of the Revenue Act of 1978 (relating to effective date for small business corporation stock provision) is amended to read as follows:

"(e) Effective Dates.—

"(1) In general.—Except as provided in paragraph (2), the amendments made by this section shall apply to stock issued after November 6, 1978.

"(2) Subsection (b). — The amendments made by subsection (b) shall apply to taxable years beginning after December 31, 1978.

"(3) Transitional rule for subsection (b).—In the case of a taxable year which includes November 6, 1978, the amendments made by subsection (b) shall apply with respect to stock issued after such date."

(10) Amendments related to section 361 of the act.—

(A) Other clubs.—Subparagraph (C) of section 274(a)(2) (relating to special rule for country clubs) is amended by striking out "country".

(B) Clerical amendment.—Subsection (b) of section 361 of the Revenue Act of 1978 is amended—

(i) by striking out "section 274(2)" and inserting in lieu thereof "section 274(a)", and

(ii) by striking out "Country" in the subsection heading.

(C) Use of facilities in case of independent contractors, etc.—

(i) In general.—Subsection (a) of section 274 of the Internal Revenue Code of 1954 (relating to disallowance of certain entertainment, etc., expenses) shall not apply to expenses paid or incurred by the taxpayer for goods, services, and facilities to the extent that the expenses are includible in the gross income of a recipient of the entertainment, amusement, or recreation who is not an employee of the taxpayer as compensation for services rendered or as a prize or award under section 74 of such Code.

(ii) Information return requirement.—Clause (i) shall not apply to any amount paid or incurred by the taxpayer if such amount is required to be included in any information return filed by such taxpayer under part III of subchapter A of chapter 61 of such Code and is not so included.

(iii) Application of subparagraph.—This subparagraph shall only apply with respect to expenses paid or incurred during 1979 or 1980.

(11) Amendments related to section 362 of the act.—

(A) Subsection (e) of section 362 of the Revenue Act of 1978 (relating to effective date for deficiency dividend procedure for regulated investment companies) is amended by striking out "860(d)" and inserting in lieu thereof "860(e)".

(B) The subsection heading of subsection (f) of section 860 is amended by striking out "Efficiency" and inserting in lieu thereof "Deficiency".

(C) Clause (i) of section 860(f)(2)(A) is amended by striking out "computed without regard" and inserting in lieu thereof "(computed without regard)".

(12) Amendment related to section 365 of the act.—Subparagraph (A) of section 357(c)(3) (relating to liabilities in excess of basis) is amended to read as follows:

"(A) In general.—If a taxpayer transfers, in an exchange to which section 351 applies, a liability the payment of which either—

"(i) would give rise to a deduction, or

"(ii) would be described in section 736(a),

then, for purposes of paragraph (1), the amount of such liability shall be excluded in determining the amount of liabilities assumed or to which the property transferred is subject."

(13) Amendments related to section 366 of the act.—

(A) Withholding. — Subsection (a) of section 3401 (defining wages) is amended—

(i) by striking out "or" at the end of paragraph (17),

(ii) by striking out the period at the end of the paragraph (18) added by section 207(a) of the Foreign Earned Income Act of 1978 [Pub. L. 95-615, 1978-2 C.B. 415] and inserting in lieu thereof a semicolon,

(iii) by redesignating the paragraph (18) added by section 164(b)(1) of the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1] as paragraph (19),

(iv) by striking out "section 124." in paragraph (19) (as so redesignated) and inserting in lieu thereof "section 127; or", and

(v) by ading at the end thereof the following new paragraph:

"(20) for any medical care reimbursement made to or for the benefit of an employee under a self-insured medical reimbursement plan (within the meaning of section 105(h)(6))."

(B) Clarification of nondiscriminatory eligibility classifications.—Clause (ii) of section 105(h)(3)(A) is amended by striking out "highly compensated participants" and inserting in lieu thereof "highly compensated individuals".

(C) Clarification of excess reimbursement of highly compensated individuals.—Subparagraph (A) of section 105(h)(7) is amended to read as follows:

"(A) in the case of a benefit available to highly compensated individuals but not to all other participants (or which otherwise fails to satisfy the requirements of paragraph (2)(B)), the amount reimbursed under the plan to the employee with respect to such benefit, and".

(D) Clarification of effective date.—Subsection (b) of section 366 of the Revenue Act of 1978 is amended to read as follows:

"(b) Effective Date. — The amendment made by this section shall apply to amounts reimbursed after December 31, 1979. For purposes of applying such amendment, there shall not be taken into account any amount reimbursed before January 1, 1980."

(14) Amendment related to section 369 of the act.—Clause (iv) of section 374(e)(1)(A) (relating to use of expired net operating loss carryovers to offset income arising from certain railroad reorganization pro-

ceedings) is amended by striking out "March 31, 1967" and inserting in lieu thereof "March 31, 1976".

(15) Amendment related to section 371 of the act.—Paragraph (2) of section 371(a) of the Revenue Act of 1978 (relating to net operating losses attributable to product liability losses) is amended by striking out "Clause (i) of section 172(b)(1)(A)" and inserting in lieu thereof "Subparagraph (A) of section 172(b)(1)".

(16) Amendment related to section 373 of the act.—Subparagraph (B) of section 466(e)(2) (relating to initial opening balance of suspense account) is amended by striking out "first taxable years" and inserting in lieu thereof "first taxable year".

(b) Effective Dates.—

(1) Special effective date.—The amendment made by subsection (a)(5)(F) shall apply to wages paid or incurred on or after November 27, 1979, in taxable years ending on or after such date.

(2) General effective date.—

For general effective date, see section 201.

Sec. 104. Amendments Related to Title IV.

(a) In General.—

(1) Amendment related to section 401 of the act.—Subsection (b) of section 877 is amended by striking out "402(e)(1), or section 1201(b)" and inserting in lieu thereof "or 402(e)(1)".

(2) Amendments related to section 402 of the act.—

(A) Amendments of transitional rule.—Subsection (c) of section 1202 (relating to transitional rule of taxable years which include November 1, 1978) is amended—

(i) by striking out so much of such subsection as precedes "a taxpayer other than a corporation" and inserting in lieu thereof:

"(c) Transitional Rule.—If for any taxable year ending after October 31, 1978, and beginning before November 1, 1979,"; and

(ii) by amending subparagraph (B) of paragraph (1) to read as follows:

"(B) the net capital gain taking into account only gain or loss properly taken into account for the portion of the taxable year after October 31, 1978, plus".

(B) Computation of maximum 25 percent alternative capital gains tax for 1978.—

(i) Paragraph (1) of section 1201(b) (as such paragraph was in effect for taxable years beginning before January 1, 1979) is amended by striking out "50 percent of the net capital gain" and inserting in lieu thereof "the excess of the net capital gain over the deduction under section 1202".

(ii) Subsection (c) of section 1201 (as such subsection was in effect for taxable years beginning before January 1, 1979) is amended to read as follows:

"(c) Computation of Tax Where Capital Gain Exceeds $50,000.—The tax computed for purposes of subsection (b)(3) shall be the amount by which a tax determined under section 1 or 511 on an amount equal to the taxable income (but not less than the excess of the net capital gain over the deduction under section 1202) for the taxable year exceeds a tax determined under section 1 or 511 on an amount equal to the sum of—

"(1) the amount subject to tax under subsection (b)(1), plus

"(2) an amount determined by multiplying the sum referred to in subsection (b)(2)(A) by a fraction—

"(A) the numerator of which is the excess of the net capital gain over the deduction under section 1202, and

"(B) the denominator of which is the net capital gain."

(C) Special rule for pass-through entities.—

(i) In general.—In applying sections 1201(c)(2)(A)(ii) and 1202(c)(1)(B) of the Internal Revenue Code of 1954 with respect to any pass-through entity, the determination of the period for which gain or loss is properly taken into account shall be made at the entity level.

(ii) Pass-through entity defined.—For purposes of clause (i), the term "pass-through entity" means —

(I) a regulated investment company,

(II) a real estate investment trust,

(III) an electing small business corporation,

(IV) a partnership,

(V) an estate or trust, and

(VI) a common trust fund.

(3) Amendments related to section 403 of the act.—

(A) Clarification of transitional rule.—Subsection (c) of section 1201 (relating to transitional rule for taxable years which include January 1, 1979) is amended—

(i) by striking out so much of such section as precedes "a corporation" and inserting in lieu thereof the following:

"(c) Transitional Rule.—If for any taxable year ending after December 31, 1978, and beginning before January 1, 1980,", and

(ii) by amending clause (ii) of paragraph (2)(A) to read as follows:

"(ii) the net capital gain taking into account only gain or loss properly taken into account for the portion of the taxable year after December 31, 1978, plus".

(B) Undistributed capital gain of regulated investment company.—Clause (iii) of section 852(b)(3)(D) (relating to treatment by shareholders of undistributed capital gain) is amended by striking out "70 percent" and inserting in lieu thereof "72 percent".

(C) Addition to reserves for bad debts.—Clause (iv) of section 593(b)(2)(E) is amended by striking out "$\frac{3}{8}$" each place it appears and inserting in lieu thereof "$\frac{18}{46}$".

(D) Clerical amendments.—

(i) Paragraph (3) of section 904(b) is amended by redesignating the subparagraph (E) added by section 403(c)(4) of the Revenue Act of 1978 as subparagraph (F).

(ii) Subparagraph (B) of section 403(c)(4) of the Revenue Act of 1978 is amended by striking out "striking the period at the end of subparagraph (D) of paragraph (3), inserting in lieu thereof a comma, and inserting immediately thereafter" and inserting in lieu thereof "adding at the end of paragraph (3)".

(4) Amendments related to section 421 of the act.—

(A) CERTAIN DEDUCTIONS WHICH MAY BE CARRIED OVER NOT TAKEN INTO ACCOUNT.—Paragraph (1) of section 55(b) (defining alternative minimum taxable income) is amended by adding at the end thereof the following new sentence:

"For purposes of subparagraph (A), a deduction shall not be taken into account to the extent such deduction may be carried to another taxable year."

(B) TREATMENT OF FOREIGN TAX CREDIT.—Paragraphs (1) and (2) of section 55(c) (relating to credits) are amended to read as follows:

"(1) CREDITS OTHER THAN FOREIGN TAX CREDIT NOT ALLOWABLE, ETC.—For purposes of determining the amount of any credit allowable under subpart A of part IV of this subchapter (other than the foreign tax credit allowed under section 33(a))—

"(A) the tax imposed by this section shall not be treated as a tax imposed by this chapter, and

"(B) the amount of the foreign tax credit allowed under section 33(a) shall be determined without regard to this section.

"(2) FOREIGN TAX CREDIT ALLOWED AGAINST ALTERNATIVE MINIMUM TAX.—

"(A) DETERMINATION OF FOREIGN TAX CREDIT.—The total amount of the foreign tax credit which can be taken against the tax imposed by subsection (a) shall be determined under subpart A of part II of subchapter N (sec. 901 and following).

"(B) INCREASE IN AMOUNT OF FOREIGN TAXES TAKEN INTO ACCOUNT.—For purposes of the determination provided by subparagraph (A), the amount of taxes paid or accrued to foreign countries or possessions of the United States during the taxable year shall be increased by an amount equal to the lesser of—

"(i) the foreign tax credit allowable under section 33(a) in computing the regular tax for the taxable year, or

"(ii) the tax imposed by subsection (a).

"(C) SECTION 904(a) LIMITATION.—For purposes of the determination provided by subparagraph (A), the limitation of section 904(a) shall be an amount equal to the same proportion of the sum of the tax imposed by subsection (a) against which such credit is taken and the regular tax (excluding the tax imposed by section 56) as—

"(i) the taxpayer's alternative minimum taxable income from sources without the United States (but not in excess of the taxpayer's entire alternative minimum taxable income), bears to

"(ii) his entire alternative minimum taxable income. For such purposes, the amount of the limitation of section 904(a) shall not exceed the tax imposed by subsection (a).

"(D) DEFINITION OF ALTERNATIVE MINIMUM TAXABLE INCOME SOURCES WITHOUT THE UNITED STATES.—For purposes of subparagraph (C), the term 'alternative minimum taxable income from sources without the United States' means the items of gross income from sources without the United States adjusted as provided in subparagraph (A), (B), and (C) of section 55(b) (1) (taking into account in such adjustment only items described in such subparagraphs which are properly attributable to items of gross income from sources without the United States).

"(E) SPECIAL RULE FOR APPLYING SECTION 904(c).—In determining the amount of foreign taxes paid or accrued during the taxable year which may be deemed to be paid or accrued in a preceding or succeeding taxable year under section 904(c)—

"(i) the limitation of section 904(a) shall be increased by the amount of the limitation determined under subparagraph (C), and

"(ii) any increase under subparagraph (B) shall be taken into account."

(C) REGULAR TAX DETERMINED WITHOUT REGARD TO FOREIGN TAX CREDIT ALLOWED AGAINST MINIMUM TAX.—Paragraph (2) of section 55(b) is amended by adding at the end thereof the following new sentence: "For purposes of this paragraph, the amount of the credit allowable under section 33 shall be determined without regard to this section."

(D) TREATMENT OF ZERO BRACKET AMOUNT.—Subsection (b) of section 55 (relating to definitions for purposes of alternative minimum tax) is amended by adding at the end thereof the following new paragraph:

"(3) TREATMENT OF ZERO BRACKET AMOUNT.—In the case of an individual who does not itemize his itemized deductions, the zero bracket amount shall be treated as a deduction allowed."

(E) TREATMENT OF CERTAIN FOREIGN TAXES FOR THE ADJUSTED ITEMIZED DEDUCTION PREFERENCE.—Paragraphs (1)(A) and (2)(A)(v) of section 57(b) (relating to adjusted itemized deductions) are each amended by inserting ", and foreign," after "State and local".

(F) ADJUSTED ITEMIZED DEDUCTIONS OF ESTATE OR TRUST.—Subparagraph (A) of section 57(b)(2) (defining adjusted itemized deductions of estate or trust) is amended by striking out "clauses (i) through (vi)" and inserting in lieu thereof "clauses (iii) through (vi)".

(G) CARRYOVER OF RESIDENTIAL ENERGY CREDIT.—Paragraph (3) of section 55(c) is amended by adding at the end thereof the following new sentence:

"In determining any carryover under subsection 44C(b)(6), a rule similar to the rule set forth in subparagraph (A) shall be treated as inserted in this paragraph before subparagraph (A), and the applications of subparagraphs (A), (B), and (C) shall be adjusted accordingly."

(H) CLERICAL AMENDMENTS.—

(i) Subsection (a) of section 55 (relating to alternative minimum tax) is amended by striking out all after paragraph (1) and inserting in lieu thereof the following:

"(2) the regular tax for the taxable year,

then there is imposed (in addition to all other taxes imposed by this title) a tax equal to the amount of such excess."

(ii) Subparagraph (A) of section 55(c)(3) (relating to carryover and carryback of certain credits) is amended by striking out "section 53 (c)" and inserting in lieu thereof "section 53(b)".

(iii) Paragraph (2) of section 443 (d) (relating to adjustment in computing minimum tax for tax preferences) is amended by striking out "in the case of a corporation,".

(iv) Paragraph (3) of section 453 (c) is amended by striking out "section 56" and inserting in lieu thereof "sections 55 and 56".

(v) Sections 871(b)(1) and 877(b) are each amended by striking out "section 55" and inserting in lieu thereof "55".

(vi) The second sentence of section 666(c) (relating to pro rata portion of taxes deemed distributed) is amended by inserting "(other than the tax imposed by section 55)" after "equal to the taxes".

(vii) Paragraph (4) of section 5(a) is amended by striking out "section 55" and inserting in lieu thereof "sections 55 and 56".

(viii) Paragraph (2) of section 55 (b) is amended by inserting "409(c)," after "408(f),"

(5) Amendments related to section 441 of the act.—

(A) Transitional rule.—Paragraph (2) of section 441(b) of the Revenue Act of 1978 (relating to transitional rules) is amended to read as follows:

"(2) Taxable years which straddle November 1, 1978.—In the case of a taxable year which begins before November 1, 1978, and ends after October 31, 1978, the amount taken into account under section 1348(b)(2)(B) of the Internal Revenue Code of 1954 by reason of section 57(a)(9) of such Code shall be 50 percent of the lesser of—

"(A) the net capital gain for the taxable year, or

"(B) the net capital gain taking into account only gain or loss properly taken into account for the portion of the taxable year before November 1, 1978."

(B) Clerical amendment.—Subsection (a) of section 441 of the Revenue Act of 1978 is amended by striking out "subparagraph (b)" and inserting in lieu thereof "subparagraph (B)".

(b) Effective Dates.—

(1) Special effective date for subsection (a)(2)(B).—The amendments made by subsection (a)(2)(B) shall apply to taxable years beginning in 1978.

(2) General effective date.—

For general effective date, see section 201.

Sec. 105. Amendments Related to Title V.

(a) General Rule.—

(1) Amendments related to section 502 of the act.—

(A) Subsection (g) of section 7463 (relating to small tax case procedures) is hereby repealed.

(B) Subsection (c) of section 7456 (relating to commissioners of the Tax Court) is amended by striking out "sections 7428" and inserting in lieu thereof "sections 7428, 7463".

(2) Amendment related to section 504 of the act.—Paragraph (2) of section 6411(d) (relating to tentative refund of tax under claim of right adjustment) is amended to read as follows:

"(2) Allowance of adjustments.—Within a period of 90 days from the date on which an application is filed under paragraph (1) or from the date of the overpayment (determined under section 1341(b)(1)), whichever is later, the Secretary shall—

"(A) review the application,

"(B) determine the amount of the overpayment, and

"(C) apply, credit, or refund such overpayment,

in a manner similar to the manner provided in subsection (b)."

(3) Amendments related to section 511 of the act.—

(A) Aggregate adjusted consideration must be less than value.—Paragraph (2) of section 2040(c) (relating to limitations) is amended by adding at the end thereof the following new subparagraph:

"(C) Aggregate adjusted consideration must be less than value.—Paragraph (1) shall not apply if the sum of—

"(i) the adjusted consideration furnished by the decedent, and

"(ii) the adjusted consideration furnished by the decedent's spouse,

equals or exceeds the value of the interest."

(B) Clerical amendment.—Paragraph (1) of section 2040(c) is amended by striking out "subsections (a)" and inserting in lieu thereof "subsection (a)".

(4) Amendments related to section 514 of the act.—

(A) The first sentence of paragraph (3) of section 2055(e) is amended—

(i) by striking out "subparagraph (a) or (B)" and inserting in lieu thereof "subparagraph (A) or (B)", and

(ii) by striking out "so that interest" and inserting in lieu thereof "so that the interest".

(B) Section 514 of the Revenue Act of 1978 is amended by adding at the end thereof the following new subsection:

"(c) Effective Dates.—

"(1) For subsection (a).—The amendment made by subsection (a) shall apply in the case of decedents dying after December 31, 1969.

"(2) For subsection (b).—Subsection (b)—

"(A) insofar as it relates to section 170 of the Internal Revenue Code of 1954 shall apply to transfers in trust and contributions made after July 31, 1969, and

"(B) insofar as it relates to section 2522 of the Internal Revenue Code of 1954 shall apply to transfers made after December 31, 1969."

(5) Amendments related to section 515 of the act.—

(A) Amendment of section 1040 of the code.—Section 1040 (relating to use of certain appreciated carryover basis property to satisfy pecuniary bequest) is amended by adding at the end thereof the following new subsection:

"(d) Application to Section 2032A Property.—For purposes of this section, references to carryover basis property shall be treated as including a reference to property the valuation of which is determined under section 2032A."

(B) Period for which section 1040 applies.—Notwithstanding section 515 of the Revenue Act of 1978, section 1040 of the Internal Revenue Code of 1954 (as amended by subparagraph (A)) shall apply with respect to the estates of decedents dying after December 31, 1976.

(6) AMENDMENTS RELATED TO SECTION 531 OF THE ACT.—

(A) Paragraph (6) of section 216 (b) (relating to deduction of taxes, interest, and business depreciation by cooperative housing corporation tenant-stockholder) is amended by redesignating subparagraphs (B) and (C) as subparagraphs (C) and (D), respectively, and by striking out subparagraph (A) and inserting in lieu thereof the following new subparagraphs:

"(A) IN GENERAL.—If the original seller acquires any stock of the corporation from the corporation or by foreclosure, the original seller shall be treated as a tenant-stockholder for a period not to exceed 3 years from the date of the acquisition of such stock.

"(B) STOCK ACQUISITION MUST TAKE PLACE NOT LATER THAN 1 YEAR AFTER TRANSFER OF DWELLING UNITS.—Except in the case of an acquisition of stock of a corporation by foreclosure, subparagraph (A) shall apply only if the acquisition of stock occurs not later than 1 year after the date on which the apartments or houses (or leaseholds therein) are transferred by the original seller to the corporation. For purposes of this subparagraph and subparagraph (A), the term 'by foreclosure' means by foreclosure (or by instrument in lieu of foreclosure) of any purchase-money security interest in the stock held by the original seller."

(B) Subparagraph (D) of section 216(b)(6) (as redesignated by subparagraph (A) of this paragraph) is amended by adding at the end thereof the following new sentence: "The estate of an original seller shall succeed to, and take into account, the tax treatment of the original seller under this paragraph."

(7) AMENDMENTS RELATED TO SECTION 543 OF THE ACT.—

(A) Section 126 (relating to certain cost-sharing payments) is amended by striking out subsections (b) and (c) and inserting in lieu thereof the following:

"(b) EXCLUDABLE PORTION.—For purposes of this section—

"(1) IN GENERAL.—The term 'excludable portion' means that portion (or all) of a payment made to any person under any program described in subsection (a) which—

"(A) is determined by the Secretary of Agriculture to be made primarily for the purpose of conserving soil and water resources, protecting or restoring the environment, improving forests, or providing a habitat for wildlife, and

"(B) is determined by the Secretary of the Treasury or his delegate as not increasing substantially the annual income derived from the property.

"(2) PAYMENTS NOT CHARGEABLE TO CAPITAL ACCOUNT.—The term 'excludable portion' does not include that portion of any payment which is properly associated with an amount which is allowable as a deduction for the taxable year in which such amount is paid or incurred.

"(c) ELECTION FOR SECTION NOT TO APPLY.—

"(1) IN GENERAL.—The taxpayer may elect not to have this section (and section 1255) apply to any excludable portion (or portion thereof).

"(2) MANNER AND TIME FOR MAKING ELECTION.—Any election under paragraph (1) shall be made in the manner prescribed by the Secretary by regulations and shall be made not later than the due date prescribed by law (including extensions) for filing the return of tax under this chapter for the taxable year in which the payment was received or accrued.

"(d) DENIAL OF DOUBLE BENEFITS.—No deduction or credit shall be allowed with respect to any expenditure which is properly associated with any amount excluded from gross income under subsection (a).

"(e) BASIS OF PROPERTY NOT INCREASED BY REASON OF EXCLUDABLE PAYMENTS. — Notwithstanding any provision of section 1016 to the contrary, no adjustment to basis shall be made with respect to property acquired or improved through the use of any payment, to the extent that such adjustment would reflect any amount which is excluded from gross income under subsection (a)."

(B) Paragraph (1) of section 1255 (a) is amended by striking out all after subparagraph (B)(i) and inserting in lieu thereof the following:

"(ii) the adjusted basis of such property,

shall be treated as ordinary income. Such gain shall be recognized notwithstanding any other provision of this subtitle, except that this section shall not apply to the extent such gain is recognized as ordinary income under any other provision of this part."

(C) Subsection (a)(9) of section 126 (relating to certain cost-sharing payments) is amended by inserting "or his delegate" after "Secretary of the Treasury".

(D) Paragraph (2) of section 1255 (b) (relating to special rules applicable to gain from disposition of section 126 property) is amended by striking out "(2)" and inserting in lieu thereof "(2) for purposes of sections 163(d), 170(e), 341(e)(12), 453(d)(4)(B), and 751(c),".

(E) Paragraph (10) of section 126 (a) (relating to certain cost-sharing payments) is amended by striking out "Any State program" and inserting in lieu thereof "Any program of a State, possession of the United States, a political subdivision of any of the foregoing, or the District of Columbia".

(b) EFFECTIVE DATES.—

(1) SPECIAL EFFECTIVE DATE FOR SUBSECTION (a)(1).—The amendments made by subsection (a)(1) shall take effect on the date of the enactment of this Act.

(2) GENERAL EFFECTIVE DATE.—

For general effective date, see section 201.

SEC. 106. AMENDMENTS RELATED TO TITLE VI.

(a) IN GENERAL.—

(1) Paragraph (1) of section 172 (b) (relating to net operating loss carrybacks and carryovers) is amended by redesignating the subparagraph (H) added by section 601(b)(1) of the Revenue Act of 1978 as subparagraph (I).

(2) Subsection (a) of section 1016 (relating to adjustments of basis) is amended by redesignating the paragraph (21) added by section 601(b) (3) of the Revenue Act of 1978 as paragraph (22).

(3) Paragraph (3) of section 601 (b) of the Revenue Act of 1978 is amended by striking out "by redesig-

nating paragraph (23) as (22) and by inserting after paragraph (20)" and inserting in lieu thereof "by inserting before paragraph (23)".

(4) Subsection (a) of section 1391 (defining general stock ownership corporation) is amended—

(A) by striking out ", and" at the end of paragraph (1) and inserting in lieu thereof a semicolon,

(B) by inserting "or" at the end of paragraph (4)(D)(ii),

(C) by inserting "and" at the end of paragraph (4)(D)(iii), and

(D) by inserting "and" at the end of paragraph (4)(E).

(5) Subsection (c) of section 1392 is amended by striking out "WHERE" in the subsection heading and inserting in lieu thereof "WHEN".

(6) Subparagraph (A) of section 172(b)(1) is amended by striking out "(and H)" and inserting in lieu thereof ", (H), and (I)".

(7) Subparagraph (B) of section 172(b)(1) is amended by striking out "and (G)" and inserting in lieu thereof "(G), and (I)".

(b) EFFECTIVE DATE.—

For general effective date, see section 201.

SEC. 107. AMENDMENTS RELATED TO TITLE VII.

(a) IN GENERAL.—

(1) AMENDMENTS RELATED TO SECTION 701 OF THE ACT.—

(A) COMPUTATION OF ADJUSTED ITEMIZED DEDUCTIONS IN CASE OF ESTATES AND TRUSTS.—Subparagraph (C) of section 57(b)(2) (relating to special rules for estates and trusts) is amended by striking out "section 170(c)(2)(B)" each place it appears and inserting in lieu thereof "section 170(c) (determined without regard to section 170(c)(2)(A))".

(B) EFFECTIVE DATE FOR PROVISION RELATING TO FOREIGN TAXES ATTRIBUTABLE TO SECTION 911 EXCLUSION.—Subparagraph (B) of section 701(u)(10) of the Revenue Act of 1978 (relating to effective date) is amended to read as follows:

"(B) EFFECTIVE DATE.—The amendment made by subparagraph (A) shall apply to taxable years beginning in calendar year 1978 but only in the case of taxpayers who make an election under section 209(c) of the Foreign Earned Income Act of 1978."

(C) ALLOCATION OF ITEMS OF TAX PREFERENCE IN THE CASE OF ESTATES AND TRUSTS.—Paragraph (1) of section 58(c) (relating to estates and trusts) is amended by striking out "on the basis of the income of the estate or trust allocable to each" and inserting in lieu thereof "in accordance with regulations prescribed by the Secretary".

(D) AMENDMENT OF SECTION 1250.—The last sentence of section 1250(a)(1)(B) (relating to gain from disposition of certain depreciable property) is amended by inserting before the period at the end thereof the following: "which was allowed under section 167(k)".

(E) CLERICAL AMENDMENTS.—

(i) Paragraph (3) of section 701(a) of the Revenue Act of 1978 is amended by striking out "Subsection (c)" and inserting in lieu thereof "Subsection (e)".

(ii) Subparagraph (C) of section 191(f)(2) is amended by striking out "the date of" and inserting in lieu thereof "the date".

(2) AMENDMENTS RELATED TO SECTION 702 OF THE ACT.—

(A) Paragraph (3) of section 1014(a) is amended by striking out "section 2032.1" and inserting in lieu thereof "section 2032A".

(B)(i) Clause (i) of section 2613(e)(2)(A) is amended by inserting "(other than as a potential appointee under a power of appointment held by another)" after "the trust".

(ii) Subparagraph (B) of section 2613(e)(2) is amended—

(I) by inserting after clause (ii) the following new clause:

"(iii) an employee of the grantor or of any beneficiary,",

(II) by striking out clause (vi), by redesignating clauses (iii), (iv), and (v) as clauses (iv), (v), and (vi), respectively, and

(III) by inserting "or" at the end of clause (vi) (as so redesignated).

(C) Paragraph (3) of section 702(r) of the Revenue Act of 1978 is hereby repealed.

(D) The section 6698 which relates to failure to file information with respect to carryover basis property is redesignated as section 6698A.

(E) The table of sections for subchapter B of chapter 68 is amended by striking out

"Sec. 6698. Failure to file information with respect to carryover basis property."

and inserting in lieu thereof the following:

"Sec. 6698A. Failure to file information with respect to carryover basis property."

(F)(i) If the executor elects the benefits of this subparagraph with respect to any estate, section 2035(b) of the Internal Revenue Code of 1954 (relating to adjustments for gifts made within 3 years of decedent's death) shall be applied with respect to transfers made by the decedent during 1977 as if paragraph (2) of such section 2035(b) read as follows:

"(2) to any gift to a donee made during 1977 to the extent of the amount of such gift which was excludable in computing taxable gifts by reason of section 2503(b) (relating to $3,000 annual exclusion for purposes of the gift tax) determined without regard to section 2513(a)."

(ii) The election under clause (i) with respect to any estate shall be made on or before the later of—

(I) the due date for filing the estate tax return, or

(II) the day which is 120 days after the date of the enactment of this Act.

(3) AMENDMENTS RELATED TO SECTION 703 OF THE ACT.—

(A) The first sentence of paragraph (8) of section 46(f) is amended by striking out "subsection (a)(7)(D)" and inserting in lieu thereof "subsection (a)7()(C)".

(B) Subsection (e) of section 703 of the Revenue Act of 1978 is hereby repealed.

(C) Paragraph (1) of section 703(q) of the Revenue Act of 1978 is amended by striking out "section 103(d)" and inserting in lieu thereof "section 103(c)".

(b) EFFECTIVE DATE.—

For general effective date, see section 201.

Sec. 108. Amendments Related to Certain Other Acts Enacted During 1978.

(a) Foreign Earned Income Act of 1978.—

(1) In general.

(A) Tax tables to apply to individuals claiming section 911 exclusion.—Section 202 of the Foreign Earned Income Act of 1978 [Pub. L. 95-615, 1978-2 C.B. 415] is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following new subsection:

"(f) Tax Tables To Apply to Individuals Claiming Section 911 Exclusion.—Paragraph (1) of section 3(b) (relating to tax tables not to apply to certain individuals) is amended by striking out subparagraph (A)."

(B) Determination of housing deduction.—

(i) Clause (i) of section 913(e)(3)(A) is amended by striking out "earned income" each place it appears and inserting in lieu thereof "housing income".

(ii) Subsection (e) of section 913 is amended by adding at the end thereof the following new paragraphs:

"(6) Housing income.—For purposes of this subsection, the term 'housing income' has the meaning given to the term 'earned income' by section 911(b) (determined with the rule set forth in paragraph (3) of section 911(c)).

"(7) Recapture of excess housing deductions attributable to treatment of after-received compensation.—

"(A) In general.—There shall be included in the gross income of the individual for the taxable year in which any after-received compensation is received an amount equal to any excess housing deduction determined for such year.

"(B) Excess housing deduction.—For purposes of subparagraph (A), the excess housing deduction determined for any taxable year is the excess (if any) of—

"(i) the aggregate amount which has been allowed as a housing deduction (for such taxable year and all prior taxable years), over

"(ii) the aggregate amount which would have been allowable as a housing deduction (for such taxable year and all prior taxable years for which a housing deduction has been allowed), by taking after-received compensation into account under this subsection as if it had been received in the taxable year in which the services were performed.

In applying the preceding sentence to any taxable year, proper adjustment shall be made for the effect of applying such sentence for purposes of all prior taxable years.

"(C) Treatment of amount included in income.—Any amount included in gross income under subparagraph (A) shall not be treated as income for purposes of applying subsection (c) of this section.

"(D) Definitions.—For purposes of this paragraph—

"(i) Housing deduction.—The term 'housing deduction' means that portion of the deduction allowable under subsection (a) for any taxable year which is attributable to qualified housing expenses. For such purpose, qualified housing expenses shall be taken into account after all other amounts described in subsection (b).

"(ii) After-received compensation.—The term 'after-received compensation' means compensation received by an individual in a taxable year which is attributable to services performed by such individual in the third preceding, second preceding, or first preceding taxable year."

(C) Clerical amendment.—Paragraph (2) of section 911(a) (relating to income earned by individuals in certain camps) is amended by striking out "qualified foreign" and inserting in lieu thereof "a foreign country or".

(D) Amendment of last sentence of section 911(a).—The last sentence of section 911(a) (relating to income earned by individuals in certain camps) is amended—

(i) by inserting "any deduction," after "his gross income", and

(ii) by striking out "deductions allowed by sections 217" and inserting in lieu thereof "deduction allowed by section 217".

(E) Amendment of section 3(b).—Paragraph (1) of section 3(b) is amended by redesignating subparagraphs (B) and (C) as subparagraphs (A) and (B), respectively.

(F) Qualified home leave travel expenses.—

(i) Subsection (g) of section 913 (relating to qualified home leave travel expenses) is amended to read as follows:

"(g) Qualified Home Leave Travel Expenses.—

"(1) In general.—For purposes of this section, the term 'qualified home leave travel expenses' means the reasonable amounts paid or incurred by or on behalf of an individual for the transportation of such individual, his spouse, and each dependent—

"(A) from a point of outside the United States to the individual's principal domestic residence, and

"(B) from the individual's principal domestic residence to a point outside the United States.

"(2) Limitation to cost between tax home and place of residence.—The amount taken into account under subparagraph (A) or (B) of paragraph (1) with respect to any transportation shall not exceed the reasonable amount for transportation between the location of the individual's tax home outside the United States and the individual's principal domestic residence.

"(3) Substitution of nearest port of entry in certain cases.—With respect to any person whose travel in the United States is not travel to and from the individual's principal domestic residence, paragraphs (1) and (2) shall be applied by substituting the nearest port of entry in the United States for the individual's principal domestic residence.

"(4) Nearest port of entry.—For purposes of paragraph (3), the nearest port of entry in the United States shall not include a nearest port of entry located in Alaska or Hawaii unless the individual elects to have such port of entry taken into account.

"(5) Principal domestic residence defined.—For purposes of this subsection, an individual's principal domestic residence is the location of such individual's present (or, if none, most recent) principal residence in the United States.

"(6) 1 ROUND TRIP PER 12-MONTH PERIOD ABROAD.—Amounts may be taken into account under paragraph (4) of subsection (b) only with respect to 1 trip to the United States, and 1 trip from the United States, per person for each continuous period of 12 months for which the individual's tax home is in a foreign country."

(ii) Clause (ii) of section 913(i)(1)(C) (relating to qualified second household) is amended by striking out ", and paragraph (1) of subsection (g)," and inserting in lieu thereof ", and subsection (g),".

(G) AMENDMENT OF SECTION 119.—Subsection (a) of section 119 (as in effect on the day before the date of the enactment of the Foreign Earned Income Act of 1978) is amended by striking out "(a) GENERAL RULE.—".

(2) EFFECTIVE DATES.—

(A) IN GENERAL.—Except as provided in subparagraph (B), the amendments made by paragraph (1) shall take effect as if included in the Foreign Earned Income Act of 1978.

(B) PARAGRAPH (1)(E).—The amendment made by paragraph (1)(E) shall apply to taxable years beginning after December 31, 1978.

(b) AMENDMENTS RELATED TO THE BLACK LUNG BENEFITS REVENUE ACT.—

(1) CORRECTION OF PROVISIONS RELATED TO TAX COURT JURISDICTION.—

(A) Subsection (g) of section 6503 is amended—

(i) by striking out "4971, 4975, 4985, or 4986" and inserting in lieu thereof "4951, 4952, 4971, or 4975", and

(ii) by striking out "4971(c)(3), 4975(f)(6), 4985(e)(4), or 4986(e)(2)" and inserting in lieu thereof "4951(e)(4), 4952(e)(2), 4971(c)(3), or 4975(f)(6)".

(B) Subsection (f) of section 6511 is amended—

(i) by inserting "or section 4975" after "chapter 42", and

(ii) by striking out "CHAPTER 42" in the subsection heading and inserting in lieu thereof "CHAPTER 42 AND CERTAIN CHAPTER 43".

(C) Section 6862 is amended by striking out "certain excise taxes" and inserting in lieu thereof "the taxes imposed by chapters 41, 42, 43, and 44".

(D) Subsection (g) of section 7422 is amended by striking out "4944, 4945" each place it appears and inserting in lieu thereof "4944, 4945, 4951, 4952".

(E) Paragraph (1) of section 7422(g) is amended by striking out "section 4945(a) (relating to initial taxes on taxable expenditures)" and inserting in lieu thereof "section 4945(a) (relating to initial taxes on taxable expenditures), section 4951(a) (relating to initial taxes on self-dealing), 4952(a) (relating to initial taxes on taxable expenditures)".

(F) Subsection (g) of section 7422 is amended by striking out "section 4945(b) (relating to additional taxes on taxable expenditures)" and inserting in lieu thereof "section 4945(b) (relating to additional taxes on taxable expenditures), section 4951(b) (relating to additional taxes on self-dealing), 4952(b) (relating to additional taxes on taxable expenditures)".

(2) CORRECTION OF REFERENCES TO 1969 ACT.—

(A) Subsections (b), (c)(1), and (d) of section 3 of the Black Lung Benefits Revenue Act of 1977 [Pub. L. 95-227, 1978-1 C.B. 494] are each amended by striking out "Federal Coal Mine Health and Safety Act of 1969" each place it appears and inserting in lieu thereof "Federal Mine Safety and Health Act of 1977".

(B) Sections 501(c)(21) and 192(e) are each amended by striking out "Federal Coal Mine Health and Safety Act of 1969" and inserting in lieu thereof "Federal Mine Safety and Health Act of 1977".

(3) CLERICAL AMENDMENTS.—

(A) Paragraph (1) of section 3(c) of the Black Lung Benefits Revenue Act of 1977 is amended by striking out "subsection (a)(4)" and inserting in lieu thereof "subsection (a)(5)".

(B) Subsection (b) of section 7454 is amended by striking out "section 502(c)(21)" and inserting in lieu thereof "section 501(c)(21)".

(4) EFFECTIVE DATE.—Any amendment made by this subsection shall take effect as if included in the provision of the Black Lung Benefits Revenue Act of 1977 to which such amendment relates.

(c) AMENDMENTS RELATED TO ENERGY TAX ACT OF 1978.—

(1) REPAYMENT OF TAX ON GASOLINE USED IN COMMERCIAL FISHERIES.—Subparagraph (B) of section 6421(d)(2) (defining qualified business use) is amended by adding at the end thereof the following new sentence: "The preceding sentence shall not apply to use in a vessel employed in the fisheries or in the whaling business."

(2) TIRES USED IN MANUFACTURE OF BUSES.—

(A) Subparagraph (C) of section 6416(b)(3) (relating to tax-paid articles used for further manufacture, etc.) is amended by striking out "such other article is" and all that follows and inserting in lieu thereof the following:

"such other article is—

"(i) an automobile bus chassis or an automobile bus body, or

"(ii) by any person exported, sold to a State or local government, sold to a nonprofit educational organization for its exclusive use, or used or sold for use as supplies for vessels or aircraft;".

(B) Subparagraph (B) of section 6416(b)(4) (relating to tires and inner tubes) is amended to read as follows:

"(B) such other article is—

"(i) an automobile bus chassis or an automobile bus body, or

"(ii) by any person exported, sold to a State or local government for the exclusive use of a State or local government, sold to a nonprofit educational organization for its exclusive use, or used or sold for use as supplies for vessels or aircraft,".

(C) Subsection (e) of section 4071 (relating to tires on imported articles) is amended by striking out "under section 4061" and inserting in lieu thereof "under section 4061 or if such article is an automobile bus chassis or an automobile bus body".

(3) REFUND OF TAX ON LUBRICATING OIL USED IN PRODUCING REREFINED OIL.—Paragraph (2) of section 6416(b) (relating to credit or refund for certain uses) is amended by striking

out "or" at the end of subparagraph (L), by striking out the period at the end of subparagraph (M) and inserting in lieu thereof "; or", and by inserting after subparagraph (M) the following:

"(N) in the case of lubricating oil taxable under section 4091 which is contained in a mixture which is rerefined oil (as defined in section 4093(b)(3)), used or sold.

The amount of the credit or refund under subparagraph (N) with respect to any lubricating oil shall be the amount which would be exempt from tax under section 4093."

(4) Credit or refund of tax on truck chassis or body used in the manufacture of a bus.—Subparagraph (A) of section 6416(b)(3) (relating to tax-paid articles used for further manufacture, etc.) is amended by striking out "component part of," and all that follows and inserting in lieu thereof the following:

"component part of—

"(i) another article taxable under chapter 32, or

"(ii) an automobile bus chassis or an automobile bus body, manufactured or produced by him;".

(5) Section 4221(e)(6) (relating to bus parts and accessories) is amended to read as follows:

"(6) Bus parts and accessories.—Under regulations prescribed by the Secretary, the tax imposed by section 4061(b) shall not apply to any part or accessory which is sold for use by the purchaser on or in connection with an automobile bus, or is to be resold by the purchaser or a second purchaser for such use."

(6) Clerical amendment.—The last sentence of section 48(a)(10)(B) is amended by striking out "51" and inserting in lieu thereof "5".

(7) Effective date.—Any amendment made by this subsection shall take effect as if included in the provision of the Energy Tax Act of 1978 [Pub. L. 95-618, 1978-3 C.B. (Vol. 2) 1] to which such amendment relates; except that the amendment made by paragraph (6) shall take effect on the first day of the first calendar month which begins more than 10 days after the date of the enactment of this Act.

(d) Amendments Related to Public Law 95-472.—Subsection (c) of section 6324B (relating to special lien for additional estate tax attributable to farm, etc., valuation) is amended to read as follows:

"(c) Certain Rules and Definitions Made Applicable.—

"(1) In general.—The rule set forth in paragraph (1), (3), and (4) of section 6324A(d) shall apply with respect to the lien imposed by this section as it it were a lien imposed by section 6324A.

"(2) Qualified real property.—For purposes of this section, the term 'qualified real property' includes qualified replacement property (within the meaning of section 2032A(h)(3)(B))."

TITLE II—GENERAL EFFECTIVE DATE

Sec. 201. General Effective Date.

Except as otherwise provided in title I, any amendment made by title I shall take effect as if it had been included in the provision of the Revenue Act of 1978 to which such amendment relates.

Approved April 1, 1980.

Senate Report No. 96-498
1st Session

[Bracketed numerals indicate official report page numbers]

TECHNICAL CORRECTIONS ACT OF 1979

December 13 (legislative day, November 29), 1979.

Mr. Long, from the Committee on Finance, submitted the following report to accompany H.R. 2797.[1]

The Committee on Finance, to which was referred the bill (H.R. 2797) to make technical corrections related to the Revenue Act of 1978, having considered the same, reports favorable thereon with amendments and recommend that the bill as amended do pass.

The amendments are shown in the reported bill, with the matter proposed to be stricken shown in linetype and the matter proposed to be inserted shown in italic type.

I. SUMMARY

In general, the bill contains technical, clerical, conforming, and clarifying amendments to provisions enacted by the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1] and other 1978 tax legislation. These amendments were developed as a result of a review of the application of the tax law changes made by 1978 tax legislation, taking into account comments submitted to the committee from the Treasury Department, the Internal Revenue Service, the staff, tax practitioners, and others from the public. In addition to written statements submitted to the committee, the Subcommittee on Taxation and Debt Management Generally received public testimony on November 7, 1979, on H.R. 2797, as passed by the House of Representatives. The committee subsequently made further amendments to the bill as a result of the testimony and comments received.

The bill is divided into nine general parts. The first part (sec. 2) coordinates the enactment dates of the Revenue Act of 1978 and the Energy Tax Act of 1978 [Pub. L. 95-618, 1978-3 C.B. (Vol. 2) 1]; the next seven parts (secs. 101-107) cover technical, clerical, and conforming amendments to the provisions of the first seven titles of the Revenue Act of 1978 (and the Internal Revenue Code provisions amended thereby); and the last part (sec. 108) covers technical, clerical, and conforming amendments to the Foreign Earned Income Act of 1978 [Pub. L. 95-615, 1978-2 C.B. 415], the Black Lung Benefits Revenue Act [Pub. L. 95-227, 1978-1 C.B. 494], and the Energy Tax Act of 1978.

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[11] III. GENERAL EXPLANATION OF PROVISIONS

A. Technical Amendments to the Revenue Act of 1978

1. Coordination of Amendments Made by the Revenue Act of 1978 and the Energy Tax Act of 1978

(Sec. 2 of the Bill and Secs. 46 and 48 of the Code)

Present law

Prior to the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1], the present investment tax credit rate of 10 percent was scheduled to decline to 7 percent (4 percent for utility property) on January 1, 1981. Under the Revenue Act of 1978, the 10-percent rate of the credit was made permanent for all taxpayers.

The provisions of the Code (sec. 46 (a)(2)) which pertain to the rate of the credit also were amended and restated by the Energy Tax Act of 1978 [Pub. L. 95-618, 1978-3 C.B. (Vol. 2) 1]. Although the energy tax amendments were passed by the Congress before the amendments made by the Revenue Act of 1978, these two bills were signed into law by the President in reverse of the order these bills were passed by Congress.[1]

Reasons for change

The order of enactment of the Revenue Act of 1978 and the Energy Tax Act of 1978 technically may have caused the 10-percent credit to again be temporary. The bill corrects this unintended result.

Explanation of provision

The bill directs that, for purposes of applying the amendments made to the investment credit provisions by these two laws, the Energy Tax Act of 1978 will be deemed to have been enacted first. As a result, the 10-percent credit rate will be permanent as was intended by the Revenue Act of 1978.

Effective date

The provision takes effect as if enacted as part of the Revenue Act of 1978.

[12] 2. Technical Amendments Relating to Individual Income Tax Reductions and Extensions

a. Eligibility for earned income credit for persons claiming section 913 deductions (sec. 101(a)(1) of the bill and sec. 43(c)(1) of the Code)

Present law

Under present law, the earned income credit is not available to taxpayers who are entitled to exclude amounts from income under section 911 (relating to income earned by certain employees in camps) or section 931 (relating to income from sources within the possessions of the United States) for the taxable year. This provision affects only those taxpayers who lived abroad during part of the year since the earned income credit generally is not available to those taxpayers whose principal place of abode for the taxable year is outside the United States.

Reasons for change

The Foreign Earned Income Act of 1978 [Pub. L. 95-615, 1978-2 C.B. 415] established a new set of deductions under section 913 of the Code which generally are available to those taxpayers who formerly were entitled to the section 911 exclusion. The committee believes that the credit should continue to be unavailable to the same type of taxpayers who formerly were denied the credit because they qualified for the section 911 exclusion.

Explanation of provision

The bill denies the earned income credit to taxpayers who claim deductions under section 913, as well as to those who claim the benefits of section 911 or 931.

Effective date

The amendment made by this provision applies to taxable years beginning after December 31, 1977.

b. Treatment of earned income credit as earned income under AFDC and SSI (secs. 101(a)(2)(A) and (B) of the bill and secs. 402 and 1612 of the Social Security Act)

Present law

Under present law, the earned income credit is not taken into account as income for purposes of determining eligibility for, or the amount of, benefits or assistance under any Federal programs or State or local program that is financed in whole, or in part, with Federal funds.

Reasons for change

The Revenue Act of 1978 repealed the provisions of present law requiring that the earned income credit be disregarded for purposes of Federal or Federally-aided assistance programs, effective in 1980. [13] However, conforming changes were not made to the Social Security Act.

Explanation of provision

The bill amends the Social Security Act to provide that the earned income credit would be treated as earned income for purposes of the aid to families with dependent children (AFDC) and supplemental security income (SSI) programs. This treatment applies both to any advance payments made by an employer and to any refund of Federal taxes made by reason of the earned income credit (because the actual credit for a year is larger than the total amount of advance payments for that year). Language is added to the bill as passed by the House of Representatives to make clear that, if advance payments of the earned income credit exceed the actual credit, so that the individual must return the difference, an appropriate reconciling increase in AFDC or SSI benefits would be made by the welfare agency. This increase could be computed, for example, by reducing by this difference the amount of earned income that is taken into account for purposes of these programs in the month the difference is returned; the increase would be equal to the amount of benefits lost in the previous year because of the excess advance payments.

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[1] The Revenue Act of 1978 (P.L. 95-600) was signed into law first, on November 6, 1978, and the Energy Tax Act of 1978 (P.L. 95-618) was then signed into law on November 9, 1978.

Effective date

The amendments made by these provisions apply to payments for months beginning after December 31, 1979.

c. Correction of effective date for advance payment of earned income credit (sec. 101(a)(2)(C) of the bill and sec. 105(g)(2) of the Act)

Present law

The Revenue Act of 1978 contained a new provision allowing employees to elect to have advance payments of the earned income credit added to their paychecks each pay period. In order to give employers time to implement procedures necessary to accommodate for the advance payment of the earned income credit to their employees, the Congress intended this provision to be effective with respect to wages paid after June 30, 1979.

Reasons for change

Due to a typographical error, the Act referred to wages paid after June 30, 1978.

Explanation of provision

The bill corrects a typographical error in the Act to provide that the provision is effective with respect to wages paid after June 30, 1979.

The committee believes that the Secretary should interpret the statute in a manner that will address the problems which occur in giving advance payments to agricultural workers in the field. Specifically, the committee believes that employers should not be required to make advance payments to these workers when they are paid on a daily basis because of the administrative difficulties employers would encounter in trying to maintain a list of all workers who had filed advanced payment certificates and, in having each day, every crew leader compare the name of every worker being paid to the names on [14] this list. Since these workers are not now subject to mandatory income tax withholding, employers are not required to consult similar records (withholding, i.e., allowance certificates) in computing net pay. In view of the potential administrative burden, the committee believes that employers should not be required to make advance payments to these workers paid on a daily basis and not subject to mandatory income tax withholding.

Effective date

The amendment made by this provision would be effective upon enactment and would apply with respect to wages paid after June 30, 1979.

d. Clerical amendment to earned income credit (sec. 101(a)(2)(D) of the bill and sec. 43(h) of the Code)

The bill redesignates subsection (h) of section 43 (relating to coordination with advance payments of earned income credit) as subsection (g).

e. Relationship of section 85 of the Code to railroad unemployment compensation (sec. 101(a)(3) of the bill and sec. 128(a)(8) of the Code)

Present law

Prior to the Revenue Act of 1978, unemployment compensation was not includible in gross income. The Act made all types of unemployment compensation paid under government programs includible in gross income for taxpayers with income above specified amounts (Code sec. 85), effective for payments of unemployment compensation made after December 31, 1978.

Reasons for change

The Code contains a cross reference indicating that the exclusion of railroad unemployment compensation from gross income is determined by a provision of the Railroad Unemployment Insurance Act. However, because the Congress intended railroad unemployment compensation insurance benefits to be treated in a manner similar to other types of unemployment compensation paid under government programs, this cross reference is no longer accurate.

Explanation of provision

The bill modifies the existing cross reference to make it clear that railroad unemployment compensation benefits are includable in gross income for certain taxpayers in a manner similar to all other unemployment compensation benefits paid under government programs.

Effective date

The amendment made by this provision applies to payments of railroad unemployment compensation insurance benefits made after December 31, 1978.

[15] 3. Technical Amendments Relating to Deferred Compensation and ESOP Provisions

a. Extension of deferred compensation rules to certain rural electric cooperatives and their trade organizations (sec. 101(a)(4) of the bill and sec. 457(d)(9)(B) of the Code)

Present law

The Revenue Act of 1978 provided that employees and independent contractors who provide services for a State or local government, a rural electric cooperative (described in section 501(c)(12)), or an association of such cooperatives, that maintains an eligible deferred compensation plan will be able to defer the inclusion of income of compensation deferral meets certain requirements.

Reasons for change

The 1978 Act provision did not apply to certain rural electric cooperatives in the Tennessee Valley Authority ("TVA") area which are exempt from taxation under section 501(c)(4) (but which, generally because of TVA requirements, cannot meet all the requirements for exemption under section 501(c)(12)). In addition, the provision did not apply to certain national and State associations of rural electric cooperatives because some of their members are not domestic rural electric cooperatives and because some of the organizations are exempt from taxation as social welfare organizations (described in sec. 501(c)(4)) rather than as trade associations (described in sec. 501(c)(6)). The committee believes that these omissions were inadvertent and that the provision should apply to these organizations.

Explanation of provision

The bill provides that the types of rural electric organizations eligible for the deferred compensation rules include (1) any organization which is exempt from tax under section 501 (a) and which is engaged primarily in providing electric service on a mutual or cooperative basis,[1] and (2) any organization described in section 501 (c)(4) or (6) which is exempt from tax under section 501(a) and at least 80 percent of the members of which are rural electric cooperatives which are eligible for these rules.

Effective date

This provision is effective as if it had been included in section 457 of the Code by section 131 of the Revenue Act of 1978. Thus, any plan to which section 457 applies by virtue of this provision will have until January 1, 1982, to satisfy the plan requirements for classification as an eligible State deferred compensation plan. However, the limitations on amounts that can be deferred under such a plan will apply for all taxable years beginning after December 31, 1978.

[16] b. Deferral of effective date of deduction timing rules relating to deferred compensation payments to independent contractors (sec. 101 (a)(5)(A) of the bill and secs. 404 (b) and (d) of the Code)

Present law

Prior to the Revenue Act of 1978, section 404(a)(5) of the Code provided that where an employer deferred payment of compensation to an employee pursuant to a nonqualified plan, the employer could deduct the compensation only in the year in which the compensation was includible in the employee's gross income. If the payment was not made pursuant to a qualified plan, but pursuant to a "method of employer contributions or compensation [having] the effect of a stock bonus, pension, profit-sharing, or annuity plan, *or similar plan* deferring the receipt of compensation . . .," the deduction-timing limitations of section 404(a) were also applicable (italics added).

Section 133 of the 1978 Act added a new Code section 404(d) which extends the deduction-timing limitation of section 404(a) to payments of deferred compensation made to independent contractors. Section 133 of the 1978 Act also amended section 404(b) by changing the word "or similar plan" to read "or other plan." These amendments apply to deductions for taxable years beginning after December 31, 1978.

Reasons for change

The Lawyers' Title Guaranty Fund (the Fund) is an unincorporated business trust whose members consist of almost 6,000 Florida lawyers. The Fund issues title insurance policies on the basis of title examinations made by the lawyer-members. Under the agreement between the lawyers and the Fund, the payment by the Fund to lawyer-members on account of their issuance of title policies is deferred for 7 years, the period of adverse possession under Florida law. One of the principal reasons for this deferral of payment is that retention of these amounts due for commissions serves to provide a more adequate financial base to provide security to policyholders. In *Lawyers' Title Guaranty Fund* v. *United States*, 508 F.2d 1 (5th Cir. 1975), the court held that the obligations of the Fund to lawyer-members were deductible by the Fund as ordinary and necessary business expenses in the year of the issuance of the policy. This decision was accepted by the Internal Revenue Service in Rev. Rul. 77-266, 1977-2 C.B. 236.

Nonetheless, the changes made by the 1978 Act would disallow any deduction for amounts due to lawyer-members of the Fund until the amounts are made available to lawyer-members after the 7-year period of limitations in Florida. The resulting tax on these amounts would decrease the necessary reserves of the Fund since it is not possible to increase the premium rates of title insurance to the home buyers for policies sold during 1979. This could adversely affect the security of the home buyers.

[17] Accordingly, the committee believes that it is appropriate to delay the effective date of the change made by the 1978 Act in this case for one year until taxable years beginning after December 31, 1979. This one-year delay will provide the Fund adequate time to restructure their handling of the commissions on title insurance.

Explanation of provision

The bill provides that the changes made by section 133 of the Revenue Act of 1978 are to apply to taxable years beginning after December 31, 1979, in the case of a qualified title title insurance company plan. A qualified title insurance company plan is a plan which defers the payment of amounts credited by a qualified title insurance company to separate accounts for members of the company in consideration of their issuance of policies of title insurance and under which no part of the credited amounts is payable to or withdrawable by the members until after the period for the adverse possession of real property under applicable State law. A qualified title insurance company is defined to mean an unincorporated title insurance company organized as a business trust which is engaged in the business of providing title insurance coverage on interest in and liens upon real property obtained by clients of the members of the company and which is subject to tax under section 831 of the Internal Revenue Code of 1954.

Effective date

This amendment is effective as if it were included in the Revenue Act of 1978.

[18] c. Nondiscriminatory participation requirements for cafeteria plans (sec. 101(a)(6)(A) of the bill and sec. 125(g)(3)(B) of the Code)

Present law

Prior to the Revenue Act of 1978, if a cafeteria plan was in existence on June 27, 1974, a participant in the plan was taxable only to the extent the participant elected taxable benefits under the plan. The 1978 Act made this favorable tax treatment applicable to all cafeteria plans meeting certain nondiscrimination standards, including a standard regarding the maximum number of years of employment which may be required as a condition of plan participation.

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[1] This provision is not intended to have any effect on the issue of whether a rural electric cooperative which is not described in section 501(c)(12) may qualify for tax exempt status under section 501(a) as an organization described in section 501(c)(4).

Reasons for change

The committee believes that the use of the term "service requirement" in the cafeteria plan participation eligibility rules might lead taxpayers to believe that hours of service must be counted as they are under the qualified retirement plan participation rules (Code sec. 410(a)).

Explanation of provision

The bill makes it clear that the cafeteria plan participation standard is based on years of employment rather than years or hours of service. The committee expects that the Treasury Department will prescribe by regulation what constitutes a year of employment.

Effective date

This provision applies for plan years beginning after December 31, 1978.

d. Effective date of cafeteria plan provisions (sec. 101(a)(6)(B) of the bill and sec. 134(c) of the Act)

Present law

Under the cafeteria plan rules added by the Revenue Act of 1978, amounts required to be included in income by a highly-compensated participant because the plan does not satisfy nondiscrimination standards will be treated as received or accrued in the participant's taxable year in which the plan year ends. The cafeteria plan rules are effective for taxable years beginning after December 31, 1978.

Reasons for change

Because the cafeteria plan rules apply to participants' taxable years beginning after December 31, 1978, amounts contributed during 1978 under a cafeteria plan which has a fiscal plan year and which does not satisfy the new nondiscrimination rules might have to be included in income by certain participants in 1979. Thus, in certain cases, the cafeteria plan rules apply retroactively.

The committee does not believe that the cafeteria plan rules should cause amounts contributed in 1978 under a cafeteria plan which was [19] in existence on June 27, 1974, to be included in income. In addition, the committee believes that cafeteria plans in existence on June 27, 1974, should not have to be amended retroactively to comply with the new rules contained in the Revenue Act of 1978.

Explanation of provision

The bill makes the cafeteria plan provisions of the Revenue Act of 1978 effective for plan years, rather than for participants' taxable years, beginning after December 31, 1978. Thus, highly compensated participants in fiscal year plans will not have income solely because of the new cafeteria plan rules until 1980. In addition, to comply with the cafeteria plan rules, amendments to plans will not have to be effective before the beginning of the first plan year after 1978.

Effective date

This provision is effective as if it had been included in the Revenue Act of 1978 as enacted.

e. Employee stock ownership plan name change (sec. 101(a)(7)(L) of the bill and secs. 48, 409A, 4975, etc. of the Code)

Present law

Under the Revenue Act of 1978, the type of plan previously referred to as a TRASOP (or investment tax credit ESOP) was designated as an ESOP. The type of plan previously referred to as an ESOP or leveraged ESOP was designated as a leveraged employee stock ownership plan.

Reason for change

The committee has determined that the names given the respective tax-qualified employee stock ownership vehicles by the 1978 Act, do not adequately describe the types of plans involved. Accordingly, the committee has decided to give each of these plans a new name which it considers more appropriate.

Explanation of provision

Under the bill, an investment tax credit ESOP or ESOP (as defined in the 1978 Act) is renamed "tax credit employee stock ownership plan" (commonly referred to as a TRASOP). Under the bill, a leveraged employee stock ownership plan is renamed "employee stock ownership plan" (commonly referred to as an ESOP).

Effective date

The amendment made by this section is effective as if it had been included in section 141 of the Revenue Act of 1978.

f. Clerical amendments relating to normalization of the investment tax credit for contributions to a tax credit employee stock ownership plan (sec. 101(a)(7)(A) of the bill and sec. 46(f)(9) of the Code)

Section 101(a)(6(A) of the bill corrects section 46(f)(9) of the Code by striking out "subparagraph (B) of subsection (a)(2)" each place it appears and inserting in lieu thereof "subparagraph (E) of subsection (a)(2)" and by striking out "an employee stock ownership plan which meets the requirements of section 301(d) of the Tax Re- [20] duction Act of 1975 [Pub. L. 94-12, 1975-1 C.B. 545]" in subparagraph (A) and inserting in lieu thereof "a tax credit employee stock ownership plan which meets the requirements of section 409A".

g. Effective dates for tax credit employee stock ownership plans and employee stock ownership plans (sec. 101(a)(7)(B) of the bill and sec. 141(g) of the Act)

Present law

Under present law, the rules governing tax credit employee stock ownership plans and employee stock ownership plans, as enacted by the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1], are effective with respect to qualified investment for taxable years beginning after December 31, 1978.

Reasons for change

The application of the general effective date was unclear with respect to several of the changes relating to tax credit employee stock ownership plans and employee stock ownership plans.

Explanation of provision

The bill clarifies the operation of the effective date provision of section 141 of the Revenue Act of 1978, which made changes in the law governing tax credit employee stock ownership plans and employee stock ownership plans. The general effective date is retained. Thus, the tax credit employee stock ownership plan changes in the 1978 Act generally apply with respect to qualified investment for taxable years beginning after December 31, 1978. In addition, special effective date provisions apply to the tax credit employee stock ownership plan provisions of the Act relating to (1) voting rights, (2) the right of a tax credit employee stock ownership plan to distribute cash in lieu of employer securities (subject to the right of a participant to demand a distribution in the form of employer securities), and (3) put option requirements.

The voting rights provision applies to plans to which the new tax credit employee stock ownership plan provisions generally apply beginning with the first day of such application. A tax credit employee stock ownership plan is required to follow the new voting rights pass-through rules with respect to all employer securities held by it if additional employer securities were acquired by the tax credit employee stock ownership plan on account of qualified investment made in a taxable year beginning after December 31, 1978.

The right of a tax credit employee stock ownership plan to distribute cash in lieu of employer securities (subject to the right of a participant to demand a distribution in the form of employer securities) applies to tax credit employee stock ownership plan distributions after December 31, 1978, provided that the new tax credit employee stock ownership plan rules have become applicable to the plan.

The tax credit employee stock ownership plan put option requirements apply to employer securities which are not readily tradable on an established market and which are acquired by the tax credit employee stock ownership plan after December 31, 1978, on account of a qualified investment made after that date. Your committee deleted the House-passed provision which provided that the employer is permitted to elect to have the 1978 Act put option rules in the Act apply to all employer securities held by the tax credit employee stock ownership plan which are not readily tradable on an established market. [21] The House-passed provision provided that the election could be revoked only with the consent of the Secretary. Your committee deleted the House-passed provision, which allows an employer to elect to have the new put option rules apply to all employer securities held by a tax credit employee stock ownership plan which are not readily tradable on an established market, because it understands that the Secretary of the Treasury has existing authority to allow the election and the revocation of the election of the 1978 Act put option rules with respect to employer securities held by a tax credit employee stock ownership plan.

The bill as passed by the House also allows taxpayers to elect irrevocably to accelerate the general effective date by a year. In such a case, the tax credit employee stock ownership plan changes would apply with respect to qualified investment for taxable years beginning after December 31, 1977. The committee amended this provision to require that, with respect to a tax credit employee stock ownership plan in existence on December 31, 1978, if such an election is made, contributions for the year of the election would have to be allocated under the pre-1978 Act rules. The committee was concerned that an election by a tax credit employee stock ownership plan in existence on December 31, 1978, to have the 1978 Act tax credit employee stock ownership plan rules apply one year early would allow an employer to change the allocation formula, with the result that some employees covered by the tax credit employee stock ownership plan who would have been entitled to an allocation of employer securities to their accounts under the pre-1978 Act tax credit employee stock ownership plan rules would be denied the allocation because of the retroactive election of the 1978 Act tax credit employee stock ownership plan rules.

The bill also would provide effective dates for the changes made by the 1978 Act relating to employee stock ownership plans. These changes concern (1) voting rights, (2) put option requirements, and (3) the right of an employee stock ownership plan to distribute cash in lieu of employer securities (subject to the right of a participant to demand a distribution in the form of employer securities).

Under the bill, in the case of qualifying employer securities acquired by an employee stock ownership plan after December 31, 1979, the plan is required (1) to pass through voting rights to plan participants on such securities, under certain circumstances, and (2) to give participants put options on qualifying employer securities which are not readily tradable on an established market. The committee expects that, under regulations prescribed by the Secretary of the Treasury, an employee stock ownership plan could treat qualifying employer securities acquired by it prior to January 1, 1980, under the new voting rights and put option provisions, but is not required to do so.

The right of an employee stock ownership plan to distribute cash in lieu of employer securities (subject to the right of a participant to demand a distribution in the form of employer securities) applies to distributions made after December 31, 1978. (Under the House-passed bill the effective date for such cash distributions from employee stock ownership plans was December 31, 1979.)

Effective date

The amendment made by this section is effective as if it had been included in section 141 of the Revenue Act of 1978.

[22] h. Definition of qualifying employer security for employee stock ownership plans (sec. 101(a)(7)(C) of the bill and sec. 4975(e)(8) of the Code)

Present law

Under present law, employee stock ownership plans are subject to certain special rules with respect to qualifying employer securities held by the plans.

Reasons for change

The Revenue Act of 1978 made certain changes in the rules governing employee stock ownership plans. Because of these changes, the definition of qualifying employer securities, as it relates to such plans, is unclear.

Explanation of provision

The bill clarifies that, for purposes of the rules governing employee stock ownership plans, the term "qualifying employer securities" is defined in the same manner as the term "employer securities" in the case of tax credit employee stock ownership plans. This definition generally includes readily tradable common stock of the employer and preferred stock convertible into such readily tradable common stock.

Effective date

This provision applies to stock acquired after December 31, 1979.

i. Nonrecognition of gain or loss on contribution to tax credit employee stock ownership plans (sec. 101(a)(7)(D) of the bill and sec. 409A(m) of the Code)

Present law

Generally, under present law, no gain or loss would be recognized by a corporation which makes a required contribution to a tax credit ownership plan of employer securities issued by a related corporation.

Reasons for change

For technical reasons, this rule, as enacted by the Revenue Act of 1978, did not apply to all required contributions of such employer securities to a tax credit employee stock ownership plan.

Explanation of provision

The bill provides that no gain or loss is recognized by an employer on the required transfer of employer securities to a tax credit employee stock ownership plan which it maintains.

Effective date

The amendment is effective with respect to qualified investment for taxable years beginning after December 31, 1978.

j. Employee stock ownership plans may distribute cash in certain cases (sec. 101(a)(7)(E) of the bill and sec. 409A(h)(2) of the Code)

Present law

Under present law, employee stock ownership plans are required to meet certain rules also applicable to tax credit employee stock ownership plans. These rules relate to the past-through of voting rights to participants and to participants' rights to demand employer securities.

[23] *Reasons for change*

Under the Revenue Act of 1978, it was not clear whether an employee stock ownership plan which meets these rules may distribute cash in lieu of employer securities to a participant entitled to a distribution from the plan.

Explanation of provision

The bill clarifies that, like a tax credit employee stock ownership plan, an employee stock ownership plan may (subject to a participant's right to require a distribution in the form of employer securities) distribute cash in lieu of employer securities to a participant entitled to a distribution from the plan.

Effective date

This provision is effective with respect to distributions made after December 31, 1978.

k. Matched employer and employee contributions must stay in plan (sec. 101(a)(7)(F) of the bill and sec. 409A(d) of the Code)

Present law

Under present law, employer securities allocated to a participant's account under a tax credit employee stock ownership plan cannot be distributed from that account for an 84-month period. Prior to the Revenue Act of 1978, this rule applied to securities contributed by the employer attributable to the additional one percent investment tax credit and to securities attributable to matched employer and employee contributions under the additional one-half percent investment tax credit rules.

Reasons for change

Under the Revenue Act of 1978, it is unclear whether the rule applies to securities attributable to matched employer and employee contributions.

Explanation of provision

The bill clarifies that the rule requiring matched employer and employee contributions to a tax credit employee stock ownership plan to remain in the plan for an 84-month period is still applicable. This is consistent with the provisions of the 1978 Act which continue the pre-1978 Act rule that employer contributions to a tax credit employee stock ownership plan may be made for the taxable year in which the additional investment tax credit is allowed regardless of when timely matching employee contributions are made.

Effective date

This provision is effective with respect to qualified investment for taxable years beginning after December 31, 1978.

l. Amount of matching employer contributions to a tax credit employee stock ownership plan (sec. 101(a)(7)(G) of the bill and sec. 48(n)(1)(B) of the Code)

Present law

Under present law, a corporate employer is entitled to an additional percentage point of investment tax credit (i.e., 11 percent rather than

[24] 10 percent) if it contributes an amount equal to the additional credit to a tax credit employee stock ownership plan. In addition to the one-percent credit, up to ½ percent of extra investment tax credit is allowed where an employer contributes the extra credit amount to the tax credit employee stock ownership plan, and the employer's extra contribution is matched by employee contributions.

Reasons for change

The provisions relating to tax credit employee stock ownership plans, as amended by the Revenue Act of 1978, do not provide for a limitation on the amount of employee contributions which must be matched by the employer as a condition of taking the extra investment tax credit.

Explanation of provision

Under the bill, an employer is eligible for an extra investment tax credit attributable to matching employee contributions if it transfers to the tax credit employee stock ownership plan employer securities having an aggregate value equal to the lesser of (1) the total matching employee contributions or (2) ½ percent of its qualified investment for the taxable year.

Effective date

The amendment made by this section is effective as if it had been included in section 141 of the Revenue Act of 1978.

m. Time for contribution of matching employer contributions to a tax credit employee stock ownership plan (sec. 101(a)(7)(H) of the bill and sec 48(n)(1)(C) of the Code)

Present law

Under present law, a corporate employer is entitled to an additional percentage point of investment credit (11 percent rather than 10 percent) if it contributes an amount equal to the additional credit to a tax credit employee stock ownership plan. In addition to the one-percent credit, up to ½ percent of extra investment tax credit is allowed where an employer contributes the extra credit amount to the tax credit employee stock ownership plan and the employer's extra contribution is matched by employee contributions.

Generally, to be eligible for the additional tax credit, employee contributions of cash or pledges must be received by the due date (including extensions) for filing the employee's tax return for the taxable year and the employer is required to transfer employer securities or cash to the tax credit employee stock ownership plan not later than 30 days after the due date (including extensions) for filing the employer's return for the taxable year.

Reasons for change

It is unclear whether the employer could transfer employer securities or cash to a tax credit employee stock ownership plan with respect to the extra ½ percent investment tax credit at a time later than 30 days after the due date (including extensions) for filing the employer's return for the taxable year for which the employer claims the additional one-percent credit with respect to employee contributions made after that date.

[25] *Explanation of provision*

The bill makes it clear that the Secretary may, by regulations, provide that the matching employer contributions to a tax credit employee stock ownership plan could be made later than 30 days after the due date (including extensions) for filing the employer's return for the taxable year for which the employer claims the additional one-percent credit, provided that the employer did not claim a credit for the matching employer contribution for the taxable year and provided that such matching employer contributions are made with respect to matching employee contributions made after the due date for the return.

Effective date

The amendment made by this section is effective as if it had been included in section 141 of the Revenue Act of 1978.

n. Time for establishing a tax credit employee stock ownership plan (sec. 101(a)(7)(I) of the bill and sec. 409A(f)(1) of the Code)

Present law

Prior to the Revenue Act of 1978, a tax-qualified plan had to be established by the close of the first taxable year for which the employer maintaining the plan claimed a deduction or credit for a plan contribution. Many tax credit employee stock ownership plans are not established until the income tax filing deadline (including extensions) for the first taxable year for which the employer maintaining the plan first claims an additional investment tax credit with respect to the plan. Prior to the Revenue Act of 1978, this caused many tax credit employee stock ownership plans not to be tax-qualified for the first year of their existence.

The Revenue Act of 1978 required tax credit employee stock ownership plans to be tax-qualified. It also created an exception for tax credit employee stock ownership plans from the general rule requiring tax-qualified plans to be established by the close of the first taxable year for which an employer claims a deduction or credit for a plan contribution.

Reasons for change

While the Revenue Act of 1978 relieved tax credit employee stock ownership plans of the requirement that a tax-qualified plan be established by the close of the first taxable year for which an employer maintaining the plan claims a deduction or credit for a plan contribution, the 1978 Act was not clear as to the date by which a tax credit stock ownership plan does have to be established for the first year of its existence.

Explanation of provision

Under the bill, a tax credit employee stock ownership plan does not have to be established by the close of the first taxable year for which the employer maintaining the plan claims an additional investment tax credit with respect to the plan. However, in order for the tax credit employee stock ownership plan to be tax-qualified for the first-year of its existence as required under present law, it must be established [26] by the income tax filing deadline (including extensions) for the first taxable year for which the employer maintaining the plan claims an additional investment tax credit with respect to the plan.

Effective date

The amendment made by this section is effective as if it had been included in section 141 of the Revenue Act of 1978.

o. Definition of employer securities for tax credit employee stock ownership plan and employee stock ownership plan purposes (sec. 101(a)(7)(J) of the bill and sec. 409A(1) of the Code)

Present law

Under present law, in the case of a tax credit employee stock ownership plan, the only types of employer securities which may be acquired and held by the plan are (1) common stock of the corporation which is readily tradable on an established securities market and (2) noncallable preferred stock of the issuing corporation which is readily convertible into such common stock. The shares acquired by a tax credit employee stock ownership plan, other than shares which are readily tradable on an established securities market, must have a combination of (1) voting rights equivalent to rights possessed by shareholders of the class of common stock of the issuing corporation having the greatest voting rights and (2) dividend rights equivalent to rights possessed by shareholders of that class of stock of the issuing corporation having the greatest dividend rights.

Reasons for change

The committee believes that a technical correction to the definition of qualifying employer securities with respect to tax credit employee stock ownership plans and employee stock ownership plans is necessary to make it clear (1) that where an employer contributes securities which are not readily tradable on an established securities market, the securities must have a combination of voting power and dividend rights equal to or in excess of the greatest voting power and dividend rights of any classes of common stock of the corporation; (2) that preferred stock convertible to such common stock which is not readily tradable could be contributed; and (3) that noncallable preferred stock would include stock which could be called provided that the holder of the stock could receive other employer securities either by conversion or in exchange for the securities surrendered pursuant to the call.

Explanation of provision

The bill makes three changes to the definition of employer securities which are applicable to both tax credit employee stock ownership plans and employee stock ownership plans.

First, the bill makes it clear that where the employer does not have a class of common stock which is readily tradable on an established market, the employer can contribute stock having a combination of voting power and dividend rights at least equal to the greatest voting power and dividend rights of any classes of common stock of the corporation.

[27] Second, the bill makes it clear that the definition of employer securities includes preferred stock which is convertible into such common stock which is not readily tradable.

Third, the bill provides that, under regulations to be issued by the Secretary, preferred stock is to be treated as noncallable if, after the call, the holder of the securities has a reasonable opportunity to convert the securities to common stock. The committee also intends that preferred stock will be treated as noncallable if, pursuant to the call the holder of the securities receives solely employer securities in exchange for the securities.

These changes to the definition of employer securities for the purpose of employee stock ownership plans, as well as the Technical Corrections Act provision which conforms the definition of qualifying employer securities for the purpose of employee stock ownership plans to the definition of employer securities for the purpose of tax credit employee stock ownership plans, are intended to make no change in the status of qualifying employer securities contributed to employee stock ownership plans before December 31, 1979, the general effective date of the 1978 Act changes affecting employee stock ownership plans.

Under the House bill, the definition of employer securities with respect to an employee stock ownership plan is the same as the definition of employer securities with respect to a tax credit employee stock ownership plan.

Effective date

The amendment made by this section is effective as if it had been included in section 141 of the Revenue Act of 1978.

p. Voting rights for participants in employee stock ownership plans (sec. 101(a)(7)(K) of the bill and sec. 4975(e)(7) of the Code)

Present law

Under the Revenue Act of 1978, an employee stock ownership plan is required to pass through to plan participants voting rights with respect to qualifying employer securities held by the plan. If the plan is maintained by an employer which has a registration-type class of securities, the vote pass-through requirement applies generally. If the plan is maintained by an employer which does not have a registration-type class of securities, the vote pass-through requirement applies only with respect to major corporate issues (e.g., mergers, consolidations, sales of substantially all of a corporation's assets).

Also, under the Revenue Act of 1978, a defined contribution plan which is established by an employer the stock of which is not publicly traded is required to pass through to plan participants voting rights on major corporate issues. This vote pass-through applies only if, after December 31, 1979, the plan acquires securities of the employer and, after the acquisition, more than 10 percent of the plan's assets are invested in such securities.

Reasons for change

Under the Revenue Act of 1978, an employee stock ownership plan maintained by an employer the stock of which is not publicly traded [28] may be subject to vote pass-through rules with respect to employer securities under two separate provisions of the Code. The committee believes that this duplication should be eliminated by deleting the special vote pass-through rule for employee stock ownership plans maintained by an employer which does not have a registration-type class of securities.

Explanation of provision

Under the bill, an employee stock ownership plan maintained by an employer which does not have a registration-type class of securities will be required to pass through voting rights to plan participants only under the vote pass-through rule generally applicable to defined contribution plans. Thus, the vote pass-through will be required only (1) with respect to major corporate issues, (2) if the plan is maintained by an employer the stock of which is not publicly traded, and (3), if after acquiring securities of the employer, more than 10 percent of the plan's assets are in such securities.

Effective date

The amendment made by this section is effetcive as if it had been included in section 141 of the Revenue Act of 1978.

q. Coordination of deduction for estate tax attributable to income in respect of a decedent and income tax on lump sum distributions from retirement plans (sec. 101(a)(8)(A) of the bill and sec. 691(c)(5) of the Code)

Present law

Under present law, lump sum distributions from qualified pension, profit-sharing, and stock bonus plans are eligible for special income tax treatment. With respect to the portion of the distribution attributable to the employee's participation in the plan after December 31, 1973, a special 10-year averaging formula is provided. With respect to the portion of the distribution attributable to the employee's participation before January 1, 1974, capital gain treatment generally is allowable.

When a beneficiary receiving a lump sum distribution on account of the death of an employee elects to be taxed under the 10-year averaging rules, the distribution is includible in the deceased employee's gross estate and the amount of the distribution is subject to an estate tax. The recipient of the distribution is allowed a separate income tax deduction for the death taxes attributable to that distribution (Code sec. 691(c)).

The Revenue Act of 1978 added a provision which coordinated this deduction for state taxes with the capital gain deduction so that the amount of any capital gain which is income in respect of a decedent is offset by the deduction for estate taxes before the capital gain deduction is computed.

Reasons for change

The Revenue Act of 1978 did not provide a rule to coordinate the use of the special 10-year forward income averaging method with the deduction for estate taxes.

[29] *Explanation of provision*

The bill provides that the amount of a death benefit distribution subject to 10-year averaging is reduced by the amount of the death tax deduction attributable to the distribution. This will have the effect of reducing the amount of the distribution eligible for the special 10-year averaging formula by the death tax adjustment. This provision will not affect the computation of the minimum distribution allowance (under Code sec. 402(e)(1)(D)).

Effective date

The provision applies with respect to estates of decedents dying after the date of enactment of the bill.

r. Unrealized appreciation in employer securities (sec. 101(a)(8)(B) of the bill and sec. 2039(f)(2) of the Code)

Present law

Prior to the Revenue Act of 1978, lump sum death benefit distributions from tax-qualified pension, etc., plans were includible in the deceased plan participant's gross estate for Federal estate tax purposes. The 1978 Act provided for an estate tax exclusion for such a distribution provided the recipient elects to forego favorable income tax treatment of the distribution.

Reasons for change

Under the Revenue Act of 1978, it is not clear whether the recipient of a lump sum death benefit distribution from a tax-qualified pension, etc., plan, who elects to forego favorable income tax treatment of the distribution in order for the distribution to be excludible from the deceased plan participant's gross estate for Federal estate tax purposes, may exclude from gross income the net unrealized appreciation on any employer securities distributed from the plan.

Explanation of provision

The bill makes it clear that, if an individual receives a lump sum death benefit distribution from a tax-qualified pension, etc., plan and elects to forego favorable income tax treatment of the distribution in order for the distribution to be excluded from the deceased plan participant's gross estate for Federal estate tax purposes, the election will not preclude the recipient from excluding from gross income the net unrealized appreciation on any employer securities distributed from the plan.

Effective date

The amendment made by this section is effective as if it had been included in section 142 of the Revenue Act of 1978.

s. Clerical amendment relating to voting rights on employer securities held by qualified plans and other clerical amendments (secs. 101(a)(7)(M) and (a)(9) of the bill and secs. 46(a)(2)(E), 48(n)(2)(B), 48(o)(5), and 401(a)(22) of the Code)

Section 101(a)(7)(M)(i) of the bill corrects section 46(a)(2)(E) of the Code by inserting "and ending on" before "December 31, 1983" each place it appears.

[30] Section 101(a)(7)(M)(ii) of the bill corrects section 48(n)(2)(B)

of the Code by striking clause (ii). The Committee believes this clause is redundant because, under the 1978 Act, tax credit employee stock ownership plans must meet the nondiscrimination requirements applicable to qualified plans.

Section 101(a)(7)(M)(iii) of the bill corrects section 48(o) of the Code by inserting "percentage" after "attributable to the matching employee plan."

Section 101(a)(9) of the bill corrects section 401(a)(22) of the Code by striking "as securities" and inserting in lieu thereof "are securities".

[31] 4. Technical Amendments Relating to Retirement Plans

a. Exclusion of certain employees from participation in simplified employee pensions (sec. 101(a)(10)(A) of the bill and sec. 408(k)(2) of the Code)

Present law

The Revenue Act of 1978 created a new type of individual retirement plan, known as a simplified employee pension. Employer contributions to simplified employee pensions must not discriminate in favor of employees who are officers, shareholders, or highly compensated. In testing employer contributions for discrimination, certain employees who are included in a collective bargaining unit or who are nonresident aliens may be excluded from consideration. However, the simplified employee pension rules may have required employers to include these employees in the group of employees who are entitled to share in employer contributions to simplified employee pensions.

Reasons for change

The requirement that certain collective bargaining unit employees or nonresident aliens share in employer contributions to simplified employee pensions even though these employees can be excluded from consideration in testing whether simplified employee pensions are discriminatory is inconsistent with the purpose of the simplified employee pension provisions and with the corresponding provisions of the Internal Revenue Code relating to tax-qualified pension plans.

Explanation of provision

The bill permits certain employees who are included in a collective bargaining unit or who are nonresident aliens to be excluded from the group of employees who are entitled to share in employer contributions to simplified employee pensions.

Effective date

The provision applies to taxable years beginning after December 31, 1978. This is the same effective date as was provided by the Revenue Act of 1978 with respect to simplified employee pensions.

b. Exemption from FICA and FUTA taxes for employer contributions to simplified employee pensions (sec. 101(a)(10)(B) of the bill and secs. 3121(a)(5) and 3306(b)(5) of the Code)

Present law

The Revenue Act of 1978 created a new type of individual retirement plan, known as a simplified employee pension. Under present law, employer contributions to an IRA (individual retirement account, annuity, or retirement bond of an employee are considered remuneration subject to FICA and FUTA taxes, but employer contributions with respect to an employee to a tax-qualified plan are not [32] subject to these taxes. The 1978 Act did not specify whether employer contributions to a simplified employee pension were subject to FICA or FUTA taxes.

Reasons for change

Employer contributions to a tax-qualified pension plan on behalf of an employee are exempt from FICA and FUTA taxes. The absence of a corresponding exemption for employer contributions to simplified employee pensions is an unintended barrier to the establishment of simplified employee pensions.

Explanation of provision

Under the bill, an amount paid by an employer to an employee's individual retirement account or annuity is not subject to FICA or FUTA taxes if the account or annuity is a simplified employee pension and it is reasonable to believe that the employee will be entitled to deduct the payments under the IRA rules applicable to simplified employee pensions.

Effective date

This provision applies for payments made on or after January 1, 1979. This is the same effective date as was provided by the 1978 Act with respect to simplified employee pensions.

c. Clarification of rules relating to excess contributions to simplified employee pensions (sec. 101(a)(10)(C) of the bill and sec. 408(d)(5)(A) of the Code)

Present law

The rules relating to individual retirement accounts and annuities permit the withdrawal of an excess contribution (other than a rollover contribution) without the usual 10 percent additional income tax on early distributions to the extent no deduction was allowed for the contribution. The early distribution tax applies, however, if the amount contributed for the year exceeds $1,750 and the excess is not withdrawn by the time for filing the tax return for the year of the excess contribution (including extensions). Under present law, deductible contributions to individual retirement accounts and annuities may not exceed $1,750, except in the case of a simplified employee pension where contributions up to $7,500 may be deductible. No dollar limitation applies to an excess rollover contribution. Consequently, if an excess contribution is made by an employer to an individual retirement account or annuity of an employee under the simplified employee pension rules and the amount of the contribution is greater than $1,750, the 10 percent additional income tax could apply if the excess is not withdrawn in time.

Reasons for change

The $1,750 limit of present law is not appropriate for employer contributions to simplified employee pensions because up to $7,500 of such contributions for a taxable year may be deductible.

Explanation of provision

The bill permits an individual to withdraw excess employer contributions to a simplified employee pension free of the 10-percent addi- [33] tional income tax where the withdrawal does not exceed the amount of the employer contribution or $7,500, whichever is less. The bill does not affect the treatment of contributions other than excess employer contributions.

Effective date

This provision applies for taxable years beginning after December 31, 1978. This is the same effective date as was provided for simplified employee pensions under the Revenue Act of 1978.

d. Contributions to simplified employee pensions after age 70½ (sec. 101(a)(10)(D) of the bill and sec. 219(b)(7) of the Code)

Present law

The Revenue Act of 1978 created a new type of individual retirement plan, known as a simplified employee pension. Under the rules for simplified employee pensions, an employer may be obligated to contribute to the individual retirement account or annuity of an employee who has attained age 70½. Under the usual rules for individual retirement accounts and annuities, such a contribution is includible in the gross income of the employee but the contribution is not deductible by the employee and is considered an excess IRA contribution.

Reasons for change

Contributions by a corporation, a sole proprietorship, or a partnership to a tax-qualified pension plan on behalf of an individual who has attained age 70½ are deductible (within limits) under present law. The nondeductibility of employer contributions to the simplified employee pension of an employee who has attained age 70½ is an unintended barrier to the establishment of simplified employee pensions.

Explanation of provision

The bill allows an employee who has attained age 70½ to deduct employer contributions to the employee's individual retirement account or annuity if the account or annuity is a simplified employee pension.

Effective date

This provision applies for taxable years beginning after December 31, 1978. This is the same effective date as was provided for simplified employee pensions under the Revenue Act of 1978.

e. Coordination of H.R. 10 plans and subchapter S corporation plans with simplified employee pensions (secs. 101(a)(10)(E) and (F) of the bill and secs. 404(h)(4) and 408(k) of the Code)

Present law

The Revenue Act of 1978 created a new type of individual retirement plan, known as a simplified employee pension. Under the Act, if an employer maintains a defined contribution H.R. 10 plan for a self-employed individual and contributes to a simplified employee pension for that individual, the limitation on the employer's deduction for the contribution to the H.R. 10 plan is reduced by the deduction allowed for [34] the contribution to the simplified employee pension so that the limitation on the total deductible amount set aside for that individual is not increased.

Reasons for change

The rules for simplified employee plans do not provide for coordination with the rules for defined benefit plans of self-employed individuals or with rules for plans covering shareholder-employees of subchapter S corporations.

Explanation of provision

Under the bill, the limitation on the amount that may be set aside tax free in a defined contribution plan by a subchapter S corporation on behalf of a shareholder-employee is reduced by the amount deducted by the employer for contributions to the simplified employee pension of that employee. Also, the bill does not allow an employer who maintains a defined benefit plan for self-employed individuals or shareholder-employees to contribute to simplified employee pensions.

Effective date

This provision applies to taxable years beginning after December 31, 1978. This is the same effective date as was provided by the Revenue Act of 1978 for simplified employee pensions.

f. Integration of simplified employee pensions with Social Security (sec. 101(a)(10)(G) of the bill and sec. 408(k)(3) of the Code)

Present law

Under present law, employer contributions to the individual retirement accounts or annuities of employees can qualify as employer contributions to the simplified employee pensions of employees if an employer contribution is made to the individual retirement account or annuity of each employee who is entitled to a contribution.[1] Although the employer's contributions must generally bear a uniform relationship to the total compensation of each employee, these contributions can be integrated with the Social Security system. Under the integration rules, which are generally similar to the rules for integrated H.R. 10 plans, if certain requirements are met, the employer contribution on behalf of an employee is reduced by the amount of Social Security tax to be imposed on the employer with respect to the employee's wages. As under an integrated H.R. 10 plan, contributions for owner-employees are reduced by the amount of the self-employment tax imposed on the individual's earnings and, in the case of a self-employed individual other than an owner-employee, by an amount equal to the Social Security tax which would have been imposed if the individual's earnings from self-employment were wages.

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[1] Each employee who has (1) attained age 25 and (2) performed service for the employer during any 3 of the immediately preceding 5 calendar years must be entitled to a contribution.

Reasons for change

Under the 1978 Act, it is not clear whether an employer could make integrated contributions to the simplified employee pension of an employee while maintaining an integrated qualified pension, profit-sharing, or stock bonus plan for the same employee (possibly reducing the employee's benefits twice with respect to the same benefits or contributions considered to be provided by the employer under Social Security).

Explanation of provision

The bill clarifies present law by providing that an employer may not make integrated contributions to simplified employee pensions for a year in which the employer maintains an integrated pension, etc., plan. Although it is possible to design rules which would permit partial integration of a simplified employee pension where a partially integrated pension, etc. plan is maintained, the committee believes that the complexity of the rules for partial integration would be inconsistent with the committee's intent in providing for simplified employee pensions. The House bill did not include any similar provision.

[36] *Effective date*

The amendment applies for taxable years beginning after December 31, 1978. This is the same effective date as was provided by the Revenue Act of 1978 for simplified employee pensions.

g. Penalty for failure to file reports (secs. 101(a)(10)(H) and 101(b)(1)(F) of the bill and sec. 6693(a) of the Code)

Present law

The rules relating to simplified employee pensions provide that if an employer contributes to a simplified employee pension, the employer may be required by Treasury regulations to file simplified reports with the Internal Revenue Service and to furnish reports to employees.

Reason for change

It is not clear that present law provides a penalty for an employer's failure to file or furnish the reports with respect to simplified employee pensions.

Explanation of provision

The bill provides that a penalty of $10 per report applies to each failure to furnish a report required under the rules for simplified employee pensions, unless the failure is due to reasonable cause. This is the same penalty that is applicable under present law for a trustee's failure to provide certain reports with respect to individual retirement accounts or annuities. The House bill did not include any similar provision.

Effective date

The amendment applies with respect to failures occurring after the date of enactment of the bill.

h. Aggregation of simplified employee pensions (secs. 101(a)(10)(I) and 101(b)(1)(G) of the bill and sec. 415(e)(5) of the Code)

Present law

The Code provides limits on the annual addition to the account of a participant in a profit-sharing or other defined contribution plan. For this purpose, annual additions consist of employer contributions, reallocated forfeitures, and a portion of employee contributions.

The limits are applied to the aggregate of all defined contribution plans maintained by an employer. If the employer is in a controlled group of companies (whether or not incorporated), the limits are applied to the aggregate of all defined contribution plans maintained by the group. Under the rules, employer contributions to the simplified employee pension of an employee are aggregated with other employer contributions to defined contribution plans only if the employee has direct or indirect control of the employer.

Reasons for change

The committee believes that, under the limitation provisions, it is appropriate to treat employer contributions to simplified employee pensions as employer contributions to a defined contribution plan [37] maintained by the employer regardless of the ownership of the employer or the employer's trade or business.

Explanation of provision

Under the bill, if an employer contributes to a simplified employee pension, the contribution is taken into account as an employer contribution to a defined contribution plan regardless of the ownership of the employer or of the employer's trade or business. The bill does not change the rule of present law under which employee contributions to an individual retirement account or annuity, or a retirement bond are treated as employer contributions to a defined contribution plan maintained by an employer where the employee has the requisite control of the employer. The House bill did not include any similar provision.

Effective date

The amendment applies for years beginning after the date of enactment of the bill.

i. Clerical amendments relating to simplified employee pensions (sec. 101(a)(10)(K) of the bill, secs. 408(j)(1), 404(h)(2), (3), and (4) of the Code, and sec. 152(g)(2) of the Act)

A clerical amendment is made to section 408(j)(1) to remove an unnecessary reference to section 408(b)(5). Clerical amendments are made to sections 404(h)(2), (3), and (4) to correct an inaccurate reference to section 404(h)(1). A clerical amendment is made to section 152(g)(2) of the Revenue Act of 1978 to correct an inaccurate reference to section 415(a)(2) of the Code.

j. Special limits on benefits under certain defined benefit pension plans (sec. 101(a)(11)(A) of the bill and sec. 415(b)(7) of the Code)

Present law

Under the Code, limits are provided for benefits and contributions under tax-qualified plans, individual retirement plans, and tax-sheltered annuities. Generally, under those rules, benefits under a defined benefit pension plan may not exceed 100 percent of a participant's average high 3-year compensation. An exception to the 100-percent limit was provided by the Revenue Act of 1978 for participants in certain collectively bargained plans.

Reasons for change

The 1978 Act did not provide for situations in which an employee participates in more than one plan maintained by a single employer.

Explanation of provision

Under the bill, the exception to the 100-percent limit is restricted to an employee who is a participant in a collectively bargained plan where the employee does not participate in any other plan (subject to the limits on benefits or contributions) maintained by an employer who maintains the collectively bargained plan.

Effective date

This provision applies for years beginning after December 31, 1978. This is the same as the effective date provided by the 1978 Act for the exception to the 100-percent limitation.

[38] k. Limitations for certain collectively bargained pension plans (sec. 101(a)(11)(B) of the bill and sec. 415(b)(7)(C) of the Code)

Present law

Prior to the Revenue Act of 1978, benefits under a qualified defined benefit pension plan generally were limited to the lesser of 100 percent of pay or $75,000 per year, adjusted for inflation since 1974 ($98,100 for 1979). The Act provides that 100-percent-of-pay limit is disregarded, and the $75,000 limit is reduced to $37,500 (adjusted for inflation since 1974), in the case of certain large collectively bargained plans under which each employee who serves during a particular year earns the same pension credit. Under the 1978 Act, the pension credit for a participant must be determined without regard to age at retirement or date of retirement.

Reasons for change

It was intended that the factors of age at retirement and date of retirement be permitted to be taken into account by a plan under the exception to the 100-percent-of-pay limit.

Explanation of provision

The bill clarifies that the 100-percent-of-pay limit applies in the case of certain large collectively bargained plans where the amount of the pension credit for a particular employee is based solely on one or more of the following factors: (1) the length of service, (2) the particular years during which service was rendered, (3) the age at retirement, and (4) the date of retirement.

Effective date

The provision applies for years beginning after December 31, 1978. This is the same effective date as was provided by the Revenue Act of 1978 for the exception to the 100-percent-of-pay limit.

l. Clerical amendments regarding tax-sheltered annuities (sec. 101(a)(12) of the bill and sec. 403(b)(7) of the Code)

Section 403(b)(7)(A) is amended by striking "which satisfied" and inserting in lieu thereof "which satisfies".

m. Effective date of section 403(b) annuity rollovers and transitional rule for payments received in 1978 (sec. 101(a)(13) of the bill and sec. 156(d) of the Act)

Present law

Prior to the Revenue Act of 1978, recipients of distributions under a tax-sheltered annuity purchased by certain employers which are tax-exempt organizations or public schools were not eligible to defer tax on those distributions by rolling the distributions over to an individual retirement plan (an individual retirement account or annuity, or a retirement bond). The Act permits the recipient of a lump-sum distribution from a tax-sheltered annuity to defer tax on the distribution by rolling it over within 60 days of receipt to an IRA or to another tax-sheltered annuity. Due to a clerical error, as enacted, the rollover provision applies to distributions or transfers made after December 31, 1978, in taxable years beginning after that date.

[39] *Reasons for change*

The conferees on the Revenue Act of 1978 intended that the tax-sheltered annuity rollover provisions would be available for lump sum distributions received after December 31, 1977. To carry out the original intent of the conferees, the committee believes it is necessary to provide an extended rollover period for recipients of distributions in 1978 who could not have satisfied the requirement that amounts distributed must be rolled over within 60 days of receipt.

Explanation of provision

The bill makes the tax-sheltered annuity rollover provisions effective for distributions or transfers made after December 31, 1977, in taxable years beginning after that date. In addition, the bill provides that the recipient of a qualifying distribution in 1978 will have until December 31, 1980, to complete a rollover to either an IRA or another tax-sheltered annuity. Upon completion of the rollover, the recipient of a qualifying distribution in 1978 will be able to amend his or her 1978 income tax return to take into account the portion of the distribution originally included in income which is no longer subject to tax because of the rollover.

The bill also makes a clerical amendment to Code sections 403(b)(1) and 4973(c)(1) by inserting "409(b)(3)(C)" in lieu of "409(d)(3)(C)".

Effective date

This provision is effective as if it had been included in the Revenue Act of 1978 as enacted.

n. Clerical amendments regarding IRAs (secs. 101(a)(14)(A) and (B) of the bill, sec. 157(h)(3) of the Act, and secs. 219(b)(4), 220 (b)(5), 408(a)(1), 409(a)(4), and 4973(b)(1)(A) of the Code)

Section 101(a)(14)(A) of the bill corrects section 157(h)(3) of the 1978 Act by striking out "the amendments made by this section" each place it appears and inserting in lieu thereof "the amendments made by this subsection".

Section 101(a)(14)(B) of the bill corrects sections 219(b)(4), 220(b)(5), 408(a)(1), 409(a)(4), and 4973 (b)(1)(A) of the Code by inserting "402(a)(7)," after "section 402(a)(5),".

o. Spousal rollovers (sec. 101(a)(14)(C) of the bill and sec. 402(a)(7)(A) of the Code)

Present law

Under present law, a surviving spouse who receives a lump sum death benefit distribution from a tax-qualified plan is permitted to make a rollover of the distribution to an IRA. Rollovers, however, are not permitted for complete distributions to surviving spouses upon termination of tax-qualified retirement plans.

Reasons for change

The Revenue Act of 1978, as enacted, did not make clear that a distribution to a surviving spouse upon plan termination is eligible for rollover treatment.

[40] *Explanation of provision*

The bill clarifies that a lump sum distribution from, or complete distribution upon termination of, a qualified plan which is paid to the surviving spouse of a deceased plan participant, and which is attributable to the participant, is eligible for rollover treatment.

Effective date

This provision applies to distributions completed after December 31, 1978, in taxable years ending after that date.

p. Extension of transitional rule relating to removal of five-year requirement for a rollover (sec. 101(a)(14)(D) of the bill and sec. 157 (h)(3)(B) of the Act)

Present law

Under present law, generally an individual who receives a lump sum distribution from a tax-qualified retirement plan is eligible to roll over all or a portion of the distribution without regard to the individual's years of participation under the plan.

However, prior to the Revenue Act of 1978, an individual was required to be a participant in a tax-qualified retirement plan for five years in order to qualify for a rollover to an IRA (or to another tax-qualified retirement plan) of a lump sum distribution from the plan. The 1978 Act eliminated this five-year requirement for taxable years beginning after December 31, 1977, and permitted individuals denied the opportunity for a rollover during 1978, because of the five-year requirement, to complete their rollovers at any time before January 1, 1979.

Reasons for change

The commitee believes that individuals denied the opportunity for a rollover during 1978 because of the five-year requirement were not given sufficient time after enactment of the Act to complete a rollover.

Explanation of provision

The bill permits individuals denied rollover treatment of distributions from tax-qualified retirement plans during 1978, solely because of the five-year plan participation requirement, to make such rollovers until the end of 1980.

Effective date

This amendment would apply to payments made in taxable years beginning after December 31, 1977.

q. Clerical amendments regarding IRAs (secs. 101(a)(14)(E)(i) and (ii) of the bill and secs. 402(a)(6)(D) and 408(d)(5)(B) of the Code)

Section 101(a)(14)(E)(i) of the bill corrects section 402(a)(6)(D) of the Code by striking "many designate" and inserting in lieu thereof "may designate".

Section 101(a)(14)(ii) of the bill corrects section 408(d)(5)(B) of the Code by striking all that follows clause (i) and inserting in lieu thereof the following:

"(ii) the information was erroneous,

subparagraph (A) shall be applied by increasing the dollar limit set [41] forth therein by that portion of the excess contribution which was attributable to such information."

r. Correction of cross references in Code section 401(a)(20) (sec. 101 (a)(14)(E)(iii) of the bill and sec. 401(a)(20) of the Code)

Present law

Prior to the enactment of Public Law 95-458 [1978-2 C.B. 367], section 401(a)(20) included cross references to sections 402(a)(5) and 403(a)(4) of the Code for the purpose of making it clear that certain total distributions on termination of a tax-qualified pension plan do not result in the disqualification of the plan. Public Law 95-458 amended sections 402(a)(5) and 403 (a)(4) of the Code.

Reasons for change

Public Law 95-458 which amended sections 402(a)(5) and 403(a)(4) of the Code did not make conforming amendments to cross references to those sections in section 401(a)(20) of the Code.

Explanation of provision

The bill conforms the cross references to sections 402(a)(5) and 403 (a)(4) of the Code in section 401(a) (20) of the Code to reflect the changes made to sections 402(a)(5) and 403 (a)(4) of the Code by Public Law 95-458. Thus, the bill makes it clear that certain total distributions on termination of a tax-qualified pension plan do not result in the disqualification of the plan.

Effective date

The amendment made by this section is effective as if it had been included in section 157 of the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1].

[42] 5. Technical Amendments Relating to Tax Shelter and Partnership Provisions

a. Correction of attribution rules for at risk provision (sec. 102(a)(1)(A) of the bill and sec. 465(a) of the Code)

Present law

Prior to the Revenue Act of 1978, the only types of corporations to which the at risk rules (Code sec. 465) applied were subchapter S corporations and personal holding companies. The 1978 Act extended the application of at risk rules to certain closely held corporations (even though they would not qualify as personal holding companies and had not made subchapter S elections). The closely held corporations to which these rules were extended included any corporation in which five or fewer individuals owned 50 percent or more of the stock. However, in determining whether this ownership test is met, the attribution rules of Code section 318, rather than those of Code section 544, are to be applied.[1]

In general, the attribution rules of section 318 are much narrower than those of section 544, which, *inter alia,* provide for attribution of one partner's stock to another partner in the same partnership and for broader family and corporate attribution. Under section 544, stock in one corporation (the "subsidiary") owned by another corporation (the "parent") is attributed to the parent's shareholders in proportion to the shareholders' ownership in the parent. However, under section 318, the stock of a subsidiary corporation is considered as owned by a shareholder of the parent corporation only if the shareholder owns 50 percent or more in value of the stock of the parent corporation. Similarly, under section 544, an individual is considered as owning stock owned directly or indirectly by his brothers and sisters, spouse, ancestors, and lineal descendants; however, under section 318, an individual is treated as owning only the stock owned directly or indirectly by his spouse, children, grandchildren, and parents.

Reasons for change

The Act adopted the attribution rules of section 318 primarily because it was thought inappropriate to attribute one partner's stock in a corporation to another partner in the same partnership. However, the adoption of these attribution rules inadvertently provided exemption from the at risk rules where the stock ownership of the corporation clearly warranted application of the at risk rules (e.g., where the corporation was a personal holding company but did not [43] meet the section 318 attribution rules). Also, under the section 318 attribution rules, the stock of a wholly-owned subsidiary corporation engaged in an at risk activity would not be treated as 50 percent or more owned by five or fewer individuals so long as no one individual was considered as owning 50 percent or more of the parent corporation's stock. The committee believes that the attribution rules of section 544, other than the rules attributing stock between partners, are more appropriate than the attribution rules of section 318 for the purpose of determining whether a corporation is to be subject to the at risk rules.

Explanation of provision

The bill provides generally that, in determining whether five or fewer individuals own 50 percent or more of the stock of a corporation under the at risk rules, the attribution rules of section 544 are to be applied. However, those rules of section 544 relating to attribution of stock ownership from one partner to another are not to be applied.

Effective date

This provision is effective for taxable years beginning after December 31, 1978. This is the same effective date as that applicable to the provision of the Revenue Act of 1978 to which this provision relates.

b. Clarification of recapture rules of at risk provision (sec. 102(a)(1)(B) of the bill and sec. 465(d) of the Code)

Present law

Under a literal interpretation of the law prior to the Revenue Act of 1978, the at risk rules may have only required the taxpayer to be at risk at the end of the taxable year for which losses are claimed. Thus, arguably, subsequent withdrawals of amounts originally placed at risk may have been made without the recapture of previously allowed losses. The Act added provisions which require the recapture of previously allowed losses when, and to the extent, the amount at risk is reduced below zero. The Act provides that this recapture income is treated as income from the activity to which the at risk rule applies and thus can be used to offset additional losses from the activity if the losses are incurred in the year in which the recapture occurs (or are suspended losses which are treated as having been incurred in such year).

Reasons for change

Because recapture income under the recapture of loss rules is considered income from the activity, any losses from the activity for the year of recapture (including losses carried over from previous years) can be offset against the recapture income without taking into account the amount of the at risk basis. Thus, notwithstanding a negative at risk basis, losses during the year of recapture, to the extent of the amount of recapture income, can be deducted. Moreover, the at risk basis is left at a negative amount, instead of being brought back up to zero by the amount of recapture income (the recapture income, instead, having been applied against the loss).

Explanation of provision

The bill provides that such recapture income is not to be treated as income from the activity for purposes of determining whether current losses (or suspended losses) are allowable.

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[1] Prior to the Act, the reference to personal holding companies resulted in the application of the section 544 personal holding company attribution rules. Of course, no attribution rules are applicable (both before and after the Act) in determining whether a corporation is a subchapter S corporation and, therefore, subject to the at risk rules.

[44] *Effective date*

This provision is effective for taxable years beginning after December 31, 1978. This is the same effective date as that applicable to the provision of the Revenue Act of 1978 to which this provision relates.

c. Clarification of limitation on recapture of losses under at risk provision (sec. 102(a)(1)(C) of the bill and sec. 465(e)(2)(A) of the Code)

Present law

The Revenue Act of 1978 modified the at risk rules to provide for a recapture of losses where the amount at risk is less than zero. These recapture of loss rules were intended to apply only to losses relating to taxable years beginning after December 31, 1978, and which (pursuant to Code sec. 465(b)(5) are reflected in reductions to the at risk basis in the activity.

Reasons for change

Because of a possible ambiguity in the provision governing the adjustments which reduce the at risk basis in an activity (Code sec. 465(b)(5)), it is unclear whether the adjustment for losses relating to a taxable year would be made as of the last day of such taxable year or as of the first day of the following taxable year. Consequently, it is unclear whether a loss relating to a taxable year beginning before December 30, 1978, but possibly reflected in an at risk basis adjustment as of the first day of a taxable year beginning after December 31, 1978, would be subject to the recapture of loss rules.

Explanation of provision

The bill clarifies the application of the recapture of loss provision (Code sec. 465(e)(2)) to indicate that it applies only to losses for taxable years beginning after December 31, 1978, and not to at risk basis adjustments possibly made after that date which relate to losses for taxable years beginning before December 31, 1978.

Effective date

This provision is effective for taxable years beginning after December 31, 1978. This is the same effective date as that applicable to the provision of the Revenue Act of 1978 to which this provision relates.

d. Waiver of controlled group rule where there is substantial leasing activity (sec. 102(a)(1)(D) of the bill and sec. 465(c) of the Code)

Present law

Prior to the Revenue Act of 1978, the only types of corporations to which the at risk rules (Code sec. 465) applied were subchapter S corporations and personal holding companies. The Act extended the application of the at risk rules to certain closely held corporations (even though they would not qualify as personal holding companies and had not made subchapter S elections). However, the Act contains an exception to the at risk limitations for closely held corporations actively engaged in equipment leasing operations. To qualify for this exception, more than 50 percent of a corporation's gross receipts must [45] be derived from equipment leasing. In order to prevent abuse, the Act provided that the 50-percent test is to be applied to the total gross receipts of all the members of a controlled group of corporations.

Reasons for change

The Act applies the at risk limitations to a number of substantial active equipment leasing operations. This has occurred because the gross receipts from equipment leasing of some members of a controlled group of corporations, while substantial in an absolute sense, constitute less than 50 percent of the total gross receipts of all the members of the controlled group. In many of these situations, some of the corporations in the group have significant active leasing activities (as measured by employees, receipts, and number of transactions). The committee concluded that members of a closely held controlled group of corporations which are substantially involved in equipment leasing should be exempted from the at risk rules.

Explanation of provision

Under the bill, if certain tests are met, the leasing gross receipts percentage requirement is not to be applied to the total gross receipts of the controlled group.[1] Instead, the gross receipts requirement, increased to 80 percent, is to be applied separately to each member corporation of the controlled group.

The provisions of the amendment are applied to the quantum of certain activities of the "qualified leasing members" of the controlled group of corporations. A corporation is a qualified leasing member if, in the current and each of the immediately preceding two taxable years, (1) it is a component member of the controlled group of corporations and (2) 80 percent or more of its gross receipts is attributable to equipment leasing.

The controlled group 50 percent requirement would be waived, and, instead, an 80-percent gross receipt corporation-by-corporation requirement would apply, if the qualified leasing members (if any) meet the following tests for the current and two immediately preceding taxable years:

(1) The controlled group had at least three full time employees, substantially all of the services of whom were directly related to the equipment leasing activities of the qualified leasing members;

(2) the qualified leasing members, in the aggregate, entered into at least five separate equipment leasing transactions;[2] and

(3) the qualified leasing members, in the aggregate, had at least $1,000,000 of equipment leasing gross receipts.

An amendment is made to Code section 465(b)(5) (relating to at risk activity basis reductions) in order to make it clear that the loss recapture provisions of section 465(e) (which apply only to previously [46] allowed deductions reflected in basis reductions required under Code sec. 465(b)(5)) do not apply to exempt leasing activity losses.[3]

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[1] Of course, if the controlled group meets the 50 percent gross receipts requirement of section 465(c)(4), this new provision would not apply.

[2] It is contemplated that separate written lease agreements with the same lessee pertaining to items of equipment which are related parts of what is in substance a single lease "package" would be treated as one equipment leasing transaction.

Effective date

This provision is effective for taxable years beginning after December 31, 1978. This is the same effective date as that applicable to the provision of the Revenue Act of 1978 to which this provision relates.

e. Certain clerical amendments to procedural provisions (secs. 102(a)(2)(A) and (B) of the bill and secs. 6501 and 6511 of the Code)

A clerical amendment to section 6501 of the Code is made to redesignate subsection (q) of section 6501 as subsection (o) to reflect the amendments made to that section by Public Law 95-628 [1978-2 C.B. 435].

A conforming amendment to section 6511 of the Code is made to conform the cross reference in that section to the newly redesignated section 6501(o).

f. Treatment of certain underwriting syndicates or partnerships (sec. 102(a)(2)(C) of the bill and sec. 761(a)(3) of the Code)

Present law

The Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1] imposed a penalty on a partnership which does not file a partnership return. Historically, partnership returns have not been filed in the case of syndicates of dealers in securities formed for the purpose of underwriting, selling, or distributing a securities issue.

Reasons for change

The committee believes that those syndicates which historically have not been treated as partnerships should be given the opportunity to avail themselves of the election under the Code not to be treated as a partnership for income tax purposes.

Explanation of provision

The bill would allow a syndicate of dealers formed for a short period for the purpose of underwriting, selling, or distributing a particular issue of securities to elect not to be treated as a partnership for income tax purposes.

Effective date

The amendment is effective for taxable years beginning after December 31, 1978.

[47] 6. Technical Amendments Relating to the Corporate Tax Rate and to the Investment Tax Credit

a. Computation of tax on income from foreclosure property of REITs (sec. 103(a)(1) of the bill and sec. 857(b)(4)(A) of the Code)

The Revenue Act of 1978 removed the surtax exemption for corporations and replaced it with a graduated rate schedule. This provision makes a technical amendment to conform the tax imposed on the net income from foreclosure property of a real estate investment trust (REIT) with the repeal of the surtax exemption.

b. Clarification of normalization provisions for purposes of investment tax credit (sec. 103(a)(2)(A) of the bill and sec. 312(c)(2) of the Act)

Present law

The Revenue Act of 1971 [Pub. L. 92-178, 1972-1 C.B. 443] added rules to provide for the normalization of the investment tax credit for public utility property which qualified for the investment credit after the credit was restored in 1971. The Revenue Act of 1978 repealed the rules relating to the restoration of the credit in 1971 as "deadwood." These amendments created uncertainty as to whether the normalization rules would now also apply to public utility property placed in service before 1971.

Reasons for change

The repeal, under the Revenue Act of 1978, of the rules relating to the 1971 restoration of the investment credit, was not intended to affect the normalization rules which were also enacted in 1971. In order to eliminate difficulties which could arise from a misinterpretation of the 1978 amendments, the bill clarifies the intent of these amendments.

Explanation of provision

The bill clarifies the application of the normalization rules to public utility property so that the normalization provisions would apply only to public utility property for the period to which the restored investment credit applies.

Effective date

The provision is effective as if enacted as part of the Revenue Act of 1978.

c. Clerical amendments to special rules for energy property (sec. 103(a)(2)((B) of the bill and secs. 46 and 6401 of the Code)

(*1*) *Amendments to section 46(a).*—Paragraph (10) of section 46(a) is redesignated as paragraph (9) to maintain the numerical sequence of the paragraphs under section 46(a). The former provisions of section 46(a)(9) were repealed by the Revenue Act of 1978. In [48] addition, section 46(a)(9), as redesignated, is amended to correct two cross-references in that provision.

(2) *Amendments to section 6401 (d).*—A cross reference in section 6401(d) is amended to reflect the redesignation of paragraph 10 of section 46(a) as paragraph (9) of that section item b, above).

d. Coordination of investment credit rules for pollution control equipment (sec. 103(a)(3) of the bill and sec. 46(c)(5)(B) of the Code)

Present law

The Energy Tax Act of 1978 [Pub. L. 95-618, 1978-3 C.B. (Vol. 2) 1] provides a 10-percent investment credit for investments in certain energy property acquired after September 30, 1978 and before January 1, 1983. This credit is in addition to the 10-percent regular investment credit for which energy property also may qualify. Qualifying energy property includes pollution control equipment which is required to be installed in connection

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[3] This amendment also has the same clarifying effect with respect to exempt real estate activity losses and those losses attributable to partnership liabilities which were not subject to section 704(d) (as in effect before the date of the enactment of the Revenue Act of 1978 by reason of section 213(f)(2) of the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1]).

with certain other energy property. However, when energy property, including pollution control equipment, is financed in whole or in part by tax-exempt industrial development bonds, a reduced credit of 5-percent is allowed on the qualified investment.

The Revenue Act of 1978 revised the rules concerning investment credits for pollution control facilities where the taxpayer elects to amortize the cost of pollution control faciilties over 5 years. Under these rules, where 5-year amortization is elected for pollution control facilities which also are financed with tax-exempt industrial development bonds, the taxpayer's qualified investment for purposes of investment credits is one-half of the investment which is subject to the 5-year amortization election.

Where pollution-control equipment which is energy property is subject both to the generally applicable rule which limits qualified investment and to the reduction in the energy credit percentage, the effective rate of the energy credit will be only 2.5 percent.

Reasons for change

It was not intended that the interaction of the changes made to the investment credit rules by the Revenue Ac of 1978 and the Energy Tax Act of 1978 would cause the energy credit for pollution control equipment to be at an effective rate of only 2.5 percent where such equipment is subject to limitations enacted under each of these two Acts. The bill corrects this unintended result.

Explanation of provision

Under the bill, the generally applicable limitation for investment credits on pollution control equipment which is both financed by tax-exempt industrial development bonds and is subject to 5-year amortization will not apply for purposes of the energy credit. As a result, pollution control equipment which is energy property and is financed by industrial development bonds will receive an energy credit of 5 percent as provided by the limitation applicable to energy property.

Effective date

The provision is effective generally with respect to property acquired after December 31, 1978.

[49] e. Treatment of noncorporate lessors for purposes of the investment credit for rehabilitation expenditures (sec. 103(a)(4)(A) of the bill and sec. 46(e)(3) of the Code)

Present law

Under the investment credit provisions generally, availability of the credit is limited with respect to property of noncorporate lessors. Under this limitation, the credit generally is not available to a noncorporate lessor of property which is otherwise qualified unless either (1) the noncorporate lessor produced the property, or (2) the lease term is less than 50 percent of the useful life of the property and the lessor's ordinary and necessary business expenses in connection with the property are more than 15 percent of the rental income produced by the property during the first 12 months of the lessee's use. This limitation was designed to deal with equipment leasing tax shelters which often involve long-term leases on a net basis (i.e., the lessee pays all expenses incident to the maintenance and operations of the leased property). However, the limitation applies with respect to "property" leased by a noncorporate lessor rather than solely to equipment.

The Revenue Act of 1978 made the investment credit generally available to expenditures incurred after October 31, 1978, for rehabilitating older business and commercial buildings (except those used for residential purposes). The 1978 Act did not contain any provision to coordinate the extension of the credit to building rehabilitations with the noncorporate lessor limitation.

Reasons for change

In the case of the rental of commercial buildings, the use of net lease arrangements is traditional and customary. Typically, the tenant of a commercial building will assume responsibility for taxes, insurance, and maintenance with respect to the building. The application of the noncorporate lessor limitation will deny the investment tax credit in many situations where taxpayers have incurred substantial expenditures in rehabilitating older buildings. This restriction will cause an unintended diminution in the impact of extending the credit to rehabilitated buildings, particularly in urban areas where older buildings are presently vacant and make no contribution to the area's economic base.

Explanation of provision

The bill makes the noncorporate lessor limitation inapplicable for purposes of the investment credit for rehabilitation expenditures in order to correct the unintended result of applying this restriction to such expenditures.

Effective date

The provision applies to taxable years ending after October 31, 1978.

f. Coordination of regular investment credit for rehabilitation expenditures with energy investment credit (sec. 103(a)(4)(B) of the bill and sec. 48(g)(2)(B) of the Code)

Present law

The Revenue Act of 1978 made the regular investment credit available to rehabilitation expenditures for certain buildings which are [50] at least 20 years old. One of the provisions of the Act excludes from the definition of qualified rehabilitation expenditures those expenditures for property which qualify as investment credit property under other investment credit rules. This provision would exclude from the regular investment credit certain rehabilitation expenditures which also qualify as expenditures for energy property eligible for the energy investment credit.

Reasons for change

The intent of the provision which excludes from the definition of qualifying rehabilitation expenditures those costs which otherwise qualify for the investment credit was to continue the application of existing limitations which may apply to such costs for purposes of the regular investment credit. However, this provision, as enacted in the Revenue Act of 1978, also has the unintended effect of disallowing the energy investment credit on expenditures for energy property (such as solar energy equipment) which is installed as part of a qualifying rehabilitation. The elimination of the energy credit in these situations dilutes the incentive to achieve energy conversion in the course of a building rehabilitation.

Explanation of provision

The bill makes both the energy investment credit and the regular investment credit available where rehabilitation expenditures also qualify as expenditures for energy property.

Effective date

The provision applies to taxable years ending after October 31, 1978.

[51] 7. Technical Amendments Relating to the Targeted Jobs Credit and the WIN Credit

a. Rules for work incentive credit and targeted jobs credit for cooperatives (sec. 103(a)(5) of the bill and secs. 50B(f), 52(f) and 52(h) of the Code)

Present law

Prior to the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1], special rules applied for purposes of determining the amount of work incentive (WIN) credit and general jobs credit which could be used by cooperatives. These special rules applied the same rules under which the amount of investment credit for cooperatives was determined.

Reasons for change

While the Act revised the rules pertaining to the investment credit for cooperatives, no change was made to the rules pertaining to the WIN and jobs tax credits for cooperatives. The Congress intended that the rules for determining the amounts of WIN and jobs credits for cooperatives should be the same as the new rules for determining the amount of investment credit for cooperatives.

Explanation of provision

The bill extends the new rules for the investment credit of cooperatives to the WIN and jobs credits. Language is added to the House bill to make clear that this provision applies to both the general jobs credit and the targeted jobs credit.

Effective date

This provision applies to taxable years ending after October 31, 1978.

b. Correction of expiration date of targeted jobs credit (sec. 103(a)(6)(A) of the bill and sec. 51(c)(4) of the Code)

Present law

The Revenue Act of 1978 provided for a targeted jobs credit which allows employers to claim a tax credit for employing certain categories of individuals.

Reasons for change

The Congress intended that the targeted jobs credit be available for employers with respect to wages paid or incurred up to and including December 31, 1981. However, due to a clerical error, the Act provides that the targeted jobs credit is to expire with respect to wages paid after December 31, 1980.

Explanation of provision

The bill corrects the clerical error to provide that the credit may be claimed with respect to wages paid or incurred up to and including December 31, 1981.

[52] *Effective date*

This amendment is effective as if it were included in the Revenue Act of 1978.

c. Clarification of the effective date for election of jobs credit (sec. 103(a)(6)(B) of the bill and sec. 321(d) of the Act)

Present law

The Revenue Act of 1978 provides that the jobs credit is elective, rather than mandatory as under prior law.

Reasons for change

While the Act provided that the jobs credit is elective, it did not contain a special effective date for this provision. The Congress intended that taxpayers should be allowed to make this election retroactively in the case of the prior law general jobs credit.

Explanation of provision

The bill corrects this oversight in the Act to provide that the election provision is effective for taxable years ending after December 31, 1976.

Effective date

This provision applies to taxable years beginning after December 31, 1976.

d. Clarification of effective date for newly targeted groups under jobs credit (sec. 103(a)(6)(C) of the bill and sec. 321(d)(2)(A) of the Act)

Present law

The Code, prior to the Revenue Act of 1978, provided a jobs credit to encourage employers to expand their work forces. In addition, an extra credit was provided for hiring persons referred under vocational rehabilitation programs. The Act amended the jobs credit to provide that, effective for amounts paid or incurred after December 31, 1978, the credit would be available only for the employment of specific target groups of individuals. For individuals in newly targeted groups (*i.e.,* all individuals in target groups except persons referred under vocational rehabilitation programs for whom the taxpayer claimed a credit under prior law), the credit is available only for persons first hired by the employer after September 26, 1978.

Reasons for change

A literal reading of the Act could imply that an employer is not entitled to the general jobs credit with respect to wages paid to a member of a newly targeted group who first begins work for an employer before January 1, 1979, but after September 26, 1978. However, the Congress intended for an employer to be allowed whatever credit was available under prior law for wages paid or incurred before January 1, 1979, with respect to a member of a newly targeted group who first begins work for an employer before January 1, 1979.

Explanation of provision

The bill clarifies that the effective date provision of the Act which relates to newly targeted groups applies only for purposes of amend- [53] ments made by the Act. Thus, with respect to a member of a newly targeted group who first begins work for an employer before January 1, 1979, the employer is allowed whatever credit was available under prior law for wages paid or incurred before January 1, 1979. For purposes of wages paid or incurred on or after January 1, 1979, credit will be allowed with respect to such an individual only if he or she was first hired after September 26, 1978, and this individual would be treated as beginning work on January 1, 1979.

Effective date

This provision is effective with respect to wages paid or incurred after September 26, 1978.

e. Clarification of transitional rule for fiscal year taxpayers claiming jobs credit (sec. 103(a)(6)(D) of the bill and sec. 321(d)(3) of the Act)

Present law

The Revenue Act of 1978 includes a transitional rule to coordinate the effective date of the targeted jobs credit for 1979 with the expiration of the prior general jobs credit at the end of 1978 for fiscal year taxpayers.

Reasons for change

Although the language in the Act was somewhat unclear, the Congress intended for a taxpayer on a 1978-1979 fiscal year to compute the pre-1979 general jobs credit (without regard to the tax liability limitation) for wages paid in 1978, compute the post-1978 targeted jobs credit under the new law (also without regard to the tax liability limitation) for wages paid in 1979, add the two credits together, and then apply the 100 percent of tax liability limitation.

Explanation of provision

The bill clarifies that, under the transitional rule, a taxpayer with a fiscal year beginning in 1978 will compute his total credit for that fiscal year by (1) determining his general jobs credit under prior law (but without regard to the 100 percent of tax liability limitation) for wages paid in 1978 and his targeted jobs credit under the Act (also without regard to the 100 percent of tax liability limitation) for wages paid in 1979, (2) adding the two amounts together, and then (3) applying the 100 percent of tax liability limitation to the sum.

Effective date

This provision applies in the case of taxable years which begin in 1978 and end after December 31, 1978.

f. Clarification that FUTA wages are to be treated as including remuneration of youths participating in cooperative education programs (sec. 103(a)(6)(E) of the bill and secs. 51(d)(8)(D) and 51(c) of the Code)

Present law

Under present law, one of the targeted groups for purposes of the targeted jobs credit is youth participating in a qualified cooperative education program. In general, wages eligible for the targeted jobs credit are Federal Unemployment Tax Act (FUTA) wages.

[54] *Reasons for change*

Section 3306(c)(10)(C) excludes services performed by cooperative education students under the age of 22 from coverage under FUTA. Thus, although cooperative education students of ages 16 through 19 would comprise an eligible target group under this bill, employers would not be able to claim a credit with respect to the wages paid to them.

Explanation of provision

The bill clarifies that wages paid to youths participating in cooperative education programs, although not FUTA wages, are eligible for the targeted jobs credit.

Effective date

The amendments made by this provision generally are effective with respect to amounts paid or incurred after December 31, 1978.

g. Definition of youth participating in a qualified cooperative education program for purposes of the targeted jobs credit (secs. 103(a)(6)(F) and (b) of the bill and sec. 51(d)(8) of the Code)

Present law

Under the Revenue Act of 1978, a credit is provided for the hiring of members of certain target groups. The credit, which is elective, is equal to 50 percent of qualified first-year wages and 25 percent of qualified second-year wages. One of the target groups consists of youths who actively participate in qualified cooperative education programs, who have attained the age of 16 but who have not attained the age of 19, and who have not graduated from high school or vocational school.

Reasons for change

When it drafted the Revenue Act of 1978, the Congress was not aware that many of the students in high school cooperative education programs were 19 years old. The intent of including cooperative education students in the targeted jobs credit would be frustrated if wages paid to 19-year old participants continued to be ineligible for the credit.

Explanation of provision

The provision would amend section 51(d)(8)(A)(i) of the Code to provide that the targeted jobs credit would be available for the hiring of youths who actively participate in qualified cooperative education programs, who have attained the age of 16 but who have not attained the age of 20, and who have not graduated from high school or vocational school.

Effective date

This provision would apply with respect to wages paid or incurred on or after November 27, 1979, in taxable years ending on or after such date.

Revenue effect

This provision would reduce budget receipts in fiscal year 1980 by less than $1 million, by less than $5 million per year in fiscal years 1981 and 1982, and by less than $1 million in fiscal year 1983.

[55] h. Clerical corrections to targeted jobs credit (sec. 103(a)(6)(G) of the bill, secs. 44B, 51, 6501, 383, and 6411 of the Code, and secs. 321(d)(2) and (4) of the Act)

(*1*) *Amendment of section 44B(a).*—Section 44B(a) is amended by replacing the phrase "at the taxpayer" with the phrase "of the taxpayer".

(*2*) *Amendment of section 44B(c)(2).*—The phrase "may be" in section 44B(c)(2) is replaced by the phrase "may by".

(*3*) *Amendment of section 51(c)(2).*—The phrase "amounts paid" in section 51(c)(2) is replaced by the phrase "amounts paid or incurred."

(*4*) *Amendment of section 51(d)(1).*—Section 51(d)(1) is amended by deleting the word "or" at the end of subparagraph (E).

(*5*) *Amendment of section 51(d)(4)(A)(i).*—Section 51(d)(4)(A)(i) is amended by substituting the phrase "active duty" for the phrase "active day".

(*6*) *Amendment of section 51(d)(4)(B).*—Section 51(d)(4)(B) is amended by substituting "preemployment for "premployment".

(*7*) *Amendment of section 51(d)(5).*—Section 51(d)(5) is amended by substituting "preemployment" for "pre-employment".

(*8*) *Amendment of section 51(d)(12).*—Section 51(d)(12) is amended by substituting "employers" for "employer".

(*9*) *Amendment of section 51(e).*—The last sentence of section 51(e) is amended by inserting the phrase "except as provided in subsection (h)(1)," after "the preceding sentence,".

(*10*) *Amendment of section 6501.*—Section 6501(q), as added by section 321(b)(2) of the Revenue Act of 1978, is redesignated as section 6501(p).

(*11*) *Amendment of section 321(d)(2)(B) of the Revenue Act of 1978.*—Clause (i) of section 321(d)(2)(B) of the Revenue Act of 1978 is deleted and replaced by "(i) such individual meets the requirements of paragraph (1) of section 51(d) of such Code, and". Clause (ii) of section 321(d)(2)(B) is deleted and replaced by "(ii) in the case of an individual meeting the requirements of subparagraph (A) of such paragraph (1), a credit was not claimed for such individual by the taxpayer for a taxable year beginning before January 1, 1979."

(*12*) *Amendment to section 321(d)(4) of the Revenue Act of 1978.*—Section 321(d)(4) of the Revenue Act is amended by inserting "subsection (c)(2)" in lieu of "subsection (u)(2)".

(*13*) *Amendments of sections 383 and 6411(a).*—The references in sections 383 and 6411(a) to "section 53(c)" are amended to refer to "section 53(b)".

i. Clarification of effective date for WIN-welfare recipient tax credit for fiscal year taxpayers (sec. 103(a)(7)(A) of the bill and sec. 322(e)(1) of the Act)

Present law

Prior to the Revenue Act of 1978, the amount of WIN credit available to any employer was limited to $50,000 of tax liability plus one-half of tax liability in excess of $50,000. The Code contained rules for allocating this amount between married individuals filing separately, among members of a controlled group, and between an estate or trust [56] and its beneficiaries. The Act increased the limitation on the credit amount to 100 percent of tax liability, effective for taxable years beginning after December 31, 1978.

Reasons for change

Although the change in the tax liability limitation made by the 1978 Act is effective for taxable years beginning after December 31, 1978, it is unclear whether the related rules for apportioning the $50,000 amount are effective during the entire taxable year of fiscal year 1978-79 taxpayers.

Explanation of provision

The bill specifies that, for purposes of applying the prior law tax liability limitation to a taxable year beginning before January 1, 1979, the prior law rules relating to the apportionment of the $50,000 amount shall apply.

Effective date

The provision is effective for taxable years beginning in 1978 and ending after December 31, 1978.

j. Clarification of transitional rule for AFDC recipients and WIN registrants hired after September 26, 1978 (sec. 103(a)(7)(B) of the bill and sec. 332(e)(2) of the Act)

Present law

The Code prior to the Revenue Act of 1978, provided a credit to employers who hired certain AFDC recipients and WIN registrants. The Act amended the credit in several respects, and the amendments generally are effective for work incentive program expenses paid or incurred after December 31, 1978. Under the Act, eligible employees hired after September 26, 1978, are to be treated as having first begun work for the employer no earlier than January 1, 1979.

Reasons for change

The Congress intended that an employer be entitled to whatever credit was available under prior law for wages paid or incurred before January 1, 1979, with respect to AFDC recipients and WIN registrants.

Explanation of provision

The bill clarifies that the effective date provision which relates to AFDC recipients and WIN registrants hired after September 26, 1978, applies only for purposes of the amendments made by the Act. Thus, with respect to such an employee who first begins work for an employer before January 1, 1979, the employer would be allowed whatever credit was available under prior law for wages paid or incurred before January 1, 1979. For the purpose of amounts paid or incurred on or after January 1, 1979, such an employee would be treated as beginning work on January 1, 1979, and any wages paid or incurred after December 31, 1978, with respect to this employee would be considered to be attributable to services rendered after that date.

Effective date

This provision is effective with respect to eligible employees hired after September 26, 1978.

[57] k. WIN credit for child care expenses between October 1, 1978 and December 31, 1978 (sec. 103(a)(7)(C) of the bill and sec. 50B(a)(2)(B) of the Code)

Present law

Whether wages are eligible for the WIN credit as adopted in the Revenue Act of 1978 does not depend on whether the work being performed by the eligible employee involves child care services. As the credit applied before the amendments of the Revenue Act of 1978, wages paid for services in connection with a child day care program were eligible for the credit only if paid for services performed before October 1, 1978.

Reasons for change

Because the amendments made by the 1978 Act were effective only for wages paid or incurred after December 31, 1978, there was an unintended three-month gap in WIN credit coverage for child day care services.

Explanation of provision

The bill extends to January 1, 1979, the October 1, 1978, termination date in the WIN credit child care service provision in effect before the amendments of the 1978 Act.

Effective date

The amendment made by this provision applies to wages paid or incurred for services rendered between October 1, 1978 and December 31, 1978.

l. Clerical corrections to WIN-welfare recipient tax credit (sec. 103(a)(7)(D) of the bill, secs. 50A and 50B of the Code, and sec. 322(d) of the Act)

(*1*) *Amendment of section 50A*(*a*)(*4*)(*C*).—Section 50A(a)(4)(C) is amended by replacing " '$6,000' and" with " '$6,000' for".

(*2*) *Amendment of section 50B*(*g*)(*2*)(*B*).—Section 50B(g)(2)(B) is amended by inserting the phrase "giving rise to such credit" in lieu of the phrase "giving to such credit".

(*3*) *Amendment of section 50B*(*h*)(*1*)(*A*)(*i*).—Section 50B(h)(1)(A)(i) is amended by inserting "90-day" in lieu of "9-day".

(*4*) *Amendment of section 322*(*d*) *of the Revenue Act of 1978*.—The second subsection designated as subsection (d) of section 322 of the Act is amended by replacing the word "our" in paragraph (1)(A) thereof with the word "out".

[58] 8. Technical Amendments Relating to Other Provisions Primarily Affecting Business Income Tax

a. Clerical amendment to Section 337(a) of the 1978 Act (sec. 103(a)(8) of the bill and sec. 337(a) of the Revenue Act of 1978)

Section 337(a) is amended to correct a typographical error by changing "or a refund profit" to "of a refund profit."

b. Effective date for limit on ordinary loss deduction for small business corporation stock (sec. 103(a)(9) of the bill, sec. 1244 of the Code, and sec. 345(e) of the Act)

Present law

Prior to the Revenue Act of 1978, the Code provided that, if certain individual shareholders realized a loss on the disposition of certain stock (sec. 1244 stock), it would be treated as an ordinary loss. Under prior law, the maximum amount of ordinary loss from the disposition of section 1244 stock that could be claimed in any taxable year was $25,000, except for married taxpayers filing joint returns, in which case ordinary loss treatment was limited to $50,000.

In general, the Act increased the amount of section 1244 stock that a qualified small business corporation could issue, simplified and liberalized some of the conditions which must be satisfied for stock to qualify as section 1244 stock, and increased the amount of loss that certain shareholders could treat as an ordinary loss rather than as a capital loss. Under the Act, the maximum amount that could be treated as an ordinary loss in a taxable year was increased to $50,000; in the case of a husband and wife filing a joint return for the taxable year in which the loss is incurred, the maximum amount that may be treated as an ordinary loss was increased to $100,000.

Reasons for change

Under the Act, these provisions applied to common stock issued after the date of enactment (November 6, 1978). This effective date is appropriate for the changes in requirements for qualifying stock; however, as drafted, the Act did not increase the limitation on the amount of loss on previously issued section 1244 stock which could be treated as an ordinary loss in a taxable year. Rather, it created two separate limitations, one for common stock issued prior to the date of enactment and another for common stock issued after the date of enactment (November 6, 1978).

The committee believes that, for taxable years beginning after December 31, 1978, one set of dollar limitations—the increased dollar limitations—should apply to losses on all section 1244 stock (whether issued before or after November 6, 1978). However, the committee believes that, for taxable years beginning prior to December 31, 1978, it is appropriate to retain the rule that the increased dollar limitation would apply only with respect to losses on section 1244 stock issued [59] after November 6, 1978, even though this will result in two differing dollar limitations applying during the same taxable year. The retention of this "dual limitation" approach for taxable years beginning in 1978 is necessary to prevent certain taxpayers who relied on the effective date for the increased loss treatment amount from being disadvantaged.

Explanation of provision

This bill amends the effective date of the provisions relating to the limitations on the amount of loss on section 1244 stock which may be treated as an ordinary loss by providing that the amendments relating to the ordinary loss limitations for individuals are applicable to taxable years beginning after December 31, 1978, whether or not the stock was issued before or after the effective date of the Act.

The bill also provides that, for taxable years beginning before December 31, 1978, the increased dollar limitations apply only with respect to losses on section 1244 stock issued after November 6, 1978. The application of the dollar limitation rules with respect to taxable years beginning before December 31, 1978, may be illustrated by the following example. Assume that an individual who reports income on a calendar year basis and files a joint return with his spouse has two blocks of section 1244 stock which became worthless in December of 1978. One block was acquired for $60,000 in cash on January 15, 1978. The other block of stock was acquired for $40,000 in cash on November 7, 1978. Since the first block of stock was issued prior to November 7, 1978, the individual may treat $50,000 of the loss on the first block of stock as an ordinary loss. The individual may also treat the entire $40,000 of loss on the second block of stock as an ordinary loss.

Effective date

The effective date of this provision is discussed in *Explanation of provision,* above.

c. Clarification of the club dues limitation on the nondeductibility of entertainment facility expenses (secs. 103(a)(10)(A) and (B) of the bill and sec. 274(a)(2)(C) of the Code)

Present law

Prior to the Revenue Act of 1978, expenses incurred with respect to entertainment facilities were deductible if they were ordinary and necessary, the facility was used primarily for the furtherance of the taxpayer's business (i.e., more than 50 percent of the time that it was used), and the expense in question was related directly to the active conduct of the taxpayer's business. For this purpose, entertainment facility expenses included dues or fees to any social, athletic, or sporting club or organization.

The Act provided generally that no deduction was allowable for any entertainment facility expense. However, the Act provided an exception from this disallowance rule for country club dues.

Reasons for change

The committee believes that the provisions of the 1978 Revenue Act which relate to the nondeductibility of entertainment facility [60] expenses should be clarified to conform to the intent of the conferees that the exception apply to other club dues.

Explanation of provision

The bill clarifies the exception from the facility expense deduction disallowance rule provided in the 1978 Revenue Act so that the exception for country club dues which meet the business use test also would apply to all social, athletic, and sporting club dues or fees which satisfy that test.

Effective date

The provision applies to items paid or incurred after December 31, 1978, in taxable years ending after that date.

d. Clarification of the limitation on the deductibility of certain entertainment facility expenses includible in income of persons who are not employees (sec. 103(a)(10)(C) of the bill and sec. 274(e) of the Code)

Present law

Prior to the enactment of the Revenue Act of 1978, expenses incurred with respect to entertainment facilities[1] were deductible if they were ordinary and necessary, the facility was used primarily for the furtherance of the taxpayer's business (i.e., more than 50 percent of the time that it was used), and the expense in question was related directly to the active conduct of the taxpayer's business. For this purpose, entertainment facility expenses included dues or fees paid to any social, athletic, or sporting club or organization. Dues or fees paid to professional associations, civic organizations, or to clubs operated solely to provide meals under circumstances normally considered to be conducive to business discussions generally were not considered to be entertainment facility expenses.

In determining whether an entertainment facility was used primarily for business purposes, all the taxpayer's ordinary and necessary business use of the facility was taken into account. Once it was determined that the facility was used primarily for business, the portion of the expenses which were related directly to the active conduct of the taxpayer's business could be deducted.

The Revenue Act of 1978 provided generally that no deduction was allowable for any entertainment facility expense. However, the Act retained a number of exceptions to the general rule that existed under prior law. One of these relates to expenses treated as employee compensation (sec. 274(e)(3)). Under this exception, expenses for goods, services, and facilities are not subject to the disallowance rules to the extent that the expenses are treated by the taxpayer, with respect to the recipient of the entertainment, as compensation to an employee on the taxpayer's return and as wages to the employee for purposes of income tax withholding. Thus, in the case of facility expenses which satisfy this exception, the Act retained the rules of prior law which formerly had applied to expenses treated as employee compensation.

[61] *Reasons for change*

It has come to the attention of the committee that there are situations where a manufacturing company promotes the sales of its products through sales incentive awards with salesmen who are not its employees and, consequently, would not come within the exception for facilities provided to employees. In several cases, the sales incentive award is arranged by another corporation on behalf of the manufacturing company. In both these cases, the amount of the award is includible in the gross income of the recipient of the award. The committee believes that the facilities rule should not apply to expenses incurred in connection with these types of sales incentive award plans where the recipient is required to include an amount in income.

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[1] An entertainment facility generally is any item of personal or real property owned, rented, or used by a taxpayer during the taxable year for, or in connection with, an activity normally considered to be of an entertainment nature.

Explanation of provision

The bill provides that disallowance of expenses for entertainment, amusement, or recreation expenses (Code Sec. 274(a)) does not apply to expenses which are includible in the gross income of the recipient of the entertainment, amusement, or recreation as compensation for services or as a prize or award under section 74 of the Code. This exception would not apply to a payor where the amounts paid are required to be furnished by the payor to the payee on information returns (Form 1099) but are not furnished by the payor.

For example, where a manufacturer provides entertainment facilities to one or more of the employees of its dealers as an incentive award and the right to use the facilities to its dealers who in turn award them to certain employees, the manufacturer will not be subject to these limitations if the value of the entertainment facilities are includible in income of the dealer and the manufacturer companies with any required information reporting. Further, the limitations will not apply to the dealer for any amount if the employee is required to include that amount in his income and the dealer complies with the applicable information reporting requirements. Of course, the rules limiting deductions for entertainment, etc., facilities continue to apply to the individual involved to determine the extent to which he is entitled to deduct the entertainment expenses.

The exemption for items includible in income as compensation for services or as a prize or award is not intended to permit entertainment facilities maintained by the taxpayer to be used for entertainment of its customers, suppliers, executives, or guests.

Effect date

The amendment is effective for expenditures paid or incurred after December 31, 1978, in taxable years ending after that date.

e. Amendments relating to deficiency dividend procedure for REITs (sec. 103(a)(11) of the bill and sec. 860 of the Code)

The bill makes three clerical amendments to the provisions relating to the deficiency dividend procedures for real estate investment trusts and regulated investment companies (Code sec. 860).

First, the bill corrects a cross reference in the effective date of the provision in the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1].

[62] Second, the bill corrects the spelling of the word "deficiency" in the heading to section 860 (f) of the Code.

Finally, the bill adds a parenthesis that was deleted in section 860(f)(2)(A) of the Code.

f. Clarification of treatment of liabilities of controlled corporation (sec. 103(a)(12) of the bill and sec. 357(c)(3) of the Code)

Present law

The Revenue Act of 1978 provided that where a cash basis taxpayer transfers property to a controlled corporation subject to certain liabilities, an "account payable" which would give rise to a deduction is not considered a liability for purposes of determining the amount of gain recognized by the transferor on the transfer. The legislative history indicates that a taxpayer could qualify under this provision where he was using a cash method or a hybrid cash method of accounting. The legislative history also indicates that an "account payable" would include a trade account payable and other liabilities (e.g., interest and taxes) which relate to the transferred trade or business.

Reasons for change

The committee believes that this provision of the 1978 Act should be clarified in order to clearly reflect the intent of Congress as indicated in the legislative history of the provision.

Explanation of provision

The bill deletes the requirement that only taxpayers who compute taxable income under the cash receipts and disbursements method of accounting are eligible to exclude certain liabilities in determining the amount of gain recognized on a transfer to a controlled corporation. The bill also deletes the requirement that the excluded liability must be an account payable.

As a result of these changes, in determining (for purposes of sections 357(c) and 358(d)) the amount of liabilities assumed, or to which the property transferred is subject, in a transfer qualifying under section 351, the amount of certain liabilities are excluded for a transferor. Liabilities excluded under this provision are those liabilities the payment of which by the transferor would give rise to a deduction and those liabilities the payment with respect to which would be described in section 736(a) of the Code.

In general, liabilities the payment of which would give rise to a deduction include trade accounts payable and other liabilities (e.g., interest and taxes) which relate to the transferred trade or business. However, such liabilities may be excluded under this provision only to the extent payment thereof by the transferor would have given rise to a deduction. A liability would not be excluded under this provision to the extent the liability has already been deducted by the transferor. In addition, a liability would not be excluded under this provision to the extent that the incurrence thereof resulted in the creation of, or increase in, the basis of any property.

Effective date

The provision applies to transfers after November 6, 1978.

[63] g. Application of withholding tax to medical reimbursements (sec. 103(a)(13)(A) of the bill and sec. 3041(a)(20) of the Code)

Present law

Prior to the Revenue Act of 1978, medical reimbursements paid to, or on behalf of, an employee under a self-insured medical reimbursement plan of an employer generally were excluded from the employee's gross income and were not subject to withholding tax. Under the Act, such payments may be fully or partly includible in an employee's gross income for a year if the medical reimbursement plan discriminates in favor of highly compensated individuals for the year, and such payments are subject to withholding tax if they are includible.

Reasons for change

In some cases, it may not be possible to make a determination under the medical reimbursement plan rules as to the amount which is includible in gross income until after the year has ended. Consequently, the committee concluded that it is inappropriate for these amounts to be subject to withholding tax.

Explanation of provision

The bill provides an exclusion from withholding tax for amounts paid under a self-insured medical reimbursement plan for an employee. The bill also corrects a clerical error by redesignating one of two paragraphs numbered (18) of Code section 3401 (a) as paragraph (19). (The House bill provides an exclusion from withholding tax where it is reasonable to believe that a reimbursement will be excludible from the employee's gross income under section 105.)

Effective date

The amendment applies to amounts reimbursed after December 31, 1979.

h. Clarification of nondiscriminatory eligibility classification for medical reimbursement plans (sec. 103(a) (13)(B) of the bill and sec. 105(h) (3)(A) of the Code)

Present law

Prior to the Revenue Act of 1978, self-insured medical reimbursement plans were not subject to statutory nondiscrimination rules. Under the Act, nondiscrimination rules regarding eligibility were added.

Reasons for change

The 1978 Act was not clear as to whether the group in whose favor discrimination as to eligibility for participation was prohibited consists of all highly compensated individuals employed by an employer or of only those who are plan participants.

Explanation of provision

The bill clarifies that the nondiscrimination rule regarding eligibility for self-insured medical reimbursement plans takes into account all highly compensated individuals employed by the employer.

[64] *Effective date*

This provision applies to payments made after December 31, 1979.

i. Clarification of excess reimbursement test under medical reimbursement plans (sec. 103(a)(13)(C) of the bill and sec. 105(h)(7)(A) of the Code)

Present law

Prior to the Revenue Act of 1978, medical reimbursements paid to, or on behalf of, an employee under a self-insured medical reimbursement plan of an employer generally were excluded from the employee's gross income. Under the Act, such payments may be fully or partly includible in an employee's gross income for a year if the medical reimbursement plan discriminates in favor of highly compensated individuals for that year.

Reasons for change

Under the 1978 Act, the discrimination tests for measuring the amount of reimbursements under a particular benefit are not the same as the tests for determining whether that particular benefit is discriminatory.

Explanation of provision

The bill conforms the rules for measuring excess reimbursements under a self-insured medical reimbursement plan to the rules prohibiting discrimination in favor of highly compensated individuals under such plans.

Effective date

This provision applies to payments made after December 31, 1979.

j. Clarification of effective date for medical reimbursement plans (sec. 103(a)(13)(D) of the bill and sec. 366(b) of the Act)

Present law

Under the rules provided by the Revenue Act of 1978 for medical reimbursement plans, excess reimbursements made during a plan year are includable in the gross income of a highly compensated individual for the taxable year in which (or with which) the plan year ends.

Reasons for change

Because the rules apply for taxable years beginning after December 31, 1979, excess reimbursements made during 1979, in a plan year beginning after January 1, 1979, and ending after December 31, 1979, will be includable in the 1980 gross income of a highly compensated individual whose taxable year is the calendar year.

Explanation of provision

The bill provides that the medical reimbursement plan rules apply only to reimbursements paid after December 31, 1979. Under the bill, reimbursements made before January 1, 1980 will not be taken into account under the rules for medical reimbursement plans for any purpose. (Under the House bill, payments made during 1979, in a plan year ending in 1980, would be excludible from gross income but would be taken into account in determining whether the plan met the nondiscrimination rules for the plan year.)

[65] *Effective date*

This provision is effective as if it had been included in section 366 of the 1978 Act.

k. Clerical amendments to other provisions primarily affecting business income tax (secs. 103(a)(14), (15), and (16) of the bill and secs. 172(b)(1), 374(e)(1)(A), and 466(e)(2)(B) of the Code)

The following clerical amendments to provisions affected by Title III of the Revenue Act of 1978 are made:

1) An amendment to section 374 (e)(1)(A)(iv) to correct the trans-

position of numbers in the date "1967" to read "1976" is made.

(A) A correct reference to the subparagraph of section 172 being amended by section 371 of the Act is made to coordinate with the redesignation of that subparagraph by section 703(p)(4) of the Revenue Act of 1978.

(3) The word "years" is corrected to read "year" in section 466(e)(2)(B).

[66] 9. Technical Amendments Relating to Capital Gains, the Minimum Tax, and the Maximum Tax

a. Clerical amendments relating to capital gains tax changes (secs. 104(a)(1), (3)(C), and (3)(D) of the bill, secs. 593(b)(2)(E)(vi), 877b, and 904b(3) of the Code and sec. 403(c)(4)(B) of the act)

The following clerical and conforming amendments to the capital gains provisions are made:

(1) A clerical amendment to section 877(b) is made to omit the reference to section 1201(b) which was repealed by the Revenue Act.

(2) Section 593(b)(2)(E)(iv) is amended to insert the fraction "18/46" in lieu of "3/8" to reflect the new capital gains and corporate tax rates.

(3) Subparagraph (E) of section 904(b)(3) added by section 403 of the Revenue Act of 1978 is redesignated as (F).

(4) The instructional paragraph of section 403(c)(4)(B) of the Act is corrected.

b. Clarification of the effective date of the increased capital gains deduction (sec. 104(a)(2)(A) of the bill and sec. 1202(c) of the Code)

Present law

The Revenue Act of 1978 increased the capital gains deduction from 50 to 60 percent of the gain effective for sales or exchanges after October 31, 1978. The Act, however, was unclear as to the amount of the deduction which was to be allowed in the case of post-effective date receipts of payments attributable to pre-effective date transactions, such as installment sales.

Reasons for change

The committee believes that the provisions of the 1978 Act should be clarified as to the amount of the capital gains deduction which is allowed in the case of amounts properly taken into account by the taxpayer after October 31, 1978, where the sale or exchange occurred on or before that date.

Explanation of provision

The bill clarifies that the increased capital gain deduction applies to all amounts properly taken into account by the taxpayer after October 31, 1978.

Effective date

This provision is effective for taxable years ending after October 31, 1978.

[67] c. Clarification of the alternative tax for noncorporate capital gains (sec. 104(a)(2)(B) of the bill and sec. 1201 of the Code)

Present law

Prior to the Revenue Act of 1978, a noncorporate taxpayer generally deducted from gross income 50 percent of any net capital gain, and the balance of the gain was taxed at the regularly applicable ordinary income rates. However, a partial alternative tax of 25 percent on the first $50,000 of net capital gain could apply, in lieu of taxing 50 percent of the gain at the regular rates, if it resulted in a lower tax than that which was produced by the regular method.

The Act repealed the noncorporate alternative tax for taxable years beginning after December 31, 1978. However, the Act inadvertently failed to conform the computation of each partial tax (for periods prior to its repeal) to reflect the increase in the capital gains deduction.

Reasons for change

The committee believes that the computation of each partial tax of the noncorporate alternative tax (for periods prior to its repeal) should be conformed to reflect the increase in the capital gains deduction.

Explanation of provision

The bill conforms the calculation of the alternative tax to reflect the Act's increase in the capital gains deduction.

Effective date

This provision applies to taxable years beginning before January 1, 1979.

d. Clarification of the application of the effective date of the capital gains changes to amounts received from certain conduit entities (sec. 104(a)(2)(C) of the bill and secs. 1201(c)(2) and 1202(c)(1) of the Code)

Present law

The Revenue Act of 1978 increased the net capital gains deduction for noncorporate taxpayers from 50 to 60 percent and decreased the corporate alternative tax rate from 30 to 28 percent. The former provision was effective with respect to post-October 31, 1978, gains and losses, and the latter provision was effective for post-December 31, 1978, gains and losses. However, the Act was unclear as to the applicability of these provisions to the capital gains of certain conduits whose income is taxed to another party where the date that the gains are includible in income by such other party is on or after the Act's effective date.

Reasons for change

The committee believes that the application of the provisions of the 1978 Act which relate to the effective dates of the capital gains changes should be clarified for cases where the capital gains of certain conduits are taxed to another.

Explanation of provision

This bill provides that, in applying the increased capital gains deduction or the reduced corporate alternative tax rate, the determination of the period for which gain or loss is properly taken into account [68] must be made at the entity level. Therefore, in the case of pass-through entities, the proper capital gains deduction of an individual will be determined with reference to the time when those gains were taken into account by an entity rather than when a distribution was made, or was deemed to be made, by the entity to that individual. For purposes of applying this rule, "pass-through entities" are regulated investment companies, real estate investment trusts, electing small business corporations, partnerships, estates, trusts, and common trust funds. This entity level determination would apply to taxable years of the recipient beginning before November 1, 1979 (or January 1, 1980, in the case of a corporation).

Effective date

This provision generally applies to taxable years of the recipient which begin before November 1, 1979 (or January 1, 1980, in the case of a corporation).

e. Clarification of the effective date of the reduced corporate alternative capital gains rate (sec. 104(a)(3)(A) of the bill and sec. 1201(c) of the Code)

Present law

The Revenue Act of 1978 reduced the corporate alternative tax rate for capital gains from 30 to 28 percent effective for sales or exchanges after December 31, 1978. The Act, however, was unclear as to the rate which was to apply in the case of post-effective date receipts of payments attributable to pre-effective date transactions, such as installment sales.

Reasons for change

The committee believes that the provisions of the 1978 Act should be clarified as to the application of the reduced corporate alternative capital gains rate in the case of amounts properly taken into account by the taxpayer after December 31, 1978, where the sale or exchange occurred on or before that date.

Explanation of provision

The bill clarifies that the reduced rate applies to all amounts properly taken into account by a corporate taxpayer after December 31, 1978.

Effective date

This provision is effective for taxable years ending after December 31, 1978.

f. Undistributed capital gains of regulated investment companies (sec. 104(a)(3)(B) of the bill and sec. 852(b) of the Code)

The bill conforms the basis adjustment rules for shareholders of certain regulated investment companies with undistributed capital gains to reflect the decreased corporate alternative tax on capital gains from 30 percent to 28 percent.

g. Clarification that carryovers may not reduce alternative minimum taxable income (sec. 104(a)(4)(A) of the bill and sec. 55(b)(1) of the Code)

Present law

The Revenue Act of 1978 imposed an alternative minimum tax which is payable by an individual to the extent the gross alternative [69] tax exceeds the regular tax as increased by the "add on" minimum tax. The alternative minimum tax base is generally the sum of an individual's gross income, adjusted itemized deductions, and capital gains, reduced by deductions allowed for the taxable year. In certain circumstances, it is possible that a deduction may reduce the alternative minimum taxable income base for a taxable year and still be available as a carryback or carryover to reduce taxable income in another taxable year.

Reasons for change

The committee believes that a deduction should not be used both to reduce the alternative minimum tax in the current year and be available as a carryover to reduce the taxpayer's tax for another taxable year.

Explanation of provision

The bill denies the use of a deduction against the alternative minimum taxable income base to the extent the deduction is available as a carryover or carryback to another taxable year.[1]

Effective date

The amendment made by this provision applies to taxable years beginning after December 31, 1978.

h. Foreign tax credit allowable against alternative minimum tax (secs. 104(a)(4)(B) and (C) of the bill and sec. 55(c) of the Code)

Present law

The Revenue Act of 1978 imposed an alternative minimum tax but allowed a foreign tax credit against the tax. In general, the regular foreign tax credit rules are applied. However, in determining the allowable credit, the foreign tax credit limitation is to be computed separately on the basis of alternative minimum taxable income. In addition, a number of adjustments are made to the credit rules to take into account the interactions between the alternative minimum tax and the regular tax.

Reasons for change

The committee believes that the rules for computing the foreign tax credit allowable against the alternative minimum tax should be clarified.

Explanation of provision

The bill would revise the foreign tax credit rules applicable to the alternative minimum tax to provide greater clarity, but no substantive changes are made. The bill would make it explicit that the credit may not exceed the amount of the alternative minimum tax. In addition, the definition of alternative minimum taxable income from sources without the United States would be revised to define more clearly the adjustments to be made to gross income.

[70] *Effective date*

The amendments made by this provision are effective for taxable years beginning after 1978.

i. Clarification of alternative minimum taxable income to taxpayers not itemizing deductions (sec. 104(a)(4)(D) of the bill and sec. 55(b) of the Code)

Present law

The Revenue Act of 1978 imposed

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[1] This rule is not applicable to the capital gains deduction under section 1202 since that deduction is not taken into account in determining a net operating loss deduction under section 172.

an alternative minimum tax which is payable by an individual to the extent the gross alternative minimum tax exceeds the regular tax as increased by the "add on" minimum tax. The alternative minimum tax base is generally the sum of an individual's gross income, adjusted itemized deductions, and capital gains preference item reduced by deductions allowed for the taxable year.

In the case of a taxpayer who does not elect to itemize deductions, no itemized deductions are allowed for the taxable year. In computing the regular income tax, a bracket is included in the tax tables to provide the taxpayer the benefit of a "standard deduction." No comparable provision is included in the computation of the alternative minimum tax.

Reasons for change

The committee believes that a taxpayer who does not itemize deductions should have the benefit of the "standard deduction" in computing the alternative minimum tax.

Explanation of provision

The bill provides that a taxpayer who does not elect to itemize deductions will be entitled to a deduction equal to the zero bracket amount (formerly the "standard deduction") in computing the alternative minimum tax.

Effective date

The amendment made by this provision applies to taxable years beginning after December 31, 1978.

j. Exclusion of foreign taxes as an adjusted itemized deduction for purposes of the alternative minimum tax (sec. 104(a)(4)(E) of the bill and sec. 57(b) of the Code)

Present law

The Revenue Act of 1978 added a provision that, for purposes of computing the tax preference for "adjusted itemized deductions" under the alternative minimum tax, deductible State and local taxes, in effect, are treated as an "above the line" deduction. No corresponding provision was made in the case of deductible foreign taxes, although the Act provided that the foreign tax credit is allowable against the alternative minimum tax.

Reasons for change

The committee believes that deductible foreign taxes should be treated in the same manner as State and local taxes for purposes of computing the tax preference for adjusted itemized deductions.

Explanation of provision

The bill clarifies that deductible foreign taxes are treated in the same manner as State and local taxes in computing the tax preference for adjusted itemized deductions.

[71] *Effective date*

The amendment made by this provision applies to taxable years beginning after December 31, 1978.

k. Adjusted itemized deductions of estate or trust and the alternative minimum tax (sec. 104(a)(4)(F) of the bill and sec. 57(b)(2)(A) of the Code)

Present law

The Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1] broadened the minimum tax on preferences to include a preference for adjusted itemized deductions. The Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1] made the preference for adjusted itemized deductions subject to the new alternative minimum tax and clarified the application of the adjusted itemized deduction preference to trusts and estates. Generally, the preference for adjusted itemized deductions is equal to the amount by which itemized deductions exceed 60 percent of adjusted gross income. In the case of estates and trusts, the preference is the amount by which all deductions other than deductions allowable in arriving at adjusted gross income and certain other deductions exceed 60 percent of the estate's or trust's adjusted gross income reduced by all deductions. However, under the Act, deductions allowable in arriving at adjusted gross income were subtracted twice. In addition, unlike an (other than who is not a trust or estate), the personal exemption of a trust or estate does reduce the amount of adjusted gross income.

Reasons for change

The Revenue Act inadvertently reduced the income of an estate or trust twice by the taxpayer's "above the line" deductions in computing adjusted itemized deductions. Moreover, the personal exemption of a trust or estate should be treated the same as an individual.

Explanation of provision

The bill modifies the computation of the preference for adjusted itemized deductions of a trust or estate to clarifying that deductions allowable in arriving at adjusted gross income are taken into account only once. In addition, your committee adds to the House-passed bill an amendment which provides that the personal exemption of a trust or estate does not reduce the adjusted gross income of the trust or estate for purposes of computing the preference for adjusted itemized deductions of the trust or estate.

Effective date

The amendment made by this provision applies to taxable years beginning after December 31, 1978.

l. Carryover of residential energy credit in connection with alternative minimum tax (sec. 104(a)(4)(G) of the bill and sec. 55(c)(3) of the Code)

Present law

The Revenue Act of 1978 imposed a new alternative minimum tax. Generally, credits are not allowed against the alternative minimum tax. However, the Act contained special rules that would allow the carryover of the jobs credit, the work incentive credit, and the investment credit that otherwise would have been lost because of the alter- [72] native minimum tax. No comparable rule was provided for the residential energy credit.

Reasons for change

The committee believes that the residential energy credit carryover should not be lost because of the alternative minimum tax.

Explanation of provision

The bill provides a rule similar to the rules applicable to the jobs, work incentive, and investment credits for the residential energy credit that will allow the carryover of the residential energy credit where the taxpayer is subject to the alternative minimum tax.

Effective date

The amendment made by this provision applies to taxable years beginning after December 31, 1978.

m. Clerical amendments relating to the alternative minimum tax (sec. 104(a)(4)(H) of the bill and secs. 5, 55, 443, 453, 666, 871, and 877 of the Code)

The following is an explanation of the clerical amendments regarding the alternative minimum tax:

(*1*) *Amendment to section 5.*—A cross reference in section 5 to the minimum tax is corrected.

(*2*) *Amendment to section 55(a).*—An amendment is made to properly space the final clause of the sentence.

(*3*) *Amendment to section 55(b).*—The definition of "regular tax" is amended to exclude the penalty tax on early redemption of retirement bonds to conform to the treatment of the penalty tax on I.R.A. distributions.

(*4*) *Amendment of section 55(c)(3).*—A cross reference to section 53(b) is corrected.

(*5*) *Amendment of section 443(d).*—Section 443(a)(2) is amended to provide that the annualization of the $10,000 minimum tax exemption applies to all taxpayers.

(*6*) *Amendment of section 453(c).*—The application of section 453(c) is clarified by providing that the computation of the adjustment is made without regard to the alternative minimum tax, as well as the add-on minimum tax.

(*7*) *Amendments to section 871 and 877.*—A clerical amendment is made by deleting the word "section" before "55".

(*8*) *Amendment of section 666(c).*—Section 666(c) relating to the treatment of accumulation distributions from trusts is amended to conform to the rule adopted in section 666(b).

n. Clarification of the treatment of post-October 1978 capital gains for purposes of the maximum tax (sec. 104(a)(5) of the bill, sec. 1348 of the Code, and sec. 441(b)(2) of the Act)

Present law

Prior to the Revenue Act of 1978, the amount of personal service income eligible for the 50 percent maximum tax rate was reduced dollar-for-dollar by an individual's items of tax-preference, including capital gains, for the year. The Act increased the net capital gains deduction from 50 to 60 percent, and provided that post-effective date [73] capital gains would not reduce the amount of personal service income eligible for the 50 percent maximum tax rate. These changes were effective for sales or exchanges after October 31, 1978. However, it was possible that in certain situations, gains after October 31, 1978, would reduce the amount eligible for the 50 percent maximum tax rate.

Reasons for change

The committee believes that the provisions of the 1978 Act should be clarified so that post-October 31, 1978 gains do not reduce the amount of personal service income eligible for the 50 percent maximum tax rate.

Explanation of provision

In the case of taxable years beginning before November 1, and ending after October 31, 1978, the bill clarifies that the amount of personal service income which is eligible for the 50 percent maximum tax rate is to be reduced only by 50 percent of the lesser of: (1) the net capital gain for the taxable year or (2) the net capital gain taking into account only gain or loss properly taken into account for the portion of the taxable year before November 1, 1978.[1]

Effective date

This provision is effective for taxable years beginning before November 31, 1978, and ending after October 31, 1978.

[74] 10. Technical Amendments Relating to Other Tax Provisions

a. Power of the Chief Judge of the Tax Court to assign small tax cases to commissioners (sec. 105(a)(1) of the bill and secs. 7456(c) and 7463(g) of the Code)

Present law

Under section 7456(c) of the Code, the chief judge of the Tax Court may assign declaratory judgment proceedings to be heard by commissioners of the court and authorize a commissioner to make the decision of the court with respect to such proceedings. In addition, under section 7463(g) of the Code, the chief judge may assign tax controversies involving a deficiency of $5,000 or less to be heard by commissioners of the court and authorize a commissioner to make the decision of the court with respect to such proceedings.

Reasons for change

The committee believes that, in order to avoid duplication in the provisions of the Code, a single provision should be utilized to empower the chief judge of the Tax Court to assign various types of proceedings to the commissioners.

Explanation of provision

The bill would repeal the specific provision granting the chief judge the power to assign small tax cases to commissioners. In place of this provision, the bill would add "small tax cases" to the types of proceedings the chief judge may assign to commissioners.

Effective date

The provision is effective on the date of enactment.

b. Refund adjustments for amounts held under claim of right (sec. 105

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[1] This bill also amends section 441 of the Revenue Act of 1978 by striking out "subparagraph (B)".

(a)(2) of the bill and sec. 6411(d)(2) of the Code)

Present law

If a taxpayer receives income under a claim of right and restores it in a later year, he may, under a special method for computing his tax liability (Code sec. 1341(b)(1)) be treated as having made an overpayment of tax on the last day prescribed by law for payment of tax for the year the income is restored. The Revenue Act of 1978 establishes an expedited procedure for a tentative refund of the overpayment. This procedure is similar to that in effect prior to the 1978 Act for tentative refunds resulting from net operating loss carrybacks.

Reasons for change

Under the 1978 Act, the time within which the Treasury must act on the tentative refund application is unclear. Also, the extent to which the Treasury is to follow procedures similar to those applied to applications for tentative refunds resulting from net operating loss carrybacks is unclear.

[75] *Explanation of provision*

The bill clarifies that the Treasury generally is to act on the tentative refund application within a period of 90 days from the date on which the application is filed or from the date of the overpayment (determined under section 1341(b)(1), whichever is later. The date of the overpayment is the last day prescribed by law for the payment of tax for the year in which a deduction is allowed for the restoration of income held under a claim of right.

It is also made clear that the Treasury, within the time period prescribed above and in a manner similar to the procedure provided for tentative refund of net operating loss carrybacks, is to (i) review the application, (ii) determine the amount of the overpayment, and (iii) apply, credit, or refund the overpayment. It is thus made clear that the requirement of similarity to tentative refunds of net operating loss carrybacks applies to all three of these actions by Treasury, and not merely the third.

Effective date

The provision is effective with respect to tentative refund claims filed on and after November 6, 1978.

c. Reduction of estate tax value of jointly held property where spouse of decedent materially participated in farm or other business (sec. 105(a)(3)(A) of the bill and sec. 2040(c)(2) of the Code)

Present law

The Revenue Act of 1978 contained a provision (Code sec. 2040(c)) which permitted the efforts of a decedent's spouse to be taken into account in determining the amount of jointly held property used in a farm or other business included in the decedent's gross estate. Generally, under this provision, the value of the gross estate could be reduced (1) by the adjusted consideration of the spouse and (2) by 2 percent of the excess of the value of the property over the total adjusted consideration provided by both spouses for each year that the decedent's spouse materially participated in the operation of the farm or other business in which the property was used. The adjusted consideration is the consideration furnished by a spouse plus interest computed at 6 percent per year from the date the consideration was furnished until the date of the decedent's death.

Reasons for change

Under this formula, it was possible that less than the decedent's adjusted consideration, or the portion of the value attributable to the decedent's adjusted consideration, would be included in the decedent's gross estate where the total appreciation in the property was less than the assumed 6 percent increase in the original consideration.

Explanation of provision

The bill would correct this result by providing that the special rule would not apply if the sum of the adjusted consideration provided by both spouses equals or exceeds the value of the property on the date of the decedent's death.

[76] *Effective date*

This provision is effective for estates of decedents dying after December 31, 1978.

d. Clerical amendment relating to jointly held property (sec. 105(a)(3)(B) of the bill and sec. 2040(c) of the Code)

As a clerical amendment, the bill amends paragraph (1) of section 2040(c) by correcting a plural reference to "subsection (a)" to a singular reference.

e. Clerical amendments relating to time to amend governing instruments of split interest trusts (sec. 105(a)(4)(A) of the bill and sec. 2055(e)(3) of the Code)

The bill makes two clerical amendments to the provision permitting amendment of governing instruments of split interest charitable trusts (Code sec. 2055(e)(3)).

First, the bill corrects the cross reference to subparagraph (A) of section 2055(e)(2) of the Code by capitalizing the letter "A".

Second, the bill adds the article "the" which was erroneously deleted.

f. Amending governing instruments of charitable split interest trusts (sec. 105(a)(4)(B) of the bill and sec. 514 of the Revenue Act of 1978)

Present law

The Tax Reform Act of 1969 [Pub. L. 91-172, 1969-3 C.B. 10] denied an estate tax, gift tax or income tax charitable deduction for the value of a remainder interest passing to charity unless the remainder interest is in a charitable remainder unitrust, charitable remainder annuity trust, or a pooled income fund. In the case of an income interest passing to charity (i.e., a lead trust), a deduction was denied unless the income interest is in the form of a guaranteed annuity or a fixed percentage of the fair market value of the trust (determined annually).

Legislation in 1974 granted a reformation period until December 31, 1975 to redraft wills and other testamentary instruments to conform to the new rules for the estate tax deduction for charitable remainders. The reformation period was extended through December 31, 1977 by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1].

The Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1] extended, through December 31, 1978, the reformation period for purposes of the estate tax charitable deduction for charitable remainders. The 1978 Act also provided a reformation period through December 31, 1978, for purposes of the income and gift tax charitable deductions in the case of charitable remainders and for purposes of the estate, income and gift tax charitable deductions for charitable lead trusts. The 1974 and 1976 legislation was made effective with respect to estates of decedents dying after December 31, 1969. In 1978, a similar effective date provision was omitted.

Reasons for change

The committee believes that reformation of charitable lead trusts and charitable remainder trusts in order to comply with the requirements of the Tax Reform Act of 1969 should be effective for Federal income, gift and estate tax purposes so long as the reformation is done before the deadline for reformations. While the committee believes it [77] appropriate to allow reformation of trusts to which the requirements of the Tax Reform Act of 1969 apply, it does not believe that the period of limitations should be waived for this purpose.

Explanation of provision

The bill provides that the amendment made by section 514 of the Revenue Act of 1978 applies to transfers in trust and contributions made after July 31, 1969, for Federal income tax purposes; to decedents dying after December 31, 1969, for Federal estate tax purposes; and to transfers after December 31, 1969, for Federal gift tax purposes.

Effective date

The amendment is effective as if it were included in the Revenue Act of 1978.

g. Distribution from estate prior to 1980 of farm valuation property (sec. 105(a)(5) of the bill and sec. 1040 of the Code)

Present law

Under present law, the distribution of property by an estate or trust in satisfaction of a pecuniary bequest is treated as a taxable transaction resulting in the recognition of gain or loss to the estate or trust.

The Revenue Act of 1978 added a provision to clarify that where property is subject to special farm or other business use valuation, the tax will be measured by the difference between the fair market value of the property on the date of distribution (determined without regard to special use valuation) and the fair market value of the property on the date of the decedent's death (also determined without regard to special use valuation). However, the postponement of the carryover basis provisions until 1980 inadvertently resulted in a postponement of this provision.

Reasons for change

The committee wishes to correct the inadvertent postponement of the effective date of the provision added by the Revenue Act clarifying the income tax treatment of the distribution of special use valuation property to satisfy a pecuniary bequest.

Explanation of provision

The bill clarifies that the provision added by the 1978 Act concerning the distribution of special use valuation property in satisfaction of a pecuniary bequest is effective for estates of decedents dying after December 31, 1976.

Effective date

The amendment made by this provision applies to estates of decedents dying after December 31, 1976.

h. Clarification of tax treatment of cooperative housing corporations where stock is acquired in a tax-free transaction or by an estate (sec. 105(a)(6) of the bill and sec. 216(b)(6) of the Code)

Present law

A tenant-stockholder in a cooperative housing corporation is entitled to deduct amounts paid to such a corporation to the extent such [78] amounts represent his or her proportionate share of allowable real estate taxes and interest relating to the corporation's land and buildings (Code sec. 216). In general, for a corporation to qualify as a cooperative housing corporation (which can pass through these deductions to tenants-shareholders), 80 percent or more of the gross income of the cooperative housing corporation must be derived from individual tenant-stockholders.

Under the Revenue Act of 1978, if a person who conveys a house, apartment-housing, or leasehold thereof, to a cooperative housing corporation acquires stock in the corporation by *purchase* or foreclosure, together with a lease or right to occupy the house or apartment, such person would be treated as a tenant-stockholder for up to three years from the date of acquisition (even if such person were not an individual).

Reasons for change

The general intent of this 1978 change was to allow corporate promoters to form cooperative housing corporations and to own the shares in such corporations during a reasonable period while the shares were being sold to individuals who would qualify as tenant-stockholders under the general rules of section 216 of the Code. The requirement that the stock be acquired "by purchase or foreclosure" may well be interpreted as not being satisfied in situations where the corporate promoter acquires the stock in a tax-free transaction (such as a transfer to a controlled corporation pursuant to the provisions of section 351 of the Code). Also, if an individual has conveyed a house, apartment building, or leasehold thereof, to a cooperative housing corporation in exchange for stock, such an individual would be treated as a tenant-stockholder, but it is not clear that his estate would be treated as a tenant-stockholder if the individual dies after acquiring such stock.

Explanation of provision

The bill amends the provisions added by the 1978 Act to provide that, if an original seller (e.g., a corporate promoter) acquires stock of a cooperative housing corporation either from the corporation or by foreclosure, the original seller shall be treated as a tenant-stockholder for a period of not to exceed three years from the date of the acquisition of the stock. However, except in the case of an acquisition of stock of a cooperative housing corporation, by foreclosure, this rule only applies to stock acquired from the cooperative housing corporation which occurs not later than one year after the date on which the apartments or houses (or leaseholds therein) are transferred by the original seller to the corporation.

The bill also provides that, if an individual original seller dies, the estate of the individual will be treated as a tenant-stockholder for the same period as the individual would have been treated as a tenant-stockholder if he had lived.

The amendments made by these provisions are the same as those in the House bill except that the House bill does not contain the provision relating to the estate of an individual original seller.

[79] *Effective date*

These provisions apply to stock acquired after November 6, 1978. This is the same effective date as the modifications made to Code section 216 by section 531 of the Revenue Act of 1978.

i. Amendments relating to exclusion of certain cost-sharing payments (secs. 105(a)(7) (A) to (D) of the bill and secs. 126 and 1255 of the Code)

Present law

The Revenue Act of 1978 provided an exclusion from gross income for all or a portion of certain payments received under a number of Federal and State cost-sharing conservation programs. Under these provisions, no deduction or credit could be claimed with respect to amounts excluded under the Act, and the basis of any property acquired or improved with these payments would not reflect the excluded amounts. Also, under the Act, a special rule was provided for the recapture (that is, treatment as ordinary income rather than capital gains) of excluded amounts if the property, or improvements, purchased with the payments are disposed of before the expiration of 20 years.

Reasons for change

Since the provisions of the Act automatically apply to the excludible portion of all cost-sharing payments, there are some circumstances under which a taxpayer could be worse off under this provision than under prior law. Generally, this results from the fact that, under some circumstances, at least some of the payments received under certain of these programs are reimbursements for costs for which a current deduction would otherwise be allowable. Thus, under prior law, a taxpayer would have had a wash (that is, deductions offsetting income) and the recapture rule would not have applied to him. Under the provisions of the Act, such a taxpayer would have the same effect of a wash (by the exclusion of the income and the disallowance of any corresponding deduction) but would be subject to recapture. Also, there are certain other circumstances where, even though the amounts attributable to reimbursements under these cost-sharing programs were not currently deductible, the taxpayer might (by reason of the application of the investment credit, net operating loss limitations, etc.) be better off under prior law than under the exclusion rule.

Explanation of provision

The bill would provide that the exclusion for cost-sharing payments and the recapture provision do not apply to any portion of any payment which is properly attributable to an amount which is allowable as a deduction for the taxable year in which the amount is paid or incurred. The bill would also provide that, if a taxpayer makes an election, the exclusion provision and the recapture provision will not apply to the excludible portion of any government cost-sharing payment. Such an election would be made not later than the due date (including extensions) for filing the taxpayer's income tax return for the taxable year in which the payment was received or accrued.

[80] In addition, an amendment is made to the recapture provision (Code sec. 1255) to coordinate this provision with the other recapture provisions which could potentially result in ordinary income from the disposition of property acquired or improved with excluded cost-sharing payments.[1] (These provisions are section 1251 (relating to recapture of amounts in so-called "Excess Deduction Accounts") and section 1252 (relating to recapture of previously deducted soil and water conservation expenses or land clearing expenses).)

The bill also contains clerical amendments to the cost-sharing payments exclusion provision and the recapture provision. The clerical amendment to the exclusion provision adds the words "or his delegate" immediately after the words "Secretary of the Treasury" in section 126(a)(9), thus allowing the Secretary to delegate certain responsibilities. Section 1255 (b)(2) indicates that amounts treated as ordinary income under section 1255 are to be treated in the same manner as ordinary income resulting from depreciation recapture with respect to section 1245 property. A clerical amendment clarifies that this rule is to be applied for purposes of sections 163(d), 170(e), 341(e)(12), 453(d) (4)(B), and 751(c).

Effective date

These provisions apply to grants made after September 30, 1979. This is the same effective date as for the related provisions in the Revenue Act of 1978.

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[1] Under this amendment, the amount recaptured under this section cannot exceed the amount of gain realized on disposition of the property reduced by the sum of the amounts treated as ordinary income by reason of sections 1231 through 1254. For example, assume that a parcel of real property is sold at a gain of $100,000, that $40,000 of such gain is treated as ordinary income under section 1250, and that $75,000 in cost-sharing payments had been excluded from gross income under section 126 with respect to this property within the preceding 10 years. Under these circumstances, $60,000 would be recaptured under section 1255. However, if the amount treated as ordinary income under section 1250 were only $10,000, then the amount recaptured under section 1255 would be the full $75,000.

j. Application of exclusion for certain cost-sharing payments to certain local programs (sec. 105(a)(7)(E) of the bill and sec. 126(a)(10) of the Code)

Present law

The Revenue Act of 1978 generally provides that gross income does not include the excludible portion of payments received under the following programs:

(1) The rural clean water program authorized by section 208(j) of the Federal Water Pollution Control Act;

(2) The rural abandoned mine program authorization by section 406 of the Surface Mining Control and Reclamation Act of 1977;

(3) The water bank program authorized by the Water Bank Act;

(4) The emergency conservation measures program authorized by title IV of the Agricultural Credit Act of 1978;

(5) The agricultural conservation program authorized by the Soil Conservation and Domestic Allotment Act;

[81] (6) The great plains conservation program authorized by section 16 of the Soil Conservation and Domestic Policy Act;

(7) The resource conservation and development program authorized by the Bankhead-Jones Farm Tenant Act and by the Soil Conservation and Domestic Allotment Act;

(8) The forestry incentive program authorized by section 4 of the Cooperative Forestry Assistance Act of 1978;

(9) Any small watershed program administered by the Secretary of Agriculture which is determined by the Secretary of the Treasury to be substantially similar to the type of programs described in items (1) through (8); and

(10) Any State program under which payments are made to individuals primarily for the purpose of conserving soil, protecting or restoring the environment, improving forests, or providing a habitat for wildlife.

However, for a payment (or portion thereof) to be excluded from income under this provision, two conditions must be met. First, a determination must be made by the Secretary of Agriculture that the payment is made primarily for the purpose of conserving soil and water resources, protecting or restoring the environment, improving forests, or providing a habitat for wildlife. Second, the Secretary of the Treasury must determine that the payment does not result in a substantial increase in the annual income derived from the property with respect to which the payment is made.

Reasons for change

Under present law, it is not clear whether the exclusion would apply to payments received under local programs for conservation purposes.

Explanation of provision

The bill provides that the exclusion for cost-sharing payments applies to payments primarily for the purpose of conserving soil, protecting or restoring the environment, improving forests, or providing a habitat for wildlife under programs of a State, possession of the United States, a political subdivision of any of the foregoing, or the District of Columbia.

Effective date

This provision applies to grants made after September 30, 1979. This is the same effective date as for the related provisions in the Revenue Act of 1978.

[82] 11. Amendments Relating to General Stock Ownership Corporations (sec. 106 of the bill and sec. 1391 of the Code)

The Revenue Act of 1978 authorized a State to establish a General Stock Ownership Corporation (GSOC) for the benefit of its citizens. A GSOC must be chartered by an act of the State legislature or as a result of a referendum and must provide for issuance of shares of stock to all the residents of the State (other than those electing not to receive a share). The income of the GSOC would be taxed directly to the shareholders.

The following clerical **amendments** to the GSOC provisions are made by the bill:

a. Amendments to section 172(b)(1).—The 1978 Act added two subparagraphs (H) to section 172(b)(1). The bill redesignates the subparagraph (H) relating to GSOCs as subparagraph (I) and makes conforming amendments.

b. Amendments to section 1016(a).—Paragraph (21) of section 1016 (a) is redesignated as paragraph (22).

c. Amendments to section 1391.—Several punctuation errors are corrected.

d. Amendment to section 1392.—The word "where" is corrected to read "when".

[83] 12. Amendments Relating to Technical Corrections to the Tax Reform Act of 1976

a. Computation of adjusted itemized deductions in case of estates and trusts (sec. 107(a)(1)(A) of the bill and sec. 57(b)(2)(C) of the Code)

Present law

Under the Revenue Act of 1978, the alternative minimum tax is imposed on the adjusted itemized deductions preference. The charitable contributions deduction is an itemized deduction that normally may result in the adjusted itemized deductions preference. However, the Act provided an exception in the case of certain charitable deductions of trusts and estates. One exception arises where all the unexpired interests in the trust are devoted to religious, charitable, scientific, literary, or educational purposes or for the prevention of cruelty to children or animals (i.e., the purpose described in section 170(c)(2)(B) of the Code). Another exception arises where all of the income interests in the trust are devoted to religious, charitable, etc., purposes (i.e., purposes described in section 170(c)(2)(B) of the Code), and the grantor had a power to revoke the trust at his death. Neither of the two exceptions applies where the interests in the trust are for purposes other than religious, charitable, etc., purposes (i.e., those purposes described in section 170(c)(2)(B) of the Code) but for which a charitable deduction is nonetheless allowable (i.e., those purposes described in Code sections 170(c)(1), (3), (4) and (5)).

Reasons for change

The committee believes that the preference for adjusted itemized deductions attributable to a charitable contribution deduction should not apply in the case of a trust devoted entirely to purposes for which a charitable deduction is allowed.

Explanation of provision

The bill modifies the exceptions for charitable contributions as an item of adjusted itemized deductions preference so that they apply to all interests in the trust devoted to purposes for which a charitable deduction is allowed to the trust.

Effective date

The amendment made by this provision applies to taxable years beginning after December 31, 1975.

b. Allocation of tax preference items in case of trusts and estates (sec. 107(a)(1)(C) of the bill and sec. 58(c)(1) of the Code)

Present law

The Revenue Act of 1978 imposed a new alternative minimum tax on individuals including trusts and estates.

[84] In the case of a trust or estate, the items of tax preference are apportioned between the estate or trust and the beneficiaries on the basis of income of the estate or trust allocated to each.

Reasons for change

The committee believes that the Treasury should have authority to allocate the tax preferences between a trust or estate and the beneficiaries other than on the basis of income to properly reflect which of the parties received the tax benefit of the preference.

Explanation of provision

The provision allows the Treasury Department to issue regulations to provide rules for apportioning the items of tax preference between a trust or estate and its beneficiaries.

Effective date

This amendment is effective for taxable years beginning after December 31, 1975.[1]

c. Recapture of depreciation of certain subsidized low-income housing (sec. 107(a)(1)(D) of the bill and sec. 1250(a)(1)(B) of the Code)

Present law

The Revenue Act of 1978 added a provision clarifying that the recapture of depreciation on property on which rehabilitation expenditures were amortized under Code section 191 is to be made under Code section 1250 rather than Code section 1245.

The 1978 Act amended Code section 1250(b)(4) to clarify that the amount of "straight line" depreciation is to be computed without regard to the 5-year useful life under Code section 191. This clarification inadvertently may have caused additional recapture to apply to certain subsidized low-income housing (described in clauses (i), (ii), and (iv) of Code sec. 1250(a)(1)(B)).

Reasons for change

This committee believes that the normal recapture rules of Code section 1250 should apply to subsidized low-income housing on which 5-year amortization under Code section 191 has been taken.

Explanation of provision

The amendment provides that the special 100-month recapture phase-out rules for subsidized low-income housing may apply even though rehabilitation expenditures for that housing have been amortized under Code section 191.

Effective date

The amendment applies to additions to capital account made after June 14, 1976 and before June 15, 1981.

[85] d. Employee of grantor or beneficiary treated as related person for purposes of the tax on generation-skipping transfers (sec. 107(a)(2)(B)(i) of the bill and sec. 2613(e) of the Code)

Present law

Under the generation-skipping provisions added by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1], an individual is a beneficiary of a trust if he has a present or future power or interest in it. "Power" means "any power to establish or alter beneficial enjoyment of the corpus or income of the trust." A person has an "interest" if the person has either "a right to receive income or corpus from the trust" or "is a permissible recipient of such income or corpus." Thus, one can be a beneficiary by satisfying either or both of the tests. However, the Tax Reform Act of 1976 excluded certain independent trustees from being treated as beneficiaries solely because of powers which they held to distribute trust corpus and income.

The Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1] expanded the categories of individuals to whom independent trustees could make distributions without being treated as beneficiaries. Specifically, the 1978 Act excluded from the group of independent trustees any person who is an employee of a corporation in which the stockholdings of the grantor, the trust, and the beneficiaries of the trust are significant from the viewpoint of voting control, an employee of a corporation in which the grantor or any beneficiary of a trust is an executive, and an employee of a partnership in which the grantor or any beneficiary of the trust is a partner. However, the provision did not exclude a person who is directly employed by the grantor or any beneficiary of the trust.

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[1] An identical provision was included in H.R. 6715 (95th Congress), the Technical Corrections bill, as passed by the House of Representatives and reported by the Finance Committee. The provision was also included in H.R. 13511 (95th Congress), the Revenue Act of 1978, as passed by the Senate. However, it was inadvertently deleted from the conference report on that bill.

Reasons for change

The committee believes that a person who is directly employed by the grantor or any beneficiary of the trust should not be considered an independent trustee for purposes of the generation-skipping tax.

Explanation of provision

The bill provides that employees of the grantor or any beneficiary of the trust are excluded from the persons who can qualify as an independent trustee for purposes of the tax on generation-skipping transfers.

Effective date

The amendment is effective for any generation-skipping transfer made after June 11, 1976.

e. Certain powers of independent trustee not treated as a power for purposes of the tax on generation-skipping transfers (sec. 107(a)(2)(B)(ii) of the bill and sec. 2613(e) of the Code)

Present law

Under the generation-skipping provisions that were added by the Tax Reform Act of 1976, an individual is a beneficiary of a trust if he has a present or future power or interest in it. "Power" means "any power to establish or alter beneficial enjoyment of the corpus or income of the trust." A person has an "interest" if the person has either "a right to receive income or corpus from the trust" or "is a permissible recipient of such income or corpus." Thus, one can be a beneficiary by satisfying either or both of the tests. The Tax Reform [86] Act of 1976 excluded certain independent trustees from being treated as beneficiaries solely because of powers which they held to distribute trust corpus and income.

Section 702(n)(2) of the Revenue Act of 1978 expanded the categories of individuals to whom independent trustees could make distributions without being treated as beneficiaries. Under the 1978 Act amendment, an individual will not be treated as having a power if such an individual "is a trustee who has no *interest* in the trust" (emphasis added). Thus, an individual trustee who is the permissible appointee of trust assets under an unexercised power of appointment held by another would be deemed to have an interest in the trust and would therefore be treated as having a power over the trust. The trustee would be a beneficiary of the trust and the independent trustee exemption would be negated. However, the legislative history of the Revenue Act of 1978 states that an individual trustee will not be treated as a beneficiary if "he has no interest in the trust other than as a potential appointee under a power of appointment held by another."

Reasons for change

The committee believes that the position taken in the legislative history technically needs to be incorporated in the Internal Revenue Code.

Explanation of provision

The bill provides that, solely for purposes of the independent trustee exemption, a trustee will not be treated as having an interest in the trust if his only interest is as a permissible appointee under an unexercised power of appointment held by another.

Effective date

The amendment is effective for any generation-skipping transfer made after June 11, 1976.

f. Estate tax treatment of gifts made within 3 years of death (sec. 107(a)(2)(F) of the bill and sec. 2035 of the Code)

Present law

Prior to the Tax Reform Act of 1976, the gross estate of a decedent included all gifts made in contemplation of death that occurred less than 3 years before the date of the decedent's death. Under this rule, the Internal Revenue Service, for administrative purposes, generally required that only gifts in excess of $1,000 need be included in the estate tax return.

The Tax Reform Act of 1976 provided that all gifts made within 3 years of the decedent's death are to be included in the gross estate of the decedent, regardless of whether the gift was made in contemplation of death. However, the 1976 Act contained an exception to this inclusion rule for gifts to which the annual $3,000 gift tax exclusion applied. The legislative history was somewhat ambiguous and could be read to mean that this exception resulted in the inclusion of only the excess of the estate value of all gifts over the amount excludible under the gift tax annual exclusion.

The Technical Corrections bill, which was added to the 1978 Act, clarified the exception so that only gifts (other than transfer with [87] respect to a life insurance policy) which were made within 3 years of death and were not required to be included in a gift tax return were not to be included in a decedent's gross estate. Under this rule, the entire amount of the gift (and not just the excess of the value of the gift over $3,000) is includible in the gross estate where the aggregate annual gifts to a donee were in excess of $3,000. This clarification was to apply to gifts made after December 31, 1976.

Reasons for change

Because of the ambiguity that existed prior to the committee's action on this issue in October 1977, it is possible that gifts could have been made in excess of $3,000 based upon the assumption that only the excess of the value over $3,000 would be included in the gross estate as transfers within 3 years of death. Therefore, the committee believes that the "subtraction out" concept should be allowed with respect to gifts made before the adoption of the clarifying change by the Ways and Means Committee.

Explanation of provision

The amendment allows executors of decedents to elect with respect to all gifts made in *1977* (other than transfer with respect to a life insurance policy) to *all donees* to include in the decedent's gross estate only the excess of the death time value over the amount excluded in computing taxable gifts by reason of the $3,000 annual exclusion under section 2503(b). If an executor elects the application of the provision, there will be included in the decedent's gross estate the death time value less the amount excluded under section 2503(b) with respect to such gifts. If this election is made, it will apply to all gifts (other than transfers with respect to a life insurance policy) made by the decedent during 1977 which were made within 3 years of death.

The election by the executor must be made by the due date of the estate tax return (including extensions), or, if later, within 120 days after the date of the enactment of this bill.

Effective date

The amendment made by this provision applies with respect to estates of decedents who made gifts during 1977 which were made within 3 years of death.

Effective date

The provision applies to involuntary conversions after December 31, 1976. This is the same effective date as section 4 of Public Law 95-472.

g. Clerical and conforming amendments (sec. 107(a) of the bill and secs. 46(f), 103, 911, 1014(a), 1016 (a), 2613, and 6698 of the Code)

The following clerical and conforming amendments to the Technical Corrections to the Tax Reform Act of 1976 are made by this provision:

(*1*) *Amendments to section 911.*—The effective date of an amendment to section 911 is conformed to the effective date under section 209 of the Foreign Earned Income Act of 1978 [Pub. L. 95-615, 1978-2 C.B. 415]; the reference to "Subsection (c)" in section 701(a)(3) of the Revenue Act is corrected to read "Subsection (e)"; and the redesignation of paragraph (8) of section 911(c) is repealed.

[88] (*2*) *Amendment to section 1014(a).*—A typographical error in the reference to "section 2032A" is corrected.

(*3*) *Amendments to section 2613.*—Section 2613(e)(2)(B) is corrected by striking out clause (vi) which is identical to another clause.

(*4*) *Amendment to section 1016 (a).*—This redesignation of paragraph (23) is repealed.

(*5*) *Amendment to section 6698.*—Section 6698 relating to carryover basis is redesignated as section 6698A.

(*6*) *Amendment to section 46(f).*—A cross reference in section 46(f) is corrected to read "subsection (a)(7)(C)".

(*7*) *Amendment to section 103.*—A reference to "section 103(d)" is corrected to read "section 103(e)".

[89] B. TECHNICAL AMENDMENTS TO OTHER 1978 TAX LEGISLATION

1. Technical Amendments Relating to the Foreign Earned Income Act of 1978

a. Use of tax tables by individuals excluding foreign earned income (sec. 108(a)(1)(A) of the bill and sec. 3 of the Code)

Present law

Prior to the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1], certain individuals working abroad were allowed to exclude from gross income up to $20,000 annually ($25,000 in some cases). The Tax Reform Act of 1976 amended this provision so that these individuals were taxed on their other income at the higher rate brackets which would have applied if the excluded earned income were not so excluded (i.e., the exclusion was "off the bottom"). This amendment made the use of tax tables inappropriate for these individuals and, under the Tax Reduction and Simplification Act of 1977 [Pub. L. 95-30, 1977-1 C.B. 451], they are not permitted to use the tables.

The Foreign Earned Income Act of 1978 [Pub L. 95-615, 1978-2 C.B. 415] made a number of changes in the foreign earned income exclusion. Among these is a rule that the excluded income is not taken into account in computing the tax on the taxpayer's other income (i.e., the exclusion is "off the top").

Reasons for change

Because the foreign earned income exclusion is taken "off the top" under the 1978 Act, the committee believes that the use of tax tables by taxpayers electing the exclusion is appropriate.

Explanation of provision

The bill would permit individuals who exclude foreign earned income to use the tax tables.

Effective date

The provision is generally effective for taxable years beginning after December 31, 1977. It does not apply, however, to any taxable year for which an individual elects to be taxed under the Tax Reform Act of 1976.

b. Definition of "earned income" for purposes of the deduction for excess foreign living costs (sec. 108(a)(1)(B) of the bill and sec. 913(j)(1)(A) of the Code)

Present law

The Foreign Earned Income Act of 1978 established a deduction for excess foreign living costs for Americans working abroad. The aggregate amount deductible under this provision cannot exceed the taxpayer's foreign "earned income," and his earned income also is relevant in the calculation of the excess costs, one element of the deduction. For purposes of determining earned income under present law, compensation received in the year after the services are per- [90] formed generally is considered received, and thus earned income, in the year in which the services were performed rather than the next year when the compensation is received. However, compensation received more than one year after the services were performed is not included in earned income for purposes of the housing deductions or the earned income limitation.

Reasons for change

Compensation arrangements for Americans working abroad may defer payment beyond the year following the year in which services are performed. If these payments are not taken into account in the performance year, the individual's earned income for that year and his base housing amount are reduced. This inflates the taxpayer's deduction for excess foreign housing costs and creates the potential for manipulation of the housing deduction.

Explanation of provision

The bill modifies the treatment of deferred compensation in computing the housing element of the excess living cost deduction under section 913.

First, for purposes of computing the housing element of the deduction, deferred compensation is taken into account in the year it is included in income, not the year in which the services giving rise to the compensation were performed. Accordingly, the bill eliminates the requirement of present law that the housing deduction for a year be recomputed and an amended return be filed in situations where the compensation for services performed that year is not taken into income until the following year. However, under the bill, deferred compensation received more than one taxable year after the taxable year in which services are performed is taken into account for purposes of computing the housing deduction, rather than being disregarded as under present law. (The bill continues the rule that compensation deferred for more than one year is not taken into account in computing the earned income limitation.)

Second, the bill provides a new recapture rule to deal with situations where a taxpayer defers compensation from a year in which he claims a deduction under section 913 for excess foreign housing costs (the "performance year") to a year in which he does not have an excess housing cost deduction. This recapture rule only applies where the compensation ("after-received compensation") is deferred for no more than 3 years after the year in which the services are performed. For purposes of determining the amount of recapture (if any), the taxpayer recomputes the qualified housing expense for both the performance year and the year of receipt as though the deferred compensation were received in the performance year rather than the year of receipt. Any decrease in the amount of the aggregate qualified housing expense deduction as a result of this recomputation will be recaptured by including an amount equal to such decrease in income (but not in "housing income") in the year of receipt.

The amount of the recapture is determined by aggregating the housing deduction for the present and all prior taxable years and subtracting from that total the aggregate of the recomputed housing [91] deduction for the present and all prior taxable years for which a housing deduction has been allowed. The recomputed housing deduction is determined by treating after-received compensation as housing income for the performance year instead of the year of receipt. The excess of the aggregate housing deductions actually taken in these years over the recomputed housing deduction for these years will be taken into income in the year the after-received compensation is received. However, any amount recaptured in one year shall not give rise to recapture in a subsequent year.

The computation of the recapture of excess housing deductions is illustrated by the following examples.

Example 1

In 1979, the taxpayer had $200 of housing income and $70 of housing expense. In 1980, he had $300 of housing income attributable to 1980, $100 of housing income that was after-received compensation attributable to 1979, and $90 of housing expenses.

Set forth below are the computations of the taxpayer's actual housing deduction for these two years and also the housing deductions for the two years as recomputed for purposes of determining the recapture amount:

	Actual		*Recomputed*	
	1979	*1980*	*1979*	*1980*
Housing income	$200	$400	[1] $300	[2] $300
Less housing expenses	70	90	70	90
	$130	$310	$230	$210
	×20%	×20%	×20%	×20%
Base housing amount	$26	$62	$46	$42
Housing expenses	$70	$90	$70	$90
Base housing amount	26	62	46	42
Housing deduction	$44	$28	$24	$48

[1] $200 of housing income attributable to 1979 plus $100 of deferred compensation attributable to 1979.

[2] $300 of housing income attributable to 1980.

The aggregate actual housing deductions for the two years is $72 and the aggregate recomputed housing deduction for the two years is $72. Since the actual deduction does not exceed the recomputed deduction, there is no excess housing deduction to be recaptured.

This example illustrates the result that, if the taxpayer takes a housing deduction in the year the after-received compensation is received, there will be no recapture under this provision. This is because the after-received compensation will have been fully taken into account in computing the current year housing deduction, thus having increased the base housing amount by 20% of such compensation, and, correspondingly, reducing the housing deduction for the current year by 20% of the after-received compensation.

[92] Where the taxpayer does not take a housing deduction in the current year, there will be recapture if the taxpayer took a housing deduction in the performance year. This is because the full measure of the after-received compensation was not included in the computation of the housing deduction for the current

year. The following example illustrates the recapture computation in this situation:

Example 2

Assume the same facts as in example 1 except that the taxpayer's housing expenses in 1980 were $60. The taxpayer's actual and recomputed housing expense in the two years would be as follows:

	Actual		*Recomputed*	
	1979	*1980*	*1979*	*1980*
Housing income	$200	$400	$300	$300
Less housing expenses	70	60	70	60
	$130	$340	$230	$240
	×20%	×20%	×20%	×20%
Base housing amount	$26	$68	$46	$48
Housing expenses	$70	$60	$70	$60
Base housing amount	26	68	46	48
Housing deduction	$44	0	$24	$12

The aggregate actual housing deductions for the two years is $44 while the aggregate recomputed housing deductions is $36. Since the actual housing deductions exceed the recomputed housing deduction by $8, the taxpayer is required to recapture the $8 as income in 1980.

Effective date

The provision is generally effective for taxable years beginning after December 31, 1977. It does not apply, however, to any taxable year for which an individual elects to be taxed under the Tax Reform Act of 1976.

c. Clerical amendment to section 911 (a)(2) (sec. 108(a)(1)(C) of the bill and sec. 911(a)(2) of the Code)

Section 911(a)(2) is amended to refer to "a foreign country or countries" rather than to "qualified foreign countries".

d. Disallowance of deductions attributable to excluded foreign earned income (sec. 108(a)(1)(D) of the bill and sec. 911(a) of the Code)

Present law

Under the law prior to the Foreign Earned Income Act of 1978, an individual who excluded foreign earned income could not claim any deductions, or take a credit for any foreign income taxes, to the extent properly allocable to or chargeable against the excluded income. This provision (Code sec. 911(a)) was carried over under the 1978 Act but the words "any deduction" inadvertently were omitted with the result [93] that it was less clear that deductions, as well as foreign tax credits, allocable to exclude foreign earned income are to be disallowed.

Reasons for change

The committee believes that it should be made clear that deductions attributable to amounts excluded under the 1978 Act are to be disallowed.

Explanation of provision

The bill amends section 911(a) of the Code to make it clear that deductions, as well as credits, allocable to or chargeable against excluded earned income are not allowable.

Effective date

The provision is generally effective for taxable years beginning after December 31, 1977. It does not apply, however, to any taxable year for which an individual elects to be taxed under the Tax Reform Act of 1976.

e. Clerical amendment to section 3 (b) (sec. 108(a)(1)(E) of the bill and sec. 3(b) of the Code)

Section 3(b)(1) of the Code is amended by redesignating subparagraphs (B) and (C) as subparagraphs (A) and (B) respectively.

f. Definition of "qualified home leave expenses" for purposes of the deduction for excess foreign living costs (sec. 108(a)(1)(F) of the bill and sec. 913(g) of the Code)

Present law

The Foreign Earned Income Act of 1978 established a deduction for excess foreign living costs of Americans working abroad. One element of the deduction consists of the taxpayer's "qualified home leave expenses." These are defined by the 1978 Act to mean the reasonable amounts paid or incurred by or on behalf of an individual for the transportation of that individual, his spouse, and each dependent from the location of the individual's tax home outside the United States to (i) the individual's present (or, if none, most recent) principal residence in the United States, or (ii) if that rule does not apply to the individual, the nearest port of entry in the continental United States (excluding Alaska), and return.

Reasons for change

Under the 1978 Act, it is unclear whether the rule allowing a deduction for travel to the nearest U.S. port of entry applies to all individuals who do not return to their present (or most recent) U.S. principal residence or only to those individuals who never had a U.S. principal residence. Also, it is unclear whether a deduction is allowable if the taxpayer departs from, or returns to, a location abroad other than his tax home. The committee believes that both these points require clarification.

The nearest-port-of-entry rule under the 1978 Act excludes Alaska and Hawaii. This was intended to permit U.S. taxpayers in the Far East to deduct the cost of travel to the 48 contiguous states and not to be confined to the cost of travel to Alaska or Hawaii, if nearer. The committee believes that individuals should be allowed to elect to include [94] Alaskan and Hawaiian ports of entry so as to permit deduction of the costs of travel to the nearest of these ports.

Explanation of provision

The bill would make it clear that the qualified home leave expenses generally mean the travel costs from any point outside the United States to the individual's principal domestic residence, and from the individual's principal domestic residence to any point outside the United States. However, the amount of the deduction may not exceed the reasonable amount for round-trip transportation between the location of his tax home outside the United States and his principal domestic residence. For these purposes, his principal domestic residence is the location of his present (or, if none, most recent) principal residence in the United States.

The taxpayer need not return to the same foreign location from which he departed. If he ends one foreign assignment and begins another in conjunction with his home leave, acquiring a new foreign tax home, the limitation on the cost of travel to the United States is to be applied with respect to the old foreign tax home and the limitation on the cost of travel from the United States is to be applied with respect to the new foreign tax home.

If the individual's travel in the United States is not travel to and from his principal domestic residence, or if he never had a principal domestic residence, these rules are to be applied by substituting the nearest port of entry in the United States for the individual's principal domestic residence. As under the 1978 Act, the taxpayer may not deduct as qualified home leave expenses the cost of bringing his family abroad to visit him and of returning them to the United States. The travel must originate abroad and be to and from the United States.

The taxpayer may elect to include ports of entry in Alaska and Hawaii among U.S. ports of entry. Thus, if the taxpayer does not travel to his domestic principal residence, he may base his deduction under the nearest-port-of-entry rule on the cost of travel to the nearest port including ports in Alaska and Hawaii.

Effective date

The provision is generally effective for taxable years beginning after December 31, 1977. It does not apply, however, to any taxable year for which an individual elects to be taxed under the Tax Reform Act of 1976.

g. Clerical amendment to section 119 (sec. 108(a)(1)(G) of the bill and sec. 119 of the Code)

The heading of section 119(a) of the Code (relating to meals or lodging furnished for the convenience of the employer) is corrected.

[95] 2. Technical Amendments Relating to the Black Lung Benefits Revenue Act

a. Correction of provisions related to Tax Court jurisdiction (sec. 108(b)(1) of the bill and secs. 6503, 6511, 6862, and 7422 of the Code)

(*1*) *Amendment of section 6503 (g)*.—In section 6503(g) of the Code, the references to the black lung benefit trust excise taxes on self-dealing and taxable expenditures are corrected to be sections 4951 and 4952, instead of sections 4985 and 4986.

(*2*) *Amendment of section 6511 (f)*.—In section 6511(f) of the Code, references to section 4975 (excise tax on certain qualified pension, etc., plan prohibited transactions) are added to references to private foundation excise taxes and black lung benefit trust excise taxes.

(*3*) *Amendment of section 6862.*—In section 6862 of the Code, references to sections 4951 and 4952 (black lung benefit trust excise taxes) "certain excise taxes."

(*4*) *Amendment of section 7422.*—In section 7422 of the Code, references to sections 4951 and 4952 (black lung benefit trust excise taxes), are added to references to private foundation excise taxes.

b. Correction of references to black lung legislation (sec. 108(b)(2) of the bill and secs. 192(e) and 501 (c)(21) of the Code)

(*1*) *Amendment of P.L. 95-227.*—The references in section 3 of the Black Lung Benefit Revenue Act of 1977, P.L. 95-227 [1978-1 C.B. 494], are corrected to be the Federal Mine Safety and Health Act of 1977, instead of the Federal Coal Mine Health and Safety Act of 1969.

(*2*) ***Amendment of sections 192(e) and 501(c)(21)***.—The references in sections 192(e) and 501(c)(21) of the Code are corrected to be the Federal Mine Safety and Health Act of 1977, instead of the Federal Coal Mine Health and Safety Act of 1969.

c. Clerical amendment (sec. 108(b)(3)(A) of the bill and sec. 3 of P.L. 95-227)

In section 3(c)(1) of the Black Lung Benefits Revenue Act of 1977, P.L. 95-227, the reference to "subsection (a)(4)" is corrected to "subsection (a)(5)."

d. Correction of cross reference in Code section 7454(b) (sec. 108(b)(3)(B) of the bill and sec. 7454 (b) of the Code)

The bill corrects a cross reference in Code section 7454(b) to Code section 501(c)(21) which was incorrectly referenced to Code section 502 (c)(21).

[96] 3. Technical Amendments Relating to the Energy Tax Act of 1978

a. Repayment of tax on gasoline used in commercial fishing vessels (sec. 108(c)(1) of the bill and sec. 6421 (d)(2) of the Code)

Present law

The Code provides that gasoline, diesel fuel, and special motor fuels purchased for use in commercial fishing vessels may be purchased free of the 4-cents-a-gallon Federal excise taxes on these fuels. In addition, prior to the Energy Tax Act of 1978 [Pub. L. 95-618, 1978-3 C.B. (Vol. 2) 1], the Code provided for a 2-cents-a-gallon reduction (through refund, credit, or exemption) of the excise taxes on gasoline, diesel fuel, and special motor fuel, and the refund (or credit) of the 6-cents-a-gallon tax on lubricating oil, with respect to gasoline, special fuels, and lubricating oil used (1) for nonbusiness, off-highway purposes (such as lawnmowers, snowmobiles, etc.) and (2) in motor boats (whether or not such use is business use). These reductions were eliminated by the Energy Tax Act: however, by cross-references the Act provided that articles sold as supplies for vessels employed in the fisheries or whaling business are not subject to the excise taxes on fuels or lubricating oil. These references made it clear that no change was intended with respect to the excise tax exemptions for commercial fishing vessels. If the sale of gasoline and lubricating oil is made to the fishermen other than by the manufacturer, producer, or importer, the Code provides for a refund (or credit) of the tax when the item is sold for use or is used as supplies for such vessels (Code secs. 6416(a) and (b)(2)(B)).

Reasons for change

In some circumstances, it appears that persons purchasing gasoline for use in commercial fishing vessels have been made worse off by the provisions of the Energy Tax Act, and this does not appear to be consistent with Congressional intent. This results from the elimination of the ability of the ultimate purchaser to obtain a 2-cents-a-gallon payment or credit directly from the Treasury for gasoline used in commercial fishing vessels. Although the 4-cents-a-gallon tax can be fully avoided by tax-free purchase, refund, or credit, this approach requires cooperation of the seller and all other persons in the chain of purchase back to the manufacturer, producer, or importer.[1] Apparently, in certain cases, cooperation from such parties is not available, and thus, denial of the 2-cents-a-gallon payment or credit may create a problem for certain taxpayers engaged in commercial fishing. A similar problem occurs with respect to lubricating oil; although a credit or refund can be obtained by a procedure which requires the cooperation of the seller (and the producer), the [97] provision which provided for a direct payment to the vessel operator (Code sec. 6424(a)) was indirectly amended to preclude such a payment.

Explanation of provision

The bill provides that the 2-cent-a-gallon payment (or credit) for certain non-highway uses can be obtained with respect to gasoline used in a vessel employed in the fisheries or in the whaling business. Also, the bill provides that a direct payment or credit of the 6-cent-a-gallon tax on lubricating oil can be obtained with respect to lubricating oil used in such vessels.

Effective date

This provision applies to uses after December 31, 1978. This is the same effective date as applies to related provisions which were added by section 222 of the Energy Tax Act of 1978.

b. Tires used in the manufacture of buses (sec. 108(c)(2) of the bill and secs. 4071(e), 6416(b)(3)(C), and 6416(b)(4)(B) of the Code)

Present law

Prior to the Energy Tax Act of 1978, a 10-percent manufacturers excise tax was imposed on the sale of buses having a gross vehicle weight of more than 10,000 pounds, with certain exceptions (Code sec. 4061(a)). Another provision (Code sec. 4071) imposes excise taxes on tires, inner tubes, and tread rubber. These taxes generally apply to tires and inner tubes used on buses (as well as other tires, inner tubes, and tread rubber).

The Energy Tax Act repealed the excise tax on buses. In the case of excise taxes on highway tires, inner tubes, and tread rubber, the Energy Tax Act also provided an exemption for sales by a manufacturer, producer, or importer of such items "sold for use" by the purchaser on or in connection with an intercity, local, or school bus.

Reasons for change

Present law allows any bus to be sold free of the 10-percent manufacturers excise tax that had previously been imposed on bus bodies and chassis. Also, the owner of an "intercity, local or school bus" can purchase tires, inner tubes, or tread rubber for use on such a bus free of the excise taxes on such items (by exemption, credit, or refund). Tires and inner tubes also may be purchased tax free by a vehicle manufacturer to be placed on a chassis which is to be sold (among other things) to a State or local government or a private nonprofit school. If purchased tax-paid and then so used, a credit or refund of tax is available to the vehicle manufacturer. However, if a manufacturer purchases tires or inner tubes to be placed on a bus which is for domestic use by other than a State or local government or by a nonprofit school, the excise taxes on tires and inner tubes are imposed, and there is no provision for credit or refund of such taxes. Since the basic excise tax on bus bodies and chassis has been repealed, the committee believes that tires and tubes purchased by a manufacturer and placed on every new bus should be exempt from the excise tax on tires and tubes (as well as the excise tax on buses).

[98] *Explanation of provisions*

The bill provides that, if tires or inner tubes are sold on a tax-paid basis to a manufacturer of bus chassis or bodies, the tire tax is to be credited or refunded to the bus manufacturer upon the sale of the chassis or body.

Effective date

This provision applies to tires and inner tubes which are to be used on a bus which is sold on or after April 20, 1977. This effective date is essentially the same as the effective date of section 231 of the Energy Tax Act of 1978, which repealed the excise tax on bus bodies and chassis effective for sales on or after April 20, 1977.

c. Refund of tax on lubricating oil used in producing rerefined oil (sec. 108(c)(3) of the bill and sec. 6416 of the Code).

Present law

Under present law, a six-cent-per-gallon manufacturers excise tax is imposed on lubricating oil (other than cutting oils) sold in the U.S. by a manufacturer or producer, or used by a manufacturer or producer. The sale of recycled oil is not subject to the tax. However, prior to the Energy Tax Act, the excise tax was imposed on lubricating oil mixed with the used oil.

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[1] See Rev. Rul. 79-48, 1979-1 C.B. 434.

Section 404 of the Energy Tax Act exempted the sale of new lubricating oil from the excise tax where the oil is sold for use in a blend with previously used or waste lubricating oil which has been cleaned, renovated, or refined. Such a blend is designated as "rerefined oil."

The exemption applies if the blend contains 25 percent or more of waste oil. All of the new oil in a mixture is exempt from the tax if the blend contains 55 percent or less of new oil. If it contains more than 55 percent new oil, the exemption applies only to so much of the new oil as does not exceed 55 percent of the blend. However, no provision was made for refunds of the excise tax where tax-paid new oil is mixed with waste oil.

Reason for change

The committee believes that a tax refund should be permitted to the extent that new oil sold for use and used in rerefined oil would be exempt from the manufacturers excise tax.

Explanation of provision

The bill provides for credit or refund of tax paid with respect to new oil in rerefined oil to the extent that the blend of new and waste oil would be exempt from the manufacturers excise tax. As a result, refunds will be available for the tax paid on up to 55 percent of a blend of new and waste lubricating oil which contains at least 25 percent of waste oil. However, refunds would not be available until the blend is used or sold.

Effective date

Credit or refund is to be available for new oil mixed with waste oil on or after December 1, 1978 (and sold or used after that date), the effective date of section 404 of the Energy Tax Act of 1978.

[99] d. Credit or refund of tax on truck bodies or chassis used in the manufacture of buses (sec. 108(c)(4) of the bill and sec. 6416(b)(3) of the Code)

Present law

Prior to the Energy Tax Act of 1978, with certain exceptions, a 10-percent manufacturers excise tax was imposed on the sale of truck or bus bodies or chassis for use on a vehicle having a gross vehicle weight of more than 10,000 pounds (Code sec. 4061(a)).

The Energy Tax Act repealed the excise tax on bus bodies and chassis, but not the excise tax on truck bodies and chassis.

Reason for change

The committee believes it is consistent with the policy of the Energy Tax Act to provide for a credit or refund of tax in situations where a person converts a truck body or chassis (on which tax has been paid) to a bus.

Explanation of provision

The bill permits a person who modifies a truck chassis or truck body into a bus to obtain a credit or refund of the tax paid with respect to the truck chassis or body.

Effective date

This provision applies, in general, to the sale of truck bodies and chassis on or after April 20, 1977, in the same manner as if this provision had been included in section 231(a) of the Energy Tax Act of 1978.

e. Excise tax exemption for bus parts (sec. 108(c)(5) of the bill and sec. 4221(e)(6) of the Code)

Present law

Prior to the Energy Tax Act of 1978, an 8-percent manufacturers excise tax was imposed on parts and accessories (other than tires and inner tubes which are taxed separately under Code sec. 4071) of the type used on buses and trucks (Code sec. 4061(b)).

The Energy Tax Act of 1978 repealed the 8-percent manufacturers excise tax on bus parts and accessories. Under regulations prescribed by the Secretary of the Treasury, the parts and accessories tax was not to apply to any part or accessory which is "sold for use" by the purchaser on or in connection with a bus. It was contemplated that such parts and accessories would be sold tax-free by the manufacturer, producer, or importer for use on or in connection with a bus only if appropriate evidence of exemption were furnished by the purchaser. If the sale of the parts and accessories is made other than by the manufacturer, producer, or importer, the Act provided for a refund of the 8-percent tax where the part or accessory is "sold for use" by the purchaser on or in connection with a bus. Thus, parts and accessories that may be interchangeable between trucks and buses continued to be subject to the parts tax if they are not "sold for use" with respect to buses.

[100] *Reasons for change*

Present law requires that the excise tax be paid on bus parts where such parts are sold to distributors and to subsequent purchasers in the marketing chain. An application is then filed and a rebate is applied for once the ultimate user of the bus part purchases it.

The committee believes that this procedure is unnecessary and that it is appropriate to allow a tax-free sale for resale of bus parts in certain circumstances.

Explanation of provision

The bill provides that, under regulations prescribed by the Treasury, a manufacturer may make a tax-free sale of bus parts to a purchaser for resale to the consumer or to a second purchaser for resale by such second purchaser to the consumer. The provision for tax-free sales may be made only where permitted by Treasury regulations because, in many instances, it is difficult for a manufacturer (or the Treasury) to determine at the point of sale whether certain parts will be used on a bus (and thus be tax-free) or on a truck (and thus be subject to tax). Thus, this grant of authority to the Treasury is designed to allow the Treasury to permit the use of the tax-free sale procedure to the extent feasible without requiring such a procedure where the Treasury does not have reasonable assurances that the parts ultimately will be used on a bus.

The House bill does not contain a comparable provision.

Effective date

The provision is effective for sales

by the manufacturer, producer, or importer on or after the first day of the first calendar month beginning more than 10 days after the date of enactment.

f. Clerical amendment relating to denial of investment credit for certain boilers (sec. 108(c)(6) of the bill and sec. 48(a)(10)(B) of the Code)

This amendment corrects a cross-reference in Code section 48(a)(10)(B) to read "section 46(f)(5)" instead of "section 46(f)(51)."

[101] 4. Technical Amendment to Public Law 95-472

Security for recapture of estate tax reduction from special use valuation where property has been involuntarily converted (sec. 108(d) of the bill and sec. 6324B(c) of the Code)

Present law

The Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1] provided that certain property used for farming or in a closely held business may be valued for estate tax purposes at its current use value instead of its highest and best use value. However, if the property is disposed of within a 15-year period, all or part of the estate tax benefit is recaptured. A lien is placed on the property for the amount of the potential recapture tax.

Section 4 of Public Law 95-472 [1978-2 C.B. 373] provides that if an involuntary conversion of qualified real property takes place, no recapture of the estate tax benefit will occur if the property is replaced by other real property of at least equal value acquired for the same use.

Reasons for change

Present law generally requires that the replacement property be treated in the same manner as the property which was subject to special use valuation. Thus, if the replacement property is sold during the recapture period, the recapture tax would apply in the same general manner as if the involuntarily converted property had been sold.

Present law is unclear as to whether the lien that was placed on the involuntarily converted property is transferred to the replacement property.

Explanation of provision

The bill makes it clear that the lien that applies to special use valuation property which is involuntarily converted applies to qualified replacement property.

[102] IV. EFFECT OF THE BILL ON THE BUDGET AND VOTE OF THE COMMITTEE IN REPORTING THE BILL

Budget Effect

In compliance with section 252(a) of the Legislative Reorganization Act of 1970, the following statement is made about the effect on the budget of this bill, H.R. 2797, as reported by the committee. The committee estimates that the bill will have a negligible net effect on budget receipts in fiscal year 1980; will reduce budget receipts by less than $5 million in fiscal years 1981 and 1982, and by less than $1 million in fiscal year 1983; and have a negligible effect on budget receipts in fiscal year 1984.

The Treasury Department agrees with this statement.

New Budget Authority and Tax Expenditures

In accordance with section 308 of the Budget Act, after consultation with the Director of the Congressional Budget Office, the committee states that the changes made to existing law by this bill involve no new budget authority or new tax expenditures, and would affect existing tax expenditures as follows: the provision relating to definition of youth under the targeted jobs tax credit would increase tax expenditures by a negligible amount in fiscal year 1980, less than $5 million in fiscal years 1981 and 1982, and less than $1 million in fiscal year 1983.

Consultation with Congressional Budget Office on Budget Estimates

In accordance with section 403 of the Budget Act, the committee advises that the Director of the Congressional Budget Office has examined the committee's budget estimates (as indicated above) and agrees with the methodology used and the resulting revenue estimates for the bill as reported.

Vote of the Committee

In compliance with section 133 of the Legislative Reorganization Act of 1946, the following statement is made about the vote of the committee on the motion to report the bill, as amended. The bill, H.R. 2797, as amended, was ordered favorably reported by voice vote.

[103] V. REGULATORY IMPACT OF THE BILL

Pursuant to paragraph 5 of Rule XXIX of the Standing Rules of the Senate, the committee makes the following statement concerning the regulatory impact that might be incurred in carrying out the provisions of H.R. 2797, as reported by the committee.

A. Numbers of individuals and businesses who would be regulated.—The provisions of this bill are primarily to make technical, conforming, clarifying and clerical amendments in order to make corrections or clarifying changes in certain income and estate and gift tax provisions of the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1], and of the 1978 tax legislation.

B. Economic impact of regulation on individuals, consumers, and businesses affected.—The provisions will make it easier for affected taxpayers to understand and comply with the tax code changes made by the Revenue Act of 1978 and other 1978 tax legislation.

C. Impact on personal privacy.—The bill makes negligible changes in those provisions of Federal law relating to the personal privacy of taxpayers.

D. Determination of the amount of paperwork.—The bill will involve little, if any, additional paperwork for taxpayers. It will reduce the uncertainties and paperwork for some taxpayers affected by the tax law changes made by the Revenue Act of 1978 and other 1978 tax legislation.

[104] VI. CHANGES IN EXISTING LAW MADE BY THE BILL AS REPORTED

In the opinion of the committee, it is necessary in order to expedite the business of the Senate, to dispense with the requirements of subsection 4 of rule XXIX of the Standing Rules of the Senate (relating to the showing of changes in existing law made by the bill, H.R. 2797, as reported by the committee).

Part IV. Items of General Interest

New Election Form for Carryover Basis

Announcement 80-63

New Form 5970-A, Election of Carryover Basis, has been developed to allow the election of the carryover basis rules.

Public Law 96-223 repealed the carryover basis rules of section 1023 of the Internal Revenue Code. However, a provision of this law allows the personal representatives of the estates of decedents who died after December 31, 1976, and before November 7, 1978, to elect the carryover basis rules. The election, once made, is irrevocable and must be made on or before July 31, 1980.

The personal representative makes this election by filing Form 5970-A, Election of Carryover Basis. If the election is made, the carryover basis rules must be applied to *all* carryover basis property, including jointly owned property, acquired or passed from the decedent. Also, if the estate has previously filed a Form 5970, Information Notice to IRS as Required by IRC Section 6039A(a), and has notified the distributees of their carryover basis as required by that form, a timely filed election must still be made by Form 5970-A in order for the carryover basis rules to apply.

The form is now available at Internal Revenue Service offices.

Statistics from 1975 Corporation Income Tax Returns

Announcement 80-64 [1]

Publication 16, Statistics of Income —1975, Corporation Income Tax Returns, is now available and may be purchased for $6.00 from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

Correction of Rev. Proc. 80-10

Announcement 80-79

Revenue Procedure 80-10, 1980-13 I.R.B. 20, (dealing with the reproduction of Forms W-2, W-2P, and W-3) contains erroneous data in the text and exhibits.

The affected text and exhibits should read as below.

The specifications of the top and right margins as prescribed in Section 6, Requirements for Substitute "Privately Printed" Form W-2 (Copy A), Forms W-2P (Copy A), and Forms W-3 That Payers Submit to the SSA, subsection .05 should read:

The top and right margins must be ¼ (or .25) inch plus or minus .0313 inch and must be free of all printing.

Exhibits A thru J should read as follows:

The indicated top margins should be .25".

Exhibits A thru C should read as follows:

The dimensions from the top of the form to the bottom rule of the first form should be 3.25".

Exhibit D should read as follows:

The dimension from the top of the form to the bottom rule of the form should be 3.62".

All corrected data in the text and exhibits will be reflected in Rev. Proc. 80-10 when it is printed in 1980-1 C.B.

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[1] Based on News Release IR-80-50, dated April 15, 1980.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

By decision on appeal from an initial decision in an administrative hearing, the following individuals have been suspended or disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Sydney M. Eisenberg	Milwaukee, WI	Attorney	April 17, 1980 Disbarment
Leon Feldt	El Paso, TX	Certified Public Accountant	March 26, 1980 Disbarment
David I. Kali	Tucson, AZ	Attorney	Indefinite Suspension from April 1, 1980
Angelos P. Romas	Endicott, NY	Attorney	April 9, 1980 Disbarment

After due notice and opportunity for hearing, the following individual was disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
William A. Carbaugh	Greenville, SC	Enrolled Agent	March 21, 1980

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Frank H. Abernathy	Richmond, VA	Certified Public Accountant	Indefinite effective April 9, 1980
Carl L. Harthun	Denver, CO	Attorney	Indefinite effective April 9, 1980
John T. Kelly, Jr.	Virginia Beach, VA	Certified Public Accountant	Indefinite effective April 15, 1980
Fran A. Moor	Fort Worth, TX	Certified Public Accountant	Indefinite effective April 15, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 301.6103(j)(1)-1 added; 404.6103(j)(1)-1 deleted.	Disclosure of returns and return information to officers and employees of Bureaus of the Census and Economic Analysis of the Department of Commerce for certain statistical purposes.	Mar. 24, 1980	May 23, 1980
26 CFR 150.0 through 150.6402-1 added; published as temporary regulations in T.D. 7690, 1980-16 I.R.B. 11.	Crude Oil Windfall Profit Tax Act of 1980.	Apr. 4, 1980	June 3, 1980
26 CFR 1.166-9, 1.482-2, 1.1371-1, amended; 1.385-1 through 1.385-12, added.	Treatment of certain interests in corporations as stock or indebtedness.	Mar. 24, 1980	June 23, 1980
26 CFR 301.6103(a)-1 through 301.6103(c)-1, 301.6103(i)-1 through 301.6103(p)(2)(B)-1 added; 301.6103(h)(2)-1 amended; 404.6103(a)-1 through 404.6103(i)-1, 404.6103(j)(2)-1 through 404.6103(n)-1, 420.6103(1)(2)-1 through 420.6103(1)(2)-3 deleted.	Disclosure of returns and return information under certain circumstances.	Mar. 24, 1980	May 23, 1980
26 CFR 1.6050-1, 301.6050-1, deleted; 53.4942(b)-1, revised.	Treatment of Certain Elderly Care Facilities.	Mar. 24, 1980	May 23, 1980
26 CFR 1.46-4, 1.316-1, 1.852-4, 1.857-4, amended; 1.852, 1.857, deleted; 1.381(c)(25)-1, 1.860-1 through 1.860-5, added.	Deficiency dividends paid by certain regulated investment companies and real estate investment trusts.	Mar. 31, 1980	May 27, 1980
26 CFR 1.411(d)-1 added.	Coordination of vesting and discrimination requirements for qualified plans.	April 9, 1980	June 9, 1980
26 CFR 1.1502-12, amended; 1.1502-44, added.	Consolidated returns for percentage depletion for independent producers and royalty owners.	April 9, 1980	June 9, 1980
26 CFR 1.21-1—53.4940-1 and intermediate sections amended.	Changes in the holding period required for gains or losses on transactions in capital assets to be treated as long-term capital gains or losses and changes in certain terms relating to transactions in capital assets.	April 9, 1980	June 9, 1980
26 CFR 1.1402(c)-3, 301.6652-1, amended; 1.6050A-1, 31.3121(b)(20)-1, 31.3401(a)(17)-1, 301.6050 A-1 added.	Treatment of certain crewmen on boats engaged in catching fish as self-employed rather than as employees.	April 9, 1980	June 9, 1980

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.1371-1, 1.1372-1 through 1.1372-4, amended; Part 14, deleted.	Certain shareholder requirements and related matters for electing small business corporations.	April 17, 1980	June 13, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1, dated January 7, 1980.

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[1] See footnote at end of list.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1 I.R.B., dated January 7, 1980.

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______	*1929–1*	*2.50*
______	*1929–2*	*3.15*
______	1930–1	7.30
______	1930–2	9.50
______	*1931–1*	*3.60*
______	*1931–2*	*3.25*
______	*1932–1*	*2.80*
______	1932–2	8.65
______	*1933–1*	*3.35*
______	*1933–2*	*3.45*
______	*1934–1*	*3.70*
______	*1934–2*	*4.10*
______	1935–1	6.90
______	*1935–2*	*4.00*
______	*1936–1*	*3.55*
______	*1936–2*	*3.90*
______	*1937–1*	*3.75*
______	1937–2	7.70
______	*1938–1*	*4.05*
______	*1938–2*	*3.50*
______	1939–1–1	8.25
______	1939–1–2	10.90
______	1939–2	9.40
______	1940–1	5.55
______	1940–2	14.00
______	1941–1	*$6.95*
______	*1941–2*	*3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
______	*1944*(*)	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*2.65*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$10.10
______	1957–2	13.00
______	1958–1	9.60
______	1958–2	13.00
______	1958–3	15.00
______	1959–1	15.00
______	1959–2	9.60
______	1960–1	9.00
______	1960–2	11.50
______	1961–1	14.00
______	1961–2	10.00
______	1962–1	6.20
______	1962–2	7.15
______	1962–3	15.00
______	1963–1	9.00
______	1963–2	10.75
______	1964–1–1	10.00
______	1964–1–2	11.00
______	1964–2	9.80
______	1965–1	10.70
______	1965–2	12.25
______	1966–1	9.25
______	1966–2	14.05
______	1967–1	10.00
______	1967–2	10.00
______	1968–1	14.00
______	1968–2	11.75
______	1969–1	7.50
______	1969–2	6.50
______	1969–3	$12.50
______	1970–1	11.00
______	1970–2	14.00
______	1971–1	10.55
______	1971–2	8.50
______	1972–1	13.50
______	1972–2	13.70
______	1973–1	13.20
______	1973–2	8.30
______	1974–1	11.00
______	1974–2	9.95
______	*1974–3*	*8.20*
______	1974–3 Supp.	10.00
______	1975–1	13.25
______	1975–2	13.00
______	1976–1	11.00
______	1976–2	10.25
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______	1976–3–2	16.00
______	1976–3–3	10.00
______	1977–1	10.75
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______	1978–2	13.00
______	1978–3–1	12.25
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May 27, 1980
Bulletin No. 1980-21

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Announcement 80-66, page 94.
The entertainment facilities rules set forth in section 274(a)(2)(C) of the Code have been clarified by Pub. L. 96-222 to allow a deduction for social, athletic, and sporting club dues or fees.

TAX CONVENTIONS

United Kingdom, page 5.
The income tax convention and protocols between the United States and the United Kingdom of Great Britain and Northern Ireland are reproduced.

Rev. Proc. 80-18, page 89.
United States-United Kingdom Income Tax Convention. Procedures are set forth for taxpayers to follow in applying certain provisions of the new United States-United Kingdom Income Tax Convention that concern the United Kingdom Advance Corporation Tax, foreign tax credits for United Kingdom taxes, and U.S. taxes on United Kingdom residents.

ADMINISTRATIVE

Announcement 80-67, page 94.
Schedule B (Form 3468)-FY 1979-80, Computation of Business Energy Investment Credit, to be used by taxpayers who have tax years beginning in 1979 and ending in 1980 is available at district offices.

Finding Lists begin on page 99.
Announcement of Disbarments and Suspensions begins on page 95.
Announcement of Notice of Proposed Rulemaking on page 97.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

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Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 901.—Taxes of Foreign Countries and of Possessions of United States

26 CFR 1.901-1: Allowance of credit for taxes.

A procedure providing information with respect to how qualifying United States taxpayers should go about claiming a refund from the United Kingdom Government of the United Kingdom Advance Corporation Tax provided by Article 10 of the new United States-United Kingdom Income Tax Convention, and providing information with respect to the United States tax consequences of the new Convention for United Kingdom residents with respect to refunds of United States tax and additional United States tax due. See Rev. Proc. 80-18, page 89.

Section 902.—Credit for Corporate Stockholder in Foreign Corporation

26 CFR 1.902-1: Credit for domestic corporate shareholder of a foreign corporation.

A procedure providing information with respect to how qualifying United States taxpayers should go about claiming a refund from the United Kingdom Government of the United Kingdom Advance Corporation Tax provided by Article 10 of the new United States-United Kingdom Income Tax Convention, and providing information with respect to the United States tax consequences of the new Convention for United Kingdom residents with respect to refunds of United States tax and additional United States tax due. See Rev. Proc. 80-18, page 89.

Section 905.—Applicable Rules [Foreign Tax Credit]

26 CFR 1.905-3: Redetermination of the tax when credit proves incorrect.

A procedure providing information with respect to how qualifying United States taxpayers should go about claiming a refund from the United Kingdom Government of the United Kingdom Advance Corporation Tax provided by Article 10 of the new United States-United Kingdom Income Tax Convention, and providing information with respect to the United States tax consequences of the new Convention for United Kingdom residents with respect to refunds of United States tax and additional United States tax due. See Rev. Proc. 80-18, page 89.

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions

United States-United Kingdom Income Tax Convention [1]

Convention signed at London December 31, 1975;

Exchange of notes signed at London April 13, 1976;

First Protocol signed at London August 26, 1976;

Second Protocol signed at London March 31, 1977;

Third Protocol signed at London March 15, 1979;

Ratification of the Convention, exchange of notes and the first two Protocols advised by the Senate of the United States of America June 27, 1978;

Ratification of the third Protocol advised by the Senate of the United States of America July 9, 1979;

Convention, exchange of notes, and first two Protocols ratified by the President of the United States of America August 1, 1978;

Third Protocol ratified by the President of the United States of America August 24, 1979;

Convention, exchange of notes, and three Protocols ratified by the United Kingdom of Great Britain and Northern Ireland March 10, 1980;

Ratifications exchanged at Washington March 25, 1980;

Proclaimed by the President of the United States of America April 9, 1980;

Entered into force April 25, 1980.

BY THE PRESIDENT
OF THE UNITED STATES
OF AMERICA

A PROCLAMATION

CONSIDERING THAT:

The Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains was signed at London on December 31, 1975, and an exchange of notes was signed at London on April 13, 1976, modifying certain provisions of the Convention, and three Protocols were signed at London on August 26, 1976, March 31, 1977 and March 15, 1979, the texts of which are hereto annexed;

The Senate of the United States of America by its resolution of June 27, 1978, two-thirds of the Senators present concurring therein, gave its advice and consent to ratification of the Convention, exchange of notes, and two Protocols, subject to the reservation that the provisions of paragraph (4) of Article 9 of the Convention, as amended by the notes exchanged on April 13, 1976, shall not apply to any political subdivision or local authority of the United States;

The Senate of the United States of America by its resolution of July 9, 1979, two-thirds of the Senators present concurring therein, gave its advice and consent to ratification of the Third Protocol;

The Convention, exchange of notes, and two Protocols were ratified, subject to the aforementioned reservation, by the President of the United States of America on August 1, 1978, in pursuance of the advice and consent of the Senate;

The Third Protocol was ratified by the President of the United States of America on August 24, 1979, in pursuance of the advice and consent of the Senate;

The Convention, exchange of notes, and three Protocols were ratified on the part of the United Kingdom of Great Britain and Northern Ireland on March 10, 1980;

It is provided in Article 28 of the Convention that the Convention shall enter into force immediately after the expiration of thirty days following the date on which the instruments of ratification are exchanged;

The instruments of ratification of the Convention were exchanged at Washington on March 25, 1980, and accordingly the Convention, exchange of notes, and three Protocols, enter into force on April 25, 1980;

NOW, THEREFORE, I, Jimmy Carter, President of the United States of America, proclaim and make public the Convention, exchange of notes, and the three Protocols, to the end that they shall be observed and fulfilled with good faith on and after April 25, 1980, by the United States of America and by the citizens of the United States of America and all other persons subject to the jurisdiction thereof.

IN TESTIMONY WHEREOF, I have signed this proclamation and caused the Seal of the United States of America to be affixed.

DONE at the city of Washington this ninth day of April in the year of our Lord one thousand nine hundred eighty and of the Independence of the United States of America the two hundred fourth.

[SEAL]

Jimmy Carter

By the President:
Cyrus Vance
Secretary of State

CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND CAPITAL GAINS

The Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland;

Desiring to conclude a new Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains;

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[1] Treaties and Other International Act Series (TIAS 9682). Pertinent excerpts from Senate Report No. 95-18, page 21 and Senate Report No. 96-5, page 49; Treasury Department Technical Explanation of Convention and first two Protocols, page 62; Treasury Department Technical Explanation of third Protocol, page 84; Senate Executives J and Q are not published.

Have agreed as follows:

Article 1—Personal Scope

(1) Except as specifically provided herein, this Convention is applicable to persons who are residents of one or both of the Contracting States.

(2) A corporation which is both a resident of the United Kingdom within the meaning of paragraph (1)(*a*)(ii) of Article 4 (Fiscal Residence), and a resident of the United States within the meaning of paragraph (1)(*b*)(ii) of such Article 4 shall be considered to be outside of the scope of this Convention except for the purposes of Articles 24 (Non-discrimination) and 26 (Exchange of Information and Administrative Assistance).

(3) Notwithstanding any provision of this Convention except paragraph (4) of this Article, a Contracting State may tax its residents (as determined under Article 4 (Fiscal Residence)) and its nationals as if this Convention had not come into effect.

(4) Nothing in paragraph (3) of this Article shall affect the application by a Contracting State of:

(*a*) Article 9 (Associated Enterprises), Articles 23 (Elimination of Double Taxation), 24 (Non-discrimination), and 25 (Mutual Agreement Procedure); and

(*b*) Articles 19 (Government Service), 20 (Teachers), 21 (Students and Trainees) and 27 (Effect of Convention on Diplomatic and Consular Officials and Domestic Laws), with respect to individuals who are neither nationals of, nor have immigrant status in, that State.

Article 2—Taxes Covered

(1) This Convention shall apply to taxes on income imposed by each Contracting State and as hereinafter provided to taxes imposed by its political subdivisions or local authorities.

(2) The existing taxes to which this Convention shall apply are:

(*a*) in the case of the United States, the Federal income taxes imposed by the Internal Revenue Code and the tax on insurance premiums paid to foreign insurers; but (except as provided in paragraph (6) of Article 10 (Dividends)) excluding the accumulated earnings tax and the personal holding company tax. The foregoing taxes covered are hereinafter referred to as "United States tax";

(b) in the case of the United Kingdom, the income tax, the capital gains tax, the corporation tax and the petroleum revenue tax. The foregoing taxes covered are hereinafter referred to as "United Kingdom tax"; and

(*c*) for the purposes of paragraph (4) of Article 9 (Associated Enterprises), taxes imposed on income by political subdivisions or local authorities of a Contracting State.

(3) This Convention shall also apply to any identical or substantially similar taxes which are imposed by a Contracting State or its political subdivisions or local authorities after the date of signature of this Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any changes which have been made in their respective taxation laws.

(4) For the purposes of Article 24 (Non-discrimination), this Convention shall also apply to taxes of every kind and description imposed by each Contracting State, or by its political subdivisions or local authorities.

Article 3—General Definitions

(1) In this Convention, unless the context otherwise requires:

(*a*) the term "corporation" means a United States corporation, a United Kingdom corporation, or any body corporate or other entity of a third State which is treated as a body corporate for tax purposes by both Contracting States;

(*b*) the term "United States corporation" means:

(i) a corporation (or any unincorporated entity treated as a corporation for United States tax purposes) which is created or organized under the laws of the United States or any state thereof or the District of Columbia; and

(ii) the term "United Kingdom corporation" means any body corporate or unincorporated association created or organized under the laws of the United Kingdom, but does not include a partnership, a local authority, or a local authority association;

(*c*) the term "person" includes an individual, a corporation, a partnership, an estate, a trust and any other body of persons;

(*d*) the term "enterprise of a Contracting State" means an industrial or commercial undertaking carried on by a resident of a Contracting State;

(*e*) the term "international traffic" means any transport by a ship or aircraft operated by an enterprise of a Contracting State, except when the ship or aircraft is operated solely between places in the other Contracting State;

(*f*) the term "competent authority" means:

(i) in the case of the United States, the Secretary of the Treasury or his delegate, and

(ii) in the case of the United Kingdom, the Commissioners of Inland Revenue or their authorized representatives;

(*g*) the term "United States" means:

(i) the United States of America; and

(ii) when used in a geographical sense, the States thereof and the District of Columbia. Such term also includes: (*aa*) the territorial sea thereof, and (*bb*) the seabed and subsoil of the submarine areas adjacent to the coast thereof, but beyond the territorial sea, over which the United States exercises sovereign rights, in accordance with international law, for the purpose of exploration for and exploitation of the natural resources of such areas, but only to the extent that the person, property, or activity to which the Convention is being applied is connected with such exploration or exploitation;

(*h*)(i) the term "United Kingdom" means Great Britain and Northern Ireland, including any area outside the territorial sea of the United Kingdom which in accordance with international law has been or may hereafter be designated, under the laws of the United Kingdom concerning the Continental Shelf, as an area within which the rights of the United Kingdom with respect to the seabed and subsoil and their natural resources may be exercised;

(*i*) the term "Contracting State" means the United States or the United Kingdom, as the context requires;

(*j*) the term "nationals" means:

(i) in relation to the United Kingdom, all citizens of the United Kingdom and Colonies, British subjects under Sections 2, 13(1) or 16 of the British Nationality Act 1948, and British subjects by virtue of Section 1 of the British Nationality Act 1965, provided they are partial within the meaning of the Immigration Act 1971, so far as these provisions are in force on the date of entry into force of this Convention or have been modified only in minor respects so as not to affect their general character;

(ii) in relation to the United States, United States citizens.

(2) As regards the application of this Convention by a Contracting State any term not otherwise defined shall, unless the context otherwise requires and subject to the provisions of Article 25 (Mutual Agreement Procedure), have the meaning which it has under the laws of that Contracting State relating to the taxes which are the subject of this Convention.

ARTICLE 4—FISCAL RESIDENCE

(1) For the purposes of this Convention:

(*a*) the term "resident of the United Kingdom" means:

(i) any person, other than a corporation, resident in the United Kingdom for the purposes of United Kingdom tax; but in the case of a partnership, estate, or trust, only to the extent that the income derived by such partnership, estate, or trust is subject to United Kingdom tax as the income of a resident, either in its hands or in the hands of its partners or beneficiaries; and

(ii) a corporation whose business is managed and controlled in the United Kingdom;

(*b*) the term "resident of the United States" means:

(i) any person, other than a corporation, resident in the United States for the purposes of United States tax; but in the case of a partnership, estate, or trust, only to the extent that the income derived by such partnership, estate, or trust is subject to United States tax as the income of a resident, either in its hands or in the hands of its partners or beneficiaries; and

(ii) a United States corporation.

(2) Where by reason of the provisions of paragraph (1) an individual is a resident of both Contracting States, then the individual's tax status shall be determined as follows:

(*a*) the individual shall be deemed to be a resident of the Contracting State in which he has a permanent home available to him. If the individual has a permanent home available to him in both Contracting States or in either of the Contracting States, he shall be deemed to be a resident of the Contracting State with which his personal and economic relations are closest (centre of vital interests);

(*b*) if the Contracting State in which the individual's centre of vital interests is located cannot be determined, he shall be deemed to be a resident of that Contracting State in which he has an habitual abode;

(*c*) if the individual has an habitual abode in both Contracting States or in neither of them, he shall be deemed to be a resident of the Contracting State of which he is a national; and

(*d*) if the individual is a national of both Contracting States or of neither of them, the competent authorities of the Contracting States shall settle the question by mutual agreement.

(3) Where by reason of the provisions of paragraph (1) an estate or trust may be a resident of both Contracting States, the competent authorities of the Contracting States may settle the question of residence by mutual agreement.

(4) Where under any provision of this Convention income arising in one of the Contracting States is relieved from tax in that Contracting State and, under the law in force in the other Contracting State a person, in respect of the said income, is subject to tax by reference to the amount thereof which is remitted to or received in that other Contracting State and not by reference to the full amount thereof, then the relief to be allowed under this Convention in the first-mentioned Contracting State shall apply only to so much of the income as is remitted to or received in the other Contracting State.

ARTICLE 5—PERMANENT ESTABLISHMENT

(1) For the purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on.

(2) The term "permanent establishment" shall include especially:

(*a*) a branch;

(*b*) an office;

(*c*) a factory;

(*d*) a workshop;

(*e*) a mine, oil or gas well, quarry, or other place of extraction of natural resources; and

(*f*) a building or construction or installation project which exists for more than 12 months.

(3) Notwithstanding the provisions of the preceding paragraphs, the term "permanent establishment" shall be deemed not to include a fixed place of business used solely for one or more of the following activities:

(*a*) the storage, display, or delivery of goods or merchandise belonging to the enterprise;

(*b*) the maintenance of a stock of goods or merchandise belonging to the enterprise for the purpose of storage, display or delivery;

(*c*) the maintenance of a stock of goods or merchandise belonging to the enterprise for the purpose of processing by another person;

(*d*) the maintenance of a fixed place of business for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise;

(*e*) the maintenance of a fixed place of business for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the enterprise; or

(*f*) a building or construction or installation project which does not exist for more than 12 months.

(4) A person acting in a Contracting State on behalf of an enterprise of the other Contracting State—other than an agent of an independent status to whom paragraph (5) applies—shall be deemed to be a permanent establishment of the enterprise in the first-mentioned State if such person has, and habitually exercises in that State, an authority to conclude contracts in the name of the enterprise, unless the contracts are confined to the activities described in paragraph (3) of this Article.

(5) An enterprise of a Contracting State shall not be deemed to have a permanent establishment in the other Contracting State merely because it carries on business in that other State through a broker, general commission agent or any other agent of independent status, where such persons are acting in the ordinary course of their business.

(6) The fact that a corporation which is a resident of a Contracting State controls or is controlled by a corporation which is a resident of the other Contracting State, or which carries on business in that other State (whether through a permanent establishment or otherwise), shall not of itself constitute either corporation a permanent establishment of the other.

ARTICLE 6—INCOME FROM IMMOVABLE PROPERTY (REAL PROPERTY)

(1) Income from immovable property (real property), including income from agriculture or forestry, may be taxed in the Contracting State in which such property is situated.

(2) The term "immovable property" shall be defined in accordance with the law of the Contracting State in which the property in question is situated. The term shall in any case include usufruct of immovable property and rights to variable or fixed payments as consideration for the working of, or the right to work, mineral deposits, sources and other natural resources; ships, boats and aircraft shall not be regarded as immovable property.

(3) The provisions of paragraph (1) shall apply to income derived from the direct use, letting, or use in any other form of immovable property.

ARTICLE 7—BUSINESS PROFITS

(1) The business profits of an enterprise of a Contracting State shall be taxable only in that State unless the enterprise carried on business in the other Contracting State through a permanent establishment situated therein. If the enterprise carries on business as aforesaid, the business profits of the enterprise may be taxed in that other State but only so much of them as is attributable to that permanent establishment.

(2) Subject to the provisions of paragraph (3), where an enterprise of a Contracting State carries on business in the other Contracting State through a permanent establishment situated therein, there shall in each Contracting State be attributed to that permanent establishment the profits which it might be expected to make if it were a distinct and separate enterprise engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

(3) In the determination of the profits of a permanent establishment, there shall be allowed as deductions those expenses which are incurred for the purposes of the permanent establishment, including a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the purposes of the enterprise as a whole (or the part thereof which includes the permanent establishment), whether incurred in the State in which the permanent establishment is situated or elsewhere.

(4) No business profits shall be attributed to a permanent establishment by reason of the mere purchase by that permanent establishment of goods or merchandise for the enterprise.

(5) For the purposes of the preceding paragraphs, the profits to be attributed to the permanent establishment shall be determined by the same method year by year unless there is good and sufficient reason to the contrary.

(6) Where profits include items of income which are dealt with separately in other Articles of this Convention, then the provisions of those Articles shall not be affected by the provisions of this Article.

(7) For the purposes of this Convention, "business profits" includes, but is not limited to, income derived from manufacturing, mercantile, banking, insurance, agricultural, fishing or mining activities, the operation of ships or aircraft, the furnishing of services, the rental of tangible personal (movable) property, and the rental or licensing of cinematographic films or films or tapes used for radio or television broadcasting or from copyrights thereof. Such term also includes any other income effectively connected with a permanent establishment which the recipient, being a resident of one of the Contracting States, has in the other Contracting State. Such term does not include the performance of personal services by an individual either as an employee or in an independent capacity.

ARTICLE 8—SHIPPING AND AIR TRANSPORT

(1) Notwithstanding the provisions of Article 7 (Business Profits), profits of an enterprise of a Contracting State from the operation in international traffic of ships or aircraft registered under the laws of the Contracting State in which the person carrying on the enterprise is resident shall be taxable only in that State.

(2) For the purposes of this Article, profits from the operation of ships or aircraft in international traffic include profits derived from the rental on a bareboat basis of ships or aircraft operated in international traffic if such rental income is incidental to other income described in paragraph (1).

(3) Notwithstanding the provisions of Article 7 (Business Profits), profits of an enterprise of a Contracting State from the use, maintenance or rental of containers (including trailers and related equipment for the transport of containers) used for the transport of goods or merchandise in international traffic shall be taxable only in that State.

(4) Gains derived by an enterprise

of a Contracting State from the alienation of ships, aircraft or containers owned and operated by the enterprise, the income from which is taxable only in that State, shall be taxable only in that State.

ARTICLE 9—ASSOCIATED ENTERPRISES

(1) Where an enterprise of a Contracting State is related to another enterprise and conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would have been made between independent enterprises, then any income, deductions, receipts, or outgoings which would, but for those conditions, have been attributed to one of the enterprises but by reason of those conditions have not been so attributed, may be taken into account in computing the profits or losses of that enterprise and taxed accordingly.

(2) Where any income, deductions, receipts, or outgoings which have been taken into account in one Contracting State in computing the profits or losses of an enterprise are also taken into account in the other Contracting State in computing the profits and losses of a related enterprise in accordance with paragraph (1) of this Article, then the first-mentioned State shall make such adjustment as may be appropriate to the amount of tax charged on those profits in that State.

(3) If one Contracting State disagrees with the amount of any income, deductions, receipts, or outgoings, taken into account in computing profits or losses in the other in accordance with paragraph (1), the two Contracting States shall endeavor to reach agreement in accordance with the procedure in Article 25 (Mutual Agreement Procedure).

(4) Except as specifically provided in this Article, in determining the tax liability of an enterprise doing business in a Contracting State, or in a political subdivision or local authority of a Contracting State, such Contracting State, political subdivision, or local authority shall not take into account the income, deductions, receipts, or outgoings of a related enterprise of the other Contracting State or of an enterprise of any third State related to an enterprise of the other Contracting State.

(5) For the purposes of this Convention, an enterprise is related to another enterprise if either enterprise directly or indirectly controls the other, or if any third person or persons (related to each other or acting together) control both.

ARTICLE 10—DIVIDENDS

(1) Dividends derived from a corporation which is a resident of a Contracting State by a resident of the other Contracting State may be taxed in the other Contracting State. However, such dividends may be taxed in the Contracting State of which the corporation paying the dividends is a resident, but if the beneficial owner is a resident of the other Contracting State, the tax so charged shall not exceed 15 per cent of the gross amount of the dividends.

(2) As long as an individual resident in the United Kingdom is entitled under United Kingdom law to a tax credit in respect of dividends paid by a corporation which is resident in the United Kingdom, paragraph (1) of this Article shall not apply. In these circumstances, dividends derived from a corporation which is a resident of a Contracting State by a resident of the other Contracting State may be taxed in the other Contracting State. However, such dividends may be taxed in the Contracting State of which the corporation paying the dividends is a resident, but if the beneficial owner is a resident of the other Contracting State, the tax so charged shall not exceed the tax provided in sub-paragraphs (*a*) and (*b*) below:

(*a*) In the case of dividends paid by a corporation which is a resident of the United Kingdom:

(i) to a United States corporation which either alone or together with one or more associated corporations controls, directly or indirectly, at least 10 per cent of the voting stock of the corporation which is a resident of the United Kingdom paying the dividend, the United States corporation shall be entitled to a payment from the United Kingdom of a tax credit equal to one-half of the tax credit to which an individual resident in the United Kingdom would have been entitled had he received the dividend, subject to the deduction withheld from such payment and according to the laws of the United Kingdom of an amount not exceding 5 per cent of the aggregate of the amount or value of the dividend and the amount of the tax credit paid to such corporation;

(ii) in all other cases, the resident of the United States to whom such dividend is paid shall be entitled to a payment from the United Kingdom of the tax credit to which an individual resident in the United Kingdom would have been entitled had he received the dividend, subject to the deduction withheld from such payment and according to the laws of the United Kingdom of an amount not exceeding 15 per cent of the aggregate of the amount or value of the dividend and the amount of the tax credit paid to such resident;

(iii) the aggregate of the amount or value of the dividend and the amount of the tax credit referred to in sub-paragraphs (*a*) (i) and (ii) of this paragraph paid by the United Kingdom to the United States corporation or other resident (without reduction for the 5 or 15 per cent deduction, as the case may be, by the United Kingdom) shall be treated as a dividend for United States tax credit purposes.

(*b*) In the case of dividends paid by a United States corporation:

(i) to a corporation which is a resident of the United Kingdom and controls, directly or indirectly, at least 10 per cent of the voting stock of the United States corporation paying such dividend, the tax charged by the United States shall not exceed 5 per cent of the gross amount of the dividend;

(ii) in all other cases, the tax charged by the United States on payment of a dividend to a resident of the United Kingdom shall not exceed 15 per cent of the gross amount of the dividend.

For the purposes of this paragraph, two corporations shall be deemed to be associated if one controls directly or indirectly more than 50 per cent of the voting power in the other corporation, or a third corporation controls more than 50 per cent of the voting power in both of them.

(3) The term "dividends" for United Kingdom tax purposes includes any item which under the law of the United Kingdom is treated as a distribution and for United States tax purposes includes any item which under the law of the United States is treated as a distribution out of earnings and profits.

(4) Paragraph (1) or (2), as the case may be, shall not apply if the person deriving the dividends, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with such permanent establishment or fixed base. In such a case the provisions of Articles 7 (Business Profits), 14 (Independent Personal Services), or 17 (Artistes and Athletes), as the case may be, shall apply.

(5) Where a corporation which is a resident of a Contracting State derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the corporation, except insofar as such dividends are paid to a resident of that other State (and where that other State is the United States, to a national of the United States) or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or fixed base situated in that other State, even if the dividends paid consist wholly or partly of profits or income arising in that other State.

(6) A corporation which is a resident of the United Kingdom shall be exempt from United States tax on its accumulated or undistributed earnings, profits, income or surplus, if individuals (other than nationals of the United States) who are residents of the United Kingdom control, directly or indirectly, throughout the last half of the taxable year, more than 50 per cent of the entire voting power in such corporation.

(7) (*a*) If the beneficial owner of a dividend being a resident of a Contracting State owns 10 per cent or more of the class of shares of a corporation in respect of which the dividend is paid, then paragraph (1), or as the case may be paragraph (2), of this Article shall not apply to the dividend to the extent that it can have been paid only out of profits which the corporation paying the dividend earned or other income which it received in a period ending 12 months or more before the relevant date. For the purposes of this paragraph the term "relevant date" means the date on which the beneficial owner of the dividend became the owner of 10 per cent or more of the class of shares in question.

(*b*) Paragraphs (1) and (2) of this Article shall not apply if:

(i) the recipient of the dividend is exempt from tax thereon in the United States; and

(ii) the dividend is paid in such circumstances that, if the recipient were a resident of the United Kingdom exempt from United Kingdom tax, the exemption would be limited or removed.

Provided that this paragraph shall not apply if the beneficial owner of the dividend shows that the shares were acquired for bona fide commercial reasons and not primarily for the purposes of securing the benefits of this Article.

ARTICLE 11—INTEREST

(1) Interest derived and beneficially owned by a resident of the United Kingdom shall be exempt from tax by the United States.

(2) Interest derived and beneficially owned by a resident of the United States shall be exempt from tax by the United Kingdom.

(3) The term "interest" as used in this Article means income from Government securities, bonds or debentures, whether or not secured by mortgage and whether or not carrying a right to participate in profits, and other debt claims of every kind as well as all other income assimilated to income from money lent by the taxation law of the State in which the income arises but subject to the provisions of paragraph (7) of this Article shall not include any income which is treated as a distribution under the provisions of Article 10 (Dividends). Penalty charges for late payment shall not be regarded as interest for the purpose of this Article.

(4) The provisions of paragraphs (1) and (2) shall not apply if the person deriving the interest, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the debt claim in respect of which the interest is paid is effectively connected with such permanent establishment or fixed base. In such a case, the provisions of Article 7 (Business Profits), Article 14 (Independent Personal Services), or Article 17 (Artistes and Athletes), as the case may be, shall apply.

(5) Where, owing to a special relationship between the payer and the person deriving the interest or between both of them and some other person, the amount of the interest paid exceeds for whatever the reason the amount which would have been paid in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In that case, the excess part of the payments shall remain taxable according to the law of each Contracting State, due regard being had to the other provisions of this Convention.

(6) Whether or not a resident of a Contracting State derives profits or income from the other Contracting State, the other State may not impose any tax on the interest paid by that resident, except insofar as such inerest is paid to a resident of that other State (and where that other State is the United States, to a national of the United States) or insofar as the debt claim in respect of which the interest is paid is effectively connected with a permanent establishment or a fixed base of the person deriving interest situated in that other State.

(7) Any provision in the law of either Contracting State relating only

to interest paid to a non-resident corporation shall not operate so as to require such interest paid to a resident of the other Contracting State to be treated as a distribution by the corporation paying such interest. The preceding sentence shall not apply to interest paid to a corporation of one Contracting State in which more than 50 percent of the voting power is controlled, directly or indirectly, by a person or persons who are residents of the other Contracting State.

(8) The provisions of paragraph (2) of this Article shall not apply if the recipient of the interest is exempt from tax on such income in the United States and such recipient sells or makes a contract to sell the holding from which such interest is derived within three months of the date such recipient acquired such holding.

ARTICLE 12—ROYALTIES

(1) Royalties derived and beneficially owned by a resident of the United Kingdom shall be exempt from tax by the United States.

(2) Royalties derived and beneficially owned by a resident of the United States shall be exempt from tax by the United Kingdom.

(3) The term "royalties" as used in this Article (*a*) means payments of any kind received as a consideration for the use of, or the right to use, any copyright of literary, artistic or scientific work (but not including cinematographic films or films or tapes used for radio or television broadcasting); any patent, trade mark, design or model plan, secret formula or process, or other like right or property, or for information concerning industrial, commercial or scientific experience; and (*b*) shall include gains derived from the alienation of any such right or property which are contingent on the productivity, use, or disposition thereof; including the supply of assistance of an ancillary and subsidiary nature furnished as a means of enabling the application or enjoyment of any such right or property.

(4) The provisions of paragraphs (1) and (2) of this Article shall not apply if the person deriving the royalties, being a resident of a Contracting State, carries on business in the other Contracting State in which the royalties arise, through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the royalties are paid is effectively connected with such permanent establishment or fixed base. In such a case the provisions of Article 7 (Business Profits), Article 14 (Independent Personal Services), or Article 17 (Artistes and Athletes), as the case may be, shall apply.

(5) Where, owing to a special relationship between the payer and the person deriving the royalties or between both of them and some other person, the amount of the royalties paid exceeds for whatever reason the amount which would have been paid in the absence of such relationship, the provisions of this Article shall apply only to the last-mentioned amount. In that case, the excess part of the payments shall remain taxable according to the law of each Contracting State, due regard being had to the other provisions of this Convention.

ARTICLE 13—CAPITAL GAINS

Except as provided in Article 8 (Shipping and Air Transport) of this Convention, each Contracting State may tax capital gains in accordance with the provisions of its domestic law.

ARTICLE 14—INDEPENDENT PERSONAL SERVICES

Income derived by an individual who is a resident of one of the Contracting States from the performance of personal services in an independent capacity may be taxed in that State. Such income may also be taxed in the other Contracting State if:

(*a*) the individual is present in that other State for a period or periods exceeding in the aggregate 183 days in the tax year concerned, but only so much thereof as is attributable to services performed in that State, or

(*b*) the individual has a fixed base regularly available to him in that other State for the purpose of performing his activities, but only so much thereof as is attributable to services performed in that State.

ARTICLE 15—DEPENDENT PERSONAL SERVICES

(1) Subject to the provisions of Articles 18 (Pensions) and 19 (Government Service), salaries, wages and other similar remuneration derived by a resident of a Contracting State in respect of an employment shall be taxable only in that State unless the employment is exercised in the other Contracting State. If the employment is so exercised, such remuneration as is derived therefrom may be taxed in that other State.

(2) Notwithstanding the provisions of paragraph (1), remuneration derived by a resident of a Contracting State in respect of an employment exercised in the other Contracting State shall be taxable only in the first-mentioned State if:

(*a*) the recipient is present in that other State for a period not exceeding in the aggregate 183 days in the tax year concerned; and

(*b*) the remuneration is paid by, or on behalf of, an employer who is not a resident of that other State; and

(*c*) the remuneration is not borne as such by a permanent establishment or a fixed base which the employer has in that other State.

(3) Notwithstanding the preceding provisions of this Article, remuneration in respect of an employment as a member of the regular complement of a ship or aircraft in international traffic may be taxed by the Contracting State of which the employer operating the ship or aircraft is a resident.

ARTICLE 16—INVESTMENT OR HOLDING COMPANIES

The provisions of Articles 10 (Dividends), 11 (Interest) or 12 (Royalties) of this Convention shall not apply to a corporation which is a resident of one of the Contracting States and which derives dividends, interest, or royalties arising within the other Contracting State if:

(*a*) (i) the tax imposed on the corporation by the first-mentioned Contracting State in respect of such dividends, interest or royalties is substantially less than the tax generally imposed by that State on corporate profits; or

(ii) the corporation is a resident of the United States and receives more than eighty per cent of its gross income from sources outside the United States as determined by and for the period prescribed in sections 861(*a*)(1)(B) and (*a*)(2)(A) of the Internal Revenue Code of 1954, as they may be amended from time to time in minor respects so as not to affect their general principle; and

(*b*) 25 per cent or more of the capital of such corporation is owned directly or indirectly by one or more persons who are not individual residents of the first-mentioned Contracting State and are not nationals of the United States.

ARTICLE 17—ARTISTES AND ATHLETES

(1) Notwithstanding the provisions of Articles 14 (Independent Personal Services) and 15 (Dependent Personal Services), income derived by entertainers, such as theatre, motion picture, radio or television artistes, and musicians, and by athletes, from their personal activities as such may be taxed in the Contracting State in which these activities are exercised, except where the amount of the gross receipts derived by an entertainer or athlete, including expenses reimbursed to him or borne on his behalf, from such activities do not exceed 15,000 United States dollars or its equivalent in pounds sterling in the tax year concerned.

(2) Where income in respect of personal activities as such of an entertainer or athlete accrues not to that entertainer or athlete himself but to another person, that income may, not withstanding the provisions of Articles 7 (Business Profits), 14 (Independent Personal Services), and 15 (Dependent Personal Services), be taxed in the Contracting State in which the activities of the entertainer or athlete are exercised. For the purposes of the preceding sentence, income of an entertainer or athlete shall be deemed not to accrue to another person if it is established that neither the entertainer or athlete, nor persons related thereto, participate directly or indirectly in the profits of such other person in any manner, including the receipt of deferred remuneration, bonuses, fees, dividends, partnership distributions or other distributions.

ARTICLE 18—PENSIONS

(1) Subject to the provisions of paragraph (2) of Article 19 (Government Service), any pension in consideration of past employment and any annuity paid to an individual who is a resident of a Contracting State shall be taxed only in that State.

(2) Alimony paid to an individual who is a resident of one of the Contracting States by an individual who is a resident of the other Contracting State shall be exempt from tax in the other Contracting State.

(3) The term "annuity" means a stated sum payable periodically at stated times, during life or during a specified or ascertainable period of time, under an obligation to make the payments in return for adequate and full consideration in money or money's worth.

ARTICLE 19—GOVERNMENT SERVICE

(1)(*a*) Remuneration, other than a pension, paid by a Contracting State to any individual in respect of services rendered to that State shall be taxable only in that State.

(*b*) However, such remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the recipient is a resident of that other Contracting State who:

(i) is a national of that State; or

(ii) did not become a resident of that State solely for the purpose of performing the services.

(2)(*a*) Any pension paid by a Contracting State or a political subdivision or a local authority thereof to any individual in respect of services rendered to that State or subdivision or local authority thereof shall be taxable only in that State.

(*b*) However, such pension shall be taxable only in the other Contracting State if the recipient is a national of and a resident of that State.

(3) The provisions of Articles 14 (Independent Personal Services), 15 (Dependent Personal Services), 17 (Artistes and Athletes), and 18 (Pensions), as the case may be, shall apply to remuneration and pensions in respect of services rendered in connection with any business carried on by or on behalf of one of the Contracting States or a political subdivision or a local authority thereof.

ARTICLE 20—TEACHERS

(1) A professor or teacher who visits one of the Contracting States for a period not exceeding two years for the purpose of teaching or engaging in research at a university, college or other recognized educational institution in that Contracting State and who was immediately before that visit a resident of the other Contracting State, shall be exempted from tax by the first-mentioned Contracting State on any remuneration for such teaching or research for a period not exceeding two years from the date he first visits that State for such purpose.

(2) The exemption provided in this Article may be applied by the Contracting State in which the teaching or research is performed to current payments to such professor or teacher in anticipation of fulfilment of the requirements of paragraph (1) or by way of withholding and refund, but in either case exemption shall be conditional upon fulfilment of the requirements of paragraph (1).

(3) This Article shall only apply to income from research if such research is undertaken by the professor or teacher in the public interest and not primarily for the benefit of some other private person or persons.

ARTICLE 21—STUDENTS AND TRAINEES

Payments which a student or business apprentice who was immediately before visiting a Contracting State a resident of the other Contracting State and who is present in the first-mentioned Contracting State for the purpose of his full-time education or training receives for the purpose of his maintenance, education or training shall not be taxed in that State, provided that such payments are made to him from sources outside that State.

ARTICLE 22—OTHER INCOME

(1) Items of income of a resident of a Contracting State, wherever aris-

ing, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State.

(2) The provisions of paragraph (1) shall not apply if the person deriving the income, being a resident of a Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein, or performs in that other State independent personal services from a fixed base situated therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base. In such a case the provisions of Article 7 (Business Profits), Article 14 (Independent Personal Services), or Article 17 (Artistes and Athletes), as the case may be, shall apply.

ARTICLE 23—ELIMINATION OF DOUBLE TAXATION

(1) In accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle hereof), the United States shall allow to a resident or national of the United States as a credit against the United States tax the appropriate amount of tax paid to the United Kingdom; and, in the case of a United States corporation owning at least 10 per cent of the voting stock of a corporation which is a resident of the United Kingdom from which it receives dividends in any taxable year, the United States shall allow credit for the appropriate amount of tax paid to the United Kingdom by that corporation with respect to the profits out of which such dividends are paid. Such appropriate amount shall be based upon the amount of tax paid to the United Kingdom, but the credit shall not exceed the limitations (for the purpose of limiting the credit to the United States tax on income from sources outside of the United States) provided by United States law for the taxable year. For the purposes of applying the United States credit in relation to tax paid to the United Kingdom:

(*a*) the taxes referred to in paragraphs (2)(*b*) and (3) of Article 2 (Taxes Covered) shall be considered to be income taxes;

(*b*) the amount of 5 or 15 per cent, as the case may be, withheld under paragraph (2)(*a*)(i) or (ii) of Article 10 (Dividends) from the tax credit paid by the United Kingdom shall be treated as an income tax imposed on the recipient of the dividend; and

(*c*) that amount of tax credit referred to in paragraph (2)(*a*)(i) of Article 10 (Dividends) which is not paid to the United States corporation but to which an individual resident in the United Kingdom would have been entitled had he received the dividend shall be treated as an income tax imposed on the United Kingdom corporation paying the dividend.

(2) Subject to the provisions of the law of the United Kingdom regarding the allowance as a credit against United Kingdom tax of tax payable in a territory outside the United Kingdom (as it may be amended from time to time without changing the general principle hereof):

(*a*) United States tax payable under the laws of the United States and in accordance with the present Convention, whether directly or by deduction, on profits or income from sources within the United States (excluding in the case of a dividend, tax payable in respect of the profits out of which the dividend is paid) shall be allowed as a credit against any United Kingdom tax computed by reference to the same profits or income by reference to which the United States tax is computed;

(*b*) in the case of a dividend paid by a United States corporation to a corporation which is resident in the United Kingdom and which controls directly or indirectly at least 10 per cent of the voting power in the United States corporation, the credit shall take into account (in addition to any United States tax creditable under (*a*)) the United States tax payable by the corporation in respect of the profits out of which such dividend is paid.

(3) For the purposes of the preceding paragraphs of this Article, income or profits derived by a resident of a Contracting State which may be taxed in the other Contracting State in accordance with this Convention shall be deemed to arise from sources within that other Contracting State, except that where the United States taxes on the basis of citizenship, the United Kingdom shall not be bound to give credit to a United States national who is resident in the United Kingdom on income from sources outside the United States as determined under the laws of the United Kingdom and the United States shall not be bound to give credit for United Kingdom tax on income received by such national from sources outside the United Kingdom, as determined under the laws of the United States.

(4) The provisions of this Article shall not affect the taxation by the United States of foreign oil and gas extraction income and foreign oil related income as provided in the Tax Reduction Act of 1975.

ARTICLE 24—NONDISCRIMINATION

(1) Individuals who are nationals of a Contracting State and who are residents of the other Contracting State shall not be subjected in that other State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which nationals of that other State in the same circumstances are or may be subjected.

(2) The taxation on a permanent establishment which an enterprise of a Contracting State has in the other Contracting State shall not be less favourably levied in that other State than the taxation levied on enterprises of that other State carrying on the same activities.

(3) Subject to the provisions of paragraph (4) of this Article, interest, royalties and other disbursements paid by an enterprise of a Contracting State to a resident of the other Contracting State shall, if reasonable in amount, be deductible for the purpose of determining the taxable profits of such enterprise under the same conditions as if they had been paid to a resident of the first-mentioned State. For the purposes of this paragraph, the term "other disbursements" shall include charges for amounts expended by such residents for the purposes of such enterprise, including a reasonable allocation of executive and general admin-

istrative expenses (except to the extent representing the expenses of a type of activity which is not for the benefit of such enterprise, but constitutes "stewardship" or "over-seeing" functions undertaken for such resident's own benefit as an investor in the enterprise), research and development in respect of which such enterprise has the benefits under a cost and risk sharing agreement and other expenses incurred by such resident for the benefit of a group of related enterprises including such enterprise.

(4) Paragraph (3) shall not apply to any interest, royalties, or other disbursements to which the provisions of Article 9 (Associated Enterprises), paragraphs (5) and (7) of Article 11 (Interest) or paragraph (5) of Article 12 (Royalties) apply, or would apply but for the provisions of paragraph (2) of Article 1 (Personal Scope).

(5) Enterprises of a Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, shall not be subjected in the first-mentioned Contracting State to any taxation or any requirement connected therewith which is other or more burdensome than the taxation and connected requirements to which other similar enterprises of the first-mentioned State are or may be subjected.

(6) Nothing contained in this Article shall be construed as obliging either Contracting State to grant to individuals not resident in that State any of the personal allowances and reliefs which are granted to individuals so resident.

ARTICLE 25—MUTUAL AGREEMENT PROCEDURE

(1) Where a resident or national of a Contracting State considers that the actions of one or both of the Contracting States result or will result in taxation not in accordance with this Convention, he may, notwithstanding the remedies provided by the national laws of those States, present his case to the competent authority of the Contracting State of which he is a resident or national.

(2) The competent authority shall endeavour, if the objection appears to it to be justified and if it is not itself able to arrive at an appropriate solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation not in accordance with the Convention. Where an agreement has been reached, a refund as appropriate shall be made to give effect to the agreement.

(3) The competent authorities of the Contracting States shall endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention. In particular the competent authorities of the Contracting States may reach agreement on:

(*a*) the attribution of income, deductions, credits, or allowances of an enterprise of a Contracting State to its permanent establishment situated in the other Contracting State;

(*b*) the allocation of income, deductions, credits, or allowances between persons;

(*c*) the nature of particular items of income;

(*d*) the meaning of terms not otherwise defined in this Convention;

(*e*) the place where a particular item of income has its source.

(4) The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching agreement as contemplated by this Convention.

ARTICLE 26—EXCHANGE OF INFORMATION AND ADMINISTRATIVE ASSISTANCE

(1) The competent authorities of the Contracting States shall exchange such information (being information available under the respective taxation laws of the Contracting States) as is necessary for carrying out the provisions of this Convention or for the prevention of fraud or the administration of statutory provisions against legal avoidance in relation to the taxes which are the subject of this Convention. Any information so exchanged shall be treated as secret but may be disclosed to persons (including a court or administrative body) concerned with the assessment, collection, enforcement or prosecution in respect of taxes which are the subject of this Convention. No information shall be exchanged which would disclose any trade, business, industrial or professional secret or any trade process.

(2) Each of the Contracting States will endeavour to collect on behalf of the other Contracting State such amounts as may be necessary to ensure that relief granted by this Convention from taxation imposed by such other Contracting State does not enure to the benefit of persons not entitled thereto. The United Kingdom will be regarded as fulfilling this obligation by the continuation of its existing arrangements for ensuring that relief from taxation imposed by the laws of the United States does not enure to the benefit of persons not entitled thereto.

(3) Paragraph (2) of this Article shall not impose upon either of the Contracting States the obligation to carry out administrative measures which are of a different nature from those used in the collection of its own tax, or which would be contrary to its sovereignty, security or public policy. In determining the administrative measures to be carried out, each Contracting State may take into account the administrative measures and practices of the other Contracting State in recovering taxes on behalf of the first-mentioned Contracting State.

(4) The competent authorities of the Contracting States shall consult with each other for the purpose of cooperating and advising in respect of any action to be taken in implementing this Article.

ARTICLE 27—EFFECT ON DIPLOMATIC AND CONSULAR OFFICIALS AND DOMESTIC LAWS

(1) Nothing in this Convention shall affect the fiscal privileges of diplomatic or consular officials under the general rules of international law or under the provisions of special agreements.

(2) This Convention shall not restrict in any manner any exclusion, exemption, deduction, credit, or other allowances now or hereafter accorded by the laws of either Contracting State.

ARTICLE 28—ENTRY INTO FORCE

(1) This Convention shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible.

(2) This Convention shall enter into force immediately after the expiration of thirty days following the date on which the instruments of ratification are exchanged and shall thereupon have effect:

(*a*) in the United Kingdom:

(i) in relation to any dividend to which sub-paragraph (2)(*a*)(ii) of Article 10 (Dividends) applies, in respect of income tax and payment of tax credit, for any year of assessment beginning on or after 6 April 1973. A dividend paid on or after 1 April 1973 and before 6 April 1973 shall be treated for tax credit purposes as paid on 6 April 1973;

(ii) in relation to sub-paragraph (2)(*a*)(i) of Article 10 (Dividends) and any other provision of this Convention, in respect of income tax and payment of tax credit and in respect of capital gains tax, for any year of assessment beginning on or after 6 April 1975;

(iii) in respect of corporation tax, for any financial year beginning on or after 1 April 1975; and

(iv) in respect of petroleum revenue tax, for any chargeable period beginning on or after 1 January 1975;

(*b*) in the United States:

(i) in respect of credits against United States tax allowed under paragraph (1) of Article 23 (Elimination of Double Taxation), for taxes paid to the United Kingdom on or after 1 April 1973;

(ii) in respect of tax withheld at the source, for amounts paid or credited on or after 1 January 1975; and

(iii) in respect of other taxes, for taxable years beginning on or after 1 January 1975.

(3) Subject to the provisions of paragraph (4) of this Article the Convention between the United Kingdom of Great Britain and Northern Ireland and the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income signed at Washington on 16 April 1945 [T.D. 5569, 1947-2 C.B. 100], as amended by the Supplementary Protocol signed at Washington on 6 June 1946 [T.D. 5569, 1947-2 C.B. 100], by the Supplementary Protocol signed at Washington on 25 May 1954 [1957-1 C.B. 665], by the Supplementary Protocol signed at Washington on 19 August 1957 [1958-2 C.B. 1078] and by the Supplementary Protocol signed at London on 17 March 1966 (hereinafter referred to as "the 1945 Convention") [1966-2 C.B. 582], shall cease to have effect in respect of taxes to which this Convention in accordance with the provisions of paragraph (2) of this Article applies.

(4) Where any provision of the 1945 Convention would have afforded any greater relief from tax any such provision as aforesaid shall continue to have effect:

(*a*) in the United Kingdom, for any year of assessment or financial year and

(*b*) in the United States, for any taxable year

beginning, in either case, before 1 January 1976.

(5) The 1945 Convention shall terminate on the last date on which it has effect in accordance with the foregoing provisions of this Article.

(6) This Convention shall not affect any Agreement in force extending the 1945 Convention in accordance with Article XXII thereof.

ARTICLE 29—TERMINATION

(1) This Convention shall remain in force indefinitely but either of the Contracting States may, on or before 30 June in any year after the year 1980, give to the other Contracting State, through diplomatic channels notice of termination and, in such event, the present Convention shall cease to be effective:

(*a*) in respect of United States tax, for the taxable years beginning on or after 1 January in the year next following that in which such notice is given;

(*b*)(i) in respect of United Kingdom income tax and capital gains tax, for any year of assessment beginning on or after 6 April in the year next following that in which such notice is given;

(ii) in respect of United Kingdom corporation tax, for any financial year beginning on or after 1 April in the year next following that in which such notice is given;

(iii) in respect of United Kingdom petroleum revenue tax, for any chargeable period beginning on or after 1 January in the year next following that in which such notice is given.

(2) The termination of the present Convention shall not have the effect of reviving any treaty or arrangement abrogated by the present Convention or by treaties previously concluded between the Contracting States.

In witness whereof the undersigned, duly authorised thereto by their respective Governments, have signed this Convention.

Done in duplicate at London this 31st day of December 1975.

For the Government of the United States of America:

RONALD I. SPIERS.

For the Government of the United Kingdom of Great Britain and Northern Ireland:

GORONWAY-ROBERTS.

VICE CONSUL OF THE
UNITED STATES OF AMERICA,
London, England,
April 13, 1976.

The Right Honorable
ANTHONY CROSLAND MP,

Secretary of State for Foreign and
Commonwealth Affairs, London.

EXCELLENCY: I have the honor to acknowledge receipt of your note of today's date which reads as follows:

"I have the honour to refer to the recent discussions between representatives of our two Governments concerning the Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, signed at London on 31 December 1975, and to propose that the Convention be amended as follows:

1. Replace paragraph (2) of Article 1 (Personal Scope) by the following:

"(2) A corporation which is both a resident of the United Kingdom within the meaning of paragraph (1)(a)(ii) of Article 4 (Fiscal Residence), and a resident of the United States within the meaning of paragraph (1)(b)(ii) of Article 4 shall not be entitled to claim any relief or exemption from tax provided by this Convention, except that such corporation may claim the benefits of Article 23 (Elimination of Double Taxation) with respect to the petroleum revenue tax referred to in paragraph (2)(b) of Article 2 (Taxes Covered), of Article 24 (Nondiscrimination) and of Article 28 (Entry into Force)."

2. Replace sub-paragraph (j) of paragraph (1) of Article 3 (General Definitions) by the following:

"(j) the term "third State" means any State or territory other than the United States or the United Kingdom and the term "enterprise of a third State" shall be construed accordingly".

3. The existing sub-paragraph (j) of paragraph (1) will become a new sub-paragraph (k).

4. Replace paragraph (3) of Article 8 (Shipping and Air Transport) by the following:

"(3) Notwithstanding the provisions of Article 7 (Business Profits), profits of an enterprise of a Contracting State from the use, maintenance or rental of containers (including trailers and related equipment for the transport of containers) used for the transport of goods or merchandise shall be taxable only in that State except where such containers are used for the transport of goods or merchandise solely between places within the other Contracting State".

5. Replace paragraph (4) of Article 9 (Associated Enterprises) by the following:

"(4) Except as specifically provided in this Article:

(*a*) Where an enterprise doing business in one Contracting State:

(i) is a resident of the other Contracting State; or

(ii) is controlled, directly or indirectly, by an enterprise which is a resident of the other Contracting State; and

(*b*) where the enterprise which is a resident of the other Contracting State is a corporation, such corporation is neither:

(i) a controlled foreign corporation within the meaning of Section 957 of the United States Internal Revenue Code of 1954 (as it may be amended from time to time without changing the general principle thereof); nor

(ii) created or organized under the laws of the first-mentioned Contracting State or of any third State or controlled, directly or indirectly, by a corporation which is a resident of any third State;

then, in determining the tax liability of the first-mentioned enterprise in the State in which it does business, or in a political subdivision or local authority of that State, such State, political subdivision or local authority shall not take into account the income, deductions, receipts or outgoings of a related enterprise which is a resident of the other Contracting State or of an enterprise of any third State which is related to the enterprise of the other Contracting State, except that this prohibition shall not apply where the first-mentioned enterprise is a resident of the first-mentioned Contracting State, to the extent that it owns, directly or indirectly, the capital of the related enterprise.

6. Replace Article 16 (Investment or holding companies) by the following:

"ARTICLE 16—INVESTMENT OR HOLDING COMPANIES

(1) The provisions of Articles 10 (Dividends), 11 (Interest) or 12 (Royalties) of this Convention shall not apply to a corporation which is a resident of one of the Contracting States and which derives dividends, interest or royalties arising within the other Contracting State if:

(*a*)(i) the tax imposed on the corporation by the first-mentioned Contracting State in respect of such dividends, interest or royalties is substantially less than the tax generally imposed by that State on corporate profits; or

(ii) the corporation is a resident of the United States and receives more than 80 percent of its gross income from sources outside the United States as determined by and for the period prescribed in Section 861(a)(1)(B) and (a)(2)(A) of the United States Internal Revenue Code of 1954, as they may be amended from time to time in minor respects so as not to affect their general principle and

(*b*) 25 percent or more of the capital of such corporation is owned, directly or indirectly, by one or more persons who are not individual residents of the first-mentioned Contracting State and are not nationals of the United States.

(2) Nothing in this Article shall however prevent a claim under the provisions of Articles 10 (Dividends), 11 (Interest) or 12 (Royalties) by a United States corporation where more than 75 percent of the capital of that corporation is directly or indirectly owned:

(*a*) by a United States corporation which receives 20 percent or more of its gross income from sources within the United States as determined by and for the period described in sub-paragraph (1)(a)(ii) of this Article; or

(*b*) by a corporation (other than a United States corporation) which by reference to the provisions of Section 283 of the United Kingdom Income and Corporation Taxes Act of 1970 (as it may be amended from time to time without changing the general principle thereof) would not fall to be treated as a close company; or

(*c*) by a corporation which is a resident of the United Kingdom and in which more than 50 percent of the voting power is controlled, directly or indirectly, by individuals who are residents of the United Kingdom".

If the foregoing proposals are acceptable to the Government of the United States of America, I have the honour to propose that this Note together with your reply in that sense shall constitute an Agreement between our two Governments which shall enter into force on the same date as the Convention."

I have the honor to inform you that the Government of the United States of America agree to the proposal set forth in the above Note and that your

Note together with this reply shall constitute an agreement between our two Governments which shall enter into force on the same date as the Convention.

Accept, Excellency, the renewed assurances of my highest consideration.

/s/ ANNE ARMSTRONG.

GREAT BRITAIN AND NORTHERN IRELAND,
London, England,
Embassy of the United States of America, ss:

I, the undersigned consular officer of the United States of America, duly commissioned and qualified, do hereby certify that the foregoing is a true and faithful copy of the original/copy this day exhibited to me, the same having been carefully examined by me and compared with the said original/copy and found to agree therewith word for word and figure for figure. In witness whereof I have hereunto set my hand and official seal this thirteenth day of April, 1976.

ROBERT E. WATKINS, JR.

FOREIGN AND COMMONWEALTH OFFICE,
April 13, 1976.

Her Excellency The Hon.
ANNE ARMSTRONG,
American Embassy,
London.

YOUR EXCELLENCY: I have the honour to refer to the recent discussions between representatives of our two Governments concerning the Convention between the Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States of America for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, signed at London on 31 December 1975, and to propose the Convention be amended as follows:

1. Replace paragraph (2) of Article 1 (Personal Scope) by the following:

"(2) A corporation which is both resident of the United Kingdom within the meaning of paragraph (1)(a)(ii) of Article 4 (Fiscal Residence), and a resident of the United States within the meaning of paragraph (1)(b)(ii) of Article 4 shall not be entitled to claim any relief or exemption from tax provided by this Convention, except that such corporation may claim the benefits of Article 23 (Elimination of Double Taxation) with respect to the petroleum revenue tax referred to in paragraph (2)(b) of Article 2 (Taxes Covered), of Article 24 (Non Discrimination) and of Article 28 (Entry into Force)".

2. Replace sub-paragraph (j) of paragraph (1) of Article 3 (General Definitions) by the following:

"(j) the term "third State" means any State or territory other than the United States or the United Kingdom and the term "enterprise of a third State" shall be construed accordingly".

3. The existing sub-paragraph (j) of paragraph (1) will become a new sub-paragraph (k).

4. Replace paragraph (3) of Article 8 (Shipping and Air Transport) by the following:

"(3) Notwithstanding the provisions of Article 7 (Business Profits), profits of an enterprise of a Contracting State from the use, maintenance or rental of containers (including trailers and related equipment for the transport of containers) used for the transport of goods or merchandise shall be taxable only in that State except where such containers are used for the transport of goods or merchandise solely between places within the other Contracting State".

5. Replace paragraph (4) of Article 9 (Associated Enterprises) by the following:

"(4) Except as specifically provided in this Article:

(*a*) Where an enterprise doing business in one Contracting State:

(i) is a resident of the other Contracting State; or

(ii) is controlled, directly or indirectly, by an enterprise which is a resident of the other Contracting State; and

(*b*) where the enterprise which is a resident of the other Contracting State is a corporation, such corporation is neither:

(i) a controlled foreign corporation within the meaning of Section 957 of the United States Internal Revenue Code of 1954 (as it may be amended from time to time without changing the general principle thereof); nor

(ii) created or organized under the laws of the first-mentioned Contracting State or of any third State or controlled, directly, or indirectly, by a corporation which is a resident of any third State;

then, in determining the tax liability of the first-mentioned enterprise in the State in which it does business, or in a political subdivision or local authority of that State, such State, political subdivision or local authority shall not take into account the income, deductions, receipts or outgoings of a related enterprise which is a resident of the other Contracting State or of an enterprise of any third State which is related to the enterprise of the other Contracting State, except that this prohibition shall not apply where the first-mentioned enterprise is a resident of the first-mentioned Contracting State, to the extent that it owns, directly or indirectly, the capital of the related enterprise.

6. Replace Article 16 (Investment or Holding Companies) by the following:

"ARTICLE 16—INVESTMENT OR HOLDING COMPANIES

(1) The provisions of Articles 10 (Dividends), 11 (Interest) or 12 (Royalties) of this Convention shall not apply to a corporation which is a resident of one of the Contracting States and which derives dividends, interest or royalties arising within the other Contracting State if:

(*a*)(i) the tax imposed on the corporation by the first-mentioned Contracting State in respect of such dividends, interest or royalties is substantially less than the tax generally imposed by that State on corporate profits; or

(ii) the corporation is a resident of the United States and receives more than 80 per cent of its gross income from sources outside the United States as determined by and for the period prescribed in Sections 861(a)(1)(B) and (a)(2)(A) of the United States Internal Revenue Code of 1954, as they may be amended from time to time in minor respects so as not to affect their general principle and (*b*) 25 per cent or more of the capital of such corporation is owned, directly or indirectly, by one or more persons who are not individual residents of the first-mentioned Contracting State and are not nationals of the United States.

(2) Nothing in this Article shall however prevent a claim under the provisions of Articles 10 (Dividends), 11 (Interest) or 12 (Royalties) by a United States corporation where more than 75 per cent of the capital of that corporation is directly or indirectly owned:

(*a*) by a United States corporation which receives 20 per cent or more of its gross income from sources within the United States as determined by and for the period described in subparagraph (1)(a)(ii) of this Article; or

(*b*) by a corporation (other than a United States corporation) which by reference to the provisions of Section 283 of the United Kingdom and Corporation Taxes Act 1970 (as it may be amended from time to time without changing the general principle thereof) would not fall to be treated as a close company; or

(*c*) by a corporation which is a resident of the United Kingdom and in which more than 50 per cent of the voting power is controlled, directly or indirectly, by individuals who are residents of the United Kingdom."

If the foregoing proposals are acceptable to the Government of the United States of America, I have the honour to propose that this Note together with your reply in that sense shall constitute an Agreement between our two Governments which shall enter into force on the same date as the Convention.

I have the honour to be with the highest consideration your Excellency's obedient Servant (for the Secretary of State).

Derek M. D. Thomas

Protocol Amending the Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income and Capital Gains Signed at London on 31 December 1975, as Amended by Notes Exchanged at London on 13 April 1976

The Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland;

Desiring to conclude a Protocol to amend the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains, signed at London on 31 December 1975, as amended by Notes exchanged at London on 13 April 1976 (hereinafter referred to as "the Convention");

Have agreed as follows:

ARTICLE I

Paragraph (2) and (4) of Article 1 (Personal Scope) of the Convention shall be deleted and replaced by the following:

"(2) A corporation which is both a resident of the United Kingdom within the meaning of paragraph (1)(a)(ii) of Article 4 (Fiscal Residence), and a resident of the United States within the meaning of paragraph (1)(b)(ii) of Article 4 shall not be entitled to claim any relief or exemption from tax provided by this Convention except that such corporation may claim the benefits of paragraph (2) of Article 8 (Shipping and Air Transport), of Article 23 (Elimination of Double Taxation) with respect to paragraph (1)(c) thereof and the petroleum revenue tax referred to in paragraph (2)(b) of Article 2 (Taxes Covered), of Article 24 (Non-discrimination) and of Article 28 (Entry into Force) and the provisions of paragraph (7) of Article 11 (Interest) shall apply to it.

"(4) Nothing in paragraph (3) of this Article shall affect the application by a Contracting State of:

"(a) Paragraph (2) of Article 8 (Shipping and Air Transport), and Articles 9 (Associated Enterprises), 23 (Elimination of Double Taxation), 24 (Non-discrimination), and 25 (Mutual Agreement Procedure); and

"(b) Articles 19 (Government Service), 20 (Teachers), 21 (Students and Trainees), and 27 (Effect on Diplomatic and Consular Officials and Domestic Laws), with respect to individuals who are neither nationals of, nor have immigrant status in, that State."

ARTICLE II

Article 8 (Shipping and Air Transport) of the Convention shall be deleted and replaced by the following:

"ARTICLE 8

"*Shipping and Air Transport*

"(1) Profits derived by an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that State.

"(2) Notwithstanding any other provision of this Convention, profits which a national of the United States not resident in the United Kingdom or a United States corporation derives from operating ships documented or aircraft registered under the laws of the United States shall be exempt from United Kingdom tax.

"(3) For the purpose of this Article, profits from the operation of ships or aircraft include profits derived from the rental on a bareboat basis of ships or aircraft if such rental income is incidental to other income described in paragraph (1) of this Article.

"(4) Notwithstanding the provisions of Article 7 (Business Profits), profits of an enterprise of a Contracting State from the use, maintenance or rental of containers (including trailers and related equipment for the transport of containers) used for the transport of goods or merchandise shall be taxable only in that State, except where such containers are used for the transport of goods or merchandise solely between places within the other Contracting State.

"(5) The provisions of this Article shall apply also to profits derived by an enterprise of a Contracting State from participation in a pool, a joint business or an international operating agency.

"(6) Gains derived by an enterprise of a Contracting State from the alienation of ships, aircraft or containers owned and operated by the enterprise, the income from which is taxable only in that State, shall be taxed only in that State."

ARTICLE III

Sub-paragraph (c) of paragraph (1) of Article 23 (Elimination of Double Taxation) of the Convention shall be deleted and replaced by the following:

"(c) that amount of tax credit referred to in paragraph (2)(a)(i) of Article 10 (Dividends) which is not paid to the United States corporation but to which an individual resident in the United Kingdom would have been entitled had he received the dividend shall be treated as an income tax imposed on the corporation paying the dividend."

ARTICLE IV

Paragraph (4) of Article 24 (Non-discrimination) of the Convention shall be deleted and replaced by the following:

"(4) Paragraph (3) shall not apply to any interest, royalties, or other disbursements to which the provisions of Article 9 (Associated Enterprises), paragraph (5) and (7) of Article 11 (Interest) or paragraph (5) of Article 12 (Royalties) apply."

ARTICLE V

(1) This Protocol shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible.

(2) This Protocol shall enter into force immediately after the expiration of thirty days following the date on which the instruments of ratification are exchanged and shall thereupon have effect in accordance with Article 28 of the Convention.

In witness whereof the undersigned, duly authorized thereto by their respective Governments, have signed this Protocol.

Done in duplicate at London this 26th day of August 1976.

For the Government of the
United Kingdom of Great
Britain and Northern
Ireland:
J. E. Tomlinson

For the Government of
the United States of
America:
Anne Armstrong

SECOND PROTOCOL AMENDING THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND AND THE GOVERNMENT OF THE UNITED STATES OF AMERICA FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND CAPITAL GAINS SIGNED AT LONDON ON 31 DECEMBER 1975, AS AMENDED BY NOTES EXCHANGED AT LONDON ON APRIL 1976 AND BY A PROTOCOL SIGNED AT LONDON ON 26 AUGUST 1976

The Government of the United Kingdom of Great Britain and Northern Ireland and the Government of the United States of America;

Desiring to conclude a second Protocol to amend the Convention for Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains, signed at London on 31 December 1975, as amended by Notes exchanged at London on 13 April 1976 and by a Protocol signed at London on 26 August 1976 (hereinafter referred to as "the Convention");

Have agreed as follows:

ARTICLE I

Paragraph (4)(a) of Article 1 (Personal Scope) of the Convention shall be deleted and replaced by the following:

"(a) paragraph (4) of Article 4 (Fiscal Residence), paragraph (2) of Article 8 (Shipping and Air Transport), and Articles 9 (Associated Enterprises), 23 (Elimination of Double Taxation), 24 (Non-discrimination), and 25 (Mutual Agreement Procedure); and"

ARTICLE II

Paragraph (4) of Article 4 (Fiscal Residence) of the Convention shall be renumbered as paragraph (5) and a new paragraph (4) shall be added, to read as follows:

"(4) a marriage before 1 January 1974 between a woman who is a United States national and a man domiciled within the United Kingdom shall be deemed to have taken place on 1 January 1974 for the purpose of determining her domicile on or after 6 April 1976 for United Kingdom tax purposes."

ARTICLE III

Paragraph (1) of Article 22 (Other Income) of the Convention shall be deleted and replaced by the following:

"(1) Items of income of a resident of a Contracting State, wherever arising, not dealt with in the foregoing Articles of this Convention shall be taxable only in that State. The preceding sentence shall not apply to income paid out of trusts."

ARTICLE IV

Sub-Paragraph (3)(e) of Article 25 (Mutual Agreement Procedure) of the Convention shall end with a semicolon and the following sub-paragraph shall be added:

"(f) the elimination of double taxation in respect of income paid out of trusts."

ARTICLE V

Clauses (ii), (iii) and (iv) of sub-paragraph (2)(a) of Article 28 (Entry into Force) of the Convention shall be renumbered as clauses (iii), (iv) and (v), respectively, and a new clause (ii) shall be added, to read as follows:

"(ii) in relation to paragraph (4) of Article 4 (Fiscal Residence), for any year of assessment beginning on or after 6 April 1976."

ARTICLE VI

(1) This Protocol shall be ratified and the instruments of ratification shall be exchanged at Washington as soon as possible.

(2) This Protocol shall enter into force immediately after the expiration of thirty days following the date on which the instruments of ratification are exchanged and shall thereupon have effect in accordance with Article 28 of the Convention.

In witness whereof the undersigned, duly authorized thereto by their respective Governments, have signed this Second Protocol.

Done in duplicate at London this 31st day of March 1977.

For the Government of the
United Kingdom of Great
Britain and Northern
Ireland:
John Tomlinson

For the Government of
the United States of
America:
Ronald I. Spiers

Third Protocol Further Amending the Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains, Signed at London on 31 December 1975

The Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland;

Desiring to conclude a third Protocol to amend the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income and Capital Gains, signed at London on 31 December 1975, as amended by Notes exchanged at London on 13 April 1976 and by Protocols signed at London on 26 August 1976 and 31 March 1977 (hereinafter referred to as "the Convention");

Have agreed as follows:

Article I

(1) Paragraph (2) of Article 2 (Taxes covered) shall be deleted and replaced by the following:

"(2) The existing taxes to which this Convention shall apply are:

(*a*) in the case of the United States, the Federal income taxes imposed by the Internal Revenue Code and the tax on insurance premiums paid to foreign insurers; but (except as provided in paragraph (6) of Article 10 (Dividends)) excluding the accumulated earnings tax and the personal holding tax. The foregoing taxes covered are hereinafter referred to as "United States tax";

(*b*) in the case of the United Kingdom, the income tax, the capital gains tax, the corporation tax and the petroleum revenue tax. The foregoing taxes covered are hereinafter referred to as "United Kingdom tax".

(2) Paragraph (3) of Article 2 (Taxes covered) shall be deleted and replaced by the following:

"(3) This Convention shall also apply to any identical or substantially similar taxes which are imposed by a Contracting State after the date of signature of this Convention in addition to, or in place of, the existing taxes. The competent authorities of the Contracting States shall notify each other of any changes which have been made in their respective taxation laws."

(3) Paragraph (4) of Article 9 (Associated enterprises) shall be deleted and replaced by the following:

"(4) Except as specifically provided in this Article:

(*a*) where an enterprise doing business in one Contracting State:

(i) is a resident of the other Contracting State; or

(ii) is controlled, directly or indirectly, by an enterprise which is a resident of the other Contracting State; and

(*b*) where the enterprise which is a resident of the other Contracting State is a corporation, such corporation is neither:

(i) a controlled foreign corporation within the meaning of section 957 of the United States Internal Revenue Code of 1954 (as it may be amended from time to time without changing the principle thereof); nor

(ii) created or organised under the laws of the first-mentioned State or of any third State or controlled, directly or indirectly, by a corporation which is a resident of any third State;

then, in determining the tax liability of the first-mentioned enterprise in the State in which it does business, such State shall not take into account the income, deductions, receipts or outgoings of a related enterprise which is a resident of the other Contracting State or of an enterprise of any third State which is related to the enterprise of the other Contracting State, except that this prohibition shall not apply where the first-mentioned enterprise is a resident of the first-mentioned Contracting State, to the extent that it owns, directly or indirectly, the capital of the related enterprise."

Article II

The following new paragraph (6A) shall be added to Article 7 (Business profits) after paragraph (6):

"(6A) The United States tax on insurance premiums paid to foreign insurers shall not be imposed on insurance on reinsurance premiums which are the receipts of a business of insurance carried on by an enterprise of the United Kingdom whether or not that business is carried on through a permanent establishment in the United States."

Article III

Paragraph (5) of Article 10 (Dividends) shall be deleted and replaced by the following:

"(5) Where a corporation which is a resident of a Contracting State (and not a resident of the other Contracting State) derives profits or income from the other Contracting State, that other State may not impose any tax on the dividends paid by the corporation, except insofar as such dividends are paid to a resident of that other State (and where that other State is the United States, to a national of the United States) or insofar as the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or fixed base situated in that other State, even if the dividends paid consist wholly or partly of profits or income arising in that other State."

Article IV

Sub-paragraph (*b*) of paragraph (1) of Article 19 (Government service) shall be deleted and replaced by the following:

"(*b*) However, such remuneration shall be taxable only in the other Contracting State if the services are rendered in that State and the recipient is a resident and a national of that State."

ARTICLE V

Paragraph (4) of Article 23 (Elimination of double taxation) shall be deleted and replaced by the following:

"(4) Notwithstanding sub-paragraph (*a*) of paragraph (1) of this Article, the amount of United Kingdom petroleum revenue tax allowable as a credit against United States tax shall be limited to the amount attributable to United Kingdom source taxable income in the following way, namely:

(*a*) The amount of United Kingdom petroleum revenue tax on income from the extraction of minerals from oil or gas wells in the United Kingdom to be allowed as a credit for a taxable year shall not exceed the amount, if any, by which the product of the maximum statutory United States tax rate applicable to a corporation for such taxable year and the amount of such income exceeds the amount of other United Kingdom tax on such income.

(*b*) The lesser of (i) the amount of United Kingdom petroleum revenue tax on income from the extraction of minerals from oil or gas wells in the United Kingdom that is not allowable as a credit under the preceding sub-paragraph, or (ii) 2 per cent of such income for the taxable year shall be deemed to be income taxes paid or accrued in the two preceding or five succeeding taxable years, to the extent not deemed paid or accrued in a prior taxable year, and shall be allowable as a credit in the year in which it is deemed paid or accrued subject to the limitation in sub-paragraph (*a*) above.

(*c*) The provisions of sub-paragraphs (*a*) and (*b*) shall apply, separately, *mutatis mutandis* (but with the deletion, in the case of (*b*), of the words "the lesser of (i)" and "or (ii) 2 per cent of such income for the taxable year"), to the amount of United Kingdom petroleum revenue tax on income from initial transportation, initial treatment and initial storage of minerals from oil or gas wells in the United Kingdom".

ARTICLE VI

The following new Article 27A (Offshore activities) shall be inserted after Article 27 (Effect on diplomatic and consular officials and domestic laws):

"ARTICLE 27A

Offshore Activities

(1) Notwithstanding the provisions of Article 5 (Permanent establishment) and Article 14 (Independent personal services), a person who is a resident of a Contracting State and carries on activities in the other Contracting State in connection with the exploration or exploitation of the seabed and sub-soil and their natural resources situated in that other Contracting State shall be deemed to be carrying on in respect of those activities a business in that other Contracting State through a permanent establishment or fixed base situated therein.

(2) The provisions of paragraph (1) shall not apply where the activities are carried on for a period not exceeding 30 days in aggregate in any 12 month period. However, for the purpose of this paragraph, activities carried on by any enterprise related to another enterprise shall be regarded as carried on by the enterprise to which it is related if the activities in question are substantially the same as those carried on by the last-mentioned enterprise.

(3) The provisions of Article 8 (Shipping and air transport) shall not apply to a drilling rig or any vessel the principal function of which is the performance of activities other than the transportation of goods or passengers."

ARTICLE VII

The following new paragraph (7) shall be added at the end of Article 28 (Entry into force):

"(7) Notwithstanding any provisions of the respective domestic laws of the Contracting States imposing time limits for applications for relief from tax, an application for relief under the provisions of this Convention shall have effect, and any consequential refunds of tax made, if the application is made to the competent authority concerned within three years of the end of the calendar year in which this Convention enters into force."

ARTICLE VIII

(1) This Protocol shall be ratified and the Instruments of Ratification shall be exchanged at Washington as soon as possible.

(2) This Protocol shall enter into force immediately after the expiration of 30 days following the date on which the Instruments of Ratification are exchanged and shall thereupon have effect, subject to the provisions of paragraph (3) of this Article, in accordance with Article 28 of the Convention.

(3) Notwithstanding the provisions of Article 28 (Entry into force) of the Convention, the provisions of Article 27A (Offshore activities) of the Convention (as added by Article VI of this Protocol) shall not have effect until the entry into force of this Protocol.

In witness whereof the undersigned, duly authorised thereto by their respective Governments, have signed this third Protocol.

Done in duplicate at London this 15th day of March 1979.

For the Government of the
United States of America:
ROBERT J. MORRIS

For the Government
of the United
Kingdom of Great Britain
and Northern Ireland:
EVAN LUARD

Senate Executive Report No. 95-18

[Bracketed numerals indicate official report page numbers]

INCOME TAX TREATY WITH THE UNITED KINGDOM AND TWO PROTOCOLS

APRIL 25, 1978

Mr. SPARKMAN, from the Committee on Foreign Relations, submitted the following report to accompany Ex. K, 94th Cong., 2d sess.; Ex. Q, 94th Cong., 2d sess.; Ex. J, 95th Cong., 1st sess.

The Committee on Foreign Relations, to which was referred the Tax

Treaty with the United Kingdom of Great Britain and Northern Ireland[1] for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income (Executive K), as amended by a subsequent Exchange of Notes and two Protocols (Executive Q and Executive J) having considered the same, reports favorably thereon without reservation and recommends that the Senate give its advice and consent to ratification thereof.

I. Purpose

The purpose of this Treaty, as amended by the Exchange of Notes and two Protocols (collectively referred to in this report as the proposed treaty), is to replace the existing tax treaty between the United States and the United Kingdom signed on April 16, 1945, and subsequently amended. The proposed treaty is intended to modernize the relationship between the two countries with respect to income taxes and, in particular, to take into account changes in the British income tax system.

II. Background

The proposed Tax Treaty with the United Kingdom was signed on December 31, 1975, and was amended by the Exchange of Notes [2] (signed on April 13, 1976), the first Protocol (signed August 26, 1976) and the second Protocol (signed on March 31, 1977). The Tax Treaty and the Exchange of Notes were transmitted to the Senate on June 24, 1976.

The proposed Tax Treaty, as amended by the Exchange of Notes and the two Protocols, has been approved by the United Kingdom House of Commons.

III. Summary of Treaty

The proposed treaty is substantially similar to the existing tax treaty with the United Kingdom, to other recent U.S. tax treaties, and to the model tax treaty of the Organization for Economic Cooperation and Development (OECD). There are, however, several provisions of the proposed treaty which are not found in other U.S. tax treaties. Of particular significance are the new provisions contained in the proposed treaty (1) which provide for a refund by the U.K. to U.S. portfolio and direct shareholders receiving dividends from British corporations of Advance Corporation Tax (ACT) paid by the distributing corporation (*Article 10*) and allow a U.S. foreign tax credit for the one-half of the ACT which is not refunded to U.S. direct corporate investors (*Article 23*), (2) which limit the right of states to apportion income of British multinational corporations under the unitary method (*Article 9(4)*), and (3) which treat the British Petroleum Revenue Tax (PRT) as a creditable tax for U.S. foreign tax credit purposes (*Articles 2 and 23*).

[3] IV. Provisions of Treaty

Article 1. Personal scope

Article 1 sets forth the persons covered by the proposed treaty: generally, citizens and residents of the United States and the United Kingdom and corporations resident in either country. This article also contains the usual "saving clause" which provides that, with specified exceptions, the treaty is not to affect the taxation by the United States or the United Kingdom of their citizens or residents.

Article 2. Taxes covered

Article 2 sets forth the taxes covered by the proposed treaty. The treaty generally covers the income taxes imposed by both countries and in addition, applies to the U.S. insurance excise tax and the British Petroleum Revenue Tax (PRT).

Insurance of U.S. risks

Application of the proposed treaty to the insurance excise tax results in the exemption under *Articles 7 (Business profits)* and *22 (Other income)* of British insurance companies with no U.S. permanent establishment from the insurance excise tax. This exemption from both taxes is a departure from the existing U.S.-U.K. tax treaty and other U.S. tax treaties.

Petroleum Revenue Tax (PRT)

The proposed treaty treats the PRT as a creditable tax for U.S. foreign tax credit purposes. The PRT is imposed at a 45-percent rate on assessable profits from oil and gas extraction activities in the United Kingdom (including the North Sea) on a field-by-field basis. It is in addition to, and separate from, the regular U.K. corporate tax and a separate royalty. In the view of the Internal Revenue Service, the PRT would probably not be treated as a creditable tax in the absence of this provision.

Article 3. General definitions

Article 3 defines the terms used in the proposed treaty, which are generally the standard definitions contained in most U.S. tax treaties.

Article 4. Fiscal residence

Article 4 sets forth the rules for determining whether a person is a resident of either country and therefore entitled to the benefits of the treaty.

Article 5. Permanent establishment

Article 5 defines the term permanent establishment for purposes of the treaty. The manner in which income of a resident of one country is taxed by the other country is generally dependent upon whether the income is attributable to a permanent establishment which the resident has in that other country.

Article 6. Real property

Article 6 sets forth the rules governing the taxation of income from real property.

[4] *Article 7. Business profits*

Article 7 defines the term "business profits" and provides the general rule that residents of one country are not to be taxed on business profits from the other country unless they are attributable to a permanent establishment in that other country.

Article 8. Shipping and air transport

The proposed treaty provides that income derived by a U.S. enterprise from the operation in international traffic of ships or aircraft is exempt from British tax and that such income derived by a British enterprise is exempt from U.S. tax. This exemption is broader than the exemption customarily provided in U.S. tax treaties (including the existing U.S.-U.K. tax treaty) under which shipping and air transport income of a resident of one country is exempt by the other only if the ships and aircraft are registered in the first country.

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[1] Page 5; Technical Explanation, page 62; Senate Executives J and Q are not published.

Article 9. Associated enterprises

Article 9 sets forth the right of each country to allocate income on an arm's-length basis in the case of transactions between related persons.

Article 9(4). State taxation/unitary method

The proposed treaty contains a new provision, not found in other United States tax treaties, which places limitations on the combined reporting method used by several states of the United States to determine the taxable income which multinational corporations derive from sources within the state. Under this apportionment method, the operations of all related corporations (both domestic and foreign) are taken into account on a consolidated basis. The proposed treaty provides generally that in determining the tax liability of a British corporation doing business within a state, or of any subsidiary (U.S. or foreign) doing business within a state which is controlled by a British corporation, the state may not use the combined reporting method to take into account the operations of any related foreign corporation which is not doing business within the state. In such cases, the arm's-length method may be applied.

Article 10. Dividends

Article 10, in conjunction with Article 23 (Elimination of double taxation), contains a new and complex set of provisions with respect to the taxation of dividends. These provisions are designed to resolve the problems presented by the interaction of the U.S. system of corporate taxation and the new hybrid system adopted by the United Kingdom in 1973 which in part integrates corporate and shareholder taxation. Under the new British system, a tax is imposed upon U.K. corporations with respect to dividend payments (the Advance Corporation Tax, or ACT) and is allowed as a refundable credit to U.K. shareholders. In the absence of a tax treaty, no refunds are paid to, and no withholding taxes imposed on, foreign shareholders receiving dividends from British corporations.

Under the proposed treaty, the U.K. is to provide full refunds of the ACT to U.S. portfolio investors (individual shareholders and corporate shareholders owning less than a 10 percent stock interest) in British corporations, but the ACT refunds and dividend payments [5] are to be subject to a 15 percent withholding tax. In the case of U.S. direct corporate investors (corporations owning at least 10 percent of the U.K. corporation's stock), the proposed treaty provides for a refund of one-half of the ACT, but also for a 5 percent withholding tax on the dividend and the refund.

The proposed treaty also provides for rules for the treatment of the ACT for U.S. foreign tax credit purposes and provides for the allowance of an indirect foreign tax credit for ACT which is not refunded (*Article 23*).

The United States agrees to reduce its statutory 30 percent withholding tax to 15 percent on dividends to Kingdom portfolio investors and to 5 percent on dividends to United Kingdom corporate direct investors. Under the existing treaty, the withholding tax rate is limited to 15 percent on dividends to both portfolio and direct corporate investors.

Article 11. Interest

Article 11 follows the existing treaty and provides for the reciprocal exemption of interest derived by residents of either country from payers in the other. (The U.S. statutory rate is 30 percent.)

Article 12. Royalties

Article 12 follows the existing treaty and provides for the reciprocal exemption of royalties derived by residents of either country from payers in the other. (The U.S. statutory rate is 30 percent).

Article 13. Capital gains

The proposed treaty provides that residents of one country may be taxed by the other country under its internal laws on capital gains derived from sources in that other country. This is a change from the existing treaty under which such capital gains are exempt. However, under the internal laws of both countries, nonresidents are not ordinarily subject to tax on such gains.

Article 16. Investment holding companies

Article 16 denies the benefits of the articles on dividends, interest, and royalties (*Articles 10-12*) to certain investment and holding companies which qualify for certain tax benefits in the country of residence or which are controlled by shareholders from third countries.

Articles 14, 15, 18-21. Compensation for personal services

Articles 14 (Independent personal services), 15 (Dependent personal services), 18 (Pensions, annuities, and alimony), 19 (Government service), 20 (Teachers), and 21 (Students and trainees) govern the treatment of compensation for personal services. These provisions generally follow the existing treaty and other recent U.S. tax treaties.

Article 17. Artistes and athletes

The proposed treaty contains a separate set of rules which govern the taxation of income earned by public entertainers and athletes. Similar rules are not contained in the existing U.K. treaty, but are contained in several recent U.S. tax treaties. These rules provide that public entertainers and athletes who are residents of either the U.S. or the U.K. and whose gross receipts from performing in the other country exceed $15,000 for the year may be taxed by the country where [6] the services are performed. Under these rules, highly paid entertainers and athletes will be taxable in the country where they perform regardless of the length of their stay in that country.

Article 22. Other income

Article 22 provides rules governing income not otherwise dealt with in other articles. In general, such income is taxed in the country of residence unless attributable to a permanent establishment in the other country.

Article 23. Elimination of double taxation

Article 23 provides the general rule that both countries will allow a foreign tax credit for income taxes paid to the other country on income from sources in the other country. The treaty also clarifies the taxation of United States source income of United States citizens residing in the United Kingdom and branches of U.S. corporations located in the United Kingdom. The treaty generally allows the United Kingdom to tax such income, but in so doing, the United Kingdom must allow a credit against its tax for any United States tax paid with respect to the same income. It also provides the general rule that income derived by a resident of one country which may be taxed under the proposed treaty by the other country will be deemed to arise from sources within that other country. These rules are consistent with our other recent treaties and the OECD model tax treaty.

Article 24. Nondiscrimination

Article 24 is a comprehensive nondiscrimination provision similar to provisions in other U.S. tax treaties under which each country agrees not to discriminate by imposing more burdensome taxes on citizens and corporations of the other country than it imposes on its own citizens and residents.

Articles 25 and 26. Administrative provisions

Articles 25 and 26 contain various administrative provisions similar to those contained in other U.S. tax treaties.

Article 27. Effect on diplomatic officials and domestic laws

Article 27 provides that the treaty will not affect the fiscal privileges of diplomats and consular officials under international law or other agreements. Article 27 also contains the general rule found in other U.S. tax treaties that its provisions do not restrict any right or benefit otherwise available under the laws of either country.

Article 28. Entry into force

Article 28 provides that the proposed treaty will enter into force on the thirty-first day after ratification. Once the treaty enters into force, it applies retroactively with different dates for different taxes and provisions. Most provisions are effective beginning in 1975, but the provisions dealing with ACT refunds to U.S. portfolio shareholders are effective beginning in 1973.

Article 29. Termination

Article 29 provides that the treaty will continue in force indefinitely, but either country may terminate it in any year after 1980 by giving notice through diplomatic channels.

[7] V. DATE OF ENTRY INTO FORCE

The proposed treaty will enter into force 30 days after the date of the exchange of instruments of ratification and have effect according to the schedule in Article 28. The proposed treaty will remain in force indefinitely but may be terminated by either party by giving notice of termination on, or before June 30, in any year after 1980 pursuant to the procedure found in Article 29.

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[9] VII. COMMITTEE ACTION

The Committee considered the proposed treaty on March 15, 1978, and ordered it favorably reported by a voice vote with the recommendation that the Senate give its advice and consent to ratification of the proposed treaty. Prior to the vote, Senator Church proposed that a reservation be attached to the provision that restricts the use of the unitary taxing method, Article 9(4). The proposed reservation on Article 9(4) was defeated by a vote of 10 to 5. The Senators favoring a reservation were Senators Church, Clark, Humphrey, Sarbanes, and Sparkman. The Senators opposing a reservation were Senators Baker, Case, Glenn, Griffin, Javits, McGovern, Pearson, Pell, Percy, and Stone.

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[11] IX. EXPLANATION OF TREATY PROVISIONS*

PART A. ARTICLE-BY-ARTICLE ANALYSIS

Article 1. Personal scope

The proposed treaty generally applies to residents of the United States and residents of the United Kingdom, with specific exceptions designated in other articles. This follows the OECD model tax treaty and most of our other income tax treaties.

However, corporations which are incorporated in the United States but are managed and controlled in the United Kingdom, and thus considered residents of both for purposes of the treaty ("dual-resident corporations"), may only claim the benefits of certain provisions (described within in connection with the relevant articles).

Additionally, the proposed treaty contains the usual "saving clause" which provides that, with specified exceptions, the treaty is not to affect the taxation by the United States or the United Kingdom of their citizens or residents. The principal exceptions involve the determination of domicile for U.K. tax purposes, the limitations placed on the power of state and local governments to tax corporations controlled by U.K. shareholders, and the benefits provided under the foreign tax credit and the nondiscrimination, governmental salaries, teachers, and students provisions.

Article 2. Taxes covered

The proposed treaty generally applies to the U.S. Federal income taxes (including the employee's share of social security taxes) imposed under the Internal Revenue Code. The proposed treaty also applies to the Federal excise tax on insurance premiums paid to foreign insurers (Code sec. 4371). The application of the proposed treaty to the insurance excise tax differs from the existing treaty and other U.S. tax treaties, and it is discussed in greater detail below in connection with the business profits article (*Article 7*). In the case of the United Kingdom, the proposed treaty applies to the income tax, the capital gains tax, the corporation tax, and the Petroleum Revenue Tax.

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* The Committee would like to thank the staff of the Joint Committee on Taxation for preparing the explanation of the provisions of the proposed treaty.

The proposed treaty applies to income taxes imposed by political subdivisions or local authorities of the United States and the United Kingdom for purposes of the limitations placed on the combined reporting method of determining income subject to tax in the case of a corporation controlled by a corporation resident in the other country (*Article 9(4)*). In practice, this applies only to states and localities in the United States because the political subdivisions and local authorities in the United Kingdom do not impose income taxes.

In addition, the nondiscrimination provisions of the proposed treaty (*Article 24*) apply with respect to all taxes of each country, including all political subdivisions and local authorities of each country.

[12] Finally, the proposed treaty also contains a provision generally found in U.S. income tax treaties to the effect that it will apply to substantially similar taxes which either country may subsequently impose.

Article 3. General definitions

The standard definitions found in most of our income tax treaties are contained in the proposed treaty.

For purposes of the treaty, the term "United States," when used in a geographical sense, includes the states and the District of Columbia. Thus, the treaty does not apply to the possessions of the United States or to Puerto Rico. The term "United Kingdom" means Great Britain and Northern Ireland. The treaty does not apply to the Channel Islands, the Isle of Man, the British colonies, or member-states of the Commonwealth. The term "Nationals" of the United Kingdom includes, for purposes of the treaty, all citizens of the United Kingdom. In addition, in certain limited cases, the term also includes citizens of British colonies and certain other British subjects from Commonwealth countries.

The proposed treaty contains the standard provisions that undefined terms are to have the meaning which they have under the applicable tax laws of the country applying the treaty. Where a term is defined in a different manner by the two countries, the competent authorities of the two countries may establish a common meaning for the term in order to prevent double taxation or to further any other purpose of the treaty.

Article 4. Fiscal residence

The benefits of the proposed treaty are generally available only to residents of the two countries. The proposed treaty defines "resident of the United Kingdom" and "resident of the United States". Generally, the proposed treaty treats as residents of a country individuals who are subject to tax in that country on account of their residence therein. In addition, a set of rules is provided to determine residence in the case of an individual with dual residence. This provision of the proposed treaty is based on the fiscal domicile article of the OECD model treaty and is similar to the provisions found in other U.S. tax treaties.

An individual whom both countries consider to be a resident according to their general rules for determining residence will be deemed for all purposes of the treaty to be a resident of the country in which he has his permanent home, his center of vital interests (his closest economic and personal relations), his habitual abode, or his citizenship. If the residence of an individual cannot be determined by these tests, applied in the order stated, the competent authorities of the countries will settle the question by mutual agreement. Where an estate or trust (taxable as such) is considered to be a resident by both countries, the competent authorities may settle the issue by mutual agreement.

Paragraph (4) of this Article is a unique transitional provision designed to eliminate a difference in the rules for determining domicile under prior U.K. law between American women married to U.K. nationals and American men married to U.K. nationals. Under U.K. [13] law, resident aliens are generally taxed on their worldwide income if they are domiciled in the United Kingdom; but if they are not domiciled there, they are only taxed on their income which they receive in the United Kingdom. Under prior U.K. law, a woman who was a resident of the United Kingdom was considered to be domiciled in the United Kingdom if she was married to a man domiciled in the United Kingdom. A man, however, was entitled to establish on the basis of the facts and circumstances that he was not domiciled in the United Kingdom notwithstanding the fact that he was married to a U.K. domiciliary. In order to eliminate this difference in treatment, the U.K. amended its law in 1973 to provide that any woman married to a U.K. domiciliary after January 1, 1974, may, to the same extent as a man, establish under the facts that she is not a U.K. domiciliary and thus not subject to tax on foreign income until it is remitted.

The problem which the treaty provision resolves is that this new rule providing for equivalent treatment of men and women in the determination of domicile under U.K. law does not apply with respect to marriages which occurred prior to 1974. U.K. law treats a woman married before 1974 as retaining her husband's domicile. The proposed treaty (as modified by the second Protocol) extends the rule providing equivalent treatment to American women married before 1974 to U.K. domiciliaries by providing that marriages before 1974 of women who are U.S. citizens and men domiciled in the United Kingdom shall be deemed to have taken place on January 1, 1974, for purposes of determining domicile for U.K. tax purposes.

Under the existing treaty, the problem of the domicile of U.S. citizens married to U.K. domiciliaries was not as important because the U.K. courts interpreted the treaty as barring the U.K. from taxing U.S. citizens domiciled in the U.K. on U.S. source dividend and interest income and, accordingly, the question of domicile was frequently moot. However, the question becomes more important under the proposed treaty because the treaty makes clear that the United Kingdom may tax U.S. citizens domiciled in the United Kingdom on income from U.S. sources (subject to a credit for U.S. taxes paid) once the existing treaty ceases to apply to such income (April 6, 1976).

A special rule is provided for cases where income eligible for treaty relief in one country is taxable to a resident of the other country only if, and to the extent that, it is remitted to or received by that person. In certain cases, individuals who are residents of the United Kingdom are not taxable on foreign source investment income, unless it is remitted to or received by them in the United Kingdom. If such income were received outside of the United Kingdom and accumulated by the taxpayer, a United Kingdom resident may not be subject to U.K. tax on that income. If the reductions in U.S. tax rate or exemptions from U.S. tax were to apply to those items of income, the United States would be foregoing tax where double taxation does not in fact occur. Thus, this paragraph provides that if under the law in the other country income would only be taxed on a remittance basis, then any reduced rates of tax (e.g., as provided by Article 10 (Dividends)), or relief from taxation (e.g., Article 7 (Business Profits) and 8 (Shipping and Air Transport), 11 (Interest), or 12 (Royalties)) provided by this treaty shall apply only to the extent that the income is remitted to or [14] received by the person in the year in which it accrues to the benefit of that taxpayer. This rule applies to all persons, including individuals, corporations, partnerships, and trusts or estates. A similar provision is contained in the existing treaty.

Article 5. Definition of permanent establishment

The proposed treaty contains a definition of permanent establishment which follows the pattern of the OECD model tax treaty and other recent U.S. income tax treaties. The permanent establishment concept is one of the basic devices used in income tax treaties to avoid double taxation. Generally, a resident of one country is not taxable on its business profits by the other country unless those profits are attributable to a permanent establishment of the resident in the other country. In addition, the permanent establishment concept is used to determine whether reduced rates of, or exemptions from, tax provided for dividends, interest, and royalties are applicable.

In general, a fixed place of business through which a resident of one country engages in industrial or commercial activities in the other country is considered a permanent establishment. This includes a branch, an office, a factory, a workshop, a mine, oil or gas well, quarry, or other place of extraction of natural resources, and any building or construction or installation project which exists for more than 12 months.

This general rule is modified to provide that a fixed place of business which is used for any or all of a number of specified activities will not constitute a permanent establishment. These activities include, among others, the use of facilities for storing, displaying, or delivering mechandise belonging to the resident, the maintenance of a stock of goods belonging to the resident for purposes of storage, display, delivery, or processing by another person, and the purchase of goods or collection of information for the resident.

A resident of one country will be deemed to have a permanent establishment in the other country if it maintains an agent in the other country who has, and habitually exercises, a general contracting authority (other than for the purchase of merchandise) in that other country. The proposed treaty contains the usual provision that the agency rule will not apply if the agent is a broker, general commission agent, or other independent agent acting in the ordinary course of its business.

The fact that a corporation which is a resident of one country controls (or is controlled by) a corporation which is a resident of the other country or which carries on business in the other country shall not of itself cause the latter corporation to be treated as a permanent establishment of the country of the parent's residence.

Article 6. Income from immovable (real) property

The proposed treaty provides that income from immovable property, including income from agriculture or forestry, may be taxed in the country where the property is located. This rule does not preclude the country of residency from taxing the income, but only confirms that the country where the property is located has the primary jurisdiction to tax the income whether or not the income is derived through a permanent establishment.

[15] Immovable property is to be defined under the laws of the country where the property is located. Generally, the term refers to real property for purposes of United States and United Kingdom law. Income from real property includes income from use or renting, but it does not include capital gains on the sale, exchange, or other disposition of real property. Ships, boats, and aircraft are not considered to be immovable property.

Article 7. Business profits

In general

Under the proposed treaty, business profits of a resident of one country are taxable in the other country only to the extent they are attributable to a permanent establishment which the resident has in the other country. The business profits provisions are substantially the same as the provisions in the existing treaty and in the OECD model tax treaty.

In computing the taxable business profits, all expenses, wherever incurred, which are reasonably connected with the business profits are allowed as deductions. These expenses include a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the enterprise as a whole (or the part which includes the permanent establishment). However, in determining the amount of the deduction for expenses incurred by the head office, the deduction generally will be limited to the expense incurred without including a profit element for the head office.

Profits will not be attributed to a permanent establishment merely because of the purchase of goods or merchandise by that permanent establishment for the account of the enterprise. Thus, for example, where a permanent establishment purchases goods for its head office, the business profits attributed to the permanent establishment with respect to its other activities will not be increased by a profit element on the purchasing.

The profits of a permanent establishment are to be determined on an arm's-length basis. Thus, there is to be attributed to it the industrial or commercial profits which would reasonably be expected to have been derived by it if it were an independent entity engaged in the same or similar activities under the same or similar conditions and dealing at arm's-length with the resident of which it is a permanent establishment. In addition, business profits are to be computed on a consistent basis from year to year.

The proposed treaty sets forth examples of types of income which are considered business profits. It follows the approach of our other recent treaties and the Internal Revenue Code by including within business profits investment income which is effectively connected with the permanent establishment. Personal services income earned by an employee is excluded from business profits.

Insurance of U.S. risks

Under the Code, premiums from insuring U.S. risks which are received by a foreign insurance company having no U.S. trade or business are not subject to U.S. income tax but are subject to the [16] U.S. insurance excise tax (secs. 4371-4374). However, the proposed treaty applies to the insurance excise tax and thus, under the business profits article and *Article 22 (Other income)*, income of a British insurance company from the insurance of U.S. risks is subject neither to U.S. income tax nor to the insurance excise tax unless that insurance income is attributable to a U.S. permanent establishment maintained by the British insurer. This treatment is a departure from the existing tax treaty with the U.K. and other U.S. tax treaties.

Under the Internal Revenue Code (in the absence of a contrary treaty provision), a foreign insurer is subject to U.S. income tax on income derived from the insurance of risks situated in the United States in situations where that insurance income is effectively connected with a U.S. trade or business. A foreign insurance company insuring U.S. risks ordinarily will not be viewed as conducting a U.S. trade or business and thus will not be subject to U.S. income tax if it has no U.S. office or agent and operates in the United States solely through independent brokers.

In these situations, a foreign insurance company is not subject to U.S. income tax, but the insurance excise tax is imposed (except as otherwise provided in a treaty) on the premiums paid for that insurance.[1] The excise tax may be viewed as serving the same function as the withholding tax imposed on dividends, interest, and other types of passive income paid to foreign investors. In general, the excise tax applies to insurance covering risks wholly or partly within the United States where the insured is (i) a U.S. person or (ii) a foreign person engaged in a trade or business in the United States. Under the Code, the excise tax generally applies to any such life, sickness, or accident insurance, or annuity contract unless the foreign insurance company is subject to U.S. income tax. It generally applies to any such casualty policy written by a foreign insurance company unless the policy is placed through an officer or agent of the foreign insurer within a state in which the insurer is authorized to do business.

The treatment of insurance income of foreign insurers is complicated somewhat in situations where, as is usually the case, some portion of the risk is reinsured with other insurance companies in order to spread the risk. In situations where the foreign insurer is engaged in a U.S. trade or business and thus subject to the U.S. income tax, reinsurance premums, whether paid to a U.S. or a foreign reinsurer, are allowed as deductions. Accordingly, the foreign insurer is taxable only on the income attributable to the portion of the risk it retains. However, while no excise tax is imposed on the insurance policy issued by the foreign insurer doing business in the United States (and, in the case of casualty insurance, the policy is written by an officer or agent of the insurer within a State in which it is authorized to do business), the one-percent excise tax on reinsurance is imposed if and when that insurer reinsures that U.S. risk with a foreign insurance company not doing business in the United States (and not subject to U.S. income tax).

[17] The statutory rules governing the taxation of foreign insurance companies insuring U.S. casualty risks have been modified through interpretations of the existing treaty contained in certain closing agreements which have been entered into between the IRS and a number of British insurance companies. These closing agreements constitute confidential taxpayer return information, and the substantive terms and the legal basis of these agreements have not been made public in the form of revenue rulings or revenue procedures. The closing agreements are apparently intended to provide relief in those situations where there is the potential liability for both income tax and excise tax liability because the foreign insurer is subject to the income tax (because it has a U.S. trade or business) but is not exempt from the excise tax (because it is not licensed by a state to write insurance). It is understood that U.K. insurance companies agree in the closing agreements to subject themselves to the U.S. income tax by treating their U.S. operations (frequently an unrelated agent) as a permanent establishment, and the IRS agrees to waive the excise tax under the nondiscrimination clause of the present treaty.

In exempting from the U.S. income tax and the insurance excise tax all insurance income which is not attributable to a permanent establishment in the United States, the proposed treaty makes two changes in the statutory rules governing the taxation of insurance income of U.K. insurance companies. First, any insurance income which is effectively connected with a U.S. trade or business but is not attributable to a U.S. permanent establishment will not be subject to U.S. income tax. This exemption is contained in the existing treaty. Second, U.K. insurance companies not engaged in a U.S. trade or business will no longer be subject to the insurance excise tax. However, those U.K. insurance companies which continue to maintain a U.S. permanent establishment after the proposed treaty enters into force will remain subject to the U.S. income tax on their net U.S. insurance income attributable to the permanent establishment. In addition, the insurance excise tax will continue to apply in situations where a U.K. insurance company with a U.S. trade or business reinsures a policy it has written on a U.S. risk with a foreign reinsurer other than a U.K. resident. The excise tax will apply to such reinsurance even where the U.K. insurance company has a U.S. trade or business but no U.S. permanent establishment and thus will not be subject to U.S. income tax on the net income it derives on the portion of the risk it retains.

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[1] The excise tax is imposed at a rate of 4 percent of the premiums paid on casualty insurance and indemnity bonds, and one percent of the premiums paid on life, sickness, and accident insurance, annuity contracts, and reinsurance.

Article 8. Shipping and air transport

The proposed treaty (as modified by the protocol of August 31, 1976)[2] provides that income derived by an enterprise of the United States from the operation in international traffic of ships or aircraft is exempt from United Kingdom tax. Income derived by an enterprise of the United Kingdom from the operation in international traffic of ships or aircraft is exempt from United States tax. These exemptions apply regardless of where the ships or aircraft are registered. The exemption provided in the treaty for U.S. and U.K. resi- [18] dents is broader than the exemption customarily provided in U.S. tax treaties (including the existing U.S.-U.K. tax treaty) under which shipping and air transport income of a resident of one country is exempt by the other only if the ships and aircraft are registered in the first country.

Income from the operation in international traffic of ships or aircraft includes the rental income on a bareboat basis of ships or aircraft operated in international traffic if the rental income is incidental to income from the actual operation of ships or aircraft in international traffic. For example, this rule permits an airline of one country which has excess equipment during certain periods to lease that excess equipment during those periods to an airline of the other country. In such a case the rental income of the lessor is exempt from tax in the other country, whether or not the other airline uses the aircraft in international traffic.

The proposed treaty also provides that income derived by a U.S. enterprise from the use, maintenance, and lease of containers (including trailers and related equipment for the inland transport of containers) used for the transportation of goods or merchandise may not be taxed by the United Kingdom unless the goods or merchandise are transported solely between places within the United Kingdom. Such income derived by U.K. enterprises is similarly exempt from U.S. tax unless the transportation is solely between places within the United States.

Under the proposed treaty, the provisions relating to the taxation of shipping and air transport apply also to profits derived by U.S. or U.K. enterprises from the participation in a pool, a joint business, or an international operating agency.

The proposed treaty also provides that gains of a U.S. enterprise on the sale or other disposition of ships, aircraft or containers owned by the U.S. enterprise shall only be taxable by the United Kingdom if under the treaty the income from the ships, aircraft or containers may be taxable by the United Kingdom. Such gains received by U.K. enterprises are similarly not subject to tax by the United States if the income from the disposed ship, aircraft or container is not subject to U.S. tax.

The proposed treaty also exempts from U.K. tax any income derived by a U.S. citizen who is not a resident of the United Kingdom, or by a U.S. corporation (including a dual resident corporation) from the operation of ships or aircraft registered in the United States. This exemption from U.K. tax applies even if the ships or aircraft are operated solely within the United Kingdom. This provision confirms that the United Kingdom grants to U.S. citizens and corporations (including dual resident corporations) the equivalent exemption required in order for the shipping and aircraft income of U.K. nationals and corporations to be exempt from U.S. tax under Code sections 872(b) and 883. As contrasted with the general shipping and aircraft exemption contained in the proposed treaty, this exemption applies only to income derived from the operation of ships or aircraft registered in the United States.

Except as set forth in the previous paragraphs, the shipping and air transport provisions are subject to the saving clause. Therefore, the [19] United States may, without regard to this article, tax income derived by U.K. residents from shipping or air transport, or from the use of rental of containers, if the U.K. residents are citizens of the United States. Similarly, the United Kingdom can tax shipping and air transport income derived by U.K. nationals resident in the United States.

A number of proposals have been made in recent years to change U.S. tax laws, and the U.S. negotiating position in tax treaties, with respect to international shipping. These have included proposals to tax, at least in some cases, international shipping into and out of the United States and proposals for international arrangements through bilateral treaties or international agreements whereby international shipping income would generally be subject to tax in some jurisdiction. These proposals are generally intended to minimize the competitive advantages of shipping companies operating through countries such as the United Kingdom which do not effectively tax the international shipping income of their residents (including local companies owned by U.S. interests). The Committee has not considered these various proposals and takes no position as to their merits. However, the Committee does not intend, in recommending the ratification of this treaty, to foreclose any such review or revision of U.S. policy toward international shipping. Thus, this treaty is not intended as a precedent for future U.S. treaty policy in this area—particularly as that policy applies to countries which encourage through favorable tax treatment the incorporation and registry of ships which neither operate in the international commerce of that country nor are owned ultimately by residents of that country. In addition, if and when the United States does change its policy toward international shipping, it may be appropriate at that time to consider conforming modifications to this treaty.

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[2] The treaty as initially negotiated included a registry test under which the exemption applied only to income of U.S. enterprises from the operation of ships and aircraft registered in the United States and income of British enterprises from the operation of ships and aircraft registered in the United Kingdom.

Article 9. Associated enterprises

The proposed treaty, like most other U.S. tax treaties, contains a provision similar to that contained in the Internal Revenue Code (sec. 482) which recognizes the right of each country to make an allocation of income in the case of transactions between related persons, if an allocation is necessary to reflect the conditions and arrangements which would have been made between unrelated persons.

It is anticipated that when a redetermination has been made by one country with respect to the income of a related person, the other country will attempt to reach an agreement with the first country in connection with the redetermination, and if it agrees with the redetermination, it will make a corresponding adjustment to the income of the other person.

Limitations on state taxation

The proposed treaty also contains a new provision, not found in other United States treaties, which limits the methods by which the United States, the United Kingdom, and political subdivisions and local authorities of each country may tax enterprises of the other country (or enterprises which are directly or indirectly controlled by enterprises of the other country). The proposed treaty provides that in determining the tax liability of such an enterprise doing business within their respective jurisdictions, the United States, the United [20] Kingdom and their political subdivisions and local authorities may not take into account the income, deductions, receipts or outgoings of a related enterprise of the other country or of any third country.

Background.—This provision applies to those states of the United States which, in determining the amount of income of a business operating within the state which is to be apportioned to that state for income tax purposes, require combined reporting of all related business operations (including related business operations of affiliated U.S. and foreign corporations, whether or not doing business within the state). The governments of the United Kingdom and the United States do not apportion income between jurisdictions under this method but rather allocate income between related enterprises under arm's-length principles as specified in other paragraphs of this article. In addition, the political subdivisions and local authorities of the United Kingdom do not impose income taxes. Consequently, this provision's only application is to limit the combined reporting method used by certain states of the United States.

In determining what business income of a corporation is earned within a state and thus subject to income tax by that state, all states imposing an income tax use some type of apportionment system. An apportionment system is necessary because of the difficulties of attempting to account separately for business income in any state where the activities of a single business are carried on beyond the borders of that one state. In most states this business income is apportioned between the state and other jurisdictions according to a basic three-factor formula (or some variation of the formula) under which total business income is multiplied by the average ratio of sales, payroll, and property values within the state to total sales, payroll, and property values associated with the business. This type of apportionment, when applied to a single business of one corporation, is called the "unitary method" of apportionment and is used by most states which have a corporate income tax. The proposed treaty does not affect the application of this method when applied to a single corporation.

However, some states have adopted "combined reporting" requirements, which extend the unitary method to corporations related to the corporation doing business within the state (subsidiaries, parent corporations, or brother-sister corporations), whether or not these related corporations are doing business within the state, where the activities of the related corporations are considered by the state to constitute a unitary business. For example, if a U.K. manufacturing company operating in a state requiring combined reporting owns a U.S. subsidiary which sells the products manufactured by the U.K. parent, the income subject to tax in that state would be determined under the combined reporting method by applying the average ratio of the sales, payroll, and property values in the state to total sales, payroll, and property values of both corporations in both countries and multipling these average ratios against the combined worldwide income of the two corporations.

California, Oregon, and Alaska are the primary states requiring the use of combined reporting in connection with related foreign corporations as well as related domestic corporations. Certain other state gov- [21] ernments have also indicated that combined reporting with respect to related foreign corporations is at times required in their states, or that they may in the future require this type of reporting at least in some cases.

Explanation of limitation.—The treaty provision prevents a state from extending the unitary method through this combined reporting system to related foreign enterprises where the enterprise doing business in the state is either a British enterprise or is controlled directly or indirectly by a British enterprise. Thus, for example, if a U.S. branch of a British corporation does business in a state, that state cannot apply the unitary method to combine the income (and sales, payroll, and property) of any related foreign enterprises (from the United Kingdom or any third country) with those of that British corporation in determining the income of its U.S. branch which is taxable by that state. However, that state may take into account the income and assets of any other branches of that corporation, wherever located, because a corporation is considered to be a single enterprise regardless of how many separate branches or businesses it has. Alternatively, if the British corporation does not do business in the state, but has a U.S. subsidiary (or any other corporation which it directly or indirectly controls) doing business in the state, that state, in determining the taxable income of that U.S. subsidiary, cannot apply combined reporting requirements to include the income (and the sales, payroll, and property values) of the British parent corporation or other related foreign enterprises. Of course, in either situation described above the state may take into account the income and assets of any related U.S. corporations.

The limitation in Article 9(4) applies only to cases where an apportionment formula is used without regard to any application of the arm's-length standard (provided under *Article 9(1)*). Of course, both countries and their political subdivisions may apply apportionment formulas, including formulas that take into account attributes of related entities, as a method of achieving an arm's-length price for a transaction between related entities. Moreover, apportionment formulas may be used as a method of apportioning income of related entities to the extent that it is established that they are not dealing on an arm's length basis.

There are two additional exceptions to the combined reporting limitation. First, if the British enterprise is a corporation which is itself directly or indirectly controlled by residents of the United States (Code sec. 957) or if any third country, the limitation does not apply. In addition, in computing the tax liability of any U.S. subsidiary (or other enterprise) resident in the state which is controlled by a British enterprise, the three-factor formula may, notwithstanding the general prohibition, be applied to any related foreign enterprise to the extent that the U.S. subsidiary owns, directly or indirectly, the capital of the related foreign enterprise.

For purposes of the proposed treaty, an enterprise is related to another enterprise if either enterprise directly or indirectly controls the other, or if any third person or persons (related to each other or acting together) control both. The term control is not limited to the ownership of the capital of an enterprise, and it includes any kind of control, whether or not legally enforceable, however exercised or exercisable.

[22] *Article 10. Dividends*

The proposed treaty contains a new and complex set of provisions with respect to the taxation of dividends which in a number of respects are substantially different from the existing tax treaty with the United Kingdom and from other U.S. tax treaties. In 1973, the United Kingdom introduced a new system of corporate taxation which in part integrates its corporate income tax with its individual income tax. The integrated tax system of the United Kingdom differs substantially from the classical system of separate corporate taxation used by the United States (under which dividends received by shareholders are generally taxed without regard to the taxes paid by the distributing corporation). The new provisions contained in the proposed treaty relating to dividends are designed to accommodate the problems which are presented by the interaction of the differing U.K. and U.S. systems.

Under the existing treaty, neither country can tax dividends paid by resident corporations to shareholders resident in the other country at a rate exceeding 15 percent of the gross amount of the dividend.[3] However, the proposed treaty provides that, as long as the U.K. integrated system is in effect, the refund withholding system described below is to apply.

ACT refund to U.S. shareholders

Description of U.K. system.—Under the new system adopted by the United Kingdom, a special "Advance Corporation Tax," or "ACT," is collected from a U.K. corporation on any distribution to its shareholders. The rate of the ACT is presently 33/67 of the amount of the dividend. For years prior to 1977, the rate of the ACT was 35/65 of the dividend. At the U.K. corporate level, ACT payments can, within certain limits, be credited against the regular U.K. 52-percent corporate income tax (the "mainstream tax"), if any, paid by the corporation in the year of the distribution. If no mainstream tax is paid, the ACT can be carried back two years and carried forward indefinitely to be credited against mainstream tax otherwise payable in those years. Where the dividend is out of income on which mainstream tax has been paid and the ACT is fully creditable against that mainstream tax, the aggregate 52-percent tax paid by the corporation is not affected by the payment of a dividend because the ACT payment with respect to the dividend is fully offset by the reduced mainstream tax.

In addition to being allowed as a credit against the distributing corporation's mainstream tax, the amount of ACT paid by the corporation is also refunded to U.K. shareholders receiving the dividends either through a credit against the shareholder's U.K. income tax liability or through a cash refund to the extent that the ACT payment exceeds the shareholder's income tax liability. However, the dividend subject to tax is "grossed up" by the amount of ACT paid by the corporation; that is, the U.K. shareholder is required to include in taxable income the amount of ACT credited or refunded to him as [23] well as the amount of the cash dividend. For example, if a U.K. corporation pays a cash dividend of $67, it must also pay ACT of $33 (which it may credit against the mainstream tax). The shareholder receives a tax credit or refund of $33 and includes in income $100 (the $67 distributed and the $33 of ACT).

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[3] The proposed treaty provides that in the event that the United Kingdom modifies its current system of taxation and ceases to allow a shareholder credit to its residents, then dividends will be treated as they are under the existing treaty, and the withholding taxes of both the United States and the United Kingdom will be limited to 15 percent on dividends paid to residents of the other country.

In the absence of a tax treaty, the ACT is not refunded to nonresident aliens of the United Kingdom, Thus, under the new U.K. hybrid system, there is a higher tax burden imposed on dividends to nonresident shareholders than is imposed on U.K. resident shareholders; the unrefunded ACT can thus be viewed as an additional U.K. tax at the corporate level on dividend distributions to foreign shareholders. On amounts distributed to U.K. resident shareholders, the aggregate U.K. tax burden (the tax paid by the corporation reduced by the shareholder credit) ranges from zero to 28 percent (the effective rate depends upon the extent to which the distribution is out of taxable income compared to the extent it is derived from nontaxable earnings or capital). Since nonresident shareholders from nontreaty countries do not receive the refundable shareholder tax credit allowed U.K. resident shareholders, the effective U.K. tax burden on distributions to them ranges from 33 percent to 52 percent. By not making the shareholder credit available to nonresidents, the U.K. hybrid integration system has substantially the same effect with respect to dividends paid to foreign shareholders as if the U.K. imposed a split rate corporate income tax of up to 52 percent on retained earnings and up to 28 percent on earnings distributed as dividends, with a 33-percent dividend withholding tax.

U.S. direct corporate investors.—Under the proposed treaty, separate rules are provided for the taxation of dividends to shareholders which are U.S. corporations owning at least 10 percent of the distributing U.K. corporation's stock (because only corporate shareholders owning 10 percent of the stock are entitled to indirect foreign tax credits for U.K. income taxes paid by the U.K. corporation paying the dividend).[4]

In the case of a U.S. corporation which is a direct investor in a U.K. corporation, the proposed treaty provides that the U.S. corporation is entitled to a payment from the United Kingdom of an amount equal to one-half of the ACT paid with respect to the dividend, subject to a deduction withheld from the payment of up to 5 percent of the combined cash dividend plus the refunded one-half of the ACT.

To illustrate by example, on a divident of $67 paid by a U.K. corporation to a U.S. direct corporate investor, the U.K. corporation pays ACT of $33 to the U.K. Treasury, which in turn refunds approximately $12.50 to the U.S. shareholder—the amount equal to one-half of the ACT paid ($16.50) reduced by 5 percent of the sum of the cash dividend and one-half of the ACT (roughly $4, or 5 percent of the sum of $67 plus $16.50). Thus, the proposed treaty requires that the U.K. refund to direct U.S. corporate investors approximately 38 [24] percent (12.5/33) of the ACT imposed on the corporation. The refund provided for in the proposed treaty reduces the maximum effective U.K. tax burden on distributions to these direct U.S. corporate investors from 52 percent to 43 percent, and the minimum effective U.K. rate from 33 percent to 20.5 percent. Alternatively, the refund can be viewed as reducing the additional U.K. tax imposed on distributions to nonresidents (that is, the unrefunded ACT) from 33 percent to 20.5 percent.

The United Kingdom does not generally impose any withholding tax on nonresident shareholders under its new hybrid system. However, it does impose a withholding tax in those situations where it has agreed in tax treaties to refund the ACT to residents of the other treaty country. In any case where the U.K. corporation pays out some but not all of its after-tax income as dividends, the 5-percent withholding tax has the effect of slightly increasing the foreign tax which is treated as paid by the shareholder on the distribution and thus increasing the U.S. foreign tax credit allowed on the distribution.

U.S. individuals and portfolio investors.—Different rules are provided with respect to dividends from U.K. corporations to U.S. shareholders who are not corporations owning 10 percent of the U.K. corporation's stock (and thus are not entitled to a U.S. indirect foreign tax credit with respect to the taxes paid by the U.K. corporation). In these other cases, the proposed treaty provides for a payment to the U.S. shareholder by the U.K. Treasury of the full amount of the ACT paid by the U.K. corporation with respect to the dividend. However, this refund is reduced by a 15 percent withholding tax on the sum of the dividend and the ACT paid. To illustrate by example, on a dividend of $67 paid by a U.K. corporation to a U.S. resident individual or to a corporate portfolio investor, the U.K. corporation pays ACT of $33 to the U.K. Treasury, which in turn pays over to the U.S. shareholder $18—the excess of the ACT paid ($33) over 15 percent of the sum of the cash dividend and the ACT ($15, or 15 percent of the sum of $67 plus $33).

As discussed in further detail in connection with the provision dealing with the foreign tax credit (*Article 23, Elimination of double taxation*), the proposed treaty also provides that the full $100 is to be treated for U.S. foreign tax credit purposes as a dividend and that the $15 not refunded is to be treated as a U.K. withholding tax imposed upon the shareholder. As indicated above, the United Kingdom does not generally impose a withholding tax except where it has agreed to refund ACT pursuant to a tax treaty. The withholding tax for shareholders who are U.S. residents has the effect of treating the ACT not refunded as a tax paid by the shareholder receiving the distribution (rather than the corporation paying the dividend), thereby giving the shareholder a foreign tax credit against his U.S. tax liability on the dividend.

U.K. shareholders

With respect to dividends paid by U.S. corporations, the withholding tax which the United States may impose on U.K. resident shareholders depends upon whether or not they are direct corporate investors. In the case of dividends paid to U.K. corporations owning at least 10 percent of the distributing U.S. corporation's stock, the [25] otherwise applicable 30-percent U.S. withholding tax is reduced to 5 percent. (The rate under the existing treaty is 15 percent.) In the case of dividends paid to all other U.K. shareholders, the U.S. withholding rate is only reduced to 15 percent.

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[4] As contrasted with the rules applicable to U.K. direct corporate investors in U.S. corporations (discussed below), a U.S. corporation will be considered to be a direct investor where it, together with any related corporations, owns a 10-percent stock interest in the U.K. corporation.

Comparison of rate reductions

As a result of these provisions, the maximum combined effective rate of tax (mainstream corporate tax and ACT) imposed by the U.K. on corporate earnings distributed to U.S. direct corporate shareholders is reduced from 52 percent to approximately 43 percent (a 52-percent corporate burden reduced by an ACT refund paid to the shareholders). In contrast, the maximum combined effective rate of U.S. tax (corporate tax and withholding tax) on U.K. direct corporate investors is reduced by the proposed treaty from approximately 63 percent (48 percent plus a 30 percent withholding tax on the remainder left for distribution) to approximately 51.5 percent (48 percent plus 5 percent of the remainder left for distribution). The combined effective U.K. rate on U.S. resident individuals and portfolio investors is reduced from 52 percent to approximately 39 percent, while the U.S. effective rate on U.K. resident individuals and portfolio investors is reduced from 63 percent to approximately 55.5 percent.

Special rules and exceptions

The dividend provisions do not apply in two circumstances where tax avoidance may occur. First, where a resident of either country owns 10 percent or more of the shares of a corporation with respect to which dividends are paid, these provisions do not apply to the extent that the dividends are paid out of income or profits which the corporation earned or received in a period ending a year or more before the date on which the shareholder became the owner of 10 percent or more of the corporation's stock. This rule is designed to prevent transactions where a 10-percent stock interest is acquired in order to obtain a distribution of the past earnings of a corporation at a reduced rate of tax.

A second rule is designed to deny the benefits of the dividend provisions to U.S. tax-exempt organizations if the dividends are received in circumstances where they would have been subject to U.K. tax if they had been received by an exempt organization of the United Kingdom. Under United Kingdom law, if a resident of the United Kingdom sells securities to a tax-exempt organization immediately before the payment of dividends, the organization will be taxable on the dividends paid in respect to the securities if the transaction was designed to accord the initial seller a preferential rate of tax on his sale. This rule is contained in the existing treaty.

These two tax avoidance rules do not apply if the beneficial owner of the shares satisfies the competent authority of the taxing country that the shares were acquired for bona fide commercial purposes and not to secure the benefits of the proposed convention.

In addition to the above new rules added to the treaty to take into account the U.K. integrated tax system, a number of other provisions were included which are generally similar to those in the existing British treaty or in the OECD model treaty.

[26] The above provisions relating to dividends do not apply to dividends received by U.S. residents who carry on business through a permanent establishment in the United Kingdom, or who perform independent services from a fixed base in the United Kingdom, where the dividends are effectively connected with the permanent establishment or fixed base. Similarly, the provisions do not apply to dividends received by U.K. residents who carry on business through a permanent establishment in the United States, or who perform independent personal services from a fixed base in the United States, where the dividends are effectively connected with the permanent establishment or fixed base. In such situations, the provisions relating to business profits (*Article 7*), independent personal services (*Article 14*), or public entertainers and athletes (*Article 17*), as the case may be, shall apply.

As in the case of most U.S. tax treaties and the OECD model tax treaty, the proposed treaty contains a general limitation on the taxation of dividends paid by corporations which are residents of the other country. Under this provision, the U.K. may not impose any taxes on the dividends paid by a U.S. corporation except where such dividends are paid to U.K. residents or where the dividends are effectively connected with a permanent establishment or fixed base in the United Kingdom. Similarly, the United States may not impose any tax on dividends paid by a U.K. corporation except where the dividends are paid to a resident or citizen of the United States or where the dividends are effectively connected with a permanent establishment or fixed base situated in the United States. These exemptions apply even if the dividends consist wholly or partly of profits or income arising in the taxing jurisdiction.

The proposed treaty also provides that a U.K. corporation shall be exempted from the U.S. accomulated earnings tax if U.K. resident individuals (other than U.S. citizens) control, directly or indirectly, throughout the last half of the taxable year, more than 50 percent of the entire voting power of the corporation. This provision is contained in the existing tax treaty with the United Kingdom.

Article 11. Interest

Under the proposed treaty, interest derived by a resident of one country (other than a citizen of the other country) from sources within the other country is exempt from tax in the source country. This exemption does not apply if the recipient has a permanent establishment or fixed base in the source country and the interest is effectively connected with the permanent establishment or fixed base. If the interest is effectively connected with a permanent establishment or fixed base, then it wil be taxed under the provisions of the proposed treaty dealing with business profits (*Article 8*), independent personal services (*Article 14*), or public entertainers and athletes (*Article 17*), as the case may be. This treatment generally conforms to that provided by other recent

U.S. tax treaties of the OECD model tax treaty.

The exemption from U.K. tax under this article will not apply if the recipient of the interest is exempt from tax on such income in the United States and the recipient sells or makes a contract to sell the holding from which such interest is derived within three months after the date the recipient acquired such holding.

[27] A definition of interest is provided which is also substantially identical to that found in the OECD model tax treaty and other recent U.S. income tax treaties. In situations where the payor and recipient are related, the proposed treaty limits the amount treated as interest to that which would have been paid had they not been related.

Interest paid by a resident of one country, regardless of where it derives its income, to a person other than a resident of the other country (and, in the case of interest paid by a U.K. corporation, to a person other than a U.S. citizen) will be exempt from tax by the other country. However, this rule is inapplicable if the interest is effectively connected with a permanent establishment or fixed base which the recipient has in the other country.

Paragraph (7) of this article is carried over from the existing treaty. Under U.K. domestic law, interest payments by U.K. corporations to non-U.K. corporations which have 75 percent or more control, directly or indirectly, of the U.S. corporation are treated as dividends rather than as deductible interest. This paragraph provides (in reciprocal terms) that this rule shall not apply where the interest payment is to a U.S. resident. A dual resident corporation may claim the benefits of the provision with respect to interest payments it makes. However, the exemption does not apply to the interest paid to a U.S. corporation if more than 50 percent of the voting power of the U.S. corporation is directly or indirectly controlled by residents of the United Kingdom.

Paragraph (8) provides that the exemption from United Kingdom tax under paragraph (2) of this Article will not apply if the recipient of the interest is exempt from tax on such income in the United States and the recipient sells or makes a contract to sell the holding from which such interest is derived within three months after the date the recipient acquired such holding.

Article 12. Royalties

Under the proposed treaty, industrial and artistic royalties derived from one country by a resident of the other country are exempt from tax in the source country. The exemption does not apply if the recipient has a permanent establishment in the source country or performs independent personal services through a fixed base in the source country, and the royalties are effectively connected with the permanent establishment or fixed base. If the royalty is effectively connected with a permanent establishment or fixed base, then it will be taxed under the provisions relating to business profits (*Article 8*), independent personal services (*Article 14*), or public entertainers and athletes (*Article 17*), as the case may be. This treatment of royalties is substantially identical to that provided in the OECD model convention.

The proposed treaty does not include film royalties within the scope of the royalties article. Instead, they are treated as business profits and, accordingly, are exempt from tax unless they are attributable to a permanent establishment which the recipient maintains in the source country.

As in the case of the interest provision, the royalty provision does not apply to that part of a royalty paid to a related person which is in excess of an arm's length rate.

[28] *Article 13. Capital gains*

The proposed treaty provides that, except as provided in *Article 8* (*Shipping and air transport*), capital gains are taxable in accordance with the domestic laws of each country. This rule applies to the existing laws of the United States and the United Kingdom respecting the taxation of capital gains and revisions of those laws subsequent to the effective date of the proposed treaty. Whether an item of income constitutes capital gains shall be determined under the laws of the country seeking to tax those gains.

Under current U.S. law, nonresident alien individuals are generally not taxable in the United States on their U.S. source capital gains unless (1) they are present in the United States for 183 days or more during a taxable year or (2) the gains are effectively connected with the conduct of a U.S. trade or business. Foreign corporations generally are taxable in the United States only on capital gains which are effectively connected with the conduct of a U.S. trade or business.

The representatives of the United States and the United Kingdom are to consult with each other upon the enactment or the proposed enactment by either country of any laws which substantially change the manner in which capital gains derived by nonresidents are taxed.

Article 14. Independent personal services

Under the proposed treaty, income from the performance of independent personal services (i.e., services performed as an independent contractor rather than as an employee) in one country by a resident of the other country is exempt from tax in the country where the services are performed unless (1) the person performing the personal service is present in the source country for 183 or more days during the taxable year and the income is attributable to services performed in that country, or (2) the person maintains a fixed base regularly available to him in the source country and such income is attributable to the fixed base.

Article 15. Dependent personal services

Under the proposed treaty, income from services performed as an employee in one country (the source country) by a resident of the other country will not be taxable in the source country if three requirements are met: (1) the individual is present in the source country for not more than 183 days during the taxable year; (2) compensation is not paid by, or on behalf of, an employer who is a resident of the source country; and

(3) the compensation is not borne by a permanent establishment of the employer in the source country. The treatment of dependent personal services is the same as that provided in the OECD model tax treaty.

Compensation derived by an employee from the performance of personal services as a member of the regular complement of a ship or aircraft operated in international traffic by a resident of one country is exempt from tax by the other country.

Article 16. Investment or holding companies

The proposed treaty contains a provision which in certain situations denies the benefits of the articles on dividends, interest and royalties (*Articles 10-12*) to a corporation which is entitled in its country of [29] residence to special tax benefits resulting in a substantially lower tax on those types of income than the tax generally imposed on corporate profits by that country. This provision applies if more than 25 percent of the capital of the corporation is owned by individuals who are not residents of that country or U.S. citizens. A similar provision is contained in several recent U.S. tax treaties (Iceland, Norway, and Trinidad and Tobago). The OECD model tax treaty does not have a comparable provision.

This article also provides that a corporation which is a resident of the United States shall not be entitled to the benefits of the articles relating to dividends, interest or royalties arising in the United Kingdom where more than 80 percent of its gross income (including such dividends, interest, or royalties) is derived from sources outside of the United States. This limitation does not apply if more than 75 percent of the capital of the corporation is owned directly or indirectly by individuals who are U.S. citizens or residents.

Neither of these limitations apply to a U.S. corporation if 75 percent or more of its capital is directly or indirectly owned: (a) by another U.S. corporation which receives 20 percent or more of its gross income from sources within the United States; (b) by a foreign corporation which would not be treated as a close company under U.K. law; or (c) by a corporation, resident in the United Kingdom, more than 50 percent of the voting power of which is controlled directly or indirectly by individuals who are residents of the United Kingdom.

The purpose of the first limitation is to prevent residents of third countries from using a corporation in one treaty country, which is preferentially taxed in that country, to obtain the tax benefits in the other treaty country which the proposed treaty provides for dividends, interest, and royalties derived from that other country. This accords with the purpose of an income tax treaty between two countries to lessen or eliminate the amount of double taxation of income derived from sources within one country by a resident of the other country. At the present time, neither the United Kingdom nor the United States grants to investment or holding companies the type of tax benefits with respect to dividends, interest or royalties which would make this limitation applicable. Thus, it will have effect only if the United Kingdom or the United States should subsequently enact special tax measures granting preferential tax treatment to dividends, interest or royalties received by an investment or holding company.

The second limitation is intended to prevent the use of U.S. corporations by residents of third countries in order to take advantage of the reduced rates of tax or exemptions from tax granted by the United Kingdom on dividends, interest and royalties paid to residents (including corporations) of the United States. Generally, interest and dividends paid by U.S. corporations to nonresidents of the United States are not subject to tax by the United States if more than 80 percent of the corporation's gross income is from sources outside the United States (sec. 862). Accordingly, were it not for this provision, a resident of a third country could establish a U.S. corporation solely to derive interest or dividends from the United Kingdom subject to the reduced rates and refunds allowed by the treaty. While such income would be subject to normal corporate taxes in the United States, the [30] corporation's dividends or interest to the third country residents would be exempt from U.S. withholding taxes. This limitation prevents this abuse where the 25 percent or more of the capital of the corporation is owned by individuals who are not U.S. citizens or residents. Since the purpose of this provision is only to prevent the use of U.S. corporations in cases where their income would otherwise qualify for reduced withholding rates in the United Kingdom and their distributions to third country residents would not attract U.S. withholding taxes, exceptions to the rule are given where that corporation is owned by another U.S. corporation whose distributions would attract U.S. withholding taxes; where that corporation is owned by a corporation which is not a close company under U.K. law; and where the corporation is owned by a corporation resident of the United Kingdom 50 percent or more of the voting power of which is controlled by U.K. resident individuals.

Article 17. Artistes and athletes

The proposed treaty contains a separate set of rules which govern the taxation of income earned by public entertainers (such as theater, motion picture, radio or television entertainers and musicians) and athletes. The proposed treaty provides that, notwithstanding the other provisions dealing with the taxation of personal services (*Articles 15 and 16*), each country may tax nonresident entertainers or athletes on the income from their personal services performed in the country during any year in which their gross receipts (including reimbursed expenses or expenses borne on their behalf) for services performed in that country during that year exceed $15,000. Thus, highly paid entertainers and athletes will be taxable by the country in which they perform, regardless of the period of time spent in that country. However, as in the case of the other provisions dealing with personal services income, this provision does not bar the country of residence or citizenship from also taxing that income. In such a case, double taxation is avoided by the grant of a foreign tax credit.

In addition, the proposed treaty provides that when income in respect of personal services performed by an entertainer or athlete is paid not to the entertainer or athlete but rather to another person or entity, that income will be taxable by the country in which the services are performed in any situation where the entertainer or athlete shares directly or indirectly in the profits of the person or entity receiving the income. For this purpose, participation in the profits of the recipient of the income includes the receipt of deferred compensation, bonuses, fees, dividends, partnership distributions, or other distributions. The provision is intended to prevent performers and athletes from avoiding tax in the country in which they perform by routing the compensation for their services through a third person such as a personal holding company.

Article 18. Private pensions and annuities, and alimony

Under the proposed treaty, private pensions and annuities derived by residents of the United States are exempt from tax by the United Kingdom, and private pensions and annuities derived by residents of the United Kingdom are exempt from tax by the United States. In addition, alimony paid to a resident of either country is exempt from tax by the other country.

[31] *Article 19. Government services*

Under the proposed treaty, compensation, other than a pension, paid by the Government of either country to an individual for services rendered to that country is generally taxable only in that country. However, such compensation is taxable only in the country in which the services are being performed if the recipient is a resident national of that country or is a resident solely for the purpose of performing the services. This provision does not apply to compensation received for services performed for political subdivisions and local authorities. The provision generally follows the OECD model tax treaty, and it is similar to the provision in the existing U.S.-U.K. tax treaty.

Any pension paid by either country, or a political subdivision or a local authority thereof, to any individual in respect of services rendered to that country or subdivision or local authority is generally taxable only in that country. However, a pension is taxable only in the other country if the recipient is both a national of and a resident of that other country.

These provisions do not apply if the services are rendered in connection with any business carried on by or on behalf of either country or a political subdivision or local authority. In such cases, the provisions of *Articles 14* (*Independent personal services*), *15* (*Dependent personal services*), *17* (*Artistes and athletes*), and *18* (*Pensions*) apply, as the case may be. In addition, these provisions do not apply to an individual who acquires immigrant status in the country in which he performs the services or receives the pension. See paragraphs (3) and (4)(b) of *Article 1* (*Personal scope*).

Article 20. Teachers

The proposed treaty provides that a professor or teacher who is a resident of one country will be exempt from tax in the other country on income from teaching or from engaging in research at an educational institution in the host country if he is present in that other country for a period not exceeding two years. Unlike the present treaty and other U.S. tax treaties, if the two-year period is exceeded, the exemption will be lost retroactively. In addition, as in other U.S. tax treaties, the exemption for income from research only applies if the research is undertaken in the public interest and not primarily for the benefit of some other private person or persons.

Article 21. Students and trainees

The treatment afforded students and trainees under the proposed treaty corresponds generally to the existing treaty and to the OECD model tax treaty. Residents of one country who become students or business apprentices in the other country will be exempt from tax in the host country on payments received for their maintenance, education, or training, if they are engaged in a full-time education or training program and the payments are made from sources outside the host country. Payments will be considered to have been made from sources outside of the host country when they are borne by a person who is not a resident of that country. The exemption does not apply to payments to students or business apprentices who are nationals of or residents with immigrant status in the host country.

[32] *Article 22. Other income*

Items of income not otherwise dealt with in the proposed treaty which are derived by residents of either country shall be taxable only by the country of residence, regardless of the source of the income. That rule, however, does not apply to residents of one country carrying on a business in the other country through a permanent establishment or performing independent personal services in that other country from a fixed base situated therein, where the income paid is effectively connected with the permanent establishment or fixed base. In such situations, the provisions of *Article 7* (*Business profits*), *Article 14* (*Independent personal services*) or *Article 17* (*Artistes and athletes*), as the case may be, shall apply.

However, the article specifies that each country may continue to tax income paid out of trusts. This provision allows the U.K. to continue to apply its taxes on accumulation and discretionary trusts.

Article 23. Elimination of double taxation

In general

The proposed treaty contains the general rule contained in many U.S. tax treaties under which the United States agrees that it will continue to allow its U.S. citizens and residents to claim a foreign tax credit (Code sec. 901) against the U.S. tax for the appropriate amount of income taxes paid to the United Kingdom. The proposed treaty also makes the indirect foreign tax credit (Code sec. 902) available where a U.S. corporation receives a dividend from a U.K. corporation in which it has at least a 10-percent ownership interest. In this case, a credit will be allowed for the appropriate amount of tax paid to the United Kingdom by the U.K. corporation with respect to the profits out of which the dividend is paid. The (direct or indirect) credit allowed under the proposed treaty is subject to the limitations and in accordance with the provisions of U.S. law (as it may be amended from time to time without changing the general principle of allowing a foreign tax credit) applicable to the year in question.

The proposed treaty similarly provides that the United Kingdom shall allow a foreign tax credit against its tax for U.S. tax paid on profits or income from sources within the United States. The credit is to be subject to the provisions of U.K. law regarding the allowance of a foreign tax credit as they may be amended from time to time without changing the general principle of allowing a foreign tax credit. In addition, the proposed treaty provides that where a U.K. corporation receives a dividend from a U.S. corporation and the U.K. corporation controls (directly or indirectly) at least 10 percent of the voting power of the U.S. corporation, the United Kingdom is to allow an indirect credit for the U.S. taxes paid by the U.S. corporation in respect to the profits out of which the dividends are paid.

In addition, the proposed treaty sets forth the general rule that income or profits derived by a resident of one country which may, under the proposed treaty, be taxed by the other country shall be deemed to arise from sources within that other country. However, an exception to that rule is provided with respect to residents of the United Kingdom who are U.S. citizens (and thus are taxed by the United States on the basis of citizenship). Under the proposed treaty, the United Kingdom shall not be required in that situation to allow a credit with re- [33] spect to U.S. tax on income the U.S. citizen earned from sources outside the United States (as determined under the laws of the United Kingdom). Similarly, the United States shall not be required to allow to such U.S. citizens a foreign tax credit for U.K. taxes on income from sources outside the United Kingdom (as determined under the laws of the United States).

The Advance Corporation Tax (the "ACT")

Background.—In addition to the general rules providing for the allowance of the foreign tax credit, the proposed treaty also sets forth special rules which govern the manner in which the taxes imposed by the United Kingdom on U.K. corporations (in particular, the ACT) are to be treated for purposes of the U.S. foreign tax credit allowable on dividends paid to U.S. shareholders.

As discussed above in connection with the provisions of the proposed treaty relating to dividends (*Article 10*), the United Kingdom has a hybrid corporate tax system which in part integrates the tax imposed on corporations and their shareholders. Under the U.K. system, the effective rate of tax paid by a U.K. corporation depends upon the extent to which it has paid out dividends. The corporation is subject to a "mainstream" corporation tax imposed at a rate of 52 percent. When it makes a distribution to its shareholders, it is subject to an additional tax, the ACT, equal to 33/67 of the distribution. However, since the corporation is entitled to credit the ACT payment against its mainstream tax liability (subject to certain limitations), the ACT payment does not result in an increased tax burden on the corporation except in situations where the U.K. corporation distributes amounts with respect to which the mainstream corporate tax has not been paid (distributions out of earnings in excess of U.K. taxable income, out of capital, or out of non-U.K. source earning against which a U.K. foreign tax credit has been allowed for mainstream tax purposes—no foreign tax credit is allowed against the ACT).

In addition to the credit of the ACT allowed against the corporation's mainstream tax, U.K. shareholders are entitled to credit an amount equal to the ACT payment against their U.K. income tax liability on the distribution (the U.K. shareholder receives a cash refund to the extent, if any, that the ACT payment by the corporation exceeds the shareholder's tax liability). In the absence of a tax treaty, the ACT is not refunded to nonresident aliens, and the unrefunded ACT results in an actual increased tax burden with respect to dividends paid to nonresidents.

Creditability of ACT.—It is open to question whether, in the absence of the proposed treaty, the unrefunded ACT would be treated as a creditable income tax for U.S. foreign tax credit purposes. On the one hand, although the unrefunded ACT may be viewed economically as a foreign tax with respect to income of the U.S. shareholders because it is imposed with respect to dividend income paid to them, it is imposed on the paying U.K. corporation rather than the U.S. shareholder receiving the distribution and thus probably would not be allowed as a direct income tax credit to the U.S. shareholder.[5]

[34] On the other hand, although it is a tax imposed on the paying U.K. corporation, it is not imposed with respect to income of the paying corporation, but rather on all distributions made by the U.K. corporation, whether out of taxable income, out of untaxed earnings, or out of capital. Under present IRS ruling policy, in order for a foreign tax to qualify for the U.S. foreign tax credit, it must be imposed on the net gain of the taxpayer (determined by allowing the deduction of the generally significant expenses incurred in the production of that income), it must be imposed only on income that is realized, and it must be imposed on the receipt of income rather than some other transaction.[6] It would appear that, at least in form, the ACT would not satisfy these criteria. There is, therefore, a reasonable possibility that the ACT would not be viewed by the IRS as a creditable tax in the absence of the proposed treaty.

However, notwithstanding these technical difficulties, the ACT could be treated as a creditable income tax to the extent that it is allowed as an offset against the U.K. "mainstream" corporate tax, which is a creditable income tax. Under this treatment, in situations where the ACT is offset against a mainstream tax accruing in years subsequent to the dividend payment, no foreign tax credit would be allowed in the absence of the treaty until that later year in which the mainstream liability is offset.

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[5] *Biddle* v. *Commissioner*, 302 U.S. 573, 1938-1 USTC ¶ 9040 [Ct. D. 1303, 1938-1 C.B. 309]. If the ACT were a shareholder tax, it would be subject to, and limited by, the dividend provisions of the existing treaty.

[6] Rev. Rul 78-61 [1978-1 C.B. 221], Rev. Rul. 78-62 [1978-1 C.B. 226], and Rev. Rul. 78-63 [1978-1 C.B. 228].

ACT refunds to U.S. portfolio shareholders.—In the case of dividends paid to U.S. resident shareholders (other than U.S. corporations owning more than 10 percent of the U.K. corporation's stock), the proposed treaty provides (*Article 10, Dividends*) that the United Kingdom is to pay to the U.S. shareholder an amount equal to the amount which would be refunded to U.K. resident shareholders with respect to the distribution. However, the refund to these U.S. shareholders is to be reduced by an amount equal to 15 percent of the sum of the distribution and the full refund which would be paid to U.K. shareholders. For example, on a distribution of $67, U.K. resident shareholders would be allowed a credit of $33. Under the proposed treaty, U.S. shareholders (other than direct corporate investors) would receive a net refund of $18—the $33 credit allowable to U.K. shareholders less $15 (15 percent of the sum of the $67 distribution and the $33 credit). Since the amount of the refund paid to U.K. shareholders is 33 percent of the sum of the dividend and the refund, the net payment made to these U.S. shareholders ($33 less $15, or 18 percent of that sum) is to be a little more than one-half of the credit allowed to U.K. shareholders (18/33rds).

The proposed treaty provides that for U.S. foreign tax credit purposes the U.S. shareholders are to be treated as having received a dividend equal to the distribution paid plus an amount equal to the full refund payable to U.K. shareholders (*Article 10*(*2*)(*a*)(*iii*)) and that the reduction in the refund payable to U.S. shareholders equal to 15 percent of that grossed-up dividend is to be treated as creditable income tax imposed on the U.S. shareholder (*Article 23*(*1*)(*b*)). For example, on a dividend of $67, the U.S. shareholder will receive a net payment from the U.K. Treasury of $18 and will be treated for U.S. [35] foreign tax credit purposes as having received a dividend of $100 ($67 distribution plus $33 gross refund) from which a $15 creditable income tax has been withheld. The effect of providing for a full 33-percent payment to the U.S. shareholder subject to the special 15-percent reduction is to permit the U.S. shareholder to claim a foreign tax credit for the 15-percent reduction.

ACT refunds to U.S. direct corporate investors.—In the case of distributions made to U.S. corporations which own at least 10 percent of the voting stock of the distributing U.K. corporations ("direct corporate investors"), the provisions contained in the proposed treaty relating to the U.S. foreign tax credit are more complicated. In the case of distributions to U.S. direct corporate investors, the proposed treaty provides that the U.K. Treasury is to make a payment to U.S. direct corporate shareholders equal to one-half the credit which would be allowed to U.K. resident shareholders. However, the payment from the U.K. Treasury is to be reduced by an amount equal to 5 percent of the sum of the distribution and the payment. To illustrate by example, on a $67 distribution to a U.S. direct corporate investor, the distributing U.K. corporation pays ACT of $33 to the U.K. Treasury, which in turn pays approximately $12.50 to the U.S. direct corporate shareholder. This payment to the U.S. shareholder is $16.50 (one-half of the $33 credit which would be allowed to a U.K. resident shareholder) less roughly $4 (5 percent of the sum of that $16.50 and the $67 distribution).

For purposes of the U.S. foreign tax credit, the proposed treaty treats the U.S. direct corporate shareholder as receiving a dividend equal to the distribution paid plus an amount equal to one-half of the credit allowable to U.K. shareholders (*Article 10*(*2*)(*a*)(*iii*)). The reduction in the payment to the U.S. shareholder of 5 percent of the grossed-up distribution is to be treated as a creditable income tax (under Code sec. 901) imposed on the U.S. shareholder (*Article 23*(*1*)(*b*)). In addition, the remaining one-half of the amount which would be credited to U.K. residents but which is not refunded to U.S. direct corporate investors is treated as a creditable income tax imposed on the distributing U.K. corporation. As a result, the U.S. direct corporate shareholder can claim a deemed-paid foreign tax credit.

For example, on a distribution of $67, the U.S. direct corporate shareholder would be treated as receiving a dividend of $83.50 (the $67 distribution plus one-half of the $33 credit which would be allowed to U.K. resident shareholders), and would be treated as having paid a creditable income tax of 5 percent of that amount, or roughly $4. In addition, the U.K. corporation would be treated as having paid additional income tax of the remaining $16.50 which is not refunded, and the U.S. shareholder will be entitled to an indirect foreign tax credit for that unrefunded $16.50.

The technical explanation of the proposed treaty issued by the U.S. Treasury Department further details the manner in which direct U.S. corporate investors are to compute their U.S. foreign tax credit with respect to dividends received from U.K. corporations. For purposes of computing the indirect foreign tax credit, the technical explanation does not treat the ACT refund which is paid to the U.S. shareholder [36] by the U.K. Treasury (equal to half the credit allowable to U.K. shareholders) as a refund of U.K. tax paid to the U.S. shareholder, but instead treats it as a refund of U.K. tax to the distributing U.K. corporation. The partial refund of the ACT paid to the U.S. shareholders provided in the proposed treaty reduces the maximum effective U.K. tax rate with respect to dividends paid to U.S. shareholders to 43 percent while the U.K. tax rate on retained profits is 52 percent. The effect of the method of computing the foreign tax credit set forth in the proposed treaty Treasury's technical explanation is to average the reduced U.K. taxes paid with respect to the distribution with the higher U.K. taxes paid on retained earnings in determining the U.K. tax which is attributed to the dividend distribution.

To illustrate by example, where a U.K. corporation with $200 of taxable income distributes one-half of its $96 of after-tax earnings, or $48, a refund is paid to the U.S. shareholder of $9 ($12 refund, reduced by $3 withholding tax). This refund reduces the effective rate of U.K. tax on the dividend to 43 percent ($52 of tax paid by the corporation reduced by a $9 refund to the U.S. shareholder). For indirect foreign tax credit purposes, however, the distributing corporation would be treated as having paid $92 in U.K. tax ($104 minus the full $12 refund without regard for the withholding tax). Since one-half of after tax income is distributed, one-half of the taxes as determined ($46) are allowed as an indirect foreign tax credit. In effect, the U.S. shareholder is permitted to average the 52-percent rate paid with respect to the retained earnings and the 43 percent paid with respect to the dividend received and claim a 48.5-percent foreign tax credit.[8] If the retained profits are subsequently distributed to the U.S. shareholder (thereby lowering the average rate attributable to the previous dividend to 43 percent), the U.S. shareholder is treated as having received a refund of a portion of the U.K. taxes claimed as a foreign tax credit with respect to the earlier dividend and must reduce the foreign tax credit claimed in the prior year.

The Treasury's technical explanation also set forth a complex set of rules and examples intended to be used for purposes of determining the earnings to which ACT payments by a U.K. corporation are to be attributed for purposes of computing the indirect U.S. foreign tax credit. The technical explanation also sets forth rules for determining the credit where the U.K. corporation has non-U.S. shareholders. These rules are necessary because the treatment of the refund of the ACT to shareholders as a refund of tax to the corporation would dis- [37] tort the average U.K. tax paid by the corporation attributed to its shareholders where the shareholders receive refunds of differing amounts.

The ACT refunds, the withholding tax, and the unrefunded portion of the ACT are treated for U.S. foreign tax credit purposes in a manner which is generally favorable to U.S. shareholders. These rules raise difficult and complex issues. In recommending the ratification of the proposed treaty, the Committee does not intend that these rules necessarily serve as a model for future treaties. Further, in recommending the ratification of the treaty, the Committee does not intend to adopt or reject the amplifications of the foreign tax credit rules contained in the Treasury technical explanation. Consequently, Treasury would not be foreclosed by the ratification of the treaty from modifying those administrative interpretations in the future should it deem it advisable to do so. Of course, the rules contained in the treaty also do not limit any legislative action in this area; the computation of the foreign tax credit for unrefunded ACT may be subject to any generally applicable changes in the U.S. foreign tax credit rules which may subsequently be enacted.

Petroleum Revenue Tax

The proposed treaty also provides that the U.K. Petroleum Revenue Tax (the "PRT") is to be treated as a creditable income tax for U.S. foreign tax credit purposes. It is the position of the Internal Revenue Service that the PRT is not a tax on net income and that therefore it would not be eligible for the U.S. foreign tax credit in the absence of the proposed treaty. In the view of the IRS, the PRT is more in the nature of a deductible royalty or excise tax.

The PRT is imposed at a 45 percent rate on assessable profits from oil and gas extraction activities in the U.K. (including the North Sea) on a field-by-field basis. It is in addition to, and separate from, the regular U.K. corporate tax (and a 12.5 percent royalty payable on North Sea production). The amount of PRT paid is allowed as a deduction for purposes of computing the regular U.K. corporate income tax. Operating and capital losses from nonextraction activities are not allowed as deductions in computing the PRT. In addition, no deduction is allowed for interest or other financing costs. However, a special additional deduction based on the amount of capital investment is provided to compensate for the disallowance of interest expenses in computing profits for purposes of the PRT. The aggregate amount payable to the U.K. Government in taxes and royalties on oil and gas extraction income is roughly 60 to 70 percent.

The proposed treaty also makes it clear that the provisions of this article requiring the U.S. to allow a foreign tax credit for U.K. taxes, in particular the PRT, do not affect the limitations on credits for foreign taxes imposed on foreign oil and gas extraction income and foreign oil-related income which are contained in the Tax Reduction Act of 1975 [Pub. L. 94-12, 1975-1 C.B. 545]. Since the treaty was negotiated prior to the enactment of the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1], the proposed treaty does not also refer to the limitations on foreign tax credits for oil and gas extraction taxes contained in the 1976 Act. However, since the proposed treaty provisions require only that a U.S. foreign tax credit be allowed in accord- [38] ance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle of allowing a foreign tax credit), the additional limitations contained in the 1976 Act, and any similar limitations applying to foreign income taxes imposed on oil and gas extraction income or oil related income which may in the future be adopted, will apply in computing the U.S. foreign tax credit allowable with respect to U.K. taxes on oil and gas extraction income and oil-related income.

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[8] The allowance of the foreign tax credit at a 48.5-percent rate rather than at the average rate of U.K. tax (47.5 percent) imposed on retained and distributed profits from the characterization of the $9 net payment by the U.K. to the U.S. shareholder as comprised of (i) a $12 ACT refund to the U.K. subsidiary (one-half of the $24 ACT imposed) reduced by (ii) a $3 withholding tax (5 percent of the sum of the $48 dividend and the $12 unrefunded ACT) rather than merely as an ACT refund of the net $9 payment made by the U.K. (or ⅜ of the ACT imposed). This treatment yields a slightly higher foreign tax credit than would otherwise be available because the full amount of the withholding tax is available to the U.S. shareholder as a direct credit, while the reduction in its deemed paid foreign taxes attributable to the ACT refund is allocated between the dividend and the earnings retained by the U.K. subsidiary.

Article 24. Nondiscrimination

The proposed treaty contains a comprehensive nondiscrimination provision similar to provisions which have been embodied in other recent U.S. income tax treaties and the OECD model treaty. One country cannot discriminate by imposing more burdensome taxes on its residents who are citizens of the other country, or on permanent establishments maintained in that country by residents of the other country, than it imposes on its nationals and resident corporations. The nondiscrimination provision also applies to corporations or other enterprises of one country which are owned by residents of the other country. The nondiscrimination provision does not, however, oblige either country to grant individual residents of the other country any personal allowances, reliefs, or deductions for taxation purposes on account of personal status or family responsibiliites (e.g., dependency deductions) which it grants to its own residents.

The proposed treaty provides generally that interest, royalties, and other disbursements paid by a U.S. enterprise to a U.K. enterprise, whether or not related, shall, if reasonable in amount, be deductible by the U.S. enterprise in computing its U.S. taxable income to the same extent as if they had been paid to another U.S. enterprise. Similarly, such payments by U.K. enterprises to U.S. enterprises are deductible for U.K. tax purposes to the same extent as deductions are allowed for similar payments made to U.K. enterprises. For purposes of this provision, the term "other disbursements" includes charges or allocations for amounts expended by a resident of the other country for the benefit of the enterprise (e.g., amounts expended by a U.S. parent corporation for the benefit of its U.K. subsidiary). It includes a reasonable allocation of executive and general administrative expense incurred on behalf of the enterprise by the resident of the other country (except that it does not include such expenses to the extent that they are not for the benefit of the enterprise, but are for "stewardship" or "overseeing" functions for the resident's own benefit as an investor in the enterprise). The term also includes charges and allocations of research and development expenses where the enterprise has the benefits of such activities under a cost or risk-sharing agreement and other expenditures incurred by the resident for the benefit of a group of related enterprises which includes the resident.

This provision does not apply to interest, royalties, or other disbursements paid or charged to a related resident of the other country to the extent that they exceed the arm's-length amount which would be paid under similar circumstances to an unrelated party. This provision also does not apply to interest payments by a corporation to a U.S. [39] corporation controlled by U.K. shareholders (see *Article 11(7), Interest*). Under certain circumstances such payments are treated as dividends for U.K. tax purposes.

Articles 25 and 26. Administrative provisions

The proposed treaty contains various administrative provisions generally along the lines of the provisions contained in other U.S. tax treaties. In general, the proposed treaty provides—

(1) for consultation and negotiation between the two countries to resolve differences arising in the application of the proposed treaty and also to resolve claims by taxpayers that they are being subjected to taxation contrary to the terms of the proposed treaty;

(2) for the exchange between the countries of information pertinent to carrying out the provisions of the proposed treaty and of the domestic laws of the countries concerning taxes covered by the proposed treaty; and

(3) that each country is to assist the other in collecting taxes imposed by the other country to the extent necessary to insure that the benefits provided by the proposed treaty are enjoyed only by persons entitled to those benefits.

Article 27. Effect on diplomatic officials and domestic laws

The proposed treaty contains the rule found in other U.S. tax treaties that its provisions are not to affect the fiscal privileges of diplomatic and consular officials under the general rules of international law or the provisions of special agreements.

In addition, the proposed treaty contains the rule found in other U.S. tax treaties that its provisions do not restrict in any manner any exclusion, exemption, deduction, credit, or other allowances accorded by the laws of either country. Thus, the proposed treaty can only be applied when it benefits a taxpayer.

Article 28. Entry into force

The proposed treaty will enter into force on the thirty-first day following the date on which the instruments of ratification are exchanged. Once the proposed treaty enters into force, it applies retroactively, with different effective dates provided with respect to different taxes and provisions.

With respect to the income and capital gains taxes imposed by the United Kingdom, the provisions of the proposed treaty generally apply for any year of assessment beginning on or after April 6, 1975 (the United Kingdom tax year begins on April 6). However, the provision relating to the refund of the ACT and the imposition of the 15 percent withholding tax on dividends paid by United Kingdom corporations to U.S. individual investors and corporate portfolio investors (*Article 10(2)(a)(ii)*) applies with respect to dividends paid after April 1, 1973 (the date the ACT system came into effect). The proposed treaty will apply with respect to the corporation tax for any financial year beginning on or after April 1, 1975. With respect to the Petroleum Revenue Tax, it applies for any chargeable period beginning on or after January 1, 1975 (the date the PRT first came into effect).

The proposed treaty will generally apply on a retroactive basis to taxes imposed in the United States (including state income taxes subject to the limitations provided in Article 9(4)) for taxable years [40] beginning on or after January 1, 1975. The proposed treaty applies to any U.S. withholding taxes paid or credited on or after January 1, 1975, without regard to when the taxable year began. In addition, the provisions under which the United States is required to allow a foreign tax credit for United Kingdom taxes (including the income tax, the capital gains tax, the corporation tax, the unrefunded ACT, the deemed withholding tax, the Petroleum Revenue Tax, and local taxes) apply with respect to United Kingdom taxes paid on or after April 1, 1973.

The provisions of the existing treaty will generally cease to have effect on a retroactive basis with respect to a tax to which the proposed treaty applies at the time the proposed treaty comes into effect with respect to that tax. However, where any provisions of the existing treaty would have afforded greater relief from tax, that provision will continue to have effect for any taxable year beginning before January 1, 1976. The existing treaty will terminate on the last date on which it has effect under the above provisions.

The termination of the existing treaty will not, however, affect agreements which extend the existing treaty to certain territories of the United Kingdom (Antigua, Belize, the British Virgin Islands, Dominica, the Falkland Islands, Montserrat, St. Christopher-Nevis-Anguilla, St. Lucia, and St. Vincent). In those cases, the existing treaty will continue to apply. However, the United States has requested the United Kingdom to advise those territories that the United States desires to renegotiate the existing treaty as it affects them so as to reflect the principles of the proposed treaty.

Article 29. Termination

The proposed treaty will continue in force indefinitely, but either country may, on or before June 30 of any year after 1980, terminate it by giving notice through diplomatic channels.

If such notice is given, the treaty will cease to be effective for taxable years beginning on or after January 1 of the following year for U.S. tax; for a year of assessment beginning on or after April 6 of the following year for the U.K. income tax and capital gains tax; for a financial year beginning on or after April 1 of the following year for the U.K. corporation tax; and for a chargeable period beginning on or after January 1 of the following year for the U.K. Petroleum Revenue Tax.

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[47] X. TEXT OF RESOLUTION OF RATIFICATION

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RESOLUTION OF RATIFICATION

Resolved (*two-thirds of the Senators present concurring therein*), That the Senate advise and consent to the ratification of the 1975 Tax Convention with the United Kingdom, signed at London on December 31, 1975 (Ex. K, Ninety-fourth Congress, second session), as amended by notes exchanged on April 13, 1976 (Ex. K, Ninety-fourth Congress, second session) and by two protocols, signed on August 26, 1976 (Ex. Q, Ninety-fourth Congress, second session) and on March 31, 1977 (Ex. J, Ninety-fifth Congress, first session).

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[50] LETTER OF TRANSMITTAL

THE WHITE HOUSE,
June 24, 1976.

To the Senate of the United States:

I transmit herewith for Senate advice and consent to ratification the Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income signed at London on December 31, 1975, together with an exchange of notes modifying certain provisions of the Convention signed at London on April 13, 1976.

I also transmit for the information of the Senate the report of the Department of State with respect to the Convention and the exchange of notes.

This Convention and exchange of notes are designed to modernize the relationship with respect to taxes on income which has evolved between the United States and the United Kingdom from a similar Convention signed at Washington on April 16, 1945.

The Convention with subsequent exchange of notes is similar to other recent United States income tax treaties, although it does have some new features which are described in the enclosed report of the Department of State.

Such tax conventions help promote economic cooperation with other countries. I urge the Senate to act favorably on this Convention and exchange of notes at an early date and to give its advice and consent to ratification.

GERALD R. FORD.

[51] LETTER OF SUBMITTAL

DEPARTMENT OF STATE,
Washington, June 8, 1976.

The PRESIDENT,
The White House.

The PRESIDENT: I have the honor to submit to you, with a view to its transmission to the Senate for advice and consent to ratification, the Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income signed at London on December 31, 1975, and an exchange of notes signed at London on April 13, 1976, modifying certain provisions of the Convention.

The proposed Convention with the United Kingdom is similar in its essential respects to other recent United States income tax treaties, and to the model income tax convention of the Organization for Economic Cooperation and Development. There are, however, several provisions in the Convention with the United Kingdom which require special comment.

Article 10 (Dividends) represents a new approach to meshing, by treaty, two tax systems which differ sharply in their treatment of corporations and their shareholders—the "classical system" in the United States, under which corporate profits and dividend income are taxed separately in the hands of the corporation and the shareholder, and the British "imputation system" under which a portion of the tax collected at the corporate level (known as The Advance Corporation Tax "Act") is refunded to a United Kingdom shareholder to satisfy his tax liability on a dividend distribution. Under the United Kingdom system which was enacted in 1973, nonresident shareholders do not receive this refund. We believe this represents discrimination against United States investors in the United Kingdom vis-a-vis United Kingdom investors.

The provisions of Article 10 of the draft treaty mitigate this discriminatory element in the British system. The British will, under the treaty, make payments to U.S. investors equivalent, in part or in whole, to the ACT credit allowed to United Kingdom investors. United States portfolio investors, defined as owning less than ten percent of the shares of the United Kingdom corporation, will receive, in addition to the dividend, a payment equal to the full credit allowed to United Kingdom investors. From the total amount paid (the dividend plus the credit payment) the United Kingdom will withhold 15 percent. For direct investors (corporations owning more than ten percent of the shares of the United Kingdom corporation), the payment will equal one-half of the credit allowed to United Kingdom [52] shareholders, and from the total amount paid, a tax of five percent will be withheld. This latter provision represents a substantial concession by the United Kingdom because under United Kingdom law, only individual domestic shareholders receive the ACT credit.

This provision is significant beyond the immediate context of the United Kingdom treaty, because it presently appears that an imputation system similar to that in the United Kingdom will be the approach adopted by the European Economic Community in harmonizing the income tax systems of the member countries. France already has such a system.

In order to clarify the United States tax treatment of the ACT, the treaty provides that the credit payments by the United Kingdom will be treated as dividend income to United States shareholders and that a foreign tax credit will be allowed for the portions of the ACT credit not refunded.

The United States will reduce its withholding rates to 15 percent on dividends to United Kingdom portfolio investors and to five percent on dividends to United Kingdom parent corporations. This reduction follows the pattern adopted in other United States treaties.

A second new provision is found in paragraph 4 of Article 9 (Associated Enterprises). This provision represents the first attempt to bind State and local taxing authorities by a substantive provision of the treaty (other than non-discrimination). Under the basic rules of our other tax conventions a Contracting State entering into such tax conventions is prohibited from taking into account, in determining the tax liability of an enterprise doing business in that Contracting State, the income, expenses, etc. of related enterprises of the other Contracting State or in other countries if those enterprises are not engaged in business in the Contracting State, except to the extent that inter-company transactions are not conducted on an arm's length basis. This treaty, for the first time, extends this limitation to State and local tax authorities with respect to enterprises conrolled by United Kingdom residents. This limitation is directed at the practice of a few States which are attempting to take into account the income on a consolidated basis of all related foreign enterprises in assessing the State income tax of a single member of the related group doing business in the State. This method of assessment, which includes the burden of producing worldwide records of all of the affiliated companies, has raised many objections by our treaty partners and we are now seeking to deal specifically with this problem in our treaties. This broadening of the scope of the treaty has been discussed informally with the Chairman of the Foreign Relations Committee.

The treaty provides for reciprocal exemption from withholding on interest and royalty payments from payers in one Contracting State received by residents of the other. Such exemption is provided in the existing treaty.

The treaty also clarifies the manner in which the United Kingdom may tax the United States source income of United States citizens residing in the United Kingdom and United Kingdom branches of United States corporations. The treaty generally allows the United Kingdom to tax such income, but in so doing, the United Kingdom must first allow a credit against its tax for any United States tax paid with respect to the same income. This rule is consistent with our [53] other recent treaties and the OECD Model Convention. The remaining provisions of the draft treaty, dealing with the taxation of business profits, personal service income and administrative matters are patterned largely after other recent United States income tax treaties.

The exchange of notes dated April 13, 1976, was entered into on the basis of information communicated to both governments since public release of the December 31, 1975, Convention. It was called to our attention that a number of corporations have been organized under the existing tax convention as dual residents of the United States and the United Kingdom on the assumption that certain benefits of the present treaty flow to such dual residents and their shareholders. Paragraph 2 of Article 1 of the convention signed on December 31 excluded all dual resident corporations from benefits under the new treaty. The proposed note modifies this provision by extending treaty benefits to residents of the United States and the United Kingdom who receive income from dual resident corporations and provides that the United Kingdom Petroleum Revenue tax will be a creditable income tax in the case of a dual resident corporation.

The April 13, 1976, exchanges of notes amended Article 8 (Shipping and Air Transport) to broaden the tax exemption for containers used in international traffic.

Paragraph 4 of Article 9 (Associated Enterprises) was restated to make it clear that the United States and States of the United States may not take into account the income or deductions of a related enterprise which is a resident of the other Contracting State unless such enterprise is engaged in business in the taxing jurisdiction or has had business transactions with a related enterprise and the adjustment is made on an arm's length basis. The rule has been restated to make it clear that this limitation on Federal and State tax rules applies only to corporations controlled by United Kingdom interests and eliminates any suggestions in the text of December 31 that United States based companies or third country companies might obtain coverage under this rule merely by establishing a United Kingdom affiliate.

Article 16 (Investment or Holding Companies) was liberalized in order to permit certain financing companies established in the United States to benefit from reduced treaty rates by the United Kingdom. Additional changes in the note are conforming amendments.

The Convention and exchange of notes will enter into force thirty days after the date of exchange of instruments of ratification and then have effect as provided in Article 28. This Convention and exchange of notes shall remain in force indefinitely subject to the right of either party to terminate it by giving notice of termination on or before June 30 in any year after the year 1980 pursuant to the procedure found in Article 29.

The Department of the Treasury, with the cooperation of the Department of State, was primarily responsible for the negotiation of this Convention. It has the approval of both Departments.

Respectfully submitted,

C. W. Robinson,
Acting Secretary.

Enclosure: Convention and exchange of notes.

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[84] APPENDIX B

Compensation of Government Employees and DOD Personnel, Committee Memo, March 14, 1978

The treaty provides that compensation paid by the government of either country to an individual for services rendered in the other, is generally taxable only in the first country. However, there are two exceptions when such compensation is taxable in the country where the services are rendered:

1. if the recipient is a resident national of the country;
2. if the recipient did not become a resident of that country solely for purposes of performing the services (e.g., they were British residents before they began to work for the U.S. Government).

Questions have arisen over the tax treatment of DOD employees in the U.K. Britain's Inland Revenue has released a press release in which it explicitly states that civilian personnel and U.S. Forces employed by DOD "will not be subject to U.K. tax."

[85] APPENDICES

[1x] 7 February 1978

DOUBLE TAXATION: UNITED STATES OF AMERICA

It has come to the attention of the Inland Revenue that there are misunderstandings about the effect of a provision of the revised Double Taxation Convention with the United States of America, which was published on 14 April 1976 as a draft Order in Council, has been approved by Parliament and awaits approval by the United States Senate. The provision concerned is paragraph 1 of Article 19 (Government Service) and the question is what effect it would have in the case of remuneration paid by the United States Government to individuals resident in the United Kingdom in respect of services rendered to the United States. In particular misunderstandings have occurred among members of the United States forces and civilian personnel employed by the United States Department of Defense who are serving in the United Kingdom.

Under the Article the remuneration would be taxable only by the United States except where the individual:

i. is a national of the United Kingdom or

ii. did not become a resident of the United Kingdom solely for the purpose of performing the services to the United States.

In cases where these exceptions apply the United Kingdom would have the sole right to tax remuneration.

The Inland Revenue wish to make clear that in the case of the second exception, individuals who are United States nationals (without also being United Kingdom nationals) would not in fact be subject to United Kingdom tax in respect of the remuneration by reason of the special exemption provisions in Section 367, Income and Corporation Taxes Act 1970 or, if that Section does not apply, in Section 373 of that Act.

There is a proviso in Section 373, Income and Corporation Taxes Act 1970, that the special exemption does not apply where the remuneration is paid by a department or agency of a foreign state which carries on any trade, business or other undertaking for the purposes of profit. Broadly similar provisos also apply under both the existing Convention and the proposed new Convention. Cases subject to these provisos would, however, be exceptional.

[86] APPENDIX D

Prepared Statement of Assistant Secretary of the Treasury Laurence N. Woodworth, July 19, 1977*

Mr. Chairman and Members of the Committee: I am very pleased to appear before your Committee today in support of three income tax conventions currently pending before the Senate — treaties with the United Kingdom, Korea, and the Philippines. Two other treaties, with Israel and Egypt, are pending before the Committee but are not being considered at this time.

As tax treaties have not been before this Committee for several years, I would like to take this opportunity to review briefly the purpose and direction of our tax treaty program.

We have income tax treaties currently in force with 23 countries, as well as with a number of former or present British, Belgian, and Dutch colonies to which the treaties with this countries have been extended. In addition to the treaties before you today, and the two others that are still pending, new or revised treaties with a number of additional countries are currently the subject of negotiations.

Besides this rather extensive network of income tax treaties, we also have treaties in force with 13 countries dealing with estate taxes and death duties, and in a few cases with gift taxes as well. Several other estate tax treaties are now being prepared for signature.

We view tax treaties as an important element in the international economic policy of the United States. One of our fundamental objectives is to minimize impediments to free international flows of capital and technology, and this objective is fostered by having the broadest possible network of income tax treaties.

Among the major impediments to freer capital and technology flows are the rules of national tax systems and their interaction with the systems of other countries. Tax treaties seek to eliminate, or at least mitigate the impact of, these impediments.

Treaties accomplish this minimization of impediments by a variety of means, the principal ones being the elimination or reduction of double taxation and the elimination, to the extent possible, of discriminatory tax rules which distinguish unreasonably between domestic and foreign investment.

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* Secretary Woodworth's statement concerned all three treaties which were the subject of the hearings: the proposed treaties with the United Kingdom, with the Republic of Korea, and with the Philippines. That portion of the statement which solely deals with the proposed treaties with Korea and the Philippines has been deleted where indicated by an ellipsis (. . .).

At the same time, tax treaties also serve other policy objectives—for example, the prevention of tax avoidance and evasion, and the fostering of international cooperation between the tax authorities of Contracting States.

[87] You will see, I believe, as I discuss the treaties currently under consideration, how their individual provisions bring about the harmonization of tax systems with resultant benefits for the United States.

Each of the treaties before you was negotiated by the Treasury Department in close consultation with the Department of State.

In the case of the United Kingdom, the proposed treaty would replace the existing treaty which was signed in 1945 and amended by four subsequent protocols, the most recent of which was signed in 1966. In the other two cases, the proposed treaties would be the first to be entered into by the United States with the treaty partner.

In their general form and many of their specific provisions, these three treaties are alike. However, each of them contains special and in some cases unique provisions, which I will discuss in detail in what of necessity is a rather lengthy statement.

Tax systems differ from country to country as do bilateral economic relations. Modifications in our standard treaty format are necessary in order to accommodate these differences. Although we enter each negotiation with the goal of achieving all of our objectives, we must sometimes accept the benefits of a good treaty when a perfect treaty is simply not attainable. Therefore despite the fact that our treaties retain a common structure and policy thrust, they invariably differ from one to another.

Let me deal first with a general overview of the treaties before you. The one with Korea was negotiated in 1973 and negotiations with the Philippines were begun at about that time. These treaties therefore reflect the model treaty which the United States was then using as a basis for discussions. In 1975 we revised our model treaty to bring it more closely into conformity with the Model Income Tax Treaty of the Organization for Economic Cooperation and Development (OECD). The revised U.S. model was used as a basis for our discussions with the United Kingdom, and, as a result, you will observe differences in form between the United Kingdom treaty and the others. We do not believe that these formal differences represent major differences in substance.

There are also differences among the three treaties reflecting differences among these countries in levels of economic development. Although we do not offer tax sparing, we do modify some treaty provisions, without altering our basic policies, to reflect the development, revenue, and foreign exchange needs of developing countries. These modifications are to be found principally in the permanent establishment, business visitor, and investment income withholding provisions.

The need of developing countries for revenue often leads them to enact statutory rules which are so burdensome as to inhibit investments. We try by treaty to bring both the levels and scope of such taxes within internationally accepted norms. We recognize, however, that developing countries have legitimate revenue needs, and we therefore seek reduction in withholding tax rates only to levels which would make these taxes creditable in the U.S. rather than to levels which would result in transfers of revenue from the foreign treasury to the U.S. Treasury.

[88] The treaties before you today have many features in common. Each of them, for example, includes the standard treaty rule stating that a resident of one State will not be subject to tax on business profits in the other State unless these profits are attributable to a permanent establishment which the resident maintains in the other State. By limiting taxation to situations where there is more than just a casual economic contact, we can remove a major irritant to the free flow of international commerce. Though this general rule is standard, there are some differences among the treaties in the definitions both of permanent establishment and business profits.

Each of these treaties also provides that residents of one country who temporarily visit the other for business or educational purposes will not be subject to tax in the host country on income derived there unless they have a significant economic contact, with that country, in terms of time spent or income earned. As in the case of permanent establishment rules, the degree of contact that we require with developing countries tends to be somewhat less than that required in treaties with developed countries.

As with almost every tax treaty, each of the treaties under consideration establishes maximum levels of withholding tax on dividends, interest, and royalties paid from the source country to residents of the other country. The aim here is to make taxation a relatively neutral factor in investment decisions. Dividend, interest, and royalty provisions probably affect more taxpayers than any other treaty provisions.

It is United States treaty policy, reflected in the treaties under consideration today, that each Contracting State may tax its residents and nationals as if a treaty had not come into effect. The only exceptions to this rule relate to provisions which are clearly intended to limit the authority of a Contracting State to apply its internal tax law to its citizens and/or residents. For example, the treaty foreign tax credit provisions give assurance that, irrespective of changes in internal law, a Contracting State will permit credit for taxes properly imposed by the other Contracting State.

We view an income tax treaty as more than a resolution by the Contracting States of specific substantive problems. There must also be a commitment not to discriminate in tax matters, and to attempt to solve problems not directly dealt with by the substantive provisions of the treaty. All of our recent treaties include a prohibition against discrimination, and all provide for consultation and administrative assistance between the tax authorities of the Contracting States. The importance and value of these provisions are, I believe, being increasingly recognized by both taxpayers and tax administrators.

The Treasury has prepared technical explanations describing in detail each of the three treaties. I would like to submit these for the record and to turn, at this time, to the highlights of each individual treaty.

U.K. TREATY

The proposed treaty with the United Kingdom was signed on December 31, 1975. In early 1976, however, several technical problems came to light. Amendments to the text to deal with these problems were agreed to in April 1976, and the proposed treaty was restated to incorporate these amendments before it was submitted to the Senate.

[89] A protocol was signed in August 1976 making further amendments, largely technical in nature, dealing with corporations resident in both countries, the treatment of shipping income, and the calculation of the U.S. foreign tax credit on dividends received from U.K. corporations. A second protocol was signed on March 31, 1977, principally to deal with a problem arising from a provision in U.K. internal law relating to the determination of British domicile. In my statement I will discuss the restated treaty as amended by the two protocols.

This treaty is, I believe, quite significant. Our economic relations with the U.K. are close and extensive. U.S. direct investment in the U.K. at the end of 1975 totalled $14 billion and U.K. direct investment in the U.S. was $7 billion. During 1975 U.S. investors received over $1 billion in dividends, interest, branch profits, and royalties from this investment. U.S. payments to U.K. investors totalled over $350 million.

Moreover, this treaty is important in principle because it breaks new ground in several fundamental respects.

DIVIDENDS

The dividend provision of the U.K. treaty reflects a major concession by the British. To understand this provision, it is necessary to outline the United Kingdom system for taxing corporations and their shareholders.

In 1973 the U.K. introduced a partially integrated system under which a portion of the tax collected at the corporate level is treated—with respect to distributed profits—as having been paid on behalf of resident individual shareholders.

Under the U.K. system, U.K. corporations are subject to an initial corporate tax liability of 52 percent. When a dividend is paid, a tax called the Advance Corporation Tax (or ACT) is levied. This ACT is equal to 35/65 of the net dividend and it is credited against the corporation's regular year-end tax liability.

An individual U.K. resident shareholder pays tax not only on the dividends but also on the ACT paid with respect to the dividend. However, he may claim a credit against his own income tax liability for the ACT. If he is a "standard rate" taxpayer subject to a 35 percent rate, the credit will exactly offset his tax on the dividend income. If he is subject to tax below the standard rate, he will receive a refund of the excess of the ACT credit over his tax due. Thus, for a U.K. resident, the ACT is clearly a prepayment at the corporate level of the shareholder's tax.

When the shareholder is a U.K. corporation, the general rule is that the ACT is paid and the recipient corporation is not subject to tax on the dividend income. When that corporation, in turn, pays a dividend to domestic individual shareholders out of this dividend income, there is no further ACT to be paid and the ACT paid on the original dividend passes through and attaches to the second dividend. Alternatively, the first corporation may elect not to pay the ACT in the case of dividends to a related domestic company, but in this case the second corporation becomes liable for payment of the ACT when it pays that income out as a dividend to individual shareholders.

However, when the shareholder is a nonresident alien, the situation is quite different. British law provides that the ACT must be paid [90] upon any distribution, but there is no credit or refund allowed to the nonresident shareholder—corporate or individual.

This treatment discriminates against U.S. investors in the U.K., since for U.K. shareholders the effective underlying corporate tax rate with respect to distributed profits is just over 26 percent (after allowance of the ACT credit) while, in the absence of this treaty, for nonresident shareholders the rate remains at 52 percent. This discrimination is potentially of significant dollar magnitude, and must be viewed as a serious problem. We concluded that an income tax treaty is probably the only appropriate vehicle for mitigating the discrimination.

The new U.K. system is not a unique or isolated phenomenon, but rather is likely to be the prototype for European tax systems generally. A June 1975 draft directive of the Commission of the European Economic Community calls for adoption of similar integrated corporate/shareholder tax systems by all Common Market countries. Such a system has been in place in France for some time, and the new tax law in West Germany follows a similar approach. It is therefore, apparent to us that a precedent must be established early if we are to deal effectively in subsequent negotiations with other countries employing integrated systems. This fact may have led to Britain's initial reluctance to deal with integration-caused discrimination at the present time, while EEC policies with respect to this issue are still in a formative stage.

Under the rules of Article 10 (Dividends) and Article 23 (Elimination of Double Taxation) of the proposed treaty, the discrimination is substantially reduced. For U.S. portfolio shareholders (defined as any shareholder except a corporation which owns at least 10 percent of the voting stock of the paying corporation), the treaty provides the same credit as that available to a U.K. shareholder. It envisions that the ACT part of the U.K. corporate tax will be refunded directly to the U.S. shareholder and, for U.S. tax purposes, be treated as part of the shareholder's dividend income. The total dividend is then subject to the withholding rate provided for in the treaty for portfolio dividends: 15 percent. Thus, on a cash dividend declared of $65.00 the shareholder is entitled to a gross refund of $35.00. From the total dividend of $100.00, the U.K. withholds 15 percent or $15.00, and the U.S. shareholder receives $85.00. For U.S. tax purposes, the shareholder includes the full $100.00 in income and receives a foreign tax credit against his U.S. tax for the $15.00 withheld by the U.K.

For portfolio shareholders the proposed system is essentially the same as the rule which has been in effect in our treaty with France since 1970. It is also the same as the provisions which the U.K. has included in a number of their recent treaties. It is provided in the proposed U.K. treaty that this system will be followed as long as the ACT credit is allowed domestically in the U.K.

The proposed treaty, for the first time in any income tax treaty, also provides a rule for mitigating the integration-related discrimination against direct investors—i.e., those U.S. corporations which own at least 10 percent of the voting stock of a U.K. corporation. The treaty provides that when a dividend is paid by a U.K. corporation to a U.S. direct investor, a refund equal to one-half of the credit allowable to a U.K. domestic shareholder, i.e., one-half of the ACT, is paid to the U.S. investor. From the gross dividend (the cash dividend paid plus [91] the ACT refund) an amount equal to 5 percent is withheld by the U.K. On a cash dividend of $65.00 paid to a U.S. direct investor, the refund from Inland Revenue would be $17.50. The amount withheld on the total dividend of $82.50 would be $4.12. The net refund therefore would be $13.38, and the parent corporation would receive $78.38.

I would like to explain why the refund paid to direct investors differs from that paid to portfolio investors. The basic premise of an imputation system is that corporate and individual income taxes are integrated. As long as profits remain in corporate solution there is no reason to allow a credit. This is reflected in the U.K. internal tax system, under which the ACT credit is not allowed to corporate recipients of dividends. However, under that internal tax system, the credit passes through a U.K. parent corporation and is allowed to U.K. individual shareholders when the profits leave corporate solution. A U.S. shareholder investing in the U.K. through the intermediary of a U.S. parent corporation would enjoy none of the benefits provided for in the U.K. statute. Using a rule of thumb that about one-half of U.S. corporate profits are paid out in dividends, agreement was reached by treaty to extend one-half of the credit to U.S. direct investors on the assumption that this credit relates to that portion of the U.K. dividend which on a average will eventually be passed through to U.S. shareholders. This resolution provides a measure of fairness for U.S. investors and does no violence to the concept of an integrated system.

The table which follows illustrates the operation of these treaty provisions for both U.S. direct and portfolio investors.

[92] On U.S. source dividends paid to residents of the United Kingdom, there is, of course, no U.S. refund. In general, the U.S. withholding rate is reduced to 15 percent, except that when a dividend is paid to a direct investor in the U.K., the U.S. tax is limited to 5 percent. These are the same withholding rates applied by the U.K. If, while the treaty is in force, the U.K. should abandon its domestic dividend credit mechanism, the U.K. withholding rates will remain at 15 and 5 percent but the provisions dealing with the refund and credit would not be applicable.

UNITARY APPORTIONMENT TAXATION

One provision of the pending treaty with the United Kingdom—paragraph 4 of Article 9—has generated a great deal of controversy and has been the subject of some misunderstanding. That provision seeks, under certain restricted circumstances, to limit the application of unitary apportionment

ILLUSTRATION OF UNITED STATES-UNITED KINGDOM TREATY PROVISIONS WITH RESPECT TO UNITED KINGDOM DIVIDENDS RECEIVED BY U.S. PARENT CORPORATION AND U.S. INDIVIDUAL SHAREHOLDER

	50-percent dividend	100-percent dividend
United Kingdom corporation:		
1. Pretax corporate profits	100.00	100.00
2. Less: Initial corporation tax liability (52 pct)	52.00	52.00
3. Amount available for distribution	48.00	48.00
4. Net dividend declared	24.00	48.00
5. ACT paid (35/65 × (4))	12.92	25.85
U.S. parent corporation:		
6. ACT refunded before withholding	6.46	12.92
7. Less: Amount withheld (5 pct × (4) + (6))	1.52	3.05
8. Net ACT refund	4.94	9.87
9. Net United Kingdom corporation tax ((2) − (6))	45.54	39.08
10. Total cash received ((4) + (8))	28.94	57.87
11. Plus: Amount withheld (line (7))	1.52	3.05
12. Plus: 902 gross-up $\frac{(4) + (6)}{(1) - (9)} \times (9)$	25.47	39.08
13. U.S. taxable income ((10) + (11) + (12))	55.93	100.00
14. U.S. tax before credit (48 pct × (13))	26.85	48.00
15. Less: Foreign tax credit ((11) + (12))	26.99	42.13
16. Net U.S. tax (excess credit)	(.14)	5.87
17. Dividend income after tax ((10) − (16))	28.94	52.00
U.S. individual shareholder:		
18. ACT refunded before withholding	12.92	25.85
19. Less: Amount withheld (15 pct × (4) + (18))	5.54	11.08
20. Net ACT refund ((18) − (19))	7.38	14.77
21. Total cash received ((4) + (20))	31.38	62.77
22. Plus: Amount withheld (line 19)	5.54	11.08
23. U.S. taxable income ((21) + (22))	36.92	73.85
24. U.S. tax before credit (45 pct for example)	16.61	33.23
25. Less: Foreign tax credit (line 22)	5.54	11.08
26. Net U.S. tax	11.07	22.15
27. Dividend income after tax ((21) − (26))	20.31	40.62

rules in those states which employ such rules.

DESCRIPTION OF THE UNITARY APPORTIONMENT SYSTEM

There are just a few states which employ the unitary apportionment system—principally California, Oregon, and Alaska—though the laws of certain other states provide for selective application of some elements of unitary apportionment. The specific details of the system may differ somewhat from state to state. Since California is the most significant of these states in terms of international business activities, my description today is based on the California system.

When a single enterprise is doing business both inside and outside California, income is apportioned to California under the traditional three-factor formula (payroll, property, and sales). However, when an enterprise doing business in California controls other corporations, is itself controlled by another corporation, or is related to other corporations by virtue of common ownership, and when the degree of common ownership or control is over 50 percent, California requires the controlled group to file a combined report of the group's worldwide income. A combined report is required regardless of whether the parent company or brother-sister companies do business in California, as long as the group constitutes a "unitary business" under California's rules. A unitary business generally exists when there is (1) a unity of ownership (common ownership; (2) a unity of operations as evidenced, for example, by central purchasing, advertising, accounting, and management, and (3) a unity of the use of a centralized executive force and general system of operation. Alternatively, a business will be treated as unitary if the operation of that part of the business carried on in the State is dependent on, or contributes to, the part which is carried on outside the state.

California tax authorities appear to construe the definition of a unitary business very broadly, so that related entities which appear to be independently engaged in very different kinds of activities are aggregated into a unitary business and must be included in a combined report to the tax authorities.

The combined report is, in effect, a consolidated return of the controlled group's worldwide income, although separate returns may be [93] made for each member of the group. California apportions income to the state on the basis of the proportions which the California assets, sales, and payroll bear to the worldwide assets, sales, and payroll of all the related companies.

In the context of multinational business operations, California does not limit its requirements of a combined report to enterprises which are California or United States controlled. For several years now, affiliated groups of corporations having a foreign parent and a California subsidiary have been required to file a combined report if the business has a "unitary" character.

BACKGROUND OF THE TREATY PROVISION

Over the past several years, a number of our treaty partners have raised the question of state application of unitary apportionment systems to multinational corporate groups based in their countries. They have made essentially two points. First, they note that our income tax treaties clearly provide that one Contracting State may not tax the business profits of an enterprise which is a resident of the other State unless those profits are attributable to a permanent establishment in the first Contracting State. They perceive the California system as taxing profits which are earned outside California and not attributable to a permanent establishment located in California. Our treaty partners recognize, of course, that this California practice does not violate the business profits provisions of our existing treaties, because existing treaty provisions apply only with respect to the Federal income tax. Nevertheless, they maintain that state unitary apportionment systems, as applied to foreign corporations, do violate the spirit of our agreements.

Secondly, foreign governments have noted the severe administrative burdens which unitary apportionment systems impose on their corporations. A substantial amount of financial and operating data from each affiliate (in effect the data necessary for a full tax return) must be included in the combined report of the group. When members of the group, and particularly the parent corporation, are located abroad, much of this information is either difficult or impossible for the taxpayer to obtain. Foreign parent corporations find it extremely burdensome to submit all of their books and records concerning all of their worldwide activities in a form satisfactory to the taxing state. This is especially true when only one of a large number of their affiliates does business in the state and the books and records are kept in different languages, different currencies, and according to different sets of accounting rules.

REASONS FOR ACCOUNTING PROVISIONS

There are several reasons, both substantive and administrative, why the Treasury believes that the application of the unitary system should be limited as it applies to foreign corporations.

Those states which employ the unitary system see it as a logical extension of the standard use of the three factor formula. It is also viewed as a means of dealing with efforts by groups of related corporations to manipulate income and expenses to the detriment of the state [94] treasury. This is a legitimate concern of both Federal and state governments. The treaty, however, deals explicitly with this issue. Paragraph 1 of Article 9 provides for the adjustment of accounts between related persons to reflect the income and expenses which would be recorded if the related persons were dealing at arm's-length.

And Paragraph 4 of Article 9 is very clear that it does not prevent Federal or state governments from making the arm's-length adjustments provided for in paragraph 1.

In this connection I would note that the arm's-length standard is the internationally accepted norm for apportioning income between related taxpayers. It is confusing to other countries and disconcerting to international relations when our states use a different standard. Furthermore, the use of a different method by one jurisdiction will often lead to double taxation. We recognize that the purpose of the unitary system is not to tax the income of the foreign corporation included in the group, but the effect, nevertheless, is often extra-territorial taxation.

Though the administrative resources available to state governments may not permit them to make the same kind of intensive transfer price investigations that the Federal tax authorities are able to make, individual states have access to materials developed by the Internal Revenue Service in its investigations of cases where related companies may not be pricing according to an arm's-length standard.

Moreover, the unitary apportionment system as a means for determining the state taxation base of a multinational corporation is highly imperfect and a poor substitute for the arm's-length standard. Implicit in the unitary system is the assumption that profit rates in different units of a corporate family, engaged in different activities and in different locations, are always the same. This is clearly not the case. And when it is not the case, the unitary system will misallocate income. Whenever profit rates are higher in foreign affiliates than in domestic activities, the unitary system allocates too much income to the domestic member or members of the group. The result is tantamount to taxation by a state government of the foreign income of a foreign corporation.

The misallocation of the tax base under the application of unitary apportionment to foreign corporations can occur for several reasons. For example, labor costs vary substantially among countries—very much more so than among regions in the U.S. If two affiliates, one in California and one in, say, Hong Kong, are engaged in essentially the same activities, the Hong Kong labor cost element in the formula will probably be lower than the California labor cost. A disproportionate amount of income will be apportioned to California. Changes in exchange rates can have a similar effect.

Some state governments have suggested that the treaty provision will result in a large revenue cost to unitary taxation states. If, in fact, there is a substantial revenue loss when an arm's-length pricing standard replaces unitary apportionment, this may be an indication that unitary apportionment does, in fact, result in unjustifiable extra-territorial taxation.

We also perceive a major problem in the extensive information required by the tax authorities applying unitary apportionment systems. If the necessary information is not provided by the taxpayer, the state [95] authorities reconstruct accounts on the basis of whatever information they can obtain from public sources, such as reports to shareholders. Tax liability calculated on the basis of such reconstructed accounts is, at best, arbitrary, and may very well be unfair. If the parent corporation operates in the taxing state, it is of course possible for the taxpayer to provide accurate information and avoid an arbitrary result. But if the taxpayer is a subsidiary of a foreign parent corporation, or stands in a brother-sister relationship to a foreign affiliate, the submission of accurate data may not be within the taxpayer's power.

The Administration is not alone in considering the issues raised by the unitary system. Legislation, known as the Jones Amendment, was proposed in the House during this past Congress, and would exclude all foreign corporations from states' unitary tax bases. The Jones Amendment was referred to a special task force of the Ways and Means Committee on foreign source income. The task force, chaired by Congressman Rostenkowski of Illinois, has recommended that "States be precluded from taking into account, under the unitary method or under any other method, the income of foreign affiliates of corporation doing business within the States until such time as that income is subject to Federal income tax."

DESCRIPTION OF THE U.K. TREATY PROVISION

The treaty will affect the tax jurisdictions of states to only a limited extent. It provides that a state, say California, in assessing the income of an enterprise doing business there, may not take into account any income or expenses of a related foreign company which is related to a U.K. enterprise. The state may, however, take into account income and expenses of any related U.S. companies, income of all branches of U.S. companies, and income of U.K. companies doing business in California.

The treaty rule will apply if the following conditions are met:

1. The enterprise doing business in California must be either a resident of the U.K. or be controlled, directly or indirectly, by a U.K. resident.
2. Where the U.K. resident is a corporation, such corporation must be neither controlled by a U.S. corporation nor by a corporation which is a resident of a third state.
3. No U.K. or third country enterprise which is related to a U.S. subsidiary doing business in California would be excluded from California unitary apportionment calculations under the treaty of that enterprise is controlled by the U.S. subsidiary.

A few examples may clarify how the rule would operate:

If a subsidiary of a U.K. corporation is doing business in California, and that U.K. parent corporation has subsidiaries in France and Germany, California would be prohibited from including in its unitary apportionment base the income or expense of the U.K. parent or of its subsidiary corporations in France or Germany.

However, if the U.K. corporation is itself controlled by, say, a New York corporation, or by a Dutch corporation, California may take into account the income and expense of the entire group—the U.K. corporation, the French and German subsidiaries, and the Dutch or New York parent.

[96] If the California subsidiary of the U.K. corporation has a subsidiary of its own in, say, Belgium, the U.K. parent and the French and German sister corporations may not be included in the unitary apportionment calculations by California, but the Belgian subsidiary, even though it is related to the U.K. corporation, may be taken into account.

OTHER PROVISIONS

There are several other issues raised by this treaty which I would like to touch on briefly.

U.S. CITIZENS RESIDENT IN U.K.

A combination of provisions in our existing treaty with the United Kingdom led the British courts to conclude, in what has come to be known as the Lady Strathalmond decision, that the United Kingdom was precluded from taxing U.K. residents who are U.S. citizens on dividend and interest income from U.S. sources. This wholly unintended benefit for U.S. citizens resident in the U.K. stood to cost the United Kingdom substantial amounts of revenue.

In addition, the Strathalmond decision introduced as asymmetry into the taxation rights granted by the treaty. U.S. residents who are U.K. nationals are subject to U.S. tax on their global income. However, U.K. residents who are U.S. citizens who receive investment income from the U.S. were not, by virtue of Strathalmond, subject to U.K. tax on their global income. The treaty before you today corrects this asymmetry.

U.K. WIVES PROBLEMS

The correction of the problem raised by the Strathalmond decision brought to light another issue, arising out of the U.K.'s internal law provisions for determining domicile. Although this is not a traditional tax treaty issue, the British agreed to deal with it, and this was the principal purpose of the second protocol, signed on March 31, 1977.

Under British law in effect prior to 1974, an individual who became a U.K. resident could easily retain a foreign domicile. The principal exception was that a married woman automatically acquired her husband's domicile. Thus, a woman who was a U.S. citizen and who could, under normal U.K. standards, be considered to have a foreign domicile would, if she was married to a U.K. domiciliary, automatically be considered as having a U.K. domicile. This rule was changed in 1974, but the change applied only for women married after 1973.

A British domiciliary is subject to higher U.K. taxes on foreign source income than a foreign domiciliary. Under the Strathalmond decision this distinction had no serious effects because a U.S. wife of a U.K. domiciliary would not be subject to U.K. tax on her U.S. source investment income even though she was domiciled in the U.K. Under the proposed treaty, however, she would be subject to U.K. tax, and the distinction between U.K. domiciliaries and non-domiciliaries becomes important. A number of women in this position complained that the U.K. rule on domicile discriminated against women and that the proposed treaty condoned this discrimination.

[97] The discrimination is eliminated now by a provision that, for purposes of determining domicile, the marriage of a woman who is a national of the United States shall be treated as having taken place on 1 January 1974. Under this provision, she would be able, if the facts warrant, to establish a non-British domicile independent of her husband's domicile.

DUAL-RESIDENCE COMPANIES

In general, our treaties seek to assign a unique residence, in one or the other country, to all persons subject to the treaty. In the proposed treaty with the United Kingdom we were not able to agree on such a rule for corporations which each country considers resident of that country. Under British law a corporation is resident where it is managed and controlled. Under U.S. law a corporation is resident where it is incorporated. A corporation organized in the United States but managed and controlled in the United Kingdom would, therefore, be a dual resident. Neither side was willing to make its test of residence subsidiary to the other, and an entity which has dual residence under the treaty could combine the benefits of residence in both countries so as to receive unjustified advantage. We agree, therefore, that with the exception of certain provisions, dual resident corporations would be denied the benefits of the treaty. While this appears to be a harsh result, we must bear in mind that, given the nature of the two tests of residence, a dual resident corporation may extract itself from the situation.

PETROLEUM REVENUE TAX

The British recently introduced a tax, called the Petroleum Revenue Tax (PRT), on petroleum production activities on its continental shelf. The British asked that we specifically cover this tax in the treaty so that U.S. companies will be assured of a foreign tax credit in the United States for the PRT. Article 2(2)(b) (Taxes Covered) specifies that the PRT is included in taxes covered. Article 23 (Elimination of Double Taxation) notes in paragraph (1)(a) that the taxes covered in Article 2(2)(b) are to be treated as income taxes for purposes of the U.S. foreign tax credit.

The special limitations in section 907 of the Internal Revenue Code relating to foreign oil and gas income apply with respect to the PRT.

ENTERTAINERS

Article 17 (Artistes and Athletes) provides, in paragraph 1, that an entertainer or athlete may be taxed by the Contracting State in which his services are performed unless the remuneration for those services, including expenses reimbursed to him or borne on his behalf, does not exceed $15,000 in the year concerned.

Paragraph 2 of Article 17 is designed to deal with an entertainer or athlete arranging for a part or all of the income for his services to be paid to another person, including a corporation or trust, so as to avoid tax in the host country. If that other person is a foreign corporation which does not have a permanent establishment in the host country, the income would, under normal treaty rules, be completely free of tax in the host country. Paragraph 2 prevents this abuse of the treaty by [98] providing that when the income from an entertainer's or an athlete's activities does not accrue directly to him, but to another person, that person will be subject to tax despite the limitations which would otherwise be applicable under the business profits or personal services articles of the treaty.

If the entertainer does not participate in any way in the profits earned by the other person, such as by the receipt of deferred remuneration, dividends, or partnership distributions, then the provisions of paragraph 2 will not apply.

Article 17 reflects the view, widely held among both developed and developing nations, that the taxation of entertainers and athletes presents special problems. Although the Treasury does not agree that such persons are wholly different from others performing personal services, we do recognize that the cricumstances under which their income is earned can often be extraordinary: it is not uncommon, for example, for entertainers and athletes to earn large sums in a very brief period of time spent in the country of source.

Our views on this issue, and in specific regard to Article 17, are set forth in detail in a letter dated March 1, 1977 which I addressed to Senator Javits. I would like to submit this letter for the record at this time.

INTEREST AND ROYALTIES

In addition to the maximum withholding rates prescribed in Article 10 for dividends, which I have already described, Articles 11 and 12 of the treaty provide for exemption from withholding in the source country on interest and royalties, respectively, paid to resident of the other Contracting State.

* * * * *

CONCLUSION

I believe that the addition of the two new treaties—with Korea and the Philippines—to our growing network of income tax treaties and the modernization of our treaty with the United Kingdom, to permit it to better serve our current needs, will strengthen our economic relations with these three countries.

The United Kingdom is one of our major trading partners with whom we have shared close economic ties for many years. We are pleased to have this opportunity to update and revitalize our tax treaty arrangements.

The United States today has only two treaties in force with developing countries—treaties with Pakistan and Trinidad and Tobago. We attach importance, therefore, to the expansion of our treaty network to include Korea and the Philippines.

This Committee has the opportunity now, by approving these three treaties, to make a clear and strong statement in support of the policies which they reflect—as well as our general policy of seeking a broadening network of income tax treaties.

I urge your approval of these three treaties.

Senate Executive Report No. 96-5

[Bracketed numerals indicate official report page numbers]

THIRD PROTOCOL TO THE 1975 INCOME TAX CONVENTION WITH THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND, AS AMENDED

JUNE 15, 1979

Mr. CHURCH, from the Committee on Foreign Relations, submitted the following report to accompany Ex. Q, 96th Cong., 1st sess.

The Committee on Foreign Relations, to which was referred the Third Protocol to the 1975 Tax Treaty with the United Kingdom of Great Britain and Northern Ireland [1] for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains (Executive Q) (referred to as the proposed protocol), having considered the same, reports favorably thereon without reservation and recommends that the Senate give its advice and consent to ratification thereof.

I. PURPOSE

The proposed third protocol to the proposed income tax treaty between the United States and the United Kingdom deals with issues which arose during the previous consideration of the treaty by the United States Senate and with other matters raised during discussion of those issues between the United States and the United Kingdom.

[2] II. BACKGROUND

The proposed protocol was signed on March 15, 1979. The protocol was transmitted to the Senate on April 12, 1979.

The proposed protocol amends the pending tax treaty, as amended by an Exchange of Notes and two Protocols, which was considered by the Foreign Relations Committee and the Senate during the Ninety-Fifth Congress. The Foreign Relations Committee reported the treaty favorably on April 25, 1978, without reservation.

Senator Church had proposed in committee a reservation which would have had the effect of deleting from the proposed treaty a provision (*Article 9(4)*) to the extent that it would have placed limitations on the worldwide combination/unitary method of apportionment used by several states of the United States to determine the taxable income of British multinational corporations subject to tax by those states. The reservation was defeated in committee by a vote of 5 yeas, 10 nays. Senator Church again proposed the reservation on the Senate floor, where it lost by a vote of 34 yeas, 44 nays. However, on June 23, 1978, the Senate by a vote of 49 yeas, 32 nays, failed to concur in the proposed treaty (containing the state taxation provision) by the required two-thirds vote. On June 27, 1978, after the Treasury Department had announced that it would accept the treaty with the Church reservation, the Senate reconsidered the treaty and gave its advice and consent to ratification of the treaty, subject to the Church reservation, by a vote of 82 yeas, 5 nays.

In the course of the Senate's consideration of the pending treaty, a second reservation was introduced by Senator Kennedy to limit a treaty provision (*Article 23(1)(a)*) which would make the U.K. Petroleum Revenue Tax (PRT) eligible for the U.S. foreign tax credit. This reservation was withdrawn because the United Kingdom and the Treasury Department agreed to go forward with discussions to include the provisions of the reservation in a protocol.

Both of these issues are among those dealt with in the proposed protocol.

[3] III. SUMMARY OF PROTOCOL

The proposed protocol contains the following modifications to the proposed tax treaty between the United States and the United Kingdom.

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[1] Page 5; Technical Explanation, page 62; Senate Executive Q is not published.

(1) *State taxation.*—In conformity with the Church reservation, the protocol makes Article 9(4) of the proposed treaty, which restricts the use of the worldwide combination/unitary method of apportioning income, inapplicable to states or local governments. Its provisions would continue to apply, however, to taxation at the national level by the United States and United Kingdom governments.

(2) *U.K. Petroleum Revenue Tax (PRT).*—In conformity with the proposed Kennedy reservation, the proposed protocol limits the amount of the British PRT which is allowable under the treaty as a tax credit so that the PRT imposed on extraction income from U.K. sources may only offset U.S. tax on that income. In addition, the PRT which is imposed on certain oil transportation, treatment, and storage income may only offset U.S. tax on that income. Under the proposed treaty, the PRT might also have been used to offset U.S. tax on extraction income from operations in other foreign countries.

(3) *Offshore drilling operations.*—Under the proposed protocol, each country will be allowed to tax under its domestic laws persons engaged in activities in connection with the exploration for or exploitation of, for more than 30 days in a 12-month period, seabed mineral resources situated in that country. This provision will primarily affect U.S. independent drilling contractors who are using movable drilling rigs to undertake exploratory drilling for oil in the U.K. sector of the North Sea and other service companies carrying on ancillary services in connection with drilling.

(4) *U.S. insurance excise tax.*—The proposed protocol expressly provides that premiums paid to British insurers will not be subject to the U.S. insurance excise tax even if the British insurers have a U.S. permanent establishment.

(5) *Dividends from dual-resident corporations.*—The protocol allows the United States to impose its withholding tax at source on dividends paid by corporations which, under the treaty, are residents of both the United Kingdom and the United States. This provision allows the United States to continue to impose its withholding taxes on dividends paid to nonresident aliens and foreign corporations by a corporation organized under U.S. law, even if that corporation is managed, and therefore resident, in the United Kingdom.

(6) *Exemption for government employees.*—The proposed protocol eliminates a provision of the proposed treaty which would have allowed the United Kingdom to tax the compensation of a U.S. citizen resident in the United Kingdom who performed services in that country for the U.S. Government if that individual did not become a U.K. resident solely to perform the services.

(7) *Override of statutes of limitations.*—The proposed protocol overrides U.S. and U.K. statutes of limitations to allow refunds to be made on the basis of the treaty provisions if claims are made within 3 years after the end of the year in which the treaty enters into force.

[4] IV. DATE OF ENTRY INTO FORCE AND TERMINATION

Entry into force

The proposed protocol will enter into force on the thirty-first day following the date on which the instruments of ratification are exchanged. Once in force, the proposed protocol generally applies retroactively, in accordance with Article 28 (*Entry into force*) of the proposed treaty. However, the provisions of Article VI (*Offshore activities*) of the protocol apply only after the protocol has entered into force.

Termination

The protocol will remain in force as long as the proposed treaty remains in force.

V. COMMITTEE ACTION

The Committee on Foreign Relations held public hearings on the proposed protocol and other tax treaties on June 6, 1979. The Committee considered the proposed protocol on June 12, 1979 and ordered it favorably reported by a vote of 13 yeas, no nays, with the recommendation that the Senate give its advice and consent to ratification of the treaty.

VI. BUDGET IMPACT

The Committee estimates that the effect of the proposed treaty on budget receipts will be negligible.

In accordance with the objectives of section 403 of the Budget Act, the Committee advises that the Director of the Congressional Budget Office has examined the Committee's budget estimate and agrees that the effect on budget receipts will be negligible. In keeping with section 308(a) of the Budget Act, and after consultation with the Director of the Congressional Budget Office, the Committee states that the treaty does not provide any new budget authority or any new or increased tax expenditures.

[5] VII. EXPLANATION OF PROTOCOL PROVISIONS

A comprehensive article-by-article explanation of the proposed protocol to the proposed income tax treaty between the United States and the United Kingdom is set forth below.

Article 1. Use of worldwide combination/unitary method of apportionment

In conformity with the Church reservation, the proposed protocol makes Article 9(4) of the proposed treaty, which restricts the use of the worldwide combination/unitary method of apportioning income, inapplicable to state or local governments. The provisions of Article 9(4) would continue to apply, however, to the United States and United Kingdom governments.

Under the protocol, political subdivisions and local authorities of either country are free to use formula methods to apportion income, deductions and other items among related enterprises in determining income subject to their taxes, so long as such methods do not violate the proposed treaty's nondiscrimination provisions (*Article 24*).

Article 9(4) of the proposed treaty would have limited the methods by which the United States, the United Kingdom, and political subdivisions and local authorities of each country could tax enterprises of the other country (or enterprises which are directly or indirectly controlled by enterprises of the other country). (This provision is not found in other U.S. tax treaties.) The proposed treaty would have provided that, in determining the tax liability of such an enterprise doing business within their respective jurisdictions, the United States, the United Kingdom and their political subdivisions and local authorities could not take into account the income, deductions, receipts or outgoings of a related enterprise of the other country, or of any third country. This provision of the proposed treaty was intended to apply to those states of the United States (principally California, Oregon, and Alaska) which, in determining the amount of income of a business operating within the state which is to be apportioned to that state for income tax purposes, require combined reporting of all related business operations (including related business operations of affiliated U.S. and foreign corporations, whether or not doing business within the state). The national governments of the United Kingdom and the United States do not apportion income between jurisdictions under this method but rather allocate income between related enterprises under arm's-length principles. In addition, the political subdivisions and local authorities of the United Kingdom do not impose income taxes.

The proposed protocol modifies this provision by eliminating its applicability to political subdivisions and local authorities of the United States and the United Kingdom. This is in conformity with the reservation proposed by Senator Church and adopted by the [6] Senate as part of its resolution of ratification of the proposed treaty. The provision would, however, continue to apply to the two national governments. (Conforming changes are made in Article 2 of the proposed treaty (*Taxes covered*) to reflect this narrowed scope.)

Moreover, the proposed treaty, like most other U.S. tax treaties, contains a provision (*Article 9(1)*) similar to that contained in the Internal Revenue Code (sec. 482) which recognizes the right of each country to make an allocation of income in the case of transactions between related persons, if an allocation is necessary to reflect the conditions and arrangements which would have been made between unrelated persons. The limitation in Article 9(4) applies only to cases where an allocation is made without regard to any application of the arm's-length standard. Of course, both countries may apply apportionment formulas, including formulas that take into account attributes of related entities, as a method of achieving an arm's-length price for a transaction between related entities. Moreover, apportionment formulas may be used as a method of apportioning income of related entities to the extent that it is established that they are not dealing on an arm's-length basis. The proposed treaty does not affect U.S. tax rules for allocating and apportioning income, deductions, and other items among related enterprises (Code sec. 482), nor is it applicable to the U.S. tax rules concerning the source of income and the deductions attributable thereto (Treas. Reg. § 1.861-8).

During last year's debate both in the Foreign Relations Committee and on the Senate floor, opponents of Article 9(4) argued that any prohibition of the right of states to use worldwide combination under the unitary tax system should be addressed legislatively rather than through the treaty process. Even some supporters of Article 9(4), while not questioning the propriety of the Article, indicated their preference for Congressional consideration through the legislative process of the issue. The Foreign Relations Committee notes that Section 303 of S. 983, the Interstate Taxation bill introduced by Senator Mathias, would accomplish for all nations what Article 9(4) of the U.S.-U.K. Tax Treaty sought to accomplish for the U.K.

The Committee urges the tax-writing Committees of the Congress—the Finance and the Ways and Means Committees—to hold hearings in the very near future on S. 983 in order to permit all sides of the issue to have their views known for the record. In addition, such legislation will give the Congress, which has the responsibility to resolve on the federal level inconsistent state taxation policies, the opportunity to take a position on the merits of the issue.

The Committee also notes both Senator Mathias' statement before the Committee in support of the Treaty and the Third Protocol and his view that the British "Parliament will ratify the U.S.-U.K. Treaty only if they perceive that we are serious about making progress on the Interstate Taxation bill. . ." The Committee wishes to make clear that it considers expeditious treatment of the Treaty by both the U.S. Senate and the U.K. Parliament to be critical in order to permit the benefits of the Treaty to flow to both sides.

Article 11. Excise tax on premiums paid to foreign insurers

The proposed protocol amends the proposed treaty so that it expressly provides that insurance premiums paid to a British insurer [7] will not be subject to the U.S. insurance excise tax even if it has a U.S. permanent establishment. The Treasury Department intended this to be a clarification of the provision of the proposed treaty which generally exempts U.K. insurance companies from the U.S. insurance excise tax.

Under the Code, premiums from insuring U.S. risks which are received by a foreign insurer having no U.S. trade or business are not subject to U.S. income tax but are subject to the U.S. insurance excise tax (secs. 4371-4374). However, the proposed treaty includes the insurance excise tax among the taxes covered and thus, under the business profits article and Article 22 (*Other income*), income of a British enterprise derived from the insurance of U.S. risks is subject neither to U.S. income tax nor to the insurance excise tax if that insurance income is not attributable to a U.S. permanent establishment maintained by the British insurer.

Those U.K. insurers which continue to maintain a U.S. permanent establishment after the proposed treaty enters into force will remain subject to the U.S. *income* tax on their net U.S. insurance income attributable to the permanent establishment. However, under the proposed protocol, the U.S. *excise* tax is not to be imposed on insurance or reinsurance premiums which are the receipts of a business of insurance carried on by a U.K. enterprise even if that business is carried on through a U.S. permanent establishment.

The statutory rules governing the taxation of foreign insurance companies insuring U.S. casualty risks have been modified through interpretations of the nondiscrimination provisions of the existing treaty contained in certain closing agreements which have been entered into between the IRS and a number of British insurers.[1] The closing agreements are intended to provide relief in certain limited situations involving casualty insurance where there is the potential liability for both income tax and excise tax because the foreign insurer is subject to the income tax (because it has a U.S. trade or business), but the premium paid is not exempt from the excise tax (because the insurer is not licensed by a state to write insurance). It is understood that U.K. insurers agree in the closing agreements to subject themselves to the U.S. income tax by treating their U.S. operations (frequently an unrelated agent) as a permanent establishment, and the IRS agrees to waive the excise tax with respect to those premiums effectively connected with the U.S. trade or business under the nondiscrimination clause of the present treaty.

The pending treaty, in a departure from the existing tax treaty and other existing U.S. tax treaties, covers the insurance excise tax.[2] As a result, British insurers which do not have U.S. permanent establishments are exempt on income from insuring U.S. risks from the U.S. insurance excise tax as well as the U.S. income tax. It had been assumed that, as a result of this exemption in the proposed treaty for [8] British insurers which did not have U.S. permanent establishments, all British insurers would be exempt from the excise tax because it had been assumed that those others which did have U.S. permanent establishments would continue to be exempt from the excise tax (but not the income tax) under the nondiscrimination clause. (It would no longer be necessary to enter into a closing agreement and agree to be subject to the U.S. income tax in lieu of the excise tax because the exemption from the excise tax would be available under the proposed treaty even if the British insurer had no U.S. permanent establishment.) However, questions have been raised as to whether the imposition of the excise tax on British insurance companies with U.S. permanent establishments does in fact constitute discrimination under the treaty and whether the exemption, which had been provided in the closing agreements pursuant to the nondiscrimination clause to the British insurers, was appropriate. In order to eliminate this doubt as to whether British insurers with U.S. permanent establishments are in fact entitled to an exemption from the insurance excise tax, the proposed protocol states expressly that British insurers are exempt from the U.S. insurance excise tax whether or not they have a U.S. permanent establishment.

The insurance excise tax will continue to be collected in situations where a U.K. enterprise with a U.S. trade or business reinsures a policy it has written on a U.S. risk with a foreign reinsurer other than a U.S. resident or a resident of a country which has a similar provision in its treaty with the U.S. (such as is provided in the proposed protocol to the U.S.-France income tax treaty and in the proposed U.S.-Hungary income tax treaty). The tax is imposed on the U.K. insurer which, in this situation, is viewed as a U.S. resident person paying a premium to a foreign insurer (Code sec. 4372(d)). The excise tax will apply to this reinsurance even where the U.K. insurance company has a U.S. trade or business but no U.S. permanent establishment and will not be subject to U.S. income tax on the net income it derives on the portion of the risk it retains. However, no U.S. excise tax will be collected if the U.K. insurer has no U.S. trade or business, regardless of whether or not it reinsures the risk.

Article III. Dividends

The proposed protocol amends the proposed treaty so that it would not prevent the United States from applying its withholding tax on dividends paid by U.S. corporations to foreign shareholders in those situations where the U.S. corporation is also considered to be a resident of the U.K. for purposes of the treaty (i.e., dual residence). This modification corrects a drafting oversight in the proposed treaty.

Under the proposed treaty, a corporation which is organized under U.S. law, but whose business is managed and controlled in the United Kingdom, is a "resident" of both the United States and the United Kingdom. Under U.S. domestic law, the United States generally imposes a withholding tax on dividends paid by a U.S. corporation to nonresident aliens and foreign corporations unless the dividends are effectively connected with a U.S. trade or business of the recipient or less than 20 percent of the U.S. corporation's gross income is from [9] U.S. sources. The provisions of the proposed treaty as approved by the Senate, however, would generally have prevented the imposition of this withholding tax if the U.S. corporation was managed in the U.K. and thus qualified as a U.K. resident.

This would have resulted because, as in the case of most U.S. tax treaties and the OECD model tax treaty, the proposed treaty contains a general limitation on the taxation by one country of dividends paid by corporations which are residents of the other country. Under this provision, the United States could not impose any tax on dividends paid by a corporation which was a "resident" of the U.K. (even if organized under U.S. law) except where the dividends were paid to a resident or citizen of the United States or where the dividends were effectively connected with a permanent establishment or fixed base of the recipient which was situated in the United States. This exemption from tax applied even if the dividends consisted wholly or partly of profits or income arising in the United States.

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[1] A similar but less detailed closing agreement with a German insurer is set forth in Letter Ruling 7846060 (Aug. 18, 1979).

[2] The pending income tax treaty with Hungary and the pending protocol to the existing income tax treaty with France both cover the excise tax, and it is covered by the U.S. model income tax treaty. In the case of the pending French protocol, however, the exemption only applies to the extent that the risk is retained by insurers who would also be eligible for the exemption under one of the treaties: to the extent it is reinsured with an insurer not so eligible, the exemption under the pending French protocol does not apply.

The proposed protocol prevents this result by making the treaty provision inapplicable to "dual status" corporations. Accordingly, dividends paid by these corporations would continue to be subject to withholding taxes to the extent provided by U.S. domestic law, except as otherwise provided in applicable treaties.

Article IV. Government service

The proposed protocol eliminates a rule in the proposed treaty which would have allowed the U.K. to tax the compensation of certain U.K. residents working for the U.S. government who did not become U.K. residents solely for the purpose of performing those services. In general, neither the United States nor the United Kingdom currently taxes income of employees of the other country's government. However, substantial concern over the treaty provision was voiced to the Foreign Relations Committee by employees of the U.S. Defense Department in the United Kingdom. The protocol will amend the treaty to allay this concern.

Under the proposed treaty as approved by the Senate, compensation, other than a pension, paid by the government of either country to an individual for services rendered to that country is generally taxable only in that country. However, such compensation is taxable in the country in which the services are being performed if the recipient (i) is a resident and national of that country or (ii) did not become a resident solely for the purpose of performing the services. (The provision does not apply to compensation received for services performed in connection with a business carried on by or on behalf of one of the countries or to services performed for political subdivisions and local authorities.) The provision generally follows the OECD and U.S. model tax treaties.

The proposed protocol changes this rule so that compensation for services performed for the government of one country may be taxed by the other country only if performed by a resident of the second country who is also a national of that country. The purpose for which he became a resident is no longer relevant. This is similar to the rule in the existing treaty between the United States and the United Kingdom.

[10] *Article V. Petroleum Revenue Tax*

The proposed protocol limits the extent to which the United States is required under the proposed treaty to allow a foreign tax credit for the U.K. Petroleum Revenue Tax (PRT). The pending treaty as approved by the Senate would in general have required the PRT to be treated as a creditable income tax, subject to the limitations on the foreign tax credit of U.S. statutory law. The proposed protocol would in general prevent excess PRT from offsetting U.S. tax on oil income from other countries.

The proposed treaty as approved by the Senate contains the general rule contained in many U.S. tax treaties under which the United States agrees that it will continue to allow its U.S. citizens and residents to claim a foreign tax credit (Code secs. 901 and 902) against the U.S. tax for the appropriate amount of income taxes paid to the United Kingdom. The credit (direct or indirect) allowed under the proposed treaty is subject to the limitations and in accordance with the provisions of U.S. law (as it may be amended from time to time without changing the general principle of allowing a foreign tax credit) applicable to the year in question.

The proposed treaty also provides that the PRT is to be treated as a creditable income tax for U.S. foreign tax credit purposes. It is the position of the Internal Revenue Service that the PRT is not an income tax in the United States sense and that therefore it would not be eligible for the U.S. foreign tax credit in the absence of the proposed treaty. In the view of the IRS, the PRT is more in the nature of a production or severance tax. Rev. 78-424, 1978-2 C.B. 197.

The PRT presently is imposed at a 45-percent rate on assessable profits from oil and gas extraction activities in the U.K. (including the North Sea) on a field-by-field basis. It is in addition to, and separate from, the regular U.K. corporate tax (and a 12.5-percent royalty payable on North Sea production). The amount of PRT paid is allowed as a deduction for purposes of computing the regular U.K. corporate income tax. Operating and capital losses from nonextraction activities are not allowed as deductions in computing the PRT. In addition, no deduction is allowed for interest or other financing costs. However, a special additional deduction based on the amount of capital investment is provided to compensate for the disallowance of interest expenses in computing profits for purposes of the PRT. The aggregate amount payable to the U.K. Government in taxes and royalties on oil and gas extraction income is roughly 60 to 70 percent.

During the Senate's consideration of the proposed treaty, Senator Kennedy introduced a reservation which would have allowed a credit for the PRT only to the extent that U.S. tax attributable to U.K. oil and gas extraction income exceeded other U.K. taxes (such as the regular U.K. corporate income tax) on that income.[3] The intent of [11] this reservation was to prevent U.S. oil companies from using the PRT as a credit against their U.S. tax liability on extraction income from other countries, such as OPEC nations. Senator Kennedy withdrew the reservation on the basis of assurances from the Treasury Department and the British Government that the issue would be dealt with in a protocol.[4]

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[3] The text of the reservation, which was reprinted at 124 Cong. Rec. S9559 (daily ed. June 27, 1978), was as follows:

"Before the period at the end of the resolution of ratification insert a comma and the following: 'subject to the reservation that, for purposes of the tax laws of the United States, the United States shall allow a credit against tax for any Petroleum Revenue Tax attributable to oil and gas extraction income from sources within the United Kingdom and paid to the United Kingdom by any resident or national of the United States, or by any United States corporation owning at least 10 percent of the voting stock of a corporation which is a resident of the United Kingdom, only to the extent that the United States tax attributable to such income for which such resident or national or such corporation is otherwise liable exceeds any credit allowable by the United States for other United Kingdom tax on such income'."

The proposed protocol incorporates the substance of the Kennedy reservation and also applies a number of rules which are similar to provisions of U.S. domestic law limiting the foreign tax credit for foreign oil and gas income (Code sec. 907). To determine the extent to which a credit for the PRT will be allowed, the taxpayer first multiplies its U.K. income from the extraction of minerals from oil and gas wells for the taxable year by the maximum statutory U.S. tax rate applicable to a corporation (currently 46 percent). Any credits for the PRT for the taxable year cannot exceed the difference (if any) between this product and other U.K. tax (such as the regular U.K. corporate tax) on that income.

If less than the full amount of the PRT is creditable under this provision, the protocol allows a 2-percent limited carryback or carryover of the excess. This is similar to provisions of U.S. law.

In addition to the limits on creditability of the PRT imposed with respect to the taxpayer's U.K. oil and gas extraction income, the protocol imposes comparable limitations on the creditability of the PRT on income from the initial transportation, initial treatment and initial storage of minerals from oil and gas wells in the U.K. This concept is similar to the limitations of U.S. domestic law relating to the foreign tax credit on foreign oil related income. It applies to a narrower group of activities, however, because the PRT is not imposed on other oil-related activities. Moreover, gains from the sale or exchange of assets used in connection with these activities is not included because the PRT is not imposed on those gains.

Article V of the proposed protocol will not reduce the foreign tax credit which may be claimed for the PRT under U.S. statutory law if it is ultimately held that the PRT is a creditable income tax under that law. Article V of the protocol only imposes a limitation on the amount of the PRT which qualifies as a creditable foreign tax, as opposed to a royalty or non-creditable tax, if the taxpayer must resort to the provisions of the proposed treaty to obtain the credit. However, the taxpayer does not avoid the limitations of U.S. statutory law by claiming the PRT under the treaty. Under paragraph (1) of Article 23 of the proposed treaty, the other limitations on creditability imposed by U.S. domestic law (in particular, those in Code secs. 904 and 907), as they are now in force or as they may be changed without changing the [12] general principle of the foreign tax credit, will continue to apply in determining the amount of the foreign tax credit the taxpayer will ultimately receive as a result of payment of the PRT and other foreign taxes.

Article VI. Offshore activities

The proposed protocol adds a new Article 27A to the proposed treaty covering offshore activities. This provision is intended to deal primarily with the activities of certain U.S. independent drilling contractors in the U.K. sector of the North Sea. As a practical matter, this provision makes it clear that the proposed treaty does not prevent the United Kingdom from taxing the activities of these drilling contractors under its domestic laws. Although the contractors would be allowed a credit against U.S. tax liability for U.K. income taxes, the credit may be less than the full U.K. tax paid. Also, the benefits to the drilling contractors of the investment tax credit may be reduced. While the protocol provisions were added primarily to deal with activities of U.S. persons in the North Sea, they also make it clear that British activities in connection with activities on the U.S. continental shelf are subject to U.S. tax.

Under the treaty, the terms "United Kingdom" and "United States" are defined to include the seabed and subsoil and their natural resources over which the countries exercise rights. Oil companies have entered into contracts with U.S. drilling companies and service and supply companies with respect to mineral exploration and exploitation in the North Sea through the use of movable drilling rigs. It is understood that a number of these drilling and service companies intended to take the position that their income was not subject to U.K. tax because of the absence of a permanent establishment which would allow the U.K. to tax them under the business profits article (*Article 7*) of the proposed treaty. The term "permanent establishment" includes "a building or construction or installation project which exists for more than 12 months" (*Article 5(2)(f)*), but it is not clear whether this language would encompass these drilling rigs. The activities of these independent drilling contractors with respect to any one project generally have been completed in less than 12 months. In addition, individuals who were performing independent services in the North Sea who could establish that they did not themselves have a fixed base in the U.K., might under certain circumstances be exempt from U.K. tax on their income from the performance of services (*Article 14*). It is also understood that some U.S. independent drilling contractors intended to take the position that their activities constituted the operation of ships which, under certain circumstances, would be taxable only in the U.S. under Article 8 (*Shipping and air transport*) of the proposed treaty.

The proposed protocol provides that a person who is a resident of one country and carries on activities for more than 30 days in a year in the other country in connection with the exploration or exploitation of the seabed and sub-soil and their natural resources situated in that other country is deemed to be carrying on in respect of those activities a business in that other country through a permanent establishment or fixed base situated therein. This rule would [13] permit this income, whether business profits or income from independent personal services, to be taxed by the other country under its domestic laws. (The treaty and protocol do not themselves impose a tax.) At present the United Kingdom would not, under its domestic law, tax the North Sea income of the U.S. drilling companies.

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[4] The assurances were contained in a letter from the Treasury Department to Senator Pell, reprinted *id.*, the text of which was as follows:

"The Treasury very recently discussed with the British Senator Kennedy's suggestion that the creditability of the U.K. Petroleum Revenue Tax (PRT) under the proposed income tax treaty be limited to income from the United Kingdom.

In those discussions, the British indicated that, unlike the provisions of Article 9(4) in the treaty, they have little concern over the specific mechanics which the United States applies to the PRT credit. Thus, the British have agreed to go forward with discussions of a protocol to the proposed treaty which will accomplish the objective suggested by Senator Kennedy.

The Treasury also stands ready to go forward with such a protocol and we hope that in this manner the proposed treaty can be ratified in its present form.

Sincerely,

DONALD C. LUBICK,
Assistant Secretary-Designate for Tax Policy.

This provision does not apply where the activities are carried on for a period not exceeding 30 days in aggregate in any 12-month period. However, for purposes of this 30-day threshold, activities carried on by an enterprise related to another enterprise are to be regarded as carried on by the enterprise to which it is related if the activities in question are substantially the same as those carried on by the other enterprise.

The proposed protocol also provides that the provisions of Article 8 (*Shipping and air transport*) of the proposed treaty do not apply to a drilling rig or any vessel the principal function of which is the performance of activities other than the transportation of goods or passengers.

Unlike the other provisions of the proposed protocol, this provision takes effect only after the protocol enters into force and is not retroactive.

Article VII. Statutes of limitations

Certain provisions of the proposed treaty are retroactive as far back as 1973. The statute of limitations (under the domestic laws of the United States and the United Kingdom) may already have run on some of the years involved. For example, a claim for refund of U.S. tax, whether based on a treaty benefit or otherwise, must ordinarily be made within 3 years after a return for the year in question is filed. The proposed protocol overrides these domestic law provisions to allow refunds to be made on the basis of the treaty provisions if claims are made within 3 years after the end of the year in which the treaty enters into force. This rule does not open the statute of limitations for other items on the return except insofar as they are affected, directly or indirectly, by application of the provisions of the treaty.

Article VIII. Entry into force

The proposed protocol will enter into force on the thirty-first day following the date on which the instruments of ratification are exchanged. Once in force, the proposed protocol generally applies retroactively, in accordance with Article 28 (*Entry into force*) of the proposed treaty. For example, Article III of the protocol will generally apply to dividends paid on or after January 1, 1975. However, the provisions of Article VI (*Offshore activities*) of the protocol apply only after the protocol has entered into force.

[14] VIII. TEXT OF RESOLUTION OF RATIFICATION

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RESOLUTION OF RATIFICATION

Resolved (*two-thirds of the Senators present concurring therein*), That the Senate advise and consent to the ratification of the 1979 Tax Protocol with the United Kingdom, done at London on March 15, 1979 (Ex. Q, Ninety-sixth Congress, first session).

* * * * *

[21] LETTER OF TRANSMITTAL

THE WHITE HOUSE,
April 12, 1979.

To the Senate of the United States:

I transmit herewith, for Senate advice and consent to ratification, a Third Protocol further amending the Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains signed at London on December 31, 1975, as amended by an exchange of notes dated April 13, 1976, and by Protocols signed at London on August 26, 1976 and March 31, 1977. For the information of the Senate, I also transmit the report of the Department of State on the Third Protocol.

The Third Protocol will enter into force immediately after the expiration of 30 days following the date on which instruments of ratification are exchanged.

I recommend that the Senate give early and favorable consideration to the Third Protocol and give advice and consent to its ratification.

JIMMY CARTER.

[23] LETTER OF SUBMITTAL

DEPARTMENT OF STATE,
Washington, April 3, 1979.

THE PRESIDENT,
The White House.

THE PRESIDENT: I have the honor to submit to you, with a view to its transmission to the Senate for advice and consent to ratification, the Third Protocol further amending the Convention between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains, signed at London on December 31, 1975, as amended by an exchange of notes dated April 13, 1976, and by Protocols signed at London on August 26, 1976 and March 31, 1977. The Third Protocol was signed at London on March 15, 1979.

The Senate gave advice and consent to ratification to the Convention, as amended, on June 27, 1978, with a reservation as to Article 9(4). Article 9(4) would have restricted the power of states of the United States to apply the unitary method of taxation to British multinational companies. The Senate's reservation stipulates that the provisions of Article 9(4) will not apply to any political subdivision or local authority of the United States.

The Third Protocol makes a number of changes to conform the language of the Convention to the Senate's reservation on Article 9(4). Execution of the Third Protocol by the United Kingdom and approval by the

British House of Commons would confirm acceptance by the United Kingdom of the Senate's reservation with respect to Article 9(4) of the Convention.

The Third Protocol also modifies the definition of a "permanent establishment" in the case of activities carried on offshore in connection with the exploration and exploitation of the seabed and subsoil and their natural resources. Such activities are deemed to create a "permanent establishment" in a Contracting State if such activities were carried on in the State for at least 31 days in a 12 month period.

In addition, the Third Protocol provides a special limitation on the creditability by United States citizens or residents of the United Kingdom petroleum revenue tax paid or accrued by them. This provision was included in the Third Protocol because of concern expressed during the Senate debate that the petroleum revenue tax (PRT) might be used by oil companies with North Sea operations to shelter oil related income from other countries. Under the provisions of the Third Protocol, the creditability of the PRT is limited by an amount determined with reference to United Kingdom source oil income.

[24] The Third Protocol also makes a number of technical and clarifying changes to the provisions of the Convention dealing with the United States excise tax on insurance premiums, the taxation of remuneration for government service, dividends from dual resident corporations, and the period of time during which refunds relating to taxes paid in previous periods may be applied for.

A technical memorandum explaining in detail the provisions of the Third Protocol is being prepared by the Department of the Treasury and will be submitted to the Senate Foreign Relations Committee.

The Department of the Treasury, with the cooperation of the Department of State, was primarily responsible for the negotiation of the Third Protocol. It has the approval of both Departments.

Respectfully submitted.

Cyrus Vance.

[43] APPENDIX C

WRITTEN RESPONSES BY WITNESSES TO QUESTIONS BY SENATORS AND COMMITTEE STAFF

Department of
the Treasury,
Washington, D.C.,
June 8, 1979.

Hon. Frank Church,
Chairman,
Committee on Foreign Relations,
U.S. Senate
Washington, D.C.

Dear Mr. Chairman: To follow-up my testimony at the June 6 hearings concerning the six tax conventions or protocols involving the United Kingdom, France, Hungary and Korea, I want to assure you that Article I of the Third Protocol of the proposed US-UK Income Tax Treaty gives full effect to the Senate's reservation on Article 9(4) of that treaty. Let me also assure you that there is no similar state tax issue in any of the other five treaties which were considered by the Committee yesterday.

Again let me emphasize our view that each of these treaties is important to the United States and that their prompt approval is desirable.

I am also enclosing answers to the written questions submitted to me by your staff at the hearings as well as copies of my answers to questions from Senator Helms and Senator Javits.

Sincerely,

Donald C. Lubick,
Assistant Secretary
(*Tax Policy*).

Enclosures.

Questions for Assistant Secretary for Tax Policy Donald C. Lubick [1]

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[45] *Questions 6 and 7.* In the third protocol proposed to the U.S.-U.K. Income Tax Treaty, the definition of permanent establishment has been changed. Please explain the basis of this change. Were the affected U.S. drilling companies contacted concerning the proposed change? If they were contacted, please give the details of when, by whom, and what resulted from such contact. Why was the permanent establishment definition selected as the item to be changed in the tax area?

Answer. In our discussions with the British subsequent to the Senate reservation on Article 9(4) of the proposed treaty, the United Kingdom specifically requested the inclusion in the protocol of a provision clarifying their taxing rights with respect to exploration and exploitation connected activities. This requested clarification was not unusual in light of the original negotiations in 1975 over the perma[46]nent establishment definition. In those negotiations, the United States agreed to delete from the twelve month permanent establishment exclusion contained in subparagraph (2)(f) of the proposed treaty any reference to "an installation or drilling rig or ship used for the exploration or development of natural resources" as a result of the British insistence that there be no limitation on their right to tax such activities. This deletion left the application of the permanent establishment definition to these activities somewhat uncertain, although as the United Kingdom authorities believe, a strong argument exists that these activities could be taxed even without the clarification of the new protocol.

We agreed to the inclusion of this provision in the Third Protocol because it was reasonable to expect the British to request some additional concession for the loss of the benefits of Article 9(4); because the terms of the provision were reasonable in light of our own statutory tax policy (we would generally tax these kinds of activities conducted in the United States, even if they were of a shorter duration than 30 days); and because it could be viewed as little more than a clarification of a reasonable interpretation taken by the British of their taxing rights under the proposed treaty without the protocol provision.

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[1] General questions and answers 1-5 may be found in Senate Executive Report 96-6, 1980-4 I.R.B. 28. The questions and answers relating specifically to the other protocols and treaties considered at the June 6, 1979 hearings are set forth in the committee reports relating to those treaties.

The drilling industry was clearly aware of the precise terms of the protocol provision at least one month prior to the signing of the Protocol on March 15, 1979. On February 16, 1979, Mr. Arnold W. Bramlett, Chairman of the Accounting and Taxation Committee of the International Association of Drilling Contractors (IADC), wrote to the International Tax Counsel, Mr. H. David Rosenbloom, expressing general concern over the provision. Subsequently, there were telephone conversations between Mr. Rosenbloom and Mr. Bramlett in which the Treasury sought specific information as to the nature of the activities and the harm which was alleged would occur. These requests were confirmed in a letter from Mr. Rosenbloom to Mr. Bramlett on March 5, 1979, still 10 days before the Protocol was signed. To date, the Treasury has not received from the IADC, or any of its members, specific information detailing any specific adverse effects of the protocol provision.

THIRD PROTOCOL TO THE U.S.-U.K. INCOME TAX TREATY

Question 1. Would you please summarize the British reaction to the reservation included in the Senate advice and consent to ratification last June 27, 1978, concerning Article 9(4).

Answer. The British tax authorities were unhappy with the Senate reservation concerning Article 9(4). They hoped that a modified version of Article 9(4) might be included in the treaty. When it became clear that there was no possibility of a modification which would be acceptable to all parties, they reluctantly agreed to seek Parliamentary approval of the treaty with the deletion of Article 9(4) but only after the Third Protocol is approved by the Senate. The British authorities view some of the provisions of the Third Protocol (particularly the North Sea permanent establishment rules) as a concession for the deletion of Article 9(4). We recently reconfirmed with the British their willingness to go forward with the treaty if the protocol is approved by the Senate.

[47] Very strong objection has been raised by the United Kingdom business community to the deletion of Article 9(4). Many business and industrial groups in the United Kingdom have urged Parliament not to reapprove the treaty in the absence of the Article 9(4) provision.

The strength of these objections was confirmed by testimony at the June 6 hearings to the effect that there is a view among some Conservative Members of Parliament that the treaty should not be approved unless some solution can be found to the state taxation problem, albeit outside the treaty framework.

Question 2. Would any reservations added at this date jeopardize the Third Protocol and/or the US/UK Income Tax Treaty? If yes, please explain.

Answer. In our judgment any reservation on the Third Protocol, or any substantial delay in approval of the Protocol will seriously jeopardize the chances that the proposed US/UK Income Tax Treaty, with its very substantial benefits for U.S. taxpayers, will ever come into effect.

While we cannot speak for the United Kingdom, or predict with absolute certainty the actions which might be taken by the British Parliament, certain facts are clear. There is strong business opposition in the United Kingdom to the treaty reservation on Article 9(4) and as time passes there is also likely concern over the growing cost of the retroactive refund to U.S. investors of the British Advance Corporation Tax (it will be over $500 million through 1979). Despite this, the British have agreed to go forward to Parliament with the treaty as long as the U.S. Senate approves the Third Protocol containing what we, and they, view as a reasonable and justifiable provision clarifying the United Kingdom's taxing rights over certain offshore activities.

Should the United States again reserve on a treaty provision important to the British, particularly one which is reasonable in light of both the domestic tax law of the United States and the history of the basic treaty, it may well provide sufficient impetus for those in the United Kingdom opposed to the treaty to secure its defeat. Prolonged delay could have a similar effect.

Question 3. Why was the definition of a "permanent establishment" in the case of activities carried on offshore in connection with the exploration and exploitation of the seabed and subsoil modified? Will this modification result in a loss of revenues to the U.S.? If yes, how much? If no, why not?

Answer. The reasons for modification of the definition of the term "permanent establishment" are set forth in the answer to questions 6 and 7 under the General Questions heading above.

Since there is a good argument, and it is the British view, that the activities dealt with in the protocol provision may be taxed in the United Kingdom under the proposed treaty without the protocol, it is likely that the protocol provision will result in no additional loss of revenues to the United States. As a general matter, United Kingdom taxation of the income from exploration and exploitation connected activities of U.S. taxpayers will give rise to foreign tax credits which are available to offset the U.S. tax liability of U.S. taxpayers on this income. To that extent, the U.S. Treasury will lose revenue [48] and the British Treasury will gain revenue. The magnitude of this revenue transfer, however, is not likely to be substantial. The information we have indicates that only a few U.S. drilling companies are actively operating in the British sector of the North Sea.

It is important to note that other provisions of the Third Protocol will raise U.S. revenues (e.g., the limitation on the credit for the British Petroleum Revenue Tax) and thus, the next revenue impact of the protocol will be insignificant.

Question 4. How will the U.S. determine the United Kingdom source oil income for oil companies operating in the North Sea? Won't the oil companies be able to shelter oil-related income from other countries under the petroleum revenue tax (PRT) established by this convention?

Answer. The procedures for determining the treaty limitation on the credit for the U.K. Petroleum Revenue Tax (PRT) are described in the Treasury's technical explanation of the Third Protocol. For example, for purposes of this limitation, the taxable income from the extraction of minerals from oil or gas wells in the United Kingdom will be determined by applying principles similar to those under section 907(c)(1)(A) and section 907(c)(3) of the Internal Revenue Code.

As limited by the provisions in the Third Protocol, excess PRT should not spill over to offset U.S. tax on income from other countries.

Question 5. Will the Third Protocol, if ratified, result in a loss of revenues to the U.S.? If yes, how much? If no, why not? What was the policy reason for accepting the loss or gain?

Answer. We do not believe that the Third Protocol will, on balance, have a significant impact on U.S. revenues, either positive or negative.

[49] DEPARTMENT OF
THE TREASURY,
Washington, D.C.,
June 8, 1979.

Hon. JACOB JAVITS,
U.S. Senate, Washington, D.C.

DEAR SENATOR JAVITS: Enclosed are answers to the questions you posed to me at the Foreign Relations Committee's Tax treaty hearings on June 6. Since the staff of the Committee asked for copies of these answers in order to facilitate their work, I have taken the liberty of sending the Chairman a copy of my reply to you.

DONALD C. LUBICK,
Assistant Secretary
(Tax Policy).

Enclosures.

QUESTIONS OF SENATOR JAVITS ON THE THIRD PROTOCOL TO THE U.S.-U.K. INCOME TAX TREATY

Question 1. Article VI of the Third Protocol to the U.S.-U.K. income tax treaty contains a provision which permits the taxation of activities connected with the exploration or exploitation of the seabed and subsoil and their natural resources after a period of 30 days in any twelve month period. Is this unusual?

Answer. As a matter of United States tax policy there is nothing particularly unusual or unjustifiable about a provision which preserves a country's right to tax exploration or exploitation connected activities after a 30-day period.

Congress, in the Tax Reform Act of 1969, enacted section 638 of the Internal Revenue Code specifically to assure that the United States would be able to tax natural resource exploration and exploitation activities conducted in the continental shelf areas of the United States.

Under domestic tax law, the United States' right to tax the income from such activities is not limited by any time requirement. Generally, a foreign company is taxable in the United States on its income effectively connected with the conduct of a trade or business in the United States even if that trade or business lasts no more than one day. It seems to us difficult to argue that the United Kingdom should not have a similar right to tax.

In addition, preservation of a right to tax the income derived from business activities without any time threshold is not an unusual provision as a matter of treaty policy. Both the United States model income tax treaty and that of the Organization for Economic Co-operation and Development (OECD) provide, as a general rule, for the taxation of business profits attributable to a permanent establishment without specifying any time requirement before which there can be no permanent establishment.

Question 2. Will Article VI of the Third Protocol adversely affect U.S. taxpayers in a significant way?

[50] *Answer.* This provision in large, if not full measure, represents merely a Treasury-to-Treasury transfer of revenue which should not have a material impact on U.S. taxpayers.

Under this provision, the income from these exploration or exploitation connected activities in the United Kingdom could be taxed by the United Kingdom. Under both the proposed treaty and our tax law, a United States company subject to this United Kingdom tax would be entitled to claim a foreign tax credit against its U.S. tax liability for the U.K. tax which may be imposed. There should be no double taxation in these circumstances. Tax on the income is paid only once, to the U.K. treasury. While it is true that the statutory corporate tax rate in the U.K. is higher than that in the U.S.—52 percent vs. 46 percent, it should be noted that at most there is only a potential excess foreign tax credit of 6 percent. But even this potential excess credit is mitigated further by other factors. By virtue of a variety of provisions of U.K. tax law, the U.K. effective tax rate may well be less than 52 percent and our overall foreign tax credit limitation would permit the U.S. company to offset any excess foreign tax credit on this income against the U.S. tax liability on any other lower-tax income from other foreign countries which the U.S. company may have. On balance, we do not believe this provision will adversely affect U.S. taxpayers in any material way.

Moreover, we have repeatedly asked the drilling industry representatives to explain specifically why they would be adversely affected and we have not received any hard evidence from any company of specific harm. Indeed, our impression is that the concern expressed over this provision is not an industry-wide one, but rather that of only a few companies.

[51] DEPARTMENT OF
THE TREASURY,
Washington, D.C.,
June 8, 1979.

Hon. JESSE A. HELMS,
U.S. Senate, Washington, D.C.

DEAR SENATOR HELMS: Enclosed are answers to the questions you posed to me at the Foreign Relations Committee's tax treaty hearings on June 6. Since the staff of the Committee asked for copies of these answers in order to facilitate their work, I have taken the liberty of sending the Chairman a copy of my reply to you.

Sincerely,

DONALD C. LUBICK,
Assistant Secretary
(Tax Policy).

Enclosures.

QUESTIONS OF SENATOR HELMS FOR DEPARTMENT OF THE TREASURY WITNESS/STAFF OF JOINT COMMITTEE ON TAXATION

Question 1. What is the U.S. Model

Tax Treaty recommended language concerning the length of time before a construction activity is considered sufficient for the "permanent establishment" test?

Answer. Paragraph 3 of Article 5 (Permanent Establishment) of the U.S. model income tax treaty published on May 17, 1977 provides that:

"3. A building site or construction or installation project, or an installation or drilling rig or ship used for the exploration or development of natural resources, constitutes a permanent establishment only if it lasts more than 24 months."

The provision in the proposed income tax treaty with the United Kingdom which was approved by the Senate last year states that:

"(2) The term 'permanent establishment' shall include especially:

"(f) a building or construction or installation project which exists for more than 12 months."

Several important conclusions can be drawn from a comparison of these provisions.

First, the U.S. model treaty only sets out the preferred United States negotiating position. We fully recognize that in negotiating a treaty we must be willing to compromise and modify at least some of our preferred negotiating positions. We cannot expect to reach agreements with any country if our demand is and remains that they sign our model treaty without change on the dotted line.

Second, in the proposed U.K. treaty this particular provision of our model was modified in two important ways—the time threshold for exclusion from the definition of permanent establishment was reduced from 24 to 12 months and the specific exclusion deleted coverage of "an installation or drilling rig or ship used for exploration or development of natural resources."

[52] Third, we note that the deletion of a reference to drilling rigs, etc. was prompted during the original negotiations of the proposed treaty in 1975 because the United Kingdom insisted on their right to tax these activities without any limitation. The British view that they may tax under the proposed treaty even without this protocol seems clear. Moreover, since the United States under its statutory tax law would, in general, subject to U.S. tax the income derived by a foreign person from exploration or exploitation connected activities carried on in the U.S. (even if those activities were of very short duration), it is very difficult to argue that the United Kingdom should not have a similar right to tax.

Question 2. Do any tax treaties of the U.S. specifically name a single industry or activity for less favorable treatment in the manner that Article VI of the Third Protocol of the U.S.-U.K. Tax Treaty does for offshore exploration and development of natural resources?

Answer. The question assumes a conclusion which is not warranted. Neither Article VI of the Protocol, nor any other provision of the proposed treaty, singles out any taxpayer for less favorable tax treatment than they would have if there were no treaty at all. In general, tax treaties only benefit taxpayers. It is true that any particular treaty may benefit some more than others, but this necessarily follows from the nature of a negotiated agreement between two countries.

Generally, our tax treaties are replete with instances where particular industries, activities or type of income receive different measures of benefit. Looking to the U.S. model, for example, one discovers that the income of a resident of the United States from most business activities which are conducted through any fixed place of business in the other country may be taxed in the other country without any limitation. (Articles 5 and 7). Under Article 8, however, income of a resident of the United States from the operation of ships or aircraft in international traffic would be exempt from tax in the other country. United States Government employees are exempt from tax on their salaries in the other country (Article 19), while U.S. citizen employees of private employers may be taxed in the other country on their income from services there unless they are present in the other country for less than 183 days and other conditions are met (Article 15). Still different rules and different levels of benefits apply to U.S. citizens rendering independent personal services (Article 14) and those who are entertainers and athletes (Article 17). United States residents would be permitted to receive interest and royalties from the other country exempt from tax (Articles 11 and 12) but would receive dividends subject to tax of up to 15 percent (Article 10).

Question 3. Does the Department of Treasury expect what appears to me to be discriminatory treatment of offshore exploration and development activities to be part of other future treaty negotiations?

Answer. In future treaty negotiations, the Treasury will continue to seek the agreement of other countries to those provisions of our model income tax treaty which provide the greatest benefits to United States taxpayers. We cannot, however, realistically expect that each of our taxpayers will under any negotiated agreement obtain the same level of benefits as every other U.S. taxpayer.

[53] The provision in the Third Protocol which permits both the United States and the United Kingdom to tax exploration and exploitation connected activities is, in our view, a reasonable one which conforms to our domestic tax law. As such, we remain prepared to consider its inclusion in future treaties where it is strongly requested by the other country as a condition for agreement to a treaty and where such a treaty is generally favorable to the United States. It must be remembered that this provision at worst only preserves a taxing right which the other country has without a treaty.

Question 4. Why was this industry singled out? Why was it not consulted before the announcement of agreement with the British? What economic impact studies were made to ascertain the effect of our country's capability to compete in the world market if this provision is adopted?

Answer. We are surprised at the assertion that the oil drilling companies were unaware of either the substance of the question or the specific terms of the protocol provision prior to the signing of the Third Protocol on March 15, 1979.

The drilling industry was clearly aware of the precise terms of the protocol provision at least one month prior to the signing of the protocol on March 15, 1979. On February 16, 1979, Mr. David W. Bramlett, Chairman of the Accounting and Taxation Committee of the International Association of Drilling Contractors (IADC), wrote to the International Tax Counsel, Mr. H. David Rosenbloom, expressing general concern over the provision. Subsequently, there were telephone conversations between Mr. Rosenbloom and Mr. Bramlett in which the Treasury sought specific information as to the nature of the activities and the harm which was alleged would occur. These requests were confirmed in a letter from Mr. Rosenbloom to Mr. Bramlett on March 5, 1979, still 10 days before the protocol was signed. To date, the Treasury has not received from the IADC, or any of its members, specific information detailing any specific adverse effects of the protocol provision.

More surprising yet is that the drilling companies did not raise any objections either when hearings were held on the proposed treaty in July 1977, or before the treaty was approved in June 1978. They surely were aware of the possibility that the United Kingdom could tax their activities under the proposed treaty. This awareness is evidenced in a letter to the Treasury's International Tax Counsel dated October 17, 1975 from the law firm of Miller & Chevalier on behalf of its client, Santa Fe International Corporation—the very company for which Mr. Bramlett of the IADC works.

While not directly addressing the basic question of British taxation, the letter and accompanying memorandum provide ample evidence of a concern that without specific treaty language the drilling activities of Santa Fe could be taxed in the United Kingdom. Since the proposed treaty as approved by the Senate does not contain such specific language, one would think concern should have arisen much earlier.

The effect of this provision in the protocol on our country's capability to compete in world markets is judged to be small if indeed there [54] is any impact at all. The provision in large, if not full measure, represents merely a Treasury-to-Treasury transfer of revenue which should not materially impact U.S. taxpayers.

Under this provision, the income from these exploration or exploitation connected activities in the United Kingdom could be taxed by the United Kingdom. Under both the proposed treaty and our tax law, a United States company subject to this United Kingdom tax would be entitled to claim a foreign tax credit against its U.S. tax liability for the U.K. tax which may be imposed. There should be no double taxation in these circumstances. Tax on the income is paid only once, to the U.K. treasury. While it is true that the statutory corporate tax rate in the U.K. is higher than that in the U.S.—52 percent vs. 46 percent, it should be noted that at most there is only a potential excess foreign tax credit of 6 percent. But even this potential excess credit is mitigated further by other factors. By virtue of a variety of provisions of U.K. tax law, the U.K. effective tax rate may well be less than 52 percent and our overall foreign tax credit limitation would permit the U.S. company to offset any excess foreign tax credit on this income against the U.S. tax liability on any other lower-tax income from other foreign countries which the U.S. company may have. On balance, we do not believe this provision will adversely affect U.S. taxpayers in any material way.

Finally, it should be reiterated that we have not received any hard evidence from any company of specific harm. Indeed, our impression is that the concern expressed over this provision is not an industry-wide one, but rather that of only a few companies.

Question 5. Are drilling rigs owned by American companies which are temporarily operating in the U.K. waters now taxed by the U.S. or some taxing authority?

Answer. We cannot answer this question. We have repeatedly asked that the drilling companies concerned over this provision provide us with specific information detailing the precise nature of their activities and the adverse tax effects they would suffer. We have never been provided with this information.

Question 6. Have you measured the degree of involvement that U.K. companies currently have on the American Outer Continental Shelf to determine the relative benefit which this country could expect to derive from the enactment of this provision?

Answer. We do not know the degree of involvement of U.K. companies on the U.S. Continental shelf. It is important to recognize, however, that in any tax treaty it is not possible to weigh relative benefits on a provision-by-provision basis. Tax treaties, by their very nature, deal with a wide variety of economic transactions and income flows. The benefitted transactions or income dealt with under one provision of a treaty may favor one country and those benefitted under another provision may favor the other country. Thus, in assessing the balance of a tax treaty it is necessary to look at all the effects and all the provisions in the aggregate. In this context, the proposed treaty taken as a whole provides many substantial benefits to U.S. taxpayers, principal among them is the British government's refund to U.S. taxpayers of a portion of the British Advance Corporation Tax. This amounts to a retroactive refund of over $500 million through 1979 and $100 million a year thereafter.

[55] CONGRESS OF THE
UNITED STATES,
JOINT COMMITTEE
ON TAXATION,
Washington, D.C.,
June 12, 1979.

Hon. JESSE HELMS,
U.S. Senate, Washington, D.C.

DEAR SENATOR HELMS: This is in response to the questions you submitted to me at the hearings last Wednesday, June 6, on the proposed Third Protocol to the pending income tax treaty with the United Kingdom. The questions concern the provision (*Offshore activities*) in the proposed protocol which is intended to make it clear that the United Kingdom can tax U.S. independent oil drilling contractors operating in the United Kingdom sector of the North Sea on a temporary basis. You submitted the same questions to the Treasury Department witnesses. Since questions three and four go to the Treasury's intentions in negotiating the offshore activities provision, I shall not attempt to answer those questions.

Question 1. What is the U.S. Model Tax Treaty recommended language concerning the length of time before a construction activity is considered sufficient for the "permanent establishment" test?

Answer. Article 5(3) (***Permanent establishment***) of the Treasury Department's model income tax treaty of May 17, 1977, provides as follows:

A building site or construction or installation project, or an installation or drilling rig or ship used for the exploration or development of natural resources, constitutes a permanent establishment only if it lasts more than 24 months.

Question 2. Do any tax treaties of the U.S. specifically name a single industry or activity for less favorable treatment in the manner that Article VI of the Third Protocol of the U.S.-U.K. Tax Treaty does for offshore exploration and development of natural resources?

Answer. In a number of U.S. tax treaties, entertainers and athletes are singled out and treated differently from other individuals receiving compensation for performing services in the other country. Treaties typically require that individuals resident in either treaty country who perform services in the other country are not taxed in that other country unless they are present there for more than 6 months during the year or they are performing services in an independent capacity through a fixed base. In those treaties where entertainers and athletes are singled out, however, there is usually no requirement that the entertainer or athlete spend a minimum period of time in the other country or have a fixed base there; all that is required is that a certain amount of income (e.g., $3,000) is derived from that country that year. Examples of such provisions are contained in the pending income tax treaties with the United Kingdom and the Philippines as well as the existing income tax treaties with Trinidad and Tobago (1970), Belgium (1972), Iceland (1975), and Romania (1976). [56] An entertainers and athletes provision of this type is found in the Treasury Department's model income tax treaty with a $15,000 minimum income level, and in the OECD model income tax treaty with no minimum income requirement.

A precedent more analogous to the offshore activities provision of the proposed U.K. protocol can be found in the existing income taxy treaty with Canada. The permanent establishment article of that treaty was amended in 1950 by a protocol to provide that the use of substantial equipment or machinery in one country ***at any time in any taxable year*** by a resident of the other country constitutes a permanent establishment for that year. The report of the State Department accompanying the protocol indicated that this modification was intended only as a clarification of the existing treaty, and stated further that "[t]he importance of this clarification arises mainly from the fact that American enterprises are engaged regularly in Canada in building roads, installing public utility projects, and carrying on other projects, and that much of this work extends over only portions of the year, such as work of a seasonal character." This provision and the offshore activities provision of the proposed protocol would appear to have essentially the same purpose and effect. It would appear, however, that this provision in the Canadian treaty would apply to offshore drilling rigs and that U.S. companies operating with substantial equipment (which presumably would encompass an offshore drilling rig) on the Canadian continental shelf at any time during the year would be treated as having a Canadian permanent establishment, and vice versa.

Question 5. Are drilling rigs owned by American companies which are temporarily operating in the U.K. waters now taxed by the U.S. or some taxing authority?

Answer. The income earned by American companies from the operation of drilling rigs on a temporary basis in U.K. waters is subject to U.S. tax if the operations are conducted through a branch of the U.S. company or through a subsidiary incorporated under U.S. law. Where, however, the operations are conducted through a foreign subsidiary of the U.S. company, the income would not be subject to U.S. tax unless and until it is distributed as dividends to the U.S. parent. Where the foreign subsidiary is incorporated in a tax haven such as Panama, as typically would be the case, there would be no foreign tax imposed on the income other than the U.K. tax.

It is not known how many U.S. companies operate drilling rigs in foreign waters using U.S. corporations which are subject to U.S. tax and how many use foreign subsidiaries which are not. Although some of the information is conflicting, industry sources indicate that the rigs are typically operated through foreign subsidiaries. Sedco, the one U.S. company presently operating in the U.K. sector of the North Sea, is operating through U.S. corporations. The reasons for using a U.S. corporation taxable by the United States rather than a nontaxed foreign subsidiary appear to be: (1) U.S. corporations operating in the U.K. sector of the North Sea claim exemptions from U.K. taxes under the existing treaty with the United Kingdom, and (2) the U.S. investment tax credit (equal to 10 percent of the cost of the drilling rig), which can be used to offset up to 60 percent (increasing [57] to 90 percent in 1982) of the U.S. company's U.S. tax liability from all activities, would not be available if the rig were owned by a foreign subsidiary.

It should be noted that the pending treaty, even as modified by the proposed protocol, would afford U.S. drilling contractors the opportunity to reduce their U.K. taxes on operations in U.K. waters significantly below the levels which would be imposed in the absence of the treaty. Under the pending treaty, income derived by U.S. companies from the rental of personal property (including floating drilling rigs) is exempt from U.K. tax as long at the U.S. company does not have a permanent establishment in the United Kingdom. Consequently, it would be possible for the U.S. corporation owning the drilling rig to lease it on a bareboat basis to an affiliated corporation which would operate the drilling rig (this, apparently, is a typical arrangement in any event). In that situation, the income derived by the affiliate operating the rig would be taxable by the United Kingdom, but the rental income received by the U.S. corporation would be exempt from U.K. tax under the proposed treaty and protocol. In the absence of a treaty, both the operating income and the rental income would be taxable by the United Kingdom.

Question 6. Have you measured the degree of involvement that U.K. companies currently have on the American Outer Continental Shelf to determine the relative benefit which this country could expect to derive from the enactment of this provision?

Answer. We have been unable to obtain adequate information to determine with any degree of accuracy the relative benefits the two countries may expect to obtain under the offshore activities provision of the protocol. It is understood, however, that U.S. drilling contractors and other U.S. service and supply companies have much more significant foreign operations than do their foreign competitors. Therefore, it is probable that the provision will be of much greater benefit at present to the United Kingdom than to the United States.

Industry sources indicate that at the present time Sedco is the only U.S. company operating in U.K. waters and thus it is the only U.S. company that might immediately be affected by the protocol. It is understood, however, that four or five other U.S. drilling contractors have operated in the U.K. sector of the North Sea in recent years and thus it may be assumed that several U.S. drilling contractors would be affected by the offshore activities provision in the next few years.

It is not known whether any U.K. contractors are operating in U.S. waters through U.K. corporations. Other provisions of U.S. law make it very difficult for foreign corporations to operate directly on the U.S. continental shelf; foreign companies generally must operate through U.S. subsidiaries if they are to operate on the U.S. continental shelf. Consequently, foreign contractors will be subject to U.S. tax in any event and thus would not be additionally affected by the offshore activities provision of the protocol.

Sincerely yours,

DAVID H. BROCKAWAY,
International Tax Counsel.

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[58] TELEGRAM

INTERNATIONAL ASSOCIATION
OF DRILLING CONTRACTORS,
Houston, Tex., June 12, 1979

PATRICK SHEA,
Committee on Foreign Relations,
Washington, D.C.

DEAR SIR: The International Association of Drilling Contractors withdraws its objection to article VI of the Third Protocol to the United States/United Kingdom Income Tax Treaty.

IADC believes that the importance of early ratification of the Third Protocol for American interests outweighs the negative impact which is directed at the offshore contract drilling industry by the language of article VI. This discriminatory provision, however, should be strongly resisted in any future treaties.

Sincerely,

ED MCGHEE,
Executive vice president.

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[59] APPENDIX D

U.S. CONGRESS,
CONGRESS BUDGET OFFICE,
Washington, D.C., June 13, 1979

Hon. FRANK CHURCH,
Chairman, Committee on
Foreign Relations,
U.S. Senate, Washington, D.C.

DEAR MR. CHAIRMAN: In accordance with the Budget Act, the Congressional Budget Office has examined the proposed Third Protocol to the 1975 Income Tax Convention with the United Kingdom of Great Britain and Northern Ireland.

The proposed protocol would not provide any new budget authority or any new or increased tax expenditures.

In accordance with Section 403 of the Budget Act, the Congressional Budget Office has reviewed the Committee's budget estimates and agrees that the effect of the proposed protocol on revenues will be negligible during fiscal years 1980 through 1984.

Sincerely,

ALICE M. RIVLIN, *Director.*

Technical Explanation[1] of the Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion With Respect to Taxes on Income and Capital Gains Signed at London, on December 31, 1975, as Amended by the Notes Exchanged at London on April 13, 1976, the Protocol Signed at London on August 26, 1976, and the Second Protocol [on March 31, 1977][2]

ARTICLE 1. PERSONAL SCOPE

This Article delineates the persons who come within the scope of the Convention. Paragraph (1) states the general rule that the Convention is applicable to residents of one or both of the Contracting States. The term "resident" of a Contracting State is defined in Article 4 (Fiscal Residence). In several cases, the Convention is also applicable to residents of third states because of their relationship with a resident of a Contracting State. For example, Articles 9 (Associated Enterprises), 25 (Mutual Agreement Procedure) or 26 (Exchange of Information and Administrative Assistance), may apply with respect to persons who are residents of neither Contracting State, and paragraph 5 of Article 10 (Dividends) and paragraph 6 of Article 11 (Interest) apply to dividends and interest derived by residents of third countries.

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[1] It is the practice of the Treasury Department to prepare for the use of the Senate and other interested persons a Technical Explanation of the tax conventions and protocols, which are submitted to the Senate for its advice and consent to ratification.

An Income Tax Convention with the United Kingdom of Great Britain and Northern Ireland was signed December 31, 1975 and an Exchange of Notes was signed April 13, 1976, and submitted by the President to the Senate on June 24, 1976. Two Income Tax Protocols to the Convention were signed August 26, 1976 and March 31, 1977. On July 19 and 20, 1977 the Senate Committee on Foreign Relations held hearings, and this Technical Explanation was presented. The Senate voted its advice and consent on June 27, 1978 and instruments of ratification were exchanged on March 25, 1980.

[2] Page 5. Senate Executive Report No. 95-18, page 21. Senate Executive's J and Q are not published.

This paragraph is similar to Article 1 of the Draft Double Taxation Convention on Income and Capital developed by the Fiscal Committee of the Organization for Economic Cooperation and Development as published in 1963 and as thereafter revised (hereinafter referred to as the "OECD Model Convention").

Paragraph (2) deals with the treatment of a corporation which is a resident of both the United Kingdom within the meaning of paragraph (1)(a)(ii) of Article 4 (Fiscal Residence) and the United States (under paragraph (1)(b)(ii) of Article 4). Under those paragraphs, a corporation which is a United States corporation as defined by paragraph (1)(b) of Article 3 (General Definitions) and is managed and controlled in the United Kingdom would be a resident of both states. This Article clarifies the status of such corporations (hereinafter referred to as "dual-resident" corporations) for purposes of the Convention by providing that dual-resident corporations may not claim the benefits of this Convention which are otherwise available to residents of a Contracting State, including the benefits of Articles 7 (Business Profits), 10 (Dividends), 11 (Interest), 12 (Royalties), 22 (Other Income) or 23 (Elimination of Double Taxation). However, a dual-resident corporation may claim the benefits of paragraph (2) of Article 8 (Shipping and Air Transport) with respect to profits derived from operating ships or aircraft, and of Article 23 (Elimination of Double Taxation) with respect to paragraph 1(c) thereof and with respect to payments of the United Kingdom petroleum revenue tax. A dual-resident corporation may also claim the benefits of Articles 24 (Non-discrimination), and 28 (Entry Into Force), and the provisions of paragraph (7) of Article 11 (Interest) relating to the character of certain interest payments will apply to it. Thus, for example, a dual-resident corporation may not claim the exemption from tax with respect to interest derived from the United States under Article 11 (Interest) or claim a refund of advance corporation tax with respect to a dividend received from a corporation which is a resident of the United Kingdom. In these cases, the dual-resident corporation is treated as a resident of neither Contracting State for purposes of the Convention.

On the other hand, interest, royalties, and dividends derived by a resident of a Contracting State from a dual-resident corporation will qualify for the exemptions or reductions in tax allowed by the Convention. For example, dividends received by a resident of the United Kingdom from a dual-resident corporation will qualify for the reductions in United States tax withholding under paragraph (1) of Article 10 (Dividends) and, a United States resident receiving dividends from a dual-resident corporation which, under the internal law of the United Kingdom, is a resident of the United Kingdom, will qualify for the refunds or credits of advance corporation tax under paragraph (2) of that Article.

Paragraph (3) contains the traditional "saving clause" under which each Contracting State reserves the right to tax its nationals (as defined by paragraph (1)(k) of Article 3 (General Definitions)) and residents (as determined under Article 4 (Fiscal Residence)) as if the Convention had not come into effect. A similar provision exists in Article XIII of the Convention now in effect (hereinafter referred to as the "1945 Convention"). The saving clause is of principal importance to the United States because the United States taxes its citizens, residents, and corporations on a worldwide basis, regardless of where they reside or derive income.

Paragraph (4) sets forth certain exceptions to the application of the saving clause where other provisions of the Convention reflect overriding policies. Thus, the saving clause does not affect the provisions dealing with the determination of domicile for United Kingdom tax purposes (paragraph (4) of Article 4), the exemption from United Kingdom tax of profits derived by United States nationals and corporations from operating ships or aircraft (paragraph (2) of Article 8), associated enterprises (Article 9), the elimination of double taxation (Article 23), non-discrimination (Article 24) or the mutual agreement procedure (Article 25). Moreover, the saving clause does not affect benefits of the Convention which are extended to an individual performing functions as an employee of a government of a Contracting State, as a teacher, as a student or trainee, or as diplomatic and consular official, who is neither a national (as defined in Article 3) of, nor has immigrant status in, the Contracting State imposing the tax. See Articles 19 (Government Service), 20 (Teachers), 21 (Students and Trainees), and 27 (Effect on Diplomatic and Consular Officials and Domestic Laws). In the case of the United States, "immigrant status" means the individual has been admitted to the United States for permanent residence.

Although Article 1 is entitled "Personal Scope", the Convention is applicable to corporations and other persons as well as to individuals.

ARTICLE 2. TAXES COVERED

Paragraph (1) of this Article states the general rule that the Convention applies to taxes on income imposed by the governments of the Contracting States. The Convention also applies to taxes on income imposed by political subdivisions or local authorities of a Contracting State (as defined in paragraph (1)(i) of Article 3 (General Definitions)) where paragraph (4) of Article 9 (Associated Enterprises) applies. This Article is important because the relief from double taxation (i.e., tax credits) accorded by Article 23 (Elimination of Double Taxation) only extends to taxes covered by this Convention. Thus, credits for taxes paid to a Contracting State may be claimed under this Convention only with respect to the taxes specified in paragraphs (2) and (3) of this Article.

Paragraph (2) designates the existing taxes on income which are the subject of the Convention. In the case of the United States, the taxes on income included (referred to as "United States tax") are the Federal income taxes imposed by the Internal Revenue Code ("Code") and the tax under Code section 4371 on insurance company premiums paid to foreign insurers. The tax under Code section 4371 is not covered by the 1945 Convention. The Convention also applies to taxes imposed under section 1401 (tax on self-employment income) and under sections 3101 and 3111 (Federal Insurance Contributions Act taxes) with respect to the employee's share of the tax. The employer's share of the tax is not regarded as an income tax and, accordingly, it is not covered by this paragraph. The Convention only applies to taxes on income contained in the Internal Revenue Code. Thus, the Convention does not, for example, apply to the excise tax under Code section 1491.

The Convention also does not apply to the taxes imposed under Code sections 531 (Accumulated Earnings Tax) or 541 (Personal Holding Company Tax), except as specified by paragraph (6) of Article 10 (Dividends). Under paragraph (6) of Article 10, a corporation which is a resident of the United Kingdom shall be exempt from the accumulated earnings or personal holding company tax if individuals (other than nationals of the United States) who are residents of the United Kingdom control, directly or indirectly, more than 50 percent of the voting power of such corporation.

In the case of the United Kingdom, paragraph (2) provides that the existing taxes on income covered by the Convention (referred to as "United Kingdom tax") are the income tax, the capital gains tax, the corporation tax, and the petroleum revenue tax.

For purposes of paragraph (4) of Article 9 (Associated Enterprises), this Convention also applies to taxes imposed on income by political subdivisions or local authorities of a Contracting State. For this purpose, the income taxes referred to include any franchise taxes measured by income which are imposed by a political subdivision or local authority of a Contracting State.

Under paragraph (3), the Convention will also apply to taxes substantially similar to those covered by paragraph (2), which are imposed in addition to, or in place of, the taxes referred to in paragraph (2) after the date of signature of the Convention (December 31, 1975).

The competent authorities of the Contracting States are to notify each other of any amendments of the laws imposing the existing taxes and of the adoption of any taxes which are imposed subsequent to the date of signature of the Convention.

For purposes of Article 24 (Nondiscrimination), the Convention will also apply to taxes of every kind and description (whether or not the taxes are on income) imposed by the Contracting States, political subdivisions or local authorities thereof.

ARTICLE 3. GENERAL DEFINITIONS

Paragraph (1) defines the principal terms used throughout the Convention. Unless the context otherwise requires, the terms defined in this paragraph shall have a uniform meaning throughout the Convention. It should be noted that a number of important terms are defined elsewhere in the Convention. For example, the term "resident" of a Contracting State and "permanent establishment" are defined in Articles 4 (Fiscal Residence) and 5 (Permanent Establishment), respectively. Moreover, certain terms which appear in Articles dealing with special categories of income, e.g., "Immovable Property" (Article 6), "Dividends" (Article 10), "Interest" (Article 11), and "Royalties" (Article 12), are defined within those Articles.

The Article defines the term "corporation" in subparagraph (a) as a United States corporation (defined in subparagraph (b)(i)) or a United Kingdom corporation (defined in subparagraph (b)(ii)), or any body corporate or entity of a third state which is treated as a body corporate for tax purposes by both Contracting States. Whether an entity is a corporation is relevant for purposes of paragraph (6) of Article 5 (Permanent Establishment), Article 10 (Dividends), Article 16 (Investment or holding companies), and Article 23 (Elimination of Double Taxation).

The term "United States corporation" means a corporation (or any unincorporated entity which is treated as a United States corporation for United States tax purposes) which is created or organized under the laws of the United States, any state thereof, or the District of Columbia.

A "United Kingdom corporation" is defined as any body corporate or unincorporated association created or organized under the laws of the United Kingdom, excluding for this purpose a partnership, a local authority, or a local authority association.

Whether a United States or United Kingdom corporation or any other corporation is a resident of a Contracting State for purposes of this Convention, or neither of them, or both of them, is to be determined in accordance with Article 4 (Fiscal Residence).

The term "person" includes an individual, a corporation, a partnership, an estate, a trust, or any other body of persons.

The term "enterprise of a Contracting State" means an industrial or commercial undertaking carried on by a resident of a Contracting State (as defined by Article 4).

The term "international traffic" is defined as any transport by a ship or aircraft operated by an enterprise of one of the Contracting States, except when the ship or aircraft is operated solely between places within a Contracting State. Thus, for example, coastal shipping along the Atlantic coast of the United States is not international traffic. However, if a ship operated by an enterprise of the United Kingdom transports goods from Canada to the United States, leaving some of the goods in New York and the remainder in Norfolk, the portion of the transport between New York and Norfolk is international traffic. The definition of this term is relevant for purposes of Article 8

(Shipping and Air Transport) which provides that profits derived by an enterprise of a Contracting State from the operation in international traffic of ships or aicraft shall be taxable only in that State.

With respect to the United States, the term "competent authority" means the Secretary of the Treasury or his delegate. With respect to the United Kingdom, the term "competent authority" refers to the Commissioners of Inland Revenue or their authorized representatives.

The term "United States" means the United States of America. When used in the geographical sense, the term means the states thereof and the District of Columbia. Thus, the Convention does not apply to possessions of the United States or the Commonwealth of Puerto Rico. The term "United States" also includes the territorial sea and, in general accord with the principles of section 638 of the Code, the continental shelf of the United States.

The term "United Kingdom" means Great Britain and Northern Ireland, including the area of the continental shelf which has or may be designated by the United Kingdom, in accordance with international law, as an area within which the rights of the United Kingdom relating to the seabed and subsoil and their natural resources may be exercised. The Convention does not apply to the Channel Islands or the Isle of Man.

The 1945 Convention does not include the continental shelf areas in the definition of the terms United States or United Kingdom. It is understood that when compared to the 1945 Convention, the United Kingdom regards the reference to its continental shelf in this Convention as an expansion of the scope of the Convention with respect to operations in these areas.

The term "Contracting State" means the United States or the United Kingdom, as the context of the Convention requires.

The term "third State" means any State or territory other than the United States or the United Kingdom and the term "enterprise of a third State" is to be construed accordingly.

In relation to the United States, the term "national" means an individual who is a citizen of the United States. In relation to the United Kingdom, the term "national" means all citizens of the United Kingdom and colonies, British subjects under sections 2, 13(1) or 16 of the British Nationality Act of 1948, and British subjects by virtue of section 1 of the British Nationality Act of 1965, provided they are patrial within the meaning of the Immigration Act of 1971, so far as these provisions are in force on the date of entry into force of this Convention or have been modified in minor respects so as not to affect their general character.

Paragraph (2) provides that any terms used in the Convention which is not defined therein shall, unless the context otherwise requires or unless the competent authorities agree to a definition of the term pursuant to Article 25 (Mutual Agreement Procedure), have the meaning which it has under the laws of the Contracting State where a tax is being determined. Under Article 25, where a term which is not defined in the Convention has a different meaning under the laws of the United Kingdom and the United States or where the meaning under the laws of one of the Contracting States is not readily determinable, the competent authorities may, for purposes of the Convention, establish a common meaning of the term in order to prevent double taxation or to further any other purpose of the Convention.

ARTICLE 4. FISCAL RESIDENCE

This Article sets forth rules for determining the residence of individuals, corporations, and other persons for purposes of the Convention. Residence is important because, except as otherwise provided in the Convention, only a resident may claim the benefits of the Convention.

The term "resident of the United Kingdom" is defined as a corporation (as defined in paragraph 1(a) of Article 3 (General Definitions)) whose business is managed and controlled in the United Kingdom, and any other person (except a corporation as defined in paragraph (1)(a) of Article 3), resident in the United Kingdom for purposes of its tax.

Similarly, the term "resident of the United States" is defined as a person (except a corporation as defined in paragraph (1)(a) of Article 3) who is resident in the United States for purposes of its tax. This includes a resident alien individual who is subject to tax in the United States on his worldwide income and a resident citizen. The term also includes a corporation (as defined in paragraph (1)(b)(i) of Article 3). A foreign corporation, regardless of the extent to which its income is effectively connected with the conduct of a United States trade or business, is not a resident of the United States.

It should especially be noted that an individual is not automatically a resident of the United States or the United Kingdom for the purposes of this Convention if he is a citizen of either country. To be a resident of a Contracting State, he must be subject to tax in that State on account of his residence therein. In the case of the United States, an individual will be considered to be a resident if, without regard to his citizenship, he would be taxable in the United States on his worldwide income as a resident. Residence for this purpose is to be determined in accordance with the principles of Treasury regulations under section 871 of the Internal Revenue Code.

The definition of a resident of a Contracting State in the Convention differs from the definition of a resident in the 1945 Convention. Under paragraph (1)(g) of Article II of the 1945 Convention, a resident of the United Kingdom is defined, in pertinent part, as "any person (other than a citizen of the United States or a United States corporation) who is resident in the United Kingdom for purposes of United Kingdom tax . . ." and under paragraph (1)(h) of Article II a resident of the United States is defined, in pertinent part, as "any individual who is resident in the United States for the purposes of United States tax and not resident in the United Kingdom for the purposes of United Kingdom tax . . ." In the case of Strathalmond (Lord) v. Inland Revenue (Ch. D. June 23, 1972), a British court interpreted this definition, in applying Article XV of the 1945 Convention, to prevent the United Kingdom from taxing the United States source dividend income of a United States citizen residing in the United Kingdom. This result is inconsistent with the principles of the OECD Model Convention. Accordingly, under this Article, a United States citizen who resides in the United Kingdom for purposes of its tax will be taxable therein as a resident and, subject to the provisions of United Kingdom law, the United Kingdom will be permitted to tax those citizens on their dividend and interest income regardless of the source of that income. However, where the income of the United States citizen has a source in the United States (as determined under the laws of the United Kingdom) the United Kingdom will allow a credit against the United Kingdom tax for any United States tax payable (on the basis of that person's United States citizenship) with respect to that income. See the discussion of paragraph (3) of Article 23 (Elimination of Double Taxation).

A corporation which is a resident of both Contracting States under this Article (i.e., a United States corporation whose business is managed or controlled in the United Kingdom), is dealt with by paragraph (2) of Article 1 (Personal Scope), and such a corporation may not claim any benefit under this Convention except as provided therein.

Paragraph (1) of this Article also provides that a partnership, estate, or trust is a resident of a Contracting State only to the extent that the income derived by such person is subject to tax in such Contracting State as the income of a resident. For example, under United States law, a partnership is never, and an estate or trust is often not, taxed as such. Under the Convention, income received by a partnership, estate, or trust will be treated for purposes of the Convention as income received by a resident of the United States only to the extent such income is subject to tax in the United States as the income of a resident. Thus, for United States tax purposes, the question of whether income received by a partnership is received by a resident will be determined by the residence of its partners rather than by whether the partnership is resident in the United States by reason of engaging in a trade or business here. To the extent the partners are subject to United States tax as residents of the United States, the income received by a partnership will be treated as income received by a resident of the United States. Similarly, the treatment of income received by a trust or estate will be determined by the residence and taxation of the person subject to tax on such income, which may be the grantor, the beneficiaries or the trust or estate itself, as the case may be.

The fact that a charitable organization or pension fund is exempt from tax in the country in which it is otherwise resident is not to be construed to deny such organization or fund resident status under this Convention.

Paragaraph (2) provides that an individual who is a resident of *both* Contracting States under paragraph (1) will, for purposes of the Convention, be deemed to be a resident of the Contracting State in which he has a permanent home available to him (e.g., where an individual dwells with his family), his center of vital interests (e.g., close economic and personal relations), an habitual abode, or the State of which he is a national, in that order. If the issue cannot be settled by the application of these tests, the competent authorities shall decide by mutual agreement the one Contracting State of which he will be considered to be a resident. Thus, for purposes of the Convention, including paragraph 3 of Article 1 (Personal Scope) (the saving clause) an individual may be a resident of the United States or the United Kingdom, but not both.

Paragraph (3) provides that if an estate or trust (taxable as such) is a resident of both Contracting States under the provisions of paragraph (1), the competent authorities may settle the issue by mutual agreement.

Since the definitions of residence in this Article apply for purposes of the entire Convention, an individual who is deemed to be a resident of one Contracting State and not a resident of the other Contracting State by reason of paragraph (2) will be deemed to be a resident of the first-mentioned Contracting State for all purposes of the Convention. For example, if an individual is determined to be a resident of the United Kingdom under paragraph (2) but would apart from that paragraph also be considered a resident of the United States under the laws of the United States, such individual would continue to receive the exemptions and special benefits granted by the Convention to residents of the United Kingdom, unless the individual is a citizen of the United States (see the saving clause of paragraph (3) of Article 1 (Personal Scope)).

Paragraph (4) provides that for United Kingdom tax purposes the domicile, on or after April, 1976, of a woman who is a United States national and who was married before January 1, 1974 to a man domiciled in the United Kingdom will be determined as though such marriage had taken place on January 1, 1974. The foreign source income of a United Kingdom resident is subject to taxation in the United Kingdom to a different extent depending on the domicile of the resident. Thus, a United Kingdom resident domiciled in the United Kingdom is subject to full United Kingdom taxation on all income, whereas a United Kingdom resident domiciled outside the United Kingdom is generally subject to tax on foreign source income only to the extent that it is remitted to the United Kingdom.

Under United Kingdom law prior to January 1, 1974, the domicile of a woman was the same as the domicile of her husband. This rule has been repealed for future years. However, as a transitional rule, United Kingdom law treats a woman married before 1974 as retaining her husband's domicile unless and until she changes her domicile by acquisition or revival of another domicile after 1973.

As a consequence, under United Kingdom law a United States citizen woman married to a man domiciled in the United Kingdom prior to January 1, 1974 does not have the same opportunity to prove a domicile outside the United Kingdom as does a United States citizen man married to a woman domiciled in the United Kingdom. Paragraph (4) of the Convention puts the United States citizen woman in the same position as the United States citizen man.

Paragraph (5) provides a special rule for cases where income dealt with by this Convention (e.g., under Articles 7 (Business Profits), 8 (Shipping and Air Transport), 10 (Dividends), 11 (Interest), 12 (Royalties), and 22 (Other Income)), is taxable to a resident of a Contracting State only if, and to the extent, it is remitted to or received by that person. In certain cases, individuals who are residents of the United Kingdom are not taxable on foreign source investment income, unless it is remitted to or received by them in the United Kingdom. If such income is received outside of the United Kingdom, or accumulated by the payer, a United Kingdom resident may not be subject to tax on that income. If the reductions in rates or exemptions from tax were to apply to those items of income, the United States would be foregoing tax where double taxation does not in fact occur. Thus, this paragraph provides that if under the law in the other Contracting State income would only be taxed on a remittance basis, then any reduced rates of tax (e.g., as provided by Articles 10 (Dividends)), or relief from taxation (e.g., Articles 7 (Business Profits) and 8 (Shipping and Air Transport), 11 (Interest), or 12 (Royalties)) provided by this Convention shall apply only to the extent such income is remitted to or received by the person in the year in which it accrues to the benefit of that taxpayer. This rule applies to all persons, including individuals, corporations, partnerships and trusts or estates taxable as such.

This provision is similar to paragraph (4) of Article II of the 1945 Convention.

ARTICLE 5. PERMANENT ESTABLISHMENT

This Article defines the term "permanent establishment." The existence of a permanent establishment is relevant under Article 7 (Business Profits) where it is provided that the business profits of an enterprise of a Contracting State shall be taxable only in that State unless it carries on business in the other Contracting State through a permanent establishment situated therein.

Under paragraph (1), the term "permanent establishment" means a fixed place of business through which an enterprise of one of the Contracting States wholly or partly carries on business. Illustrations in paragraph (2) of a permanent establishment include a branch; an office; a factory; a workshop; a mine, oil or gas well, quarry or other place of extraction of natural resources; and a building site, or construction or installation project which exists for more than twelve months. Under the construction or installation project rule the twelve month period begins only when work physically commences in the other Contracting State. A series of contracts or projects which are interdependent both commercially and geographically is to be treated as a single project for the purpose of applying the twelve months test. As a general rule, any fixed facility or premises through which a resident carries on business for an indefinite or substantial period of time will be treated as a permanent establishment unless it is used only for one or more of the activities described in paragraph (3) of this Article.

Paragraph (3) specifically provides that a permanent establishment does not include a fixed place of business if it is used solely for one or more of the following activities:

"(a) the storage, display, or delivery of goods or merchandise belonging to the enterprise;

"(b) the maintenance of a stock of goods or merchandise belonging to the enterprise for the purpose of storage, display or delivery;

"(c) the maintenance of a stock of goods or merchandise belonging to the enterprise for the purpose of processing by another person;

"(d) the maintenance of a fixed place of business for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise;

"(e) the maintenance of a fixed place of business for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the enterprise; or

"(f) a building or construction or installation project which does not exist for more than 12 months."

As noted, these exceptions are cumulative and a fixed place of business used only for one or more of these purposes will not be considered a permanent establishment under the Convention.

Under paragraph (4), a person acting in one Contracting State on behalf of a resident of the other Contracting State, other than an agent of an independent status to whom paragraph (5) applies, will be deemed to constitute a permanent establishment if such person has, and habitually exercises in that first-mentioned Contracting State, an authority to conclude contracts in the name of the resident, unless the contracts are limited to the activities described in paragraph (3) of this Article.

On the other hand, paragraph (5) provides that an enterprise of one Contracting State will not be deemed to have a permanent establishment in the other Contracting State merely because such enterprise carries on business in such other Contracting State through a broker, general commission agent, or any other agent of an independent status, where such broker or agent is acting in the ordinary course of his business.

Under paragraph (6), the fact that a corporation which is a resident of a Contracting State controls or is controlled by a corporation of the other Contracting State, or which carries on business in the other Contracting State, through a permanent establishment or otherwise shall not of itself constitute either corporation a permanent establishment of the other.

ARTICLE 6. INCOME FROM IMMOVABLE PROPERTY (REAL PROPERTY)

Paragraph (1) provides that income from immovable property including income from agriculture or forestry, may be taxed in the Contracting State where the property is situated. This rule does not confer an exclusive right of taxation to the State where the property is located, but only confirms that the situs State has the primary right to tax such income regardless of whether the income is derived through a permanent establishment in that State.

Paragraph (2) provides that the term "immovable property" is to be defined under the laws of the Contracting State where the property is located. Generally, the term "immovable property" refers to real property for purposes of United States and United Kingdom law. Moreover, paragraph (2) also defines the term "immovable property" to include usufruct of immovable property and rights to variable or fixed payments (e.g., royalties) as consideration for the working of, or the right to work, mineral deposits, sources, and other natural resources (e.g., oil or gas wells). Ships, boats and aircraft shall not be regarded as immovable property.

This Article shall apply to income derived from the use in any form of immovable property, including income from leases of immovable property, but it does not include interest on indebtedness secured by real property (e.g., mortgages).

Where income is derived from immovable property through a permanent establishment in a Contracting State, such income may be taxed in accordance with Article 7 (Business Profits).

Income from immovable property does not include gains from the sale of immovable property. Where those gains are capital gains within the meaning of Article 13 (Capital Gains), that Article shall apply.

This Article differs from the provisions of Article IX of the 1945 Convention. During the years since that Convention was ratified both the United States and the United Kingdom have enacted statutes permitting the taxpayer to elect to treat income in respect of real property, wells, mines and other natural resources, as income from a trade or business. In these cases, the taxpayer is taxed only on net income rather on the gross income derived from such operations. Thus, it was determined that this Convention need not continue the terms of the 1945 Convention.

ARTICLE 7. BUSINESS PROFITS

Paragraph (1) provides that business profits (as defined in paragraph (7) of this Article) of an enterprise of one Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein, except where the enterprise is a national of that other Contracting State. (See the saving clause in paragraph (3) of Article 1 (Personal Scope)). The term "permanent establishment" is defined in Article 5 (Permanent Establishment). Where business is carried on through a permanent establishment in the other Contracting State, the business profits attributable to the permanent establishment can be taxed by that other Contracting Sate.

Business profis may be attributable to a permanent establishment which an enterprise of one Contracting State has in the other Contracting State, whether from sources within or without a Contracting State. Thus, items of income described in section 864 (c)(4)(B) of the Code which are attributable to a permanent establishment situated in the United States will be subject to tax by the United States.

In determining the proper attribution of business profits under the Convention to a permanent establishment, paragraph (2) provides that both Contracting States will attribute to the permanent establishment such profits as it would reasonably be expected to derive if it were an independent entity engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

Under paragraph (3), expenses, wherever incurred, which are reasonably connected with profits attributable to the permanent establishment, including a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the enterprise as a whole (or the part which includes the permanent establishment), will be allowed as deductions in determining the business profits of the permanent establishment. However, in determining the amount of the deduction under paragraph (3) for expenses incurred by the head office, the deduction generally will be limited to the expense incurred without including a profit element for the head office.

Under paragraph (4) profits will not be attributed to a permanent establishment merely because of the purchase of goods or merchandise by that permanent establishment for the account of the enterprise. Paragraph (2) of the Article does not override paragraph (4). Thus, for example, where a permanent establishment purchases goods for its head office, the business profits attributed under paragraph (2) to the permanent establishment with respect to its other activities will not be increased by adding a notional figure for profits from purchasing.

For purposes of this Article, paragraph (5) provides that the profits attributed to a permanent establishment shall be determined by the same method every year unless there is a good reason to change such method. The purpose of this provision is to give assurance of continuous and consistent tax treatment.

Paragraph (6) provides that, where the profits of a permanent establishment include items of income which are dealt with separately in other Articles of the Convention, the provisions of those Articles will not be affected by the provisions of this Article. Thus, for example, the taxation of interest income will be controlled by Article 11 (Interest) and not by this Article unless, as provided by paragraph (4) of Article 11, the interest is effectively connected with a permanent establishment which the recipient, being a resident of one of the Contracting States, has in the other State. This same exception applies with respect to items of income dealt with in Article 8 (Shipping and Air Transport), dividends under paragraph (4) of Article 10 (Dividends), royalties under paragraph (4) of Article 12 (Royalties) or other income under paragraph (2) of Article 22 (Other Income).

Under paragraph (7), the term "business profits" includes, but is not limited to, income derived from manufacturing, mercantile, banking, insurance (or reinsurance), agricultural, fishing or mining activities, the operation of ships or aircraft, the furnishing of services, the rental of tangible personal (movable) property, and the rental or licensing of motion picture films or films or tapes used for radio or television broadcasting or from copyrights thereof. Thus, for example, income derived by a resident of the United States from the rental of tangible personal property to a person in the United Kingdom shall not be subject to tax in the United Kingdom unless that lessor has a permanent establishment in the United Kingdom to which such income is attributable. The term "business profits" also includes any other income which is effectively connected with a permanent establishment which the recipient, being a resident of one of the Contracting States, has in the other Contracting State. The term "business profits" does not include income from the performance of personal services derived by an individual either as an employee or in an independent capacity. Income from such activities is dealt with under Articles 14 (Independent Personal Services), 15 (Dependent Personal Services) and 17 (Artistes and Athletes), as the case may be.

This Article is substantially similar to Article III of the 1945 Convention and is also based on Article 7 (Business Profits) of the OECD Model Convention.

ARTICLE 8. SHIPPING AND AIR TRANSPORT

Paragraph (1) provides that profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that Contracting State.

Paragraph (2) confirms that the United Kingdom grants to nationals of the United States and United States corporations the equivalent shipping and aircraft exemption required for application of Code sections 872(b) and 883. It should be noted that the exemption provided under this paragraph is available only with respect to the profits derived from operating ships documented or aircraft registered under the laws of the United States.

Under paragraph (3), this Article applies to profits derived from the rental of ships or aircraft under a bareboat charter if the lessor is engaged in the operation of ships or aircraft in international traffic and the rental income is incidental to operations of the lessor described in paragraph (1). In these cases the lessee of the property need not be a resident of a Contracting State. For example, if an airline which is a resident of one Contracting State has excess equipment in the winter months and leases several of its aircraft which are not required by it during that period to another airline, the rental profits of the lessor are not subject to tax by that other Contracting State, regardless of the state of residence of the lessee.

Paragraph (4) provides that profits derived by an enterprise of a Contracting State from the use, maintenance, or rental of containers (including trailers and related equipment for the transport of containers), used to transport goods or merchandise shall be taxable only in that State except to the extent that those goods or merchandise are transported solely between places within a Contracting State. The income covered by this provision need not be incidental to the operation of ships or aircraft. Thus, this Article applies to lessors of containers who do not own or operate the ships or aircraft upon which the containers are carried. This paragraph also applies to income derived by an enterprise from the use, maintenance, and lease of containers and other related equipment in connection with the operation of ships or aircraft described in paragraph (1).

Paragraph (5) provides that this Article shall also apply to profits derived by an enterprise of a Contracting State from participation in a pool, a joint business or an international operating agency.

Paragraph (6) provides that gains of an enterprise of a Contracting State from the alienation of ships, aircraft or containers owned and operated by the enterprise shall be taxable only in that State if the income from such ships, aircraft or containers is taxable only in that State.

Except for paragraph (2), this Article is subject to the saving clause of paragraph (3) of Article 1 (Personal Scope). Therefore, a Contracting State may tax income from shipping or air transport, or from the use or rental of containers, derived by a resident of the other Contracting State without regard to this Article if such resident is a national of the first-mentioned Contracting State.

ARTICLE 9. ASSOCIATED ENTERPRISES

Article 9 confirms the authority of the United States under section 482 of the Code. Thus, where an enterprise of a Contracting State is related to another enterprise and conditions are made or imposed between them in their commercial or financial relations which are different from those which would be made between independent enterprises, under paragraph (1) any income, deductions, receipts or outgoings which would, but for those conditions, have been attributed to one of the enterprises, but by reason of those conditions have not been so attributed, may be taken into account in computing the profits and losses of that enterprise and taxed accordingly.

Paragraph (2) sets forth an explicit formulation of the consequence of a redetermination made in accordance with paragraph (1) by a Contracting State. In such event, the other Contracting State shall make such corresponding adjustment as may be appropriate to the amount of tax charged to the related enterprise by the other Contracting State. In the case of the United States, assuming application within a reasonable time after notice of such adjustment, any refunds of tax in respect of such an adjustment shall be made notwithstanding the statute of limitations.

Under paragraph (3), if a Contracting State disagrees with a redetermination of tax by the other Contracting State, the two Contracting States will endeavor to resolve the matter in accordance with the mutual agreement procedure in Article 25 (Mutual Agreement Procedure).

Paragraph (4) deals with the methods by which a Contracting State or a political subdivision or local authority thereof may tax an enterprise which is controlled by an enterprise of the other Contracting State. Where an enterprise doing business in one Contracting State is a resident (as defined in Article 4 (Fiscal Residence) of the other Contracting State, or is controlled, directly or indirectly, by an enterprise which is a resident of the other Contracting State, the first-mentioned Contracting State, or political subdivision or local authority thereof, in determining the tax liability of the enterprise doing business therein, may not take into account the income, deductions, receipts, or outgoings of a related enterprise which is a resident of the other Contracting State or of an enterprise of any third State which is related to the enterprise of the other Contracting State. The taxing jurisdiction may, however, attribute income to the enterprise under the arm's-length principles contained in the other paragraphs of this Article. In addition, where the enterprise which is a resident of the other Contracting State is a corporation, the provisions of paragraph (4) of this Article will apply only if such corporation: (1) is not a controlled foreign corporation within the meaning of Code section 957; (2) is not created or organized under the laws of the first-mentioned Contracting State or any third State; and (3) is not controlled, directly or indirectly, by a corporation which is a resident of any third State.

Finally, the prohibition contained in paragraph (4) will not apply where the enterprise doing business in a Contracting State is a resident of that State to the extent that it owns, directly or indirectly, the capital of a related enterprise. Thus, this provision does not affect the application of the United States "subpart F" rules of Code sections 951-964.

The following is an illustration of the operation of this paragraph: Corporation M, organized under the laws of the United Kingdom, is a resident of the United Kingdom, and all of its stock is owned by individuals residing in the United Kingdom who are not United States nationals. Corporation M controls subsidiaries A, B, and C, which are incorporated in, and do business in, respectively, France, Germany, and Belgium. Corporation M also controls a United States subsidiary, Z, which is incorporated in and conducts its business in X, a state of the United States. In determining the tax liability of Z, to X or to the United States, neither X nor the United States, are permitted to allocate to, apportion to, or otherwise include in Z's tax base income earned by M, A, B, or C, except to the extent the dealings between Z and those persons require the application of the arm's-length principles of the other paragraphs of this Article. Thus, in these circumstances, the United States or the states will be required to determine Z's tax liability solely on the basis of its income. The determination of Z's tax liability under any unitary or combined reporting basis is, therefore, prohibited by this Article.

The broad standard of tax jurisdiction embodied in United States tax treaties provides that one Contracting State will not tax the business profits of an enterprise of the other Contracting State unless that enterprise does business in the first-mentioned Contracting State through a permanent establishment located there. The purpose of this provision is to harmonize the tax jurisdiction under this Convention at the national, state and local levels by equating the tax base of an enterprise doing business in a state or political subdivision of the United States with the enterprise's Federal income tax base.

Paragraph (5) provides that for purposes of the Convention an enterprise is related to another enterprise if either owns or controls directly or indirectly the other, or if a third person or persons (related to each other or acting together) own or control, directly or indirectly, both. The term "control" is not limited to the ownership of the capital of an enterprise, and includes any kind of control, whether or not legally enforceable, and however exercised or exercisable.

ARTICLE 10. DIVIDENDS

Article 10 deals with the taxation of dividends derived from a corporation which is a resident of a Contracting State. Under Article VI of the 1945 Convention, the rate of tax on dividends derived by residents of one Contracting State from a corporation of the other Contracting State is limited to 15 percent of the gross amount of the dividends. In 1973 the United Kingdom introduced a system of integrating corporate and shareholder taxation. Under the system adopted by the United Kingdom, a special "Advance Corporation Tax" ("ACT" hereafter), is collected at the corporate level on a distribuiton of dividends by the corporation. This tax is treated both as an advance payment of a portion of the corporate income tax, and also as a payment by an individual United Kingdom resident shareholder in satisfaction of his personal tax liabilities on the dividend. The introduction of this system rendered inapplicable the current provisions of the Convention relating to United Kingdom dividends. Accordingly, the proposed Article provides a mechanism by which United States shareholders of a United Kingdom corporation will receive the benefits of the shareholder credits which have heretofore not been granted to United States residents.

This Article contains two alternatives for the taxation of dividends, depending on whether the United Kingdom continues to allow a tax credit to individual shareholders in respect of dividends derived from a corporation which is a resident of the United Kingdom. Paragraph (1) will apply only if the United Kingdom modifies its current system of shareholder credits. This paragraph limits the tax on dividends paid by a corporation which is a resident of one Contracting State to a resident (who derives and beneficially owns the dividend) of the other Contracting State to 15 percent of the gross amount of the dividends. As noted above, this is the rule contained in the 1945 Convention.

Paragraph (2) applies where, as at the present time, an individual resident in the United Kingdom is entitled to a credit in respect of dividends paid by a corporation which is a resident of the United Kingdom. So long as this system remains in force, only paragraph (2), and not paragraph

(1), shall apply. With respect to dividends paid by a corporation resident in the United Kingdom to a United States corporation which either alone or together with one or more associated corporations (defined below) controls, directly or indirectly, at least 10 percent of the voting stock of the United Kingdom resident corporation which is paying the dividend, the shareholder will be entitled to payment from the United Kingdom of a tax credit (hereinafter referred to as a refund) equal to one-half of the tax credit to which an individual resident in the United Kingdom would be entitled, less 5 percent of the aggregate amount of the cash dividend and the United Kingdom refund.

For United States tax purposes, the gross amount of the refund (without reduction for the tax withheld) will be considered as a dividend (see discussion under Article 23 (Elimination of Double Taxation)) and the 5 percent tax withheld will be considered as a tax on the shareholder receiving the dividend (see paragraph (1)(b) of Article 23 (Elimination of Double Taxation)). The unrefunded portion of the ACT paid in respect of the dividend will be regarded as an income tax imposed on the distributing corporation (see paragraph (1)(c) of Article 23).

In the case of United States shareholders other than corporations which control at least 10 percent of the voting stock of the United Kingdom resident corporation, the United Kingdom refund will equal the full credit payable to an individual resident in the United Kingdom, less 15 percent of the aggregate amount of the dividend and the U.K. refund. For United States tax purposes, the U.K. refund shall be treated as additional gross income and the 15 percent withholding shall be considered as a tax on the shareholder. In the case of a $65 dividend, the result is as follows:

Dividend for U.S. Tax Purposes	
Dividend	$ 65.00
U.K. refund	35.00
Gross Dividend	100.00
United Kingdom Withholding Tax	$15.00
Foreign Tax Credit	$15.00

With respect to dividends paid by a United States corporation to a corporation which is a resident of the United Kingdom, and which controls, directly or indirectly, at least 10 percent of the voting stock of the United States corporation paying the dividend, the United States tax shall not exceed 5 percent of the gross dividend.

In all other cases of dividends paid by a United States corporation to any other resident of the United Kingdom, the rate of tax imposed by the United States shall not exceed 15 percent.

For purposes of paragraph (2), two corporations are associated if one controls directly or indirectly more than 50 percent of the voting power in the other corporation, or a third corporation controls more than 50 percent of the voting power in both of them.

As noted above, a resident of a Contracting State may benefit from this Article only if he derives and beneficially owns the dividend paid by a corporation of one of the Contracting States. A nominee or agent which is a resident of a Contracting State may not claim the benefits of this Article if the dividend is received on behalf of a person who is not a resident of that Contracting State. Similarly, dividends received by a nominee for the benefit of a resident, as, for example, with respect to a depositary receipt, would qualify for the benefits of this Article. This is generally the case with respect to all income tax conventions of the United States.

Paragraph (3) defines the term "dividends" to include any item which is treated as a distribution under the laws of the United Kingdom for United Kingdom tax purposes or, as a distribution out of earnings and profits for United States tax purposes. Distributions which are not within this definition of "dividends," or covered by any other provision of this Convention, shall be treated as "other income" under Article 22 (Other Income) of this Convention.

Paragraph (4) provides that paragraphs (1) and (2) of this Article shall not apply if the person deriving the dividends, being a resident of a Contracting State, has a permanent establishment in the other Contracting State or performs personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with the permanent establishment or fixed base. In such a case, the dividends will be treated as business profits subject to the provision of Article 7 (Business Profits) or taxable in accordance with Articles 14 (Independent Personal Services) or 17 (Artistes and Athletes), as the case may be.

Paragraph (5) provides that dividends paid by a corporation which is a resident of a Contracting State, regardless of where it derives its income, to a person other than a resident of the other Contracting State (and in the case of dividends paid by a corporation which is a resident of the United Kingdom, to a person other than a United States citizen), shall be exempt from tax by the other Contracting State unless the holding with respect to which such dividends are paid is effectively connected with a permanent establishment or a fixed base which the person deriving the dividends has in that other State. For example, if a corporation which is a resident of the United Kingdom and is doing business in the United States pays dividends to a resident of the United Kingdom, or to a resident of a third State, those dividends shall be exempt from United States tax unless they are paid to a citizen or resident of the United States, or unless the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or fixed base which the United Kingdom resident or resident of a third State maintains in the United States. This rule is contained in Article XV of the 1945 Convention. A dual-resident corporation which derives dividends from a resident of a Contracting State may not claim the benefits of this provision, although dividends received from a dual-resident corpuoration will qualify for the benefits of this Article.

Paragraph (6) continues the provisions of Article XVI of the 1945 Convention, and provides that a corporation which is a resident of the United Kingdom shall be exempt from the United States tax on accumulated or undistributed earnings (as provided by Code sections 531 (the accumulated earnings tax) and 541 (the personal holding company tax)), if individuals, other than citizens of the United States, who are residents of the United Kingdom control, directly or indirectly, more than 50 percent of the entire voting power in such corporation.

Paragraph (7) prevents the application of paragraphs (1) and (2) of this Article in two circumstances where tax avoidance may occur. First, under subparagraph (a), where a resident of a Contracting State owns 10 percent or more of the shares of a corporation with respect to which dividends are paid, paragraphs (1) or (2) of this Article shall not apply to the extent that the dividends are paid out of profits which the corporation earned or other income which it received in a period ending 12 months or more before the date on which the shareholder became the owner of 10 percent or more of the corporation's stock. This rule is designed to prevent transactions where a 10 percent stock interest is acquired in order to obtain a distribution of the past earnings of a corporation at reduced rates of tax.

A second rule contained in subparagraph (b) is designed to deny the benefits of the Convention to tax exempt organizations if the recipient of a dividend is exempt from tax in the United States and the dividends are received in circumstances where if received by an exempt organization of the United Kingdom such interest or dividends would not be so exempt. Under United Kingdom law, if a resident of the United Kingdom sells securities to an exempt organization immediately before the payment of dividends, the organization will be taxable on the dividends paid in respect of the securities if the transaction was designed to accord the initial seller a preferential rate of tax on his sale. This rule is contained in Article VII A of the 1945 Convention.

The rules of paragraph (7), stated above, shall not apply if the beneficial owner of the shares satisfies the competent authorities of the respective States that the shares were acquired for *bona fide* commercial purposes and not to secure the benefits of the Convention.

This Article is subject to the saving clause of paragraph (3) of Article 1 (Personal Scope). Thus, dividends derived by a citizen of a Contracting State may be taxed by that Contracting State without regard to this Article.

Article 11. Interest

Paragraphs (1) and (2) provide that interest derived and beneficially owned by a resident of one Contracting State shall be exempt from tax by the other Contracting State. In these cases, interest is taxable only in the taxpayer's State of residence. The exemption only applies where the person deriving the interest is a resident of a Contracting State (as defined in Article 4 (Fiscal Residence)) and is the beneficial owner of the interest. Thus, the exemption does not apply where an intermediary, which is a resident of a Contracting State, such as an agent or nominee, collects or receives the interest on behalf of a person who is not a resident of that Contracting State.

Paragraph (3) defines the term interest for purposes of this Article as income from Government securities, bonds or debentures, whether or not secured by mortgage or whether or not carrying a right to participate in profits, and debt claims of every kind, as well as all other income (such as original issue discount) which, under the taxation law of the Contracting State in which the income has its source, is assimilated to income from money lent. Paragraphs (1) and (2) apply to all "interest," from whatever source derived. Penalty charges and late payment penalties shall not be regarded as interest. Such payments shall be regarded as "other income" dealt with by Article 22 (Other Income).

Paragraph (4) provides that the exemption from tax provided by paragraphs (1) and (2) shall not apply if the person deriving the interest, being a resident of a Contracting State, has a permanent establishment in the other Contracting State or performs personal services from a fixed base situated therein, and the indebtedness giving rise to the interest is effectively connected with the permanent establishment or fixed base. In such a case, the interest will be treated as business profits subject to the provisions of Article 7 (Business Profits) or will be taxable in accordance with Articles 14 (Independent Personal Services) or 17 (Artistes and Athletes), as the case may be.

If excessive interest is paid pursuant to a special relationship between the payer and the person deriving the interest or between both of them and a third person, under paragraph (5) the provisions of Article 11 shall not apply to the excess portion of the payment. For this purpose, those persons need not be "related" within the meaning of paragraph (5) of Article 9 (Related Enterprises). The excessive portion may be taxed by each Contracting State, in accordance with its own law, including the Convention where applicable. In the case of the United States, the excessive portion may, for example, be taxed as a dividend, in which case the provisions of Article 10 (Dividends) will apply.

Paragraph (6) provides that interest paid by a resident of a Contracting State, regardless of where it derives its income, to a person other than a resident of the other Contracting State (and in the case of interest paid by a resident of the United Kingdom, to a person other than a United States citizen), shall be exempt from tax by the other Contracting State unless the debt claim in respect of which such interest is paid is effectively connected with a permanent establishment or a fixed base which the person deriving the interest has in that other State. For example, if a corporation which is a resident of the United Kingdom and is doing business in the United States pays interest to a resident of the United Kingdom, or to a resident of a third State, that interest shall be exempt from United States tax unless it is paid to a citizen or resident of the United States, or unless the debt obligation is effectively connected with a permanent establishment or a fixed base which the United Kingdom resident or resident of a third State maintains in the United States. A dual-resident corporation may not claim the benefits of this provision. A debt obligation is effectively connected with a permanent establishment in the United States when interest on that obligation is effectively connected with a trade or business in the United States within the meaning of Code section

864(c)(2) or 864(c)(4)(B)(ii), depending on the source of the interest under United States law.

Paragraph (7) is carried over from paragraph (5) of Article VII of the 1945 Convention. Under United Kingdom domestic law, interest payments by United Kingdom corporations to non-United Kingdom corporations which have 75 percent or more control, directly or indirectly, of the United Kingdom corporation are treated as distributions (dividends) rather than as deductible interest. This paragraph provides, in reciprocal terms, that this rule shall not apply where the payment is to a resident of the other Contracting State. By virtue of paragraph (2) of Article 1 (Personal Scope), a dual-resident corporation may claim the benefits of this provision with respect to interest payments it makes. However, this paragraph also provides that where the interest is paid to a corporation which is a resident of a Contracting State of which more than 50 percent of the voting power is directly or indirectly controlled by persons who are residents of the other Contracting State, the exemption shall not apply.

Paragraph (8) provides that the exemption from United Kingdom tax under paragraph (2) of this Article will not apply if the recipient of the interest is exempt from tax on such income in the United States and the recipient sells or makes a contract to sell the holding from which such interest is derived within three months after the date the recipient acquired such holding.

The provisions of this Article are subject to the saving clause of paragraph (3) of Article 1 (Personal Scope). Thus, interest derived by a citizen of a Contracting State may be taxed by that Contracting State without regard to this Article.

ARTICLE 12. ROYALTIES

Paragraphs (1) and (2) provide that royalties derived and beneficially owned by a resident of a Contracting State shall be exempt from tax by the other Contracting State. Such income, therefore, is taxable only in the State of residence. As in Article 10 (Dividends) and 11 (Interest), this exemption applies only where the person deriving the royalties is a resident of a Contracting State and is the beneficial owner of the royalty. Thus, the exemption does not apply where an intermediary, such as an agent or nominee, who is a resident of a Contracting State collects or receives the royalties on behalf of a nonresident of that Contracting State. This Article deals with royalties from sources within a Contracting State or from sources within any third State, except as described below.

Paragraph (3) defines the term "royalties" as payment of any kind made as consideration for the use of, or the right to use, copyrights of literary, artistic, or scientific works (but not including copyrights of motion picture films or films or tapes used for radio or television broadcasting (which are treated as business profits under paragraph (7) of Article 7 (Business Profits)), patents, trade mark, design or model, plan, secret formula or process, or other like right or property, or for information concerning industrial, commercial or scientific experience. This term includes "know-how" and similar experience or skill, including the supply of assistance of an ancillary and subsidiary nature furnished as a means of enabling the application or enjoyment of any such right or property. The term also includes gains derived from the alienation (e.g.; the sale, exchange, or other disposition) of any such right or property to the extent the amounts realized on such alienation are contingent on the productivity, use, or disposition of the right or property. If the amounts realized are not so contingent, the provisions of Article 13 (Capital Gains) may apply. The article does not apply to amounts which are characterized as interest pursuant to section 483 of the Code.

Paragraph (4) provides that paragraphs (1) and (2) will not apply if the royalty recipient, being a resident of one Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein or performs in that other Contracting State personal services from a fixed base situated therein, and the right or property giving rise to the royalty is effectively connected with such permanent establishment or fixed base. In such a case, the royalty will be treated as business profits subject to Article 7 (Business Profits) or will be taxable in accordance with Articles 14 (Independent Personal Services) or 17 (Artistes and Athletes) as the case may be.

If excessive royalties are paid pursuant to a special relationship between the payer and the person deriving the royalty or between both of them and a third person, paragraph (5) provides that the provisions of this Article shall not apply to the excessive portion of the payment. For this purpose, the persons covered by this paragraph need not be "related" within the meaning of paragraph (5) of Article 9 (Related Enterprises). The excessive portion may be taxed in each Contracting State, in accordance with its own law, including the Convention where applicable. In the case of the United States, the excessive portion may, for example, be taxed as a dividend, in which case the provisions of Article 10 (Dividends) will apply.

This Article is subject to the saving clause of paragraph (3) of Article 1 (Personal Scope). Therefore, royalties derived by a citizen of a Contracting State may be taxed by the Contracting State without regard to this Article.

ARTICLE 13. CAPITAL GAINS

This Article provides that, except as provided in Article 8 (Shipping and Air Transport) capital gains are taxable in accordance with the domestic laws of the Contracting States. This rule applies to the existing laws of a Contracting State respecting the taxation of capital gains and revisions of those laws subsequent to the effective date of this Convention. Thus, for example, capital gains in respect of the sale of immovable property described by Article 6 (Immovable Property) or the sale of a right or property giving rise to royalties described by Article 12 (Royalties) (which are not contingent on productivity, etc.), may be taxed in accordance with the respective domestic laws of the Contracting States. The provisions of Article 7 (Business Profits) shall apply to gains attributable to a permanent establishment. Article 22 (Other Income) does not apply to capital gains.

Under current United States law, contained in Code sections 871 and 872, nonresident alien individuals are generally not taxable in the U.S. on their United States source capital gains unless they are present in the United States for 183 days or more during a taxable year, or if the gains are effectively connected with the conduct of a U.S. trade or business. Under Code sections 881 and 882 foreign corporations generally are taxable in the U.S. only on capital gains which are effectively connected with the conduct of a U.S. trade or business.

Notwithstanding the foregoing rules, under paragraph (6) of Article 8 (Shipping and Air Transport) gains which an enterprise of a Contracting State derives from the sale, exchange or other disposition of ships, aircraft or containers which the enterprise owns or operates (dealt with by Article 8 (Shipping and Air Transport)), shall be taxable only in the State in which the income from the ships, aircraft or containers was taxable.

Under paragraph (2) of Article 3 (General Definitions), whether an item of income constitutes capital gains shall be determined under the laws of the Contracting State seeking to tax those gains.

The representatives of the Contracting States will consult with each other upon the enactment or proposed enactment by either State of any laws which substantially change the manner in which capital gains derived by nonresidents are taxed by the respective States.

ARTICLE 14. INDEPENDENT PERSONAL SERVICES

In dealing with the taxation of income from personal services, the Convention distinguishes between "independent" and "dependent" personal services. The Convention also provides special treatment for individuals who are "artistes or athletes" and for amounts received in certain circumstances in respect of the services of an artiste or athlete.

Personal services performed in an independent capacity, that is, independent personal services, are services performed by an individual for his own account where he receives the income and bears the losses arising from such services. If an individual is an independent contractor he is considered as rendering independent personal services. Income from services in which capital is a material income-producing factor, however, will generally be governed by the provisions of Article 7 (Business Profits). Generally, services rendered as a director of a corporation, or rendered by physicians, lawyers, engineers, architects, dentists, consultants, and accountants, performing personal services as sole proprietors or partners, are independent personal services, whereas the income earned by the employees of such persons, or as an officer of a corporation, is considered to be income from dependent personal services.

Under this Article income derived by an individual who is a resident of one Contracting State from the performance of personal services in an independent capacity may be taxed by that Contracting State. Except as permitted by subparagraphs (a) and (b) of this Article, such income will be exempt from tax by the other Contracting State.

Subparagraph (a) provides that income derived from services performed in the other Contracting State may also be subject to tax in that other Contracting State if the individual is present therein for a period or periods exceeding 183 days in the tax year, but only to the extent such income is attributable to services performed in that State. In addition, subparagraph (b) provides that income from personal services may be taxed in the other Contracting State if the individual has a fixed base regularly available to him for the purpose of performing his activities, but only to the extent such income is attributable to services performed in that State. The term fixed base is synonymous with the term "permanent establishment" as described in Article 5 (Permanent Establishment).

ARTICLE 15. DEPENDENT PERSONAL SERVICES

This Article deals with the taxation of income in respect of dependent personal services. The Article is based on Article 15 (Dependent Personal Services) of the OECD Model Convention. Under paragraph (1), subject to Articles 18 (Pensions) and 19 (Government Service), salaries, wages and other similar remuneration derived by an individual who is a resident of one Contracting State from labor or personal services performed as an employee (of any person) shall be taxed only by that Contracting State unless that employment is exercised in the other Contracting State. Except as provided by paragraph (2), remuneration derived with respect to services performed within the other Contracting State may also be taxed by that other Contracting State. It is intended that for purposes of the Convention the term "salaries, wages and other similar remuneration" includes income from services performed as an officer of a corporation.

Under paragraph (2), remuneration derived by an individual who is a resident of one Contracting State in respect of an employment exercised in the other Contracting State will be exempt from tax by the other Contracting State if: (a) the individual is present in that other Contracting State for a period or periods aggregating less than 183 days in the taxable year; (b) the employee's remuneration is paid by or on behalf of an employer who is not a resident of that other Contracting State; and (c) the remuneration is not borne as such by a permanent establishment or fixed base which the employer has in that other Contracting State. Such income may nevertheless be taxed by that other Contracting State if the individual is a citizen or resident of that Contracting State, pursuant to the saving clause of paragraph (3) of Article 1 (Personal Scope).

In the United States, remuneration from the performance of dependent services will be viewed as not having been borne by the permanent establishment or fixed base maintained in the United States if the employee is performing stewardship or overseeing functions for the benefit of a resident of or a permanent establishment maintained in the United Kingdom. However, the remuneration will be considered to be borne by the permanent establishment or fixed base maintained in the United States if the remuneration is paid for activities other than stewardship or overseeing functions and the permanent establishment or fixed base is entitled to claim the employee's remuneration as a deduction in computing taxable income for United States purposes because the renumeration is definitely related and allocable to its gross income or a class of its gross income pursuant to Code section 861 and the regulations thereunder.

Paragraph (3) provides that, notwithstanding paragraphs (1) and (2) of this Article, remuneration derived by an individual employee in respect of an employment as a member of the regular complement of a ship or aircraft in international traffic may be taxed by the Contracting State of which the employer operating the ship or aircraft is a resident.

ARTICLE 16. INVESTMENT OR HOLDING COMPANIES

This Article provides that a corporation which is a resident of one Contracting State and which derives dividends, interest or royalties arising within the other Contracting State shall not be entitled to claim the benefits of Articles 10 (Dividends), 11 (Interest), or 12 (Royalties), if the tax imposed by the first-mentioned Contracting State with respect to such dividends, interest or royalties is substantially less than the tax generally imposed by that State on corporate profits; and 25 percent or more of the capital of such corporation is owned directly or indirectly by persons who are not individual residents of the first-mentioned Contracting State and are not nationals of the United States.

This Article also provides that a corporation which is a resident of the United States and which derives dividends, interest or royalties arising in the United Kingdom shall not be entitled to the benefits of Articles 10 (Dividends), 11 (Interest), or 12 (Royalties) where more than 80 percent of its gross income (including such dividends, interest, or royalties) is derived from sources outside of the United States as determined by and for the purposes of Code Sections 861(a)(1)(B) and 861(a)(2)(A), and as they may be amended from time to time without changing their general principles. This limitation applies only if 25 percent or more of the capital of the corporation is owned directly or indirectly by persons who are not individual residents of the United States or nationals of the United States.

Paragraph (2) provides that nothing in this Article will prevent a claim under the provisions of Articles 10 (Dividends), 11 (Interest) or 12 (Royalties) by a United States corporation, if 75 percent or more of the capital of that corporation is directly or indirectly owned: (a) by another United States corporation which receives 20 percent or more of its gross income from sources within the United States as determined by and for the period described in sections 861(a)(1)(B) and (a)(2)(A) of the Code, as they may be amended from time to time so as not to affect their general principle; or (b) by a corporation other than a United States corporation which would not be treated as a close company under section 283 of the United Kingdom Income and Corporation Taxes Act of 1970 (as may be amended without changing the general principal thereof); or (c) by a corporation, resident in the United Kingdom, more than 50 percent of the voting power of which is controlled directly or indirectly by individuals who are residents of the United Kingdom.

The purposes of this Article are, first, to prevent the potential abuse of the Convention which would occur if residents of a third country could take advantage of the reduced rates of withholding provided by this treaty in situations where one of the Contracting States provided preferential rates of tax for investment or holding companies deriving foreign source income. In the absence of this Article, residents of a third country could organize a corporation in the Contracting State extending the preferential rates for the purpose of making investments in the other Contracting State. The combination of low tax rates in the first Contracting State and the reduced rates or exemptions in the other Contracting State would enable the third country residents to realize unintended benefits.

The Article is also intended to prevent the use of United States corporations by residents of third countries to take advantage of the reduced rates of tax or exemptions from tax granted by the United Kingdom on dividends, interest and royalties paid to residents (including corporations) of the United States. Generally, under sections 861(a)(1)(B) and 861(a)(2)(A) of the Code, interest and dividends paid by U.S. corporations to nonresidents of the United States are not subject to tax by the United States if more than 80 percent of the corporation's gross income is from sources outside the United States. Accordingly, were it not for this provision, a resident of a third country could establish a United States corporation solely to derive interest or dividends from the United Kingdom subject to the reduced rates and refunds allowed by the Convention. While such income would be subject to normal corporate taxes in the United States, the corporation's dividends or interest to the third country residents would be exempt from U.S. withholding taxes if the conditions of Code sections 861 (a)(1)(B) and (a)(2)(A) are met. The Article prevents this abuse where the above mentioned share-ownership requirements apply. Since the purpose of this provision is only to prevent the use of United States corporations in cases where their income would otherwise qualify for reduced withholding rates in the United Kingdom and their distributions to third country residents would not attract United States withholding taxes, exceptions to the rule are given where that corporation is owned by another United States corporation whose distributions would attract United States withholding taxes; where that corporation is owned by a corporation which is not a close company under United Kingdom law; and where that corporation is owned by a corporation resident in the United Kingdom 50 percent or more of the voting power of which is controlled by United Kingdom resident individuals.

ARTICLE 17. ARTISTES AND ATHLETES

This Article deals with the taxation of income derived by entertainers, musicians, and athletes (sometimes referred to hereinafter as "artistes and athletes") in respect of the performance of services in a Contracting State. The Article applies in cases where an artiste or athlete performs services on his own behalf and in cases where services are performed on behalf of another person, as an employee or pursuant to any other arrangement.

Paragraph (1) states the general rule that notwithstanding the provisions of Article 14 (Independent Personal Services) and Article 15 (Dependent Personal Services), income derived by entertainers such as theatre, motion picture, radio, or television artistes, and musicians or athletes, for their personal activities as such, may be taxed in the Contracting State where those services are exercised. Such income, however, is taxable under this Article only where the gross receipts derived by the artiste or athlete, including expenses reimbursed to him or borne on his behalf, in respect of such activities, exceed $15,000 or its equivalent in pounds sterling for the tax year concerned. In computing the $15,000 limitation, expenses borne on behalf of the entertainer include any expenditures for travel, meals and lodging, payments to persons such as band members or agents, and other amounts which are generally related to the activities of the artiste or athlete. This rule includes expenses borne by persons in the Contracting State where services are performed or borne by persons in the other or any third State if borne on behalf of the artiste or athlete. If the total of these expenses, including the amounts paid to the artiste or athlete, exceed $15,000, the entire amount is taxable in the State where the activities are performed. For example, where an entertainer's gross income, including reimbursed expenses and expenses borne on his behalf, totals $20,000, the full $20,000 is subject to tax in the State where the services are performed.

Also, in computing the $15,000 limitation, amounts paid in taxable years prior or subsequent to the year in which the services were performed shall be included in the determination of the amount of income attributable to the year in which the services were performed.

As noted above, this paragraph overrides the provisions of Articles 14 and 15, so that an artiste or athlete may be taxed in the State where his activities take place regardless of the period of time he is present in that State. Generally, however, income derived from services rendered by producers, directors, technicians and others who are not artistes and athletes is taxable in accordance with the provisions of Article 14 (Independent Personal Services), or Article 15 (Dependent Personal Services), as the case may be.

Paragraph (2) deals with cases where income in respect of the activities of an entertainer or athlete accrues to a person other than, or in addition to, the entertainer or athlete. A common method employed by foreign entertainers is to perform services in the United States as an employee of, or a contractor for, a corporation or other person. That person may act as the nominal recipient of the income in respect of the entertainer's services and the entertainer may act as its "employee" or "contractor." In such cases, the corporation may escape taxation in respect of those services under the provisions of Article 7 (Business Profits) because it does not have a permanent establishment in the United States described in Article 5 (Permanent Establishment). The entertainer may also escape taxation by being paid a small salary while in the United States and by receiving payment in a later year when the income is subject to reduced rates of tax or no tax at all, or by liquidating the corporation after the services are performed.

Paragraph (2) is designed to deal with these situations by providing that where income in respect of the personal activities of an artiste or athlete accrues to the benefit of another person (including a corporation, trust, or partnership of either Contracting State or any third State), that income may, notwithstanding the provisions of Article 7 (Business Profits), 14 (Independent Personal Services), and 15 (Dependent Personal Services), be taxed in the Contracting State in which the activities of the entertainer or athlete take place. Thus, for example, such other person could not claim the permanent establishment protection provided by Articles 5 (Permanent Establishment) and 7 (Business Profits).

For purposes of paragraph (2), income is considered to accrue to the benefit of another person where that person has control over or the right to gross income derived in respect of an entertainer or athlete's services as such. This rule applies regardless of whether the other person is a "sham" corporation or conduit. Income will not, however, be deemed to accrue to the benefit of another person where it is established to the satisfaction of the competent authority of the Contracting State in which the services are performed that neither the entertainer or athlete, nor persons related thereto, participate directly or indirectly in the profits of such other person, in any manner, including the receipt of deferred compensation, bonuses, fees, dividends, partnership distributions or other distributions. Persons may be considered to be related to the artiste or athlete regardless of whether the persons are considered to be related under the provisions of paragraph (5) of Article 9 (Related Enterprises). For this purpose, a person may be considered to be related to the artiste or athlete if he is an employee or agent of the artiste or athlete, or if he is regularly employed by the artiste or athlete in an advisory capacity, such as his attorney, accountant, or investment advisor.

This section is similar to provisions in other recent Conventions of the United States with Japan, Trinidad and Tobago, and Iceland, and follows Article 17 (Artistes and Athletes) of the OECD Model Convention. It differs from the 1945 Convention, which under Article I exempts an entertainer or athlete from United States tax where he: (a) is present in the United States for a period or periods not exceeding 183 days of a taxable year and (b) services are performed for or on behalf of a person who is a resident of the United Kingdom. The application of this section and Article III, regarding the industrial or commercial profits of an enterprise furnishing the services of an entertainer, was discussed in detail in Revenue Rulings 74-330 and 74-331. Both rulings considered cases where the services of foreign entertainers were "loaned" to United Kingdom corporations in order to benefit from the provisions of the 1945 Convention and to thereby avoid any taxation of the income derived in respect of their activities in the United States.

Article 18. Pensions

Paragraph (1) provides that, subject to the provisions of paragraph (2) of Article 19 (Government Service), pension payments received in consideration of past employment and annuity payments paid to an individual who is a resident of a Contracting State shall be taxable only in that State. The term "pension" includes payments from qualified retirement plans as well as other forms of retirement benefits paid for services rendered, or by way of compensation for injuries or sickness incurred in connection with past employment. A pension does not include payments in respect of the cancellation or premature termination of employment contracts (e.g., "golden handshakes" or severance pay). Such payments are taxable under the provisions of Articles 14 (Independent Personal Services), 15 (Dependent Personal Services), or 17 (Artistes and Athletes), as the case may be.

Payments which are not covered by any other Article of this Convention (e.g., Article 14 (Independent Personal Services), 15 (Dependent Personal Services), 17 (Artistes and Athletes), or 19 (Government Service)), are taxable in accordance with Article 22 (Other Income) in the recipient's State of residence.

For purposes of this Article, the term "pension" does not include social security payments and other public pensions, e.g., railroad retirement benefits. Such items are taxable pursuant to Article 22 (Other Income).

Paragraph (2) provides that alimony paid to an individual who is a resident of a Contracting State is taxable only in that State. The term "alimony" is not defined, but with respect to the United States, means periodic payments made pursuant to a decree of divorce, separate maintenance agreement, or support or separation agreement which is taxable to the recipient under the internal laws of the United States. Thus, for the United States, the term "alimony" would not include a payment which would not be taxable to the recipient even though such payment is made pursuant to a decree of divorce or of separate maintenance agreement. Payments for child support within the meaning of the Code are not covered by this Article and are, accordingly, taxable in the State where the recipient resides under Article 22 (Other Income). In the case of the United States, under present law, a recipient of child support is not taxable on such payments.

Paragraph (3) defines the term "annuity" to mean a stated sum payable periodically at stated times, during life or during a specified or ascertainable period of time, under an obligation to make the payments in return for adequate and full consideration in money or money's worth.

This Article is subject to the saving clause of paragraph (3) of Article 1 (Personal Scope). Thus, individuals who are nationals of a Contracting State may be taxed by that Contracting State without regard to this Article.

Article 19. Government Service

This Article generally follows Article 19 (Government Service) of the OECD Model Convention and is similar to Article X of the 1945 Convention.

Paragraph (1)(a) provides that remuneration, other than a pension, paid by a Contracting State to an individual for services rendered to that State will be taxable only in that State. This paragraph only applies to individuals who are employees of a Contracting State, and not to employees of a political subdivision or local authority of a Contracting State. Under paragraph (1)(b), such remuneration will be taxable only in the State in which the services are being performed if the recipient is a resident of that State and either is a national of that State or did not become a resident of that State solely for the purpose of performing the services.

Under paragraph (2)(a), any pension paid by a Contracting State or a political subdivision or a local authority thereof to any individual in respect of services rendered to that State or subdivision or local authority thereof will be taxable only in that State. An exception similar to the one contained in paragraph (1)(b) is incorporated in paragraph (2)(b) with respect to pensions. That paragraph provides that a pension described in paragraph (2)(a) will be taxable only in the other Contracting State if the recipient is both a national of and a resident of that State.

Paragraphs (1) and (2) do not apply if the services are rendered in connection with any business carried on by or on behalf of one of the Contracting States or one of its political subdivisions, or local authorities paying the remuneration. In such cases, the provisions of Articles 14 (Independent Personal Services), 15 (Dependent Personal Services), 17 (Artistes and Athletes), and 18 (Pensions), as the case may be, shall apply.

If an individual acquires immigrant status in the State in which he performs the services or receives the pension, that Contracting State may tax the individual without regard to this Article. See paragraphs (3) and (4)(b) of Article 1 (Personal Scope).

Article 20. Teachers

Paragraph (1) provides that a professor or teacher who visits one of the Contracting States for a period not exceeding two years, for the purpose of teaching or engaging in research at a university, college, or other recognized educational institution in that Contracting State, and who was immediately before that visit a resident of that other Contracting State, will be exempted from tax by the first-mentioned Contracting State on any remuneration for such teaching or research for a period not exceeding two years from the date he first visits that State for the purpose of teaching or engaging in research. Since this two year period is determined from the date he first visits the Contracting State, periodic vacations outside the first-mentioned Contracting State, or a brief return to the other Contracting State will not toll the running of the two year period. Unlike the existing Convention, if the two-year period beginning from the date of his arrival is exceeded, the exemption will be lost retroactively. Thus, if a person comes to a Contracting State for the purpose of teaching and stays for a period in excess of two years, the exemption will not apply for the first two years. A person who meets the qualifications of this provision may again claim its benefits if he first reestablishes his residence in the other Contracting State. In such case, the person claiming these benefits on a subsequent occasion must first satisfy the competent authority of the first-mentioned Contracting State that he had become a bona fide resident of the other State for a substantial period of time (normally at least one year).

Under paragraph (2), the Contracting State in which the teaching or research is performed may apply this exemption either to current payments to a professor or teacher in anticipation of fulfillment of the requirements of paragraph (1) or by way of withholding and refund. Thus, the recipient may be required to report and pay taxes on such income on a current basis and seek a refund of taxes paid upon fulfillment of the requirements of paragraph (1).

If an individual becomes a national of, or acquires immigrant status in, the State where he is visiting, that other Contracting State may tax the individual without regard to this Article. See paragraphs (3) and (4)(b) of Article 1 (Personal Scope).

Pursuant to paragraph (3), this Article only applies to income from research undertaken in the public interest which is not primarily for the benefit of a private person or persons. For example, research projects which are undertaken to discover or perfect product processes, designs, etc., which are expected to be commercially exploited by the researcher or his present (or former) employer do not qualify under this Article.

ARTICLE 21. STUDENTS AND TRAINEES

This Article corresponds generally to Article XIX of the 1945 Convention and Article 20 (Students) of the OECD Model Convention. Under this Article, payments which a student or business apprentice, who immediately before visiting a Contracting State was a resident of the other Contracting State receives for his maintenance, education or training, will not be taxed in the first-mentioned State if the recipient of the payments is engaged in a full-time education or training program and the payments are made from sources outside the State in which the education or training takes place. Payments will be considered to have been made from sources outside a State when they are borne by a person who is not a resident (as defined in Article 4 (Fiscal Residence)) of the Contracting State in which the education or training takes place. Like other articles referred to in paragraph 4(b) of Article 1, this Article will not apply to payments to students or business apprentices who are nationals of or residents with immigrant status in the first-mentioned Contracting State.

ARTICLE 22. OTHER INCOME

This Article follows Article 21 (Other Income) of the OECD Model Convention. It contains the general rule that income of a resident of a Contracting State, from any source, which is not dealt with by any specific Article in the Convention, shall be taxable only in that person's State of residence. This is the first United States tax convention to follow this rule. The scope of this Article is not confined to income having a source in the other Contracting State, but applies to a resident's income from sources in third countries. Moreover, this rule applies irrespective of whether the State of residence exercises its right to tax the income covered by this Article. Specific items of income not dealt with by other Articles of this Convention include child support payments, prizes or awards, and social security payments. These items are subject to the provisions of this Article and are taxable only in the State of residence.

This Article also makes it clear that the United Kingdom may continue to impose its tax on discretionary and accumulation trusts. United Kingdom law currently provides that discretionary and accumulation trusts are subject to the basic rate of income tax (35 percent) and to an additional tax of 15 percent. Trustees are eligible to claim double taxation relief in the respect of foreign tax paid on the income. Under United Kingdom law a distribution of income from a discretionary or accumulation trust is treated in the hands of the beneficiary as a payment from which tax has been deducted at the aggregate of the two rates (35 and 15) in force for the year of payment. That is, the distribution is grossed-up by 100 percent and the amount of the gross-up is treated as tax paid by, and creditable to, the distributee in the year of distribution.

Under paragraph (1) of Article 22 (Other Income) and paragraph (3) of Article 25 (Mutual Agreement Procedure), the United Kingdom will continue to impose its taxes on discretionary and accumulation trusts and will not be obliged to refund these taxes at the time of distributions to United States residents. However, to give double taxation relief, the United Kingdom will treat a United States person taxable on the income as if he were entitled to receive the income of the trust directly. Thus, the beneficiary will be given the benefit of relief provisions in United Kingdom domestic law (e.g., government securities held by nonresidents). Additionally, any income covered by the Convention, such as dividends and interest, will receive the benefits of the Convention to the extent that the payments from the trust are made out of this income.

This Article is subject to the saving clause provisions of paragraph (3) of Article 1 (Personal Scope).

This Article does not apply if the resident deriving the income carries on business in the other Contracting State through a permanent establishment situated therein or performs independent personal services from a fixed base therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base. In such cases, the provisions of Articles 7 (Business Profits), 14 (Independent Personal Services), or 17 (Artistes and Athletes), as the case may be, apply. As in the case of paragraph (1), this paragraph applies to income from all sources.

It should be noted that the proposed Convention specifically covers most types of income.

ARTICLE 23. ELIMINATION OF DOUBLE TAXATION

In order to prevent the double taxation of income covered by this Convention, each Contracting State agrees in this Article to provide a credit against its taxes for taxes paid to the other Contracting State.

Under paragraph (1), the United States agrees to allow a United States citizen or resident as a credit against United States tax the appropriate amount of taxes paid or accrued to the United Kingdom in accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle of paragraph (1)). In addition, in the case of a United States corporation owning at least ten percent of the voting stock of a United Kingdom corporation from which it receives dividends in any taxable year, the United States will allow credit for the appropriate amount of taxes paid or accrued to the United Kingdom by the United Kingdom corporation paying such dividends with respect to the profits out of which such dividends are paid. The rules for calculating the appropriate amount of taxes creditable in such a case are set forth below. However, the amount of tax credit is not to exceed the limitations (for the purpose of limiting the credit to the United States tax on income from sources within the United Kingdom or on income from sources outside of the United States) provided by United States law for the taxable year. This provision does not require the United States to maintain a per-country or overall limitation in the future so long as the general principle of a foreign tax credit remains in effect.

For the purpose of applying the United States credit in relation to taxes paid to the United Kingdom, the taxes referred to in paragraphs (2)(b) and (3) of Article 2 (Taxes Covered) shall be considered to be income taxes. In the case of dual-resident corporations described by paragraph (2) of Article 1 (Personal Scope), the United Kingdom petroleum revenue tax and the unrefunded portion of the ACT referred to in paragraph (1)(c) of this Article shall be regarded as an income tax for purposes of this Article. (See paragraph (2) of Article 1 (Personal Scope)). Any other taxes imposed by the United Kingdom on such corporation shall be treated as income taxes for purposes of the United States tax credit only in accordance with the laws of the United States.

Under paragraphs (2)(a)(i) and (2)(a)(ii) of Article 10 (Dividends), the United Kingdom allows residents of the United States certain tax credits or refunds in respect of dividends paid by a corporation which is a resident of the United Kingdom, subject to taxes withheld of 5 or 15 percent on the aggregate amounts received as dividends and tax credits. Subparagraph (1)(b) of this Article provides that the amounts withheld (5 or 15 percent) by the United Kingdom pursuant to paragraph 2(a)(i) or (ii) of Article 10 (Dividends) from the refund paid to residents of the United States shall be regarded as an income tax imposed on the recipient of the dividend. Thus, the United States foreign tax credit with respect to those amounts shall be computed in accordance with Code section 901.

In the case of tax credits allowed to corporate shareholders of a corporation which is a resident of the United Kingdom pursuant to subparagraph (2)(a)(i) of Article 10, only one-half of the credit otherwise paid to individual shareholders is paid to those corporate shareholders. Subparagraph (1)(c) of this Article provides that the portion of the cerdit not paid to these corporate shareholders, i.e., one-half of the ACT paid in respect to the distribution, shall be treated as an income tax imposed on the corporation paying the dividend.

In order that the derivative foreign tax credit be computed as intended under the Convention, corporate shareholders receiving the benefits of subparagraph 2(a)(i) of Article 10 (Dividends) must apply the following rules:

1. ACT paid with respect to a distribution shall be treated as attributable to the accumulated profits of those years in which it reduces the United Kingdom corporate tax imposed without regard to distributions (hereinafter referred to as "mainstream tax") for United Kingdom tax purposes. Thus, such ACT shall be treated as reducing mainstream tax and increasing (by the amount of the unrefunded ACT) ACT for the year or years for which the United Kingdom considers the mainstream tax to have been reduced; and unrefunded ACT shall not be considered to be attributable to accumulated profits until, and except to the extent that, it reduces British mainstream tax.

2. A distribution in respect of which the ACT paid reduces mainstream tax for the current taxable year may be treated by the Internal Revenue Service as made first out of the entire profits of that year (computed as of the close of the year). This rule, which applies regardless of whether the distribution is made in the first 60 days of the taxable year, will be applied where necessary to prevent crediting of a prior year's mainstream tax unreduced by ACT, while at the same time using such ACT to reduce the current year's mainstream tax.

3. Where a United States corporation owns less than all the stock of a corporation resident in the United Kingdom, the derivative tax credit will be calculated with reference solely to the proporationate interest in accumulated profits attributable to the United States shareholder. Thus, for example, the ratio which the distribution to the United States shareholder bears to accumulated profits in excess

of income taxes, as well as the amount of mainstream tax and ACT paid with respect thereto, will be calculated as if the United States shareholder's proportionate interest in the accumulated profits were the entire accumulated profits of a corporation of which it was the sole owner. The amount of foreign tax credit will not vary according to either (1) the status of any other shareholder; or (2) the imposition or refund of ACT with respect to a distribution to any other shareholder.

In the case of dividends paid by a United Kingdom corporation wholly owned by a United States parent corporation, the determination of the appropriate amount of creditable taxes is illustrated by the following examples:

Example 1. *A* United Kingdom resident corporation wholly owned by a United States parent corporation has $100 of pretax earnings in year 1 and pays a dividend equal to 50 percent of the amount available for distribution in year 1.

1.	Accumulated profits	$100.00
2.	British mainstream tax at 52% rate	52.00
3.	Available for distribution	48.00
4.	Distribution	24.00
5.	ACT with respect to distribution before refund	12.92
6.	Net mainstream tax, reduced by ACT[*]	39.08
7.	Refund of one-half ACT pursuant to paragraph (2)(a)(i) of Article 10	6.46
8.	Unrefunded one-half of ACT treated as corporate tax pursuant to paragraph (1)(c) of Article 23	6.46
9.	Total corporate tax (39.08 mainstream plus 6.46 unrefunded ACT)	45.54
10.	Total dividend received before withholding tax (24.00 declared plus 6.46 refund treated as dividend pursuant to paragraph (1)(a)(iii) of Article 10)	30.46
11.	Accumulated profits in excess of British corporate taxes (100 — 45.54)	54.46
12.	Derivative tax credit $\left(\frac{30.46}{54.46} \times 45.54\right)$	25.47
13.	British withholding tax (5 percent of total dividend of 30.46)	1.52
14.	Total foreign tax credit	26.99
15.	Taxable income (30.46 dividend plus 25.47 "gross-up" of derivative tax credit)	55.93
16.	United States tax before credit (48% of 55.93)	26.85
17.	Amount by which foreign tax credit exceeds U.S. tax	0.14

Example 2. Assume the same facts as in the previous example, except that in year two the British corporation makes a distribution out of what, under United States tax law principles, are the remaining $24.00 of earnings from year one. Assume further that there are no earnings in year two for United Kingdom purposes, and that the ACT with respect to the distribution is carried back and credited against mainstream tax of year one.

1.	Distribution in year two	$24.00
2.	ACT	12.92
3.	Reduction in mainstream tax for year one	12.92
4.	Net mainstream tax for year one, reduced by ACT	26.06
5.	Refund of one-half ACT	6.46
6.	Unrefunded ACT	6.46
7.	Total corporate tax (26.06 mainstream + 6.46 unrefunded ACT in respect of distribution in year one + 6.46 unrefunded ACT in respect of distribution in year two)	39.08
8.	Total dividend received before withholding tax	30.46
9.	Accumulated profits in excess of British corporate taxes (100 — 39.08)	$60.92
10.	Derivative tax credit $\left(\frac{30.46}{60.92} \times 39.08\right)$	19.54
11.	Taxable income (30.46 dividend plus 19.54 "gross-up" of derivative tax credit)	50.00

It should be noted that the total taxable income in respect of the two distributions is $105.93 ($55.93 + $50), which is $5.93 more than the accumulated profits of $100; and the total derivative tax credit is $45.01, which is $5.93 more than the corporate tax of $39.08. The disparity occurs for two reasons: first, that the Convention treats refunded ACT as a dividend, but does not treat ACT that is potentially refundable as profits out of which future dividends can be paid[*]; and second, that $6.46 of the $45.54 mainstream tax considered paid in respect of the accumulated profits in *Example 1* is subsequently refunded.

The above result is considered appropriate in order to ensure that, with reference to a 50 percent distribution, the British refund substantially benefits the United States shareholder. An adjustment is necessary, however, when tax which has been taken into account in computing derivative foreign tax credit in respect of a prior distribution—of whatever percentage of the accumulated profits—is refunded in the form of ACT. The refunded ACT must, with respect to such distribution, both

a) increase accumulated profits in excess of income taxes, and

b) decrease taxes paid in respect of accumulated profits.

By reason of the $6.46 refund of ACT in *Example 2*, therefore, the derivative foreign tax credit in *Example 1* must be recalculated as follows:

1.	Calculation before adjustment (see (12) of *Example 1*)	$\frac{30.46}{54.46} \times 45.54$
2.	Addition of $6.46 to accumulated profits in excess of income taxes	$\frac{30.46}{60.92}$
3.	Subtraction of $6.46 from taxes paid	$45.54 — 6.46 = $39.08
4.	Derivative foreign tax credit $\left(\frac{30.46}{60.92} \times 39.08\right)$	$19.54

The adjusted result in *Example 1* is the same as in *Example 2*. Both the taxable income and tax credit in respect of the prior distribution will therefore be decreased by $5.93, in accordance with section 905(c) of the Internal Revenue Code.

The determination of the appropriate amount of creditable taxes in the case of dividends paid by a less-wholly-owned United Kingdom corporation is illustrated by the following example:

Example 3. A United Kingdom resident corporation, *W*, is owned by U.S. corporation *X* (25%), U.K. corporation *Y* (60%), corporation *Z* (10%), and individual *A* (5%). *W* has $400 of pre-tax earnings in year 1 and pays a dividend of 50 percent of the amount available for distribution in year 1. *Z* is organized in country *M* and has no right to receive a refund of ACT from the United Kingdom. *A*, a United Kingdom resident, receives a tax credit equal to the entire ACT imposed, and *Y* makes an election under U.K. law to eliminate ACT with respect to distributions to itself.

1.	Accumulated profits	$400.00
2.	Mainstream tax imposed at a 52% rate	208.00
3.	Available for distribution	192.00
4.	Total distribution	96.00
5.	Portion of accumulated profits attributable to *X*'s shareholding—25%	100.00
6.	*Determination of X's United States foreign tax credit:*	
A.	Accumulated profits	$100.00
B.	British mainstream tax at 52% rate	52.00
C.	Available for distribution	48.00
D.	Distribution to U.S. corporation *X*	24.00
E.	For remainder of computation see *Example 1*	

In the above examples it has been assumed that the earnings and profits used in calculating the indirect tax

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[*] It is assumed in this example, as is generally the case, that ACT is fully credited against mainstream tax.

[*] If that were done, the fraction for computing the derivative tax credit in respect of the distribution in *Example 1* would be

$$\frac{30.46}{54.46 + 6.46 \text{ potentially refundable ACT}} \text{ or } \frac{30.46}{60.92} \times \text{ taxes paid.}$$

credit for United States tax purposes approximate the earnings and profits of the United Kingdom corporation as computed in the United Kingdom for United Kingdom tax purposes. This assumption, of course, is not always valid and there will be situations where the earnings and profits differ for United Kingdom and United States tax purposes. Accordingly, it will be necessary for United States shareholders to maintain separate records to reflect these differences. Such records must currently be maintained by United States shareholders of foreign corporations where the amount of earnings and profits of that corporation differ under the rules of the respective countries. Separate records will be especially important where United States shareholders do not own all of the shares of a United Kingdom corporation. Quite often the shares of a United Kingdom corporation are owned by both United States and foreign shareholders. In these cases, the payment of an ACT credit to the United States shareholder will require a separate computation of earnings and profits for United States tax purposes which reflects that shareholder's proportionate interest in the corporation.

Paragraph (2) of this Article parallels paragraph (1) with respect to the treatment of United States taxes paid by a resident of the United Kingdom. Under this paragraph, the United Kingdom will allow a resident of the United Kingdom as a credit against United Kingdom taxes paid to the United States in accordance with the provisions of the law of the United Kingdom for the allowance of credits for taxes to territories outside the United Kingdom (as it may be amended from time to time without changing the general principle of paragraph (2)). Such credit shall be allowed with respect to taxes payable in accordance with this Convention on profits or income from sources within the United States, as determined by subparagraph (3) of this Article (excluding, in the case of a dividend, tax payable in respect of the profits out of which the dividend is paid).

In the case of a dividend paid by a United States corporation to a corporation which is a resident of the United Kingdom which controls directly or indirectly 10 percent or more of the voting power of that paying corporation, the United Kingdom shall also allow a credit for the appropriate amount of taxes paid or accrued to the United States by the United States corporation paying such dividends with respect to the profits out of which such dividends are paid.

Paragraph (3) sets forth the source of income rules applicable for purposes of determining the allowance of tax credits under this Article. For purposes of the preceding paragraphs, income or profits derived by a resident of a Contracting State which are taxed in the other Contracting State in accordance with the Convention (other than by reason of the saving clause referred to below) shall be deemed to arise from sources within that other Contracting State. However, where a United States citizen is subject to tax in the United States by reason of his citizenship under the saving clause of paragraph (3) of Article 1 (Personal Scope), the United Kingdom will allow that person a tax credit for any United States tax paid with respect to income which under the internal laws of the United Kingdom has its source in the United States; and the United States will allow that person, subject to limitations of the Internal Revenue Code to claim a credit for taxes paid to the United Kingdom with respect to income which under the internal laws of the United States has its source in the United Kingdom. This paragraph has particular relevance with respect to a United States citizen who is a resident of the United Kingdom for purposes of this Convention (see Article 4 (Fiscal Residence)).

In the case of third country income earned by a United States citizen who is a resident of the United Kingdom (e.g., dividends from Germany), the United Kingdom is not required to allow a credit for United States taxes on that income. Double taxation of income may be avoided, however, under the overall method for computing foreign tax credits. In such case, the United States will allow under its internal law a credit for both the United Kingdom and third country taxes.

Finally, paragraph (4) makes it clear that the credit allowed for taxes paid to the United Kingdom, especially the petroleum revenue tax, shall be subject to the tax credit limitations of the Tax Reduction Act of 1975 which apply to foreign oil and gas extraction income.

ARTICLE 24. NON-DISCRIMINATION

Paragraph (1) provides that individuals who are nationals of a Contracting State and who are residents of the other Contracting State will not be subjected in that other Contracting State to taxation or any other requirement connected therewith which is other or more burdensome than the taxation or requirements connected therewith to which nationals of that other Contracting State in the same circumstances are or may be subjected. Thus, for example, a national of the United Kingdom who is a resident of the United States and who meets the requirements specified in Code section 911 would, under this Article, be entitled to the benefits of that section even though he is not also a national of the United States. On the other hand, just as a United States citizen who becomes a non-resident alien at any time during a taxable year or whose spouse is a non-resident alien cannot in the absence of an election file a joint return for that year, a United Kingdom national would not be entitled to file a joint return with his spouse in the absence of such election if either is a non-resident alien at any time during the taxable year.

Paragraph (2) provides that a permanent establishment which an enterprise of one Contracting State has in the other Contracting State will not be subject in that other Contracting State to less favorable taxation than an enterprise of that other Contracting State carrying on the same activities.

Subject to the provisions of paragraph (4), discussed below, paragraph (3) provides that interest, royalties, and other disbusements paid by an enterprise of a Contracting State to an enterprise of the other Contracting State shall, if reasonable in amount, be deductible for purposes of determining the taxable profits of the enterprise in that Contracting State under the same conditions as if they had been paid to a resident of the Contracting State. This rule is not limited to payments to related parties.

For purposes of this paragraph, the term "other disbursements" includes charges for amounts expended by a resident of the other Contracting State for the benefit of the enterprise. The term "other disbursements" is to be broadly defined, to include charges or allocations by such resident for the benefit of such enterprise, including reasonable allocations of executive and general administrative overhead (except to the extent such expenses are not for the benefit of the enterprise, but are for "stewardship" or "overseeing" functions for the resident's own benefit as an investor in the enterprise). The term also includes charges and allocations of research and development expenses where the enterprise has the benefits of such activities under a cost or risk sharing agreement and other expenditures by the resident of a group of enterprises which includes such enterprise.

Paragraph (4) states that paragraph (3), above, does not apply to interest, royalties, or other disbursements to which the provisions of Article 9 (Associated Enterprises), paragraphs (5) and (7) of Article 11 (Interest), or paragraph (5) of Article 12 (Royalties) apply with respect to transactions between related parties.

Paragraph (5) prohibits one Contracting State from subjecting an enterprise of such Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, to any taxation or any requirement connected with taxation which is other or more burdensome than is applicable to enterprises of the first-mentioned Contracting State carrying on the same activities, the capital of which is wholly or partly owned or controlled by one or more residents of the first-mentioned Contracting State.

Paragraph (6) provides that nothing in this Article obliges a Contracting State to grant to individual residents of the other Contracting State any personal allowances, reliefs, or deductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

This Article is similar to Article XXI of the 1945 Convention and Article 24 (Non-Discrimination) of the OECD Model Convention.

Article 25. Mutual Agreement Procedure

This Article generally extends the mutual agreement procedures found in Article XXA of the 1945 Convention and is similar to Article 25 (Mutual Agreement Procedure) of the OECD Model Convention.

Under paragraph (1), when a resident or national of a Contracting State considers that the actions of one or both Contracting States results or will result in taxation which is not in accordance with the Convention, he may, notwithstanding the remedies provided by the national laws of those States, present his case to the competent authority of the Contracting State of which he is a resident or national. A resident or national of a Contracting State need not, although it is anticipated that in the normal situation he will, exhaust his other administrative or judicial remedies prior to resorting to the use of the mutual agreement procedure.

Under paragraph (2), if the claim is considered to be justified by the competent authority and if it cannot alone arrive at an appropriate solution to the issue involved, that competent authority shall endeavor to resolve the case by agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is contrary to the Convention. In cases in which the competent authorities reach an agreement, taxes will be imposed, and refunds or credits of taxes will be allowed, as appropriate, by the Contracting States in accordance with such agreement. In the case of the United States, where an agreement is reached between the competent authorities which requires the United States to make a refund of tax or to extend any other similar credit, such refund or credit will be made, assuming presentation of his case to the competent authority within a reasonable period, notwithstanding any procedural barriers otherwise existing under United States law, including any statute of limitations. In cases where an agreement cannot be reached between the competent authorities, the United States will not be required to provide any relief for double taxation on a unilateral basis.

Paragraph (3) permits the competent authorities of the two Contracting States to endeavor to resolve by mutual agreement any difficulties or doubts arising as to the application of the Convention. In particular, the competent authorities may reach agreement on the attribution of income, deductions, credits, or allowances of an enterprise of a Contracting State to its permanent establishment situated in the other Contracting State; the allocation of income, deductions, credits, or allowances between persons; the nature of particular items of income; the meaning of terms not otherwise defined in this Convention; the place where a particular item of income has its source; and the elimination of double taxation in respect of income paid out of trusts. In the case of trust distributions, the competent authorities may conclude that elimination of double taxation requires that the character of the income giving rise to such distributions must be determined. In such a case, taxpayers will be expected to have the records necessary to demonstrate the character of income underlying a trust distribution.

Under paragraph (4), the competent authorities may communicate with each other directly and, when advisable, meet together for an oral exchange of opinions, for the purpose of reaching an agreement.

Article 26. Exchange of Information and Administrative Assistance

This Article extends without change the exchange of information Article (Article XX) and the assistance in collection Article (Article XIXA) of the 1945 Convention.

Paragraph (1) provides for a system of administrative cooperation between the competent authorities of the two

Contracting States by requiring an exchange of information necessary for the carrying out of the Convention and of the domestic laws of the Contracting States concerning taxes covered by the Convention insofar as the taxation thereunder is in accordance with the Convention. The competent authorities may exchange information in connection with tax compliance generally, not merely illegal acts or crimes. Information need be exchanged, however, only if it is of a class that can be obtained under the laws and administrative practices of each Contracting State with respect to its own taxes.

The information exchanged must be treated as secret. However, such information may be disclosed to any persons or authorities (including a court or administrative body) concerned with the assessment, collection, or enforcement of, or prosecution with respect to, the taxes which are the subject of the Convention. No information may be exchanged which would disclose any trade, business, industrial or profesional secret or any trade process.

Paragraph (2) provides that one Contracting State will give the other Contracting State limited assistance in collecting its taxes. Thus, each Contracting State is required to collect on behalf of the other Contracting State only those taxes imposed by such other Contracting State as will ensure that any exemption or reduced rate of tax granted under this Convention by such other Contracting State is not enjoyed by persons not entitled to such benefits.

Paragraph (3) makes clear that a Contracting State is not obligated to carry out measures which are at variance with its laws or the administrative practice with respect to the collection of its own taxes; or which would be contrary to its sovereignty, security or public policy. A Contracting State may also consider, in determining the administrative measures it will use, the administrative measures utilized by the other Contracting State in a comparable situation.

Paragraph (4) provides that the competent authorities will consult to cooperate and advise each other on the implementation of these provisions.

ARTICLE 27. EFFECT ON DIPLOMATIC AND CONSULAR OFFICIALS AND DOMESTIC LAWS

Paragraph (1) of this Article provides that nothing in the Convention will affect the fiscal privileges of diplomatic and consular officials under the general rules of international law or under the provisions of special agreements.

Paragraph (2) provides that the Convention will not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded by the laws of a Contracting State. This rule reflects the principle that a Convention should not increase the tax burden on residents of the Contracting States.

ARTICLE 28. ENTRY INTO FORCE

Paragraph (1) provides that the proposed Convention shall be ratified and that the instruments of ratification shall be exchanged at Washington, D.C. as soon as possible after both States have ratified the Convention.

Paragraph (2) provides that the Convention will enter into force on the thirty-first day following the date of exchange of the instruments of ratification. With respect to the United Kingdom, the proposed Convention will take effect in the following manner. In relation to any dividend to which subparagraph (2)(a)(ii) of Article 10 (Dividends) applies, the provisions of that Article shall apply to any year of assessment beginning on or after April 6, 1973. For this purpose, a dividend paid on or after April 1, 1973, and before April 6, 1973, shall be treated for tax credit purposes (i.e., for purposes of any refund of the ACT) as paid on April 6, 1973. United States shareholders who derived dividends from corporations which were residents of the United Kingdom during this period will be entitled to claim refunds from the United Kingdom in respect of those dividends and in accordance with the provisions of paragraph 2(a)(ii) of Article 10. It is anticipated that the United Kingdom will prescribe the procedures for claiming those refunds upon ratification of this Convention.

In the case of dividends to which subparagraph (2)(a)(i) of Article 10 (Dividends) applies (i.e., dividends received from a corporation which is a resident of the United Kingdom by a United States corporation owning 10 percent or more of the voting stock thereof), and any other provision of the Convention in respect of income tax and payments of tax credits (i.e., refunds of ACT), and in respect of the United Kingdom capital gains tax, those provisions shall be effective for any year of assessment beginning on or after April 6, 1975. Refunds of tax may be claimed in the manner to be prescribed by the United Kingdom.

The Convention will be effective in respect of the United Kingdom corporation tax, for any financial year beginning on or after April 1, 1975, in respect of the United Kingdom petroleum revenue tax, for any chargeable period beginning on or after January 1, 1975, and (in accord with Article V of the Protocol of [March 31], 1977) in respect of the special domicile rule of paragraph (4) of Article 4 (Fiscal Residence) for any year of assessment beginning on or after April 6, 1976.

For the United States, tax credits for taxes paid to the United Kingdom on or after April 1, 1973, shall be allowed for the period subsequent to that date in accordance with paragraph (1) of Article 23 (Elimination of Double Taxation). In the case of dividends received for any year of assessment beginning on or after April 6, 1973, and before any year of assessment beginning on or after April 6, 1975, by a United States corporation described by paragraph (2)(a)(i) of Article 10 (Dividends), the full amount of ACT paid in respect of such dividends shall be regarded as a tax imposed on the distributing corporation.

With respect to taxes withheld at source, this Convention shall become effective in the United States on January 1, 1975, for taxes withheld on or after that date and with respect to all other taxes, this Convention will be effective in the United States for taxable years beginning on or after January 1, 1975.

Subject to the provisions of paragraph (4) of this Article, the 1945 Convention, as amended by the Supplementary Protocol of June 6, 1946, by the Supplementary Protocol of May 25, 1954, by the Supplementary Protocol of August 19, 1957, and by the Supplementary Protocol of March 17, 1966, will cease to have effect in respect of taxes to which this Convention in accordance with the provisions of paragraph (2) of this Article applies.

Where any provision of the 1945 Convention would have afforded any greater relief from tax, any such provision will continue to have effect for any year of assessment or financial year in the United Kingdom and for any taxable year in the United States beginning, in either case, before January 1, 1976.

The 1945 Convention will terminate on the last date on which it has effect in accordance with the foregoing provisions of this Article. In addition, this Convention will not affect any Agreement in force extending the 1945 Convention in accordance with Article XXII thereof. In those cases, the 1945 Convention will continue to apply to those territories. The United States has requested the United Kingdom to advise territories to which the 1945 Convention has been extended that the United States desires to renegotiate the Convention as it affects those territories so as to reflect the principles of this Convention.

The amendments to this Convention effected by the Notes exchanged at London on April 13, 1976 shall enter into force on the same date as determined under paragraph (2) of this Article and, in accord with the provisions of Article V of the Protocol of August 26, 1976 and of Article VI of the Protocol of [March 31], 1977, the amendments to this Convention effected by those protocols shall, upon ratification, enter into force on the thirty-first day following the date of the exchange of the instruments of ratification of those Protocols. Once in force, the provisions of the Notes and the two protocols shall have effect in accordance with this Article.

ARTICLE 29. TERMINATION

This Article is drafted in substantially the same manner as the termination Article of the 1945 Convention.

Paragraph (1) provides that the Convention will remain in force indefinitely, but that either Contracting State may, on or before June 30 in any year after the year 1980, give to the other Contracting State through diplomatic channels notice of termination. When notice is properly given, the Convention ceases to be effective for taxable years beginning on or after January 1 of the following year for United States tax; for a year of assessment beginning on or after April 6 of the following year for United Kingdom income tax and capital gains tax; for a financial year beginning on or after April 1 of the following year for United Kingdom corporation tax; and for a chargeable period beginning on or after January 1 of the following year for United Kingdom petroleum revenue tax.

Under paragraph (2), the termination of the proposed Convention will not have the effect of reviving any treaty or arrangement abrogated by the present Convention or by treaties previously concluded between the Contracting States.

Technical Explanation [1] of the Third Protocol Signed at London on March 15, 1979 (the "Third Protocol" or the "Protocol") Further Amending the Convention Between the Government of the United States of America and the Government of the United Kingdom of Great Britain and Northern Ireland for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income and Capital Gains Signed at London, on December 31, 1975, as Amended by the Notes Exchanged at London on April 13, 1976, and the Protocols Signed at London on August 25, 1976 and March 31, 1977 (the Convention as Amended by the Notes and the Two Protocols Being Referred to as the "Convention") [2]

The Third Protocol contains seven articles which modify Articles 2 (Taxes covered), 7 (Business profits), 9 (Associated enterprises), 10 (Dividends), 19 (Government service), 23 (Elimination of double taxation), and 28 (Entry into force) of the Convention. In addition, Article VI of the Protocol adds a new Article 27A (Offshore activities) to the Convention. Set forth below is an explanation of each article of the Protocol.

ARTICLE I

Article I contains three paragraphs serving to conform the text of the Convention to the United States Senate's reservation which was made a part of its June 27, 1978 resolution of advice and consent to ratification. The references to income taxes imposed by political subdivisions or local authorities are deleted from paragraphs (2) and (3) of Article 2 (Taxes covered) and from paragraph (4) of Article 9 (Associated enterprises). The other provisions of those paragraphs are restated. Taxes imposed by political subdivisions and local authorities remain subject to the provisions of Article 24 (Non-discrimination) of the Convention, by reason of paragraph (4) of Article 2 (Taxes covered).

ARTICLE II

Article II adds a new subparagraph (6A) to Article 7 (Business profits) of the Convention. The new subparagraph provides that the United States excise tax on insurance premiums paid to foreign insurers, imposed by section 4371 of the Internal Revenue Code (the "Code"), will not apply to insurance or reinsurance premiums received by a business of insurance conducted by a United Kingdom enterprise regardless of whether that business is carried on through a permanent establishment in the United States.

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[1] It is the practice of the Treasury Department to prepare for the use of the Senate and other interested persons a Technical Explanation of the tax protocols, which are submitted to the Senate for its advice and consent to ratification.

An Income Tax Protocol with the United Kingdom of Great Britain and Northern Ireland was signed on March 15, 1979, and submitted by the President to the Senate on April 12, 1979. On June 6, 1979, the Senate Committee on Foreign Relations held hearings and this Technical Explanation was presented. The Senate voted its advice and consent on July 9, 1979, and instruments of ratification were exchanged on March 25, 1980.

[2] Page 5. Senate Executive Report No. 96-5, page 49. Senate Executive Q is not published.

Under paragraph (1) of Article 7 (Business profits) and subparagraph (2)(a) of Article 2 (Taxes covered) of the Convention, no insurance excise tax (or income tax) is payable with respect to premiums paid to a United Kingdom enterprise if the enterprise does not have a permanent establishment in the United States. In the case of an enterprise with a permanent establishment in the U.S., the United States will tax the income effectively connected with a U.S. trade or business, under section 864 of the Code, as is permitted by paragraphs (1) and (7) of Article 7.

In the case of a United Kingdom enterprise with a permanent establishment in the United States, there was some uncertainty over the applicability of the insurance excise tax. The intention of the Convention was that the excise tax would not be imposed in addition to the income tax on premiums or income arising from the insurance of United States risks. However, since the income tax and the insurance excise tax are not necessarily mutually exclusive under the Code, and since the application of the non-discrimination provisions of Article 24 (Non-discrimination) was not entirely clear in the circumstances, it was thought desirable to provide explicitly that only the income tax would apply in the case of a British enterprise with a United States permanent establishment.

ARTICLE III

A corporation organized under the laws of the United States, one of the states, or the District of Columbia is a United States resident under subparagraph (1)(b)(ii) of Article 4 (Fiscal residence). Such a corporation may also be a resident of the United Kingdom, however, under subparagraph (1)(a)(ii) of that Article if its business is managed and controlled in the United Kingdom. Paragraph (5) of Article 10 (Dividends) of the Convention, which corresponds to Article XV of the 1945 Convention, prohibits (with certain exceptions) a Contracting State from taxing dividends paid by a corporation which is a resident of the other Contracting State. Although paragraph (2) of Article 1 (Personal scope) precludes a dual resident corporation from claiming relief under Article 10, a question arose over whether paragraph (5) of Article 10 of the Convention would prohibit the United States from withholding tax on dividends paid by such a dual resident corporation, since the relief granted by paragraph (5) extends to the recipient of a dividend and not to the paying corporation. Article III of the Protocol amends paragraph (5) to provide clearly that the United States is not prohibited from applying its withholding tax in cases where the corporation paying the dividends is a resident of both the U.K. and the U.S.

ARTICLE IV

Under United Kingdom law (sections 367 or 373, Income and Corporation Taxes Act 1970), United States nationals, who are not also United Kingdom nationals, are not subject to U.K. income tax on their remuneration received from the United States government (or any agency or instrumentality thereof) for services rendered to the United States in the United Kingdom. Although U.K. internal law does not provide for taxation in those circumstances, concern has been expressed that paragraph (1) of Article 19 (Government service) of the Convention would permit the U.K. to impose a tax if the U.S. national did not become a resident of the U.K. solely for the purpose of performing the services.

To allay this concern, Article IV of the Protocol modifies subparagraph (b) of paragraph (1) of Article 19 (Government service) to permit a Contracting State to tax remuneration (other than a pension) paid by the other Contracting State for services rendered to it only where the services are rendered in the first-mentioned State and the recipient is a resident and national of that State.

ARTICLE V

Article V replaces paragraph (4) of Article 23 (Elimination of double taxation) with a new paragraph (4). The new paragraph limits the credit for the United Kingdom petroleum revenue tax allowed against United States tax by subparagraph (2)(b) of Article 2 (Taxes covered) and subparagraph (1)(a) of Article 23 (Elimination of double taxation). The limit prescribed by new paragraph (4) of Article 23 is to be applied before applying the provisions and limitations relating to the foreign tax credit contained in the Code. These provisions include, among others, the rules in section 907 of the Code pertaining to foreign oil and gas extraction income and foreign oil related income. Application of the provisions of United States law as they now exist or as they may be amended from time to time (without changing the general principle of allowance of a credit) may limit the amount of PRT allowable as a credit in any taxable year to an amount less than that arrived at by applying the rules of new paragraph (4) of Article 23.

The limit for a taxable year prescribed by subparagraph (a) of new paragraph (4) is arrived at by making the computations explained in steps (1)-(4) below.

Step (*1*). The first step involves multiplying the maximum statutory United States tax rate applicable to the taxable income of a corporation for the taxpayer's taxable year by the amount of the taxpayer's taxable income (computed under United States standards) from the extraction of minerals from oil or gas wells in the United Kingdom.

The maximum statutory United States tax rate applicable to the taxable income of a corporation is the highest rate of tax specified in section 11 of the Code. This rate is currently 46 percent for taxable years beginning after December 31, 1978.

In arriving at taxable income from extraction for purposes of computing the limit, principles similar to those under section 907(c)(1)(A) and section 907(c)(3) of the Code shall be applied. Taxable income from extraction includes taxable income derived by a person holding a royalty or other economic interest in an oil or gas well, even though the extraction is physically performed by a person other than the taxpayer.

Step (2). From the product arrived at under Step (1) is subtracted other United Kingdom tax on income from the extraction of minerals from oil or gas wells in the United Kingdom. Because other United Kingdom tax may be calculated under United Kingdom law on a base which includes income from non-extraction activities, it may be necessary to allocate other United Kingdom tax to the income from extraction. In making this allocation, principles similar to those under section 907(c)(5) of the Code are to apply. The difference between the product computed under Step (1) above and the other United Kingdom tax computed here is the limit with respect to the PRT on income from extraction.

Step (3). Under the United Kingdom's Oil Taxation Act of 1975, as amended on March 15, 1979 ("OTA"), which imposes the PRT, it is possible for PRT to be levied on what under United States standards would be income from activities other than extraction. Specifically, the base on which PRT is computed is determined by reference to the value of oil or gas after initial transportation to the place in the United Kingdom (on land) at which the seller could reasonably be expected to deliver it, and after initial treatment and initial storage. (These terms shall have the meaning specified in the OTA.) Because of this, total PRT paid or accrued will have to be allocated to (a) income from extraction, and (b) income from initial transportation, initial treatment, and initial storage.

The allocation of PRT is to be made by multiplying total PRT (other than amounts deemed to have been paid or accrued in the year by reason of the carryback or carryforward provisions set forth in new subparagraphs (b) and (c) of paragraph (4)) by a fraction, the numerator of which is taxable income from extraction (computed under U.S. standards, i.e. the same number as that determined under Step (1)) and the denominator of which is taxable income from extraction, initial transportation, initial treatment, and initial storage. If the denominator so computed is less than taxable income from extraction alone, then the denominator shall be taxable income from extraction.

Step (4). The lesser of the PRT paid or accrued with respect to extraction income under Step (3) or the limit determined under Step (2) is treated as an income tax paid or accrued for the taxable year for purposes of computing the credit allowable under section 901. Such amount will also be treated as oil and gas extraction taxes for purposes of section 907(c)(5) of the Code. Amounts in excess of the limit determined under Step (2) are not deductible if the taxpayer chooses to take to any extent the benefits of paragraph (1) of Article 23 for the taxable year.

Subparagraph (b) of paragraph (4) applies in cases where the PRT allocable to extraction income (determined under Step (3) above) exceeds the credit limit provided under subparagraph (a) (determined under Step (2) above). In such cases, the lesser of such excess or 2 percent of the taxable income from extraction (see Step (1) above) shall be treated as income tax paid or accrued in the second preceding taxable year, the first preceding taxable year, and in the first, second, third, fourth, or fifth succeeding taxable year in that order and to the extent not deemed paid or accrued in a prior taxable year. In determining the year in which such PRT carried back or forward shall be deemed to have been paid, the limitation of subparagraph (a) of new paragraph (4) shall apply.

If an amount of PRT which does not exceed the limit of subparagraph (a) is limited by application of sections 907 or 904 and is carried to another taxable year pursuant to sections 907 or 904, the amount treated as paid or accrued in such other taxable year will be treated as an income tax and will not be again subject to the limitation of new paragraph (4).

Subparagraph (c) of paragraph (4) applies to determine the limit on the PRT with respect to income from initial transportation, initial treatment, and initial storage. These three items of income are to be combined for this purpose. The limit is computed by applying *mutatis mutandis*, Steps (1), (2) and (4) described with respect to subparagraph (a) above. As with extraction, taxable income is to be determined by United States standards. The PRT allocable to initial transportation, treatment, and storage is the PRT paid or accrued in the current year not allocable to extraction income. The PRT allocated to initial transportation, initial treatment, and initial storage is not treated as oil and gas extraction tax under section 907(c)(5) of the Code but will be treated as income tax on foreign oil related income within the meaning of section 907(c)(2) of the Code.

Where the PRT allocable to initial transportation, initial treatment, and initial storage exceeds the limit of subparagraph (c) for the taxable year, such excess shall be deemed paid or accrued under subparagraph (c) in the second preceding taxable year, the first preceding taxable year and in the first, second, third, fourth, or fifth succeeding taxable years in that order and to the extent not deemed paid or accrued in a prior taxable year by reason of the limitation of subparagraph (c).

If an amount of PRT which does not exceed the limit of subparagraph (c) is limited by application of sections 907 or 904 and is carried to another taxable year pursuant to sections 907 or 904, the amount treated as paid or accrued in such other taxable year will be treated as an income tax and will not be again subject to the limitation of new paragraph (4).

Miscellaneous Rules: In the case of a United States corporation owning at least 10 percent of the voting stock of a corporation which is a resident of the United Kingdom from which it receives dividends in any taxable year, the appropriate amount of PRT paid to the United Kingdom by that U.K. resident corporation with respect to the profits out of which such dividends are paid shall be a ratable portion of the PRT attributable to the accumulated profits out of which the dividend is paid.

ARTICLE VI

Article VI adds a new Article 27A (Offshore activities) to the Convention, to deal with activities carried on in connection with the exploration or exploitation of the seabed or subsoil and their natural resources. The new Article 27A has particular relevance to activities in the United Kingdom sector of the North Sea. It would apply reciprocally, however, to activities conducted by United Kingdom enterprises with respect to exploration or exploitation of the seabed or subsoil of the United States.

Except in cases where the *de minimis* rule in paragraph (2) applies, paragraph (1) of Article 27A treats a resident of one State as carrying on a business in the other State through a permanent establishment or fixed base with respect to activities in the other State (whether physically carried out on land or offshore) in connection with the exploration or exploitation of the seabed or subsoil and their natural resources situated in that other State. This permanent establishment or fixed base is deemed to exist notwithstanding the provisions of Article 5 (Permanent establishment) and Article 14 (Independent personal services). This provision is not intended to apply in the case of a determination under Article 15 (Dependent personal services).* A permanent establishment is a prerequisite for taxation of business profits in the State of source under paragraph (1) of Article 7 (Business profits) and a "fixed base" is one of the prerequisites for taxation of income derived from services performed in an independent personal capacity in the State or source under Article 14 (Independent personal services).

In determining the business profits or income from independent personal services that are attributable to the permanent establishment or fixed base, the United Kingdom Inland Revenue would normally rely on a taxpayer's branch accounts if they accurately and realistically measure the commercial profits generated by the activities of the permanent establishment or fixed base and reflect generally accepted accounting principles. In the case of offshore activities such accounts would normally include, as income, the gross receivables attributable to the services and trading activities performed on the United Kingdom Continental Shelf and, as expenses, the direct expenditures together with such indirect costs as are properly attributable to these activities, apportioned in a fair and reasonable manner in light of the particular facts of the case. The profit or loss shown by such accounts is then subject to adjustment in the usual way in accordance with the general rules for computing United Kingdom taxable profits of a trade. In particular, a deduction would be allowed for depreciation of plant and machinery based on the length of time during which the activities are performed on the United Kingdom Continental Shelf. A deduction would also normally be allowed for any interest paid on borrowings from third parties in respect of such assets.

In the United States, the business profits or income from independent personal services that are attributable to a permanent establishment or fixed base deemed to exist by reason of Article 27A would be the enterprise's effectively connected income determined under the rules of section 864 of the Code. Gross income would include amounts which are effectively connected with the conduct of the trade or business within the United States. Under section 638(1) of the Code the term "United States" when used in the geographical sense includes the Continental Shelf. The deductions alowable in arriving at taxable income would include all deductions generally allowable by the Code to the extent they are connected with effectively connected gross income.

Paragraph (2) of Article 27A establishes the minimum threshold for application of the Article. Activities carried on in connection with exploration or exploitation of the seabed or subsoil will not be treated as giving rise to a permanent establishment or fixed base if the activities are carried on for 30 days or less in the aggregate in any 12 month period. In making this computation, the time spent by an enterprise engaged in activities described in paragraph (1) of Article 27A, and the time spent by any related enterprise on activities which are substantially the same, will be aggravated. This rule is designed to prevent abuse of the 30 day rule. Aggregation of time spent by related persons will be applied only for the purpose of determining whether the requirement of presence for more than 30 days is met. The profits or income which can be taxed, once the threshold is met, will reflect the actual time spent by each taxpayer.

Paragraph (3) of new Article 27A provides that the exemption provisions of Article 8 (Shipping and air transport) will not prevent a State from taxing earnings from the operation of a drilling rig or any vessel the principal function of which is the performance of activities other than the transportation of goods or passengers. Rentals received under a bareboat charter of a drilling rig or other vessel are not considered activities within the scope of new Article 27A, even if the vessel is used in connection with exploration or exploitation of the seabed or subsoil.

ARTICLE VII

The delay in ratification of the Convention has raised administrative questions under United States and United Kingdom internal law relating to refund claims which may arise upon the entry into force of the Convention by reason of its retroactive effect under Article 28 (Entry into force) upon taxes paid for prior years. Article VII adds a new paragraph (7) to Article 28, providing for a specific three-year time limit during which such claims may be filed and relief granted.

For example, a calendar year taxpayer who paid the insurance excise tax imposed by section 4371 for the year 1975 with respect to insurance premiums remitted to a United Kingdom enterprise could file a timely claim for refund of such taxes under the Protocol within the three-year period after the calendar year in which the Convention enters into force, notwithstanding the expiration of the period set forth in section 6511 of the Code for filing claims for refunds. Similarly, the United Kingdom Inland Revenue will make payments of the United Kingdom tax credit on dividends under its imputation system of company taxation, to the extent it is required to do so under subparagraph (2)(a) of Article 10 (Dividends), notwithstanding the expiration of the period under internal law during which claims for relief must be filed.

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* Corrected.

ARTICLE VIII

The Third Protocol will enter into force immediately upon the expiration of 30 days following the date on which the instruments of ratification are exchanged. Upon its entry into force, it will have effect, with the exception of new Article 27A (Offshore activities) in accordance with Article 28 (Entry into force) of the Convention.

The provisions of new Article 27A (Offshore activities) will only have effect as of the date of entry into force of the Protocol. In determining whether the *de minimis* threshold of paragraph (2) of Article 27A is met, periods of time spent in the State of source before the date on which the Protocol enters into force will not be counted.

United States-United Kingdom Income Tax Convention

1980-21 I.R.B.

A procedure providing information with respect to how qualifying United States taxpayers should go about claiming a refund from the United Kingdom Government of the United Kingdom Advance Corporation Tax provided by Article 10 of the new United States-United Kingdom Income Tax Convention, and providing information with respect to the United States tax consequences of the new Convention for United Kingdom residents with respect to refunds of United States tax and additional United States tax due. See Rev. Proc. 80-18, page 89.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.701: Publicity of information. (Also Part I, Sections 901, 902, 905; 1.901-1, 1.902-1, 1.905-3; Part II, United States-United Kingdom Income Tax Convention.)

Rev. Proc. 80-18 [1]

SECTION 1. PURPOSE

The purpose of this revenue procedure is to set forth procedures for taxpayers to follow in applying certain provisions of the United States-United Kingdom Income Tax Convention, signed on December 31, 1975, as amended by an Exchange of Notes, signed on April 13, 1976, and Protocols, signed on August 26, 1976, March 31, 1977, and March 15, 1979 (the "Convention"), page 5, this Bulletin. The provisions of the Convention that are the subject of this revenue procedure concern: (1) payments from the United Kingdom of a tax credit representing United Kingdom Advance Corporation Tax to qualifying U.S. shareholders of United Kingdom corporations; and (2) U.S. tax consequences of the Convention for United Kingdom residents in regard to amounts with respect to which U.S. tax has been paid prior to April 25, 1980, or is due for periods prior to April 25, 1980 (the date the Convention enters into force). The provisions of the Convention and the rules for its application are described and explained in the Technical Explanation of the Convention prepared by the Department of the Treasury (the "Treasury Explanation"), page 62, this Bulletin.

SEC. 2. BACKGROUND

In 1973, the United Kingdom adopted a new system of corporate taxation that partially integrates its corporate and individual income taxes. Under this system, Advance Corporation Tax ("ACT") is levied on a United Kingdom corporation upon the payment of a dividend by that corporation to its individual shareholders. ACT is an advance payment in partial satisfaction of the corporation's general corporate tax ("mainstream tax") liability.

The rate of ACT has varied since 1973 but is currently 3/7 (approximately 42.86 percent) of the dividend. At the corporate level, ACT is generally credited against the distributing corporation's mainstream tax for the year of the distribution and, if in excess of the part of that year's mainstream tax that may be offset, under United Kingdom law, by ACT (or if there is no mainstream tax), may be carried back two years and carried forward indefinitely. At the shareholder level, ACT paid by the distributing corporation is allowed as a credit against the shareholder's own income tax liability or paid in cash to the extent that the ACT credit exceeds the shareholder's own income tax liability. The shareholder must include in taxable income the sum of ACT and the dividend received; that is, the dividend is "grossed up" by the amount of ACT paid by the distributing corporation.

In the absence of a specific tax treaty provision, ACT is not credited or refunded to persons not resident in the United Kingdom. Article 10 (Dividends) of the Convention provides for a payment from the United Kingdom of a tax credit ("refund") of ACT to qualifying U.S. taxpayers and allows the United Kingdom to reduce the refund by an amount that serves the function of a withholding tax.

Other provisions of the Convention affect the computation of the U.S. foreign tax credt for United Kingdom taxes, including the portion of ACT that is not refunded to U.S. corporations owning, directly or indirectly, 10 percent or more of the voting stock of a distributing United Kingdom corporation ("direct investors"). Section 3 of the revenue procedure explains the procedures applicable to these ACT related matters.

The Convention also contains provisions regarding the U.S. tax applicable to income of residents of the United Kingdom. Certain of these provisions result in a different U.S. tax liability from that provided for in the Income Tax Convention between the United States and the United Kingdom of Great Britain and Northern Ireland effective for taxable years beginning on or after January 1, 1945, T.D. 5569, 1947-2 C.B. 100, as amended by Protocols signed on June 6, 1946, T.D. 5569, 1947-2 C.B. 100, May 25, 1954, 1957-1 C.B. 665, August 19, 1957, 1958-2 C.B. 1078 and March 17, 1966, 1966-2 C.B. 582 (the "1945 Convention"). Under Article 28 (Entry Into Force) of the Convention, the 1945 Convention ceases to have effect in the United States in respect of withholding taxes for amounts paid or credited on or after January 1, 1975 and, in respect of other taxes, for taxable years beginning on or after January 1, 1975. Under paragraph (4) of Article 28, however, if any provision of the 1945 Convention would have afforded greater relief than the Convention, the provision of the 1945 Convention has effect in the United States for any taxable year beginning prior to January 1, 1976.

Thus, the Convention applies for U.S. tax purposes to amounts with respect to which U.S. tax has been paid prior to April 25, 1980 or is due for periods prior to April 25, 1980. Section 4 of this revenue procedure explains the procedures applicable to the payment or refund of U.S. tax with respect to such amounts.

SEC. 3. APPLICATION OF ACT REFUNDS TO UNITED STATES SHAREHOLDERS

.01 *Amount of ACT Refunds.* Paragraph (2)(a) of Article 10 (Dividends) provides a mechanism whereby U.S. direct investors and others who are U.S. residents and hold stock in a corporation resident in the United Kingdom, within the meaning of paragraph (1)(a)(ii) of Article 4 (Fiscal Residence) (a "United Kingdom corporation"), may avail themselves of the benefits of the shareholder credit available, in the absence of the Convention, only to United Kingdom residents. Such benefits will be available to U.S. residents as long as ACT credit is allowed in the United Kingdom to individual United Kingdom residents. Paragraph (2) of Article 10. Otherwise, United Kingdom taxation of dividends derived by U.S. residents from a corporation resident in the United Kingdom will be limited to 15 percent of the gross amount of the dividends. Paragraph (1) of Article 10.

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[1] Also released as News Release IR-80-57, dated April 25, 1980.

Under paragraph (2)(a) of Article 10, separate rules are provided for the taxation of dividends beneficially owned by U.S. direct investors and for the taxation of dividends beneficially owned by other U.S. residents ("portfolio investors"). For portfolio investors, paragraph (2)(a)(ii) of Article 10 provides for the refund by the United Kingdom of the full amount of ACT paid with respect to a dividend. This refund is reduced, however, by a 15-percent withholding on the sum of the dividend and the ACT refund. For direct investors, paragraph (2)(a)(i) of Article 10 provides for the refund by the United Kingdom of an amount equal to one-half of the ACT paid with respect to a dividend. This refund is reduced, however, by a 5-percent withholding on the sum of the dividend and the portion of ACT refunded (one-half).

.02 *Shareholders Entitled to ACT Refunds.* Shareholders entitled to ACT refunds include only residents of the United States, within the meaning of paragraph (1)(b)(i) and (ii) of Article 4 (Fiscal Residence), that derive and beneficially own dividends paid by a corporation resident in the United Kingdom.

Paragraph (4) of Article 10 (Dividends) provides that ACT refunds are not available to U.S. shareholders who have a permanent establishment in the United Kingdom or perform personal services from a fixed base therein if the holding with respect to which the dividends are paid is effectively connected with the permanent establishment or fixed base. Paragraph (7) of Article 10 provides that an ACT refund is not available in certain circumstances where tax avoidance may occur. Paragraph (7) is explained in the Treasury Explanation.

Pursuant to paragraph (2) of Article 1 (Personal Scope), an ACT refund is not available to a U.S. corporation that is also a resident of the United Kingdom within the meaning of paragraph (1)(a)(ii) of Article 4. However, an ACT refund is available to qualifying shareholders with respect to a dividend from a U.S. corporation that is also a resident of the United Kingdom.

U.S. shareholders are entitled to ACT refunds based on whether they meet the standards of the Convention as of the time the United Kingdom corporation paid the dividend subject to ACT that is refundable under the Convention.

.03 *Effective Dates for ACT Refunds.* The ACT refunds described in paragraph (2)(a)(i) of Article 10 (Dividends) are available to direct investors for dividends with respect to years of assessment beginning on or after April 6, 1975.

The ACT refunds described in paragraph (2)(a)(ii) of Article 10 are available to portfolio investors for dividends with respect to years of assessment beginning on or after April 6, 1973. A dividend paid on or after April 1, 1973, and before April 6, 1973, shall be treated for tax purposes as paid on April 6, 1973. The year of assessment referred to in the Convention (and in this paragraph .03) is the United Kingdom general income tax year, which begins on April 6 of each year.

.04 *Year of Inclusion of ACT Refunds.* Paragraph (2)(a)(iii) of Article 10 (Dividends) provides that for U.S. tax credit purposes the sum of a dividend and ACT refund paid by the United Kingdom to a U.S. corporation or other U.S. resident, without reduction for the amount withheld thereon, shall be treated as a dividend. For U.S. income tax purposes such amount must be included in the shareholder's gross income in the year the shareholder becomes entitled to such a refund. Thus, a calendar year U.S. taxpayer must include refunds of ACT paid prior to April 25, 1980 in his income for 1980 and a fiscal year U.S. taxpayer must do so for the first taxable year ending after April 24, 1980.

.05 *Allowance of Foreign Tax Credits With Respect to ACT Refunds.* Paragraph (1) of Article 23 (Elimination of Double Taxation) provides that the United States shall allow to its citizens and residents a foreign tax credit for the appropriate amount of tax paid to the United Kingdom, subject to the limitations of the laws of the United States for the taxable year. These limitations include the provisions of sections 904, 905, and 907 of the Internal Revenue Code. The Treasury Explanation, this paragraph .05, and paragraph .06 below provide rules to be used in determining the U.S. foreign tax credit pursuant to Article 23.

Paragraph (1)(a) of Article 23 provides that, for purposes of applying the U.S. credit, the United Kingdom income tax, capital gains tax, corporation tax and petroleum revenue tax are considered to be income taxes for persons entitled to the benefits of Article 23. Paragraph (1)(b) of Article 23 provides that the amount of 5-percent or 15-percent withholding, as the case may be, under paragraph (2)(a)(i) or (ii) of Article 10 (Dividends) from the grossed-up dividend (the sum of the dividend and the ACT refund) is to be treated as an income tax imposed on the recipient of the dividend (the U.S. shareholder).

Paragraph (1)(c) of Article 23 provides, in addition, that the one-half of the ACT paid by a United Kingdom corporation that is not refunded to a U.S. direct investor and that would be credited or refunded to a United Kingdom individual resident is treated as an income tax imposed on the distributing United Kingdom corporation (rather than the U.S. shareholder). Under United Kingdom law, a United Kingdom corporation that pays ACT may, however, transfer to a related United Kingdom corporation the right to apply ACT against mainstream tax liability. Thus, for example, a United Kingdom subsidiary of a United Kingdom corporation may benefit from the parent's ACT payment by offsetting part or all of the ACT against its own liability for United Kingdom mainstream tax. In such a case, for U.S. foreign tax credit purposes and pursuant to Article 23, the parent corporation has not paid or accrued the unrefunded ACT offset against the subsidiary's mainstream tax and has contributed to the capital of the subsidiary an amount equal to the unrefunded ACT offset. The subsidiary is considered to have paid or accrued only mainstream tax paid or accrued in excess of the ACT offset, plus the amount of unrefunded ACT so offset.

For purposes of Articles 10 and 23 of the Convention, refunded ACT offset against the United Kingdom subsidiary's mainstream tax is a deemed distribution from such subsidiary to the United Kingdom parent corporation (and from the parent to the U.S. shareholder) only if and to the extent that such refunded ACT was not useable by the parent (inasmuch as the parent owes no mainstream tax) and was imposed with respect to profits distributed by the subsidiary to the parent and which were then immediately redistributed to the U.S. shareholder. In all other cases, refunded ACT is a deemed dividend distribution only from the United Kingdom parent corporation to the U.S. shareholder.

A U.S. direct investor seeking to claim an indirect foreign tax credit as provided in paragraph (1)(c) of Article 23 (and pursuant to section 902 or section 960 of the Code) for the one-half of the ACT not refunded to such direct investor must compute the credit pursuant to this revenue procedure and the rules and examples set forth in the Treasury Explanation. Those rules and examples attribute ACT to accumulated profits, state which years' accumulated profits have been distributed as actual dividend distributions and ACT refund "dividends," and establish which accumulated profits are attributable to a U.S. shareholder that owns less than all of the stock of a distributing United Kingdom corporation. The rules in the Treasury Explanation for attributing ACT refunds to accumulated profits apply whether ACT is refunded at the time of the payment of the dividend that is subject to the ACT or at a later date (e.g., because the Convention enters into force in 1980 with retroactive effect). Thus, a refund in 1980 of ACT imposed with respect to a prior dividend distribution is a dividend distribution out of the years' accumulated profits to which, under this revenue procedure and the rules of the Treasury Explanation, the ACT is attributable. Accumulated profits and earnings and profits are determined under U.S. principles under sections 902 or 960, as the case may be, and the regulations thereunder.

As stated in section 2.05 of this revenue procedure, the right to receive ACT refunds gives rise to income for U.S. income tax purposes. For U.S. direct investors that prior to April 25, 1980 received actual distributions and claimed foreign tax credits for ACT for which a refund can be obtained under the Convention, an adjustment is required for U.S. income tax purposes; the amount of any foreign tax credits previously claimed by the direct investor pursuant to section 902 or 960 of the Code with respect to ACT that is refundable as of April 25, 1980 must be reduced by the direct investor to the extent of the refundable ACT (without reduction for the 5 percent withheld under the Convention by the United Kingdom). Section 905(c) and section 1.905-1(c) of the Income Tax Regulations provide that if any credited tax payment is refunded, in whole or in part, the taxpayer shall immediately notify the Commissioner of Internal Revenue. For purposes of the Convention and this revenue procedure, the reference to immediate notification of the Commissioner shall be construed to mean notification within 120 days of the receipt of an ACT refund from the United Kingdom pursuant to the Convention. Notification is to be accomplished by submitting, to the Internal Revenue Service Center where the taxpayer files its income tax return, an amended income tax return accompanied by a revised Form 1116 or 1118, as the case may be, for each taxable year involved.

The 5 percent withheld by the United Kingdom at the time of such a refund of ACT may, pursuant to the Convention and section 6511(d)(3)(A) of the Code, be claimed by a U.S. direct investor as a foreign income tax paid or accrued. Under paragraph (2)(a)(i) of Article 10 (Dividends), the 5-percent withholding is imposed by the United Kingdom on the aggregate of the dividend and the ACT refund paid to the U.S. direct investor. In the case of refunds of ACT with respect to a dividend distribution prior to April 25, 1980, the portion of the 5-percent withholding that is attributable to the prior dividend distribution (and not attributable to the ACT refund) is a foreign income tax paid or accrued for the U.S. taxable year in which such prior dividend was included in income by the U.S. direct investor. Similarly, the portion of the 15-percent withholding by the United Kingdom on ACT refunds to U.S. portfolio shareholders that is attributable to a prior dividend received by such a shareholder is a foreign income tax paid or accrued for the U.S. taxable year in which the dividend was included in income by the U.S. shareholder. (Since for U.S. income tax purposes ACT is imposed on the distributing corporation, not the shareholder, U.S. portfolio shareholders are not entitled to a foreign tax credit for ACT. The 15-percent United Kingdom withholding authorized by Article 10 is, however, treated under the Convention as an income tax imposed on the U.S. shareholder.) The portion of the 5- and 15-percent withholdings attributable to the ACT refund (and not to the prior dividend distribution) is for U.S. purposes a foreign income tax paid or accrued in the year in which refundable ACT is taken into income for U.S. purposes.

.06 *Exchange Rates.* The rate of exchange between the United Kingdom pound and the U.S. dollar on April 25, 1980 differs from the rate at the time when ACT with respect to prior distributions was paid to the United Kingdom. The refund of ACT to a U.S. shareholder must be included in the shareholder's gross income at the rate of exchange in effect on April 25, 1980 unless the rate of exchange on the date of receipt of the refund differs from the April 25, 1980 rate, in which case the rate on the date of receipt applies. The same rate of exchange also applies for claiming a foreign tax credit for the full amount of the 5- and 15-percent withholdings provided for by the Convention (regardless of the years to which such withholdings are attributable).

The change in the exchange rate also has implications for the section 905(c) adjustment described in section 2.06 of this revenue procedure which requires a reduction for any refundable ACT previously claimed as a creditable foreign tax. In the case of a U.S. direct investor entitled to an ACT refund and which previously claimed a deemed paid foreign tax credit under section 902, the section 905(c) adjustment requires a reduction for any refundable ACT previously claimed as a deemed paid credit. The amount of ACT claimed as a foreign income tax paid or accrued by the United Kingdom corporation is reduced (and accumulated profits in excess of foreign income taxes are increased) in United Kingdom pounds by the amount of such ACT that is refundable. The U.S. direct investor must then recompute the amount of its income and the deemed paid foreign tax credit with respect to the prior dividend distribution or distributions, translating the three elements of the deemed paid tax credit formula into U.S. dollars at the rate of exchange in effect at the time of the prior distribution or distributions. See *Bon Ami*, 39 B.T.A. 825 (1939).

In the case of a U.S. direct investor entitled to an ACT refund and which previously claimed a deemed paid foreign tax credit for ACT under section 960 of the Code, the section 905(c) adjustment requires a reduction for any refunded ACT previously claimed as a deemed paid credit. The amount of ACT claimed as a foreign income tax paid or accrued by the United Kingdom corporation is reduced (and earnings and profits is increased) in United States dollars using the April 25, 1980 rate or, if it is different from the April 25, 1980 rate, the rate on the date of receipt of the ACT refund. The U.S. direct investor must then recompute its income and deemed paid foreign tax credit with respect to the prior inclusion.

In the case of a U.S. corporation managed and controlled in the United Kingdom which previously claimed a foreign tax credit for ACT under section 901(b) of the Code, and which has U.S. shareholders entitled to an ACT refund, section 905(c) requires a reduction, for any refundable ACT previously claimed as a credit, using the U.S. dollar amount of the refundable ACT at the rate of exchange on April 25, 1980 or, if it is different from the April 25, 1980 rate, the rate of exchange in effect on the date of receipt of the ACT refund.

.07 *Manner of Claiming ACT Refunds from United Kingdom.* A U.S. shareholder claiming ACT refunds as provided in paragraph (2)(a) of Article 10 must make such claim on the appropriate United Kingdom form. The appropriate United Kingdom forms are: 1) *U.S. 7/Credit,* for a U.S. direct investor to obtain authorization for a United Kingdom corporation to distribute *future* dividends with ACT refunds; 2) *U.S./Corporation/Credit,* for a U.S. corporation owning less than 10 percent of the voting stock of a distributing United Kingdom corporation, for a U.S. direct investor with respect to ACT which is not subject to a claim for relief pursuant to *U.S. 7/Credit* (including ACT paid with respect to dividends distributed prior to April 25, 1980), and for any other U.S. resident other than an individual (e.g., a partnership or a trust); 3) *U.S./Individual/Credit,* for U.S. individual residents. (U.S. persons must use other United Kingdom forms for relief under the Convention from United Kingdom tax on other items of income: 1) *U.S./Individual* (interest, royalties, pensions, annuities, alimony); 2) *U.S./Corporation* (interest, royalties).) In the United States the United Kingdom forms for ACT refunds may be obtained from the Office of International Operations, Internal Revenue Service, 1325 K Street, NW, ATTN: Taxpayer Service Division, Room 900, Washington, DC 20225. In the United Kingdom forms may be obtained from the Inspector of Foreign Dividends, Lynwood Road, Thames Ditton, Surrey, England, KT70DP.

The first claim under the Convention by a U.S. resident for an ACT refund should be initiated by filling out the appropriate United Kingdom form (in duplicate) and filing it with the Director of the Internal Revenue Service Center with which the shareholder's last U.S. income tax return was filed, so that it can be certified. The Service Center will transmit such United Kingdom forms that it certifies to the United Kingdom Inspector of Foreign Dividends. Because certification by the appropriate Service Center Director is necessary, the shareholder or the shareholder's representative should send the appropriate form to the appropriate Service Center for processing in sufficient time to make a timely claim for refund in the United Kingdom. Claims for ACT refunds must normally be made, under United Kingdom law, within 6 years of the end of the year of assessment in which a dividend distribution is made. Under the United Kingdom system the year of assessment ends on April 5. In addition, paragraph (7) of Article 28 (Entry Into Force) provides a three-year period after the end of the calendar year in which the Convention enters into force to obtain refunds of taxes pursuant to the Convention, notwithstanding the expiration of the period of limitations provided by United Kingdom internal law.

Any claim for ACT refunds by a U.S. resident after the first claim does not require prior certification by an Internal Revenue Service Center. The appropriate United Kingdom forms should be filed in such cases directly with the United Kingdom Inspector of Foreign Dividends.

SEC. 4. APPLICATION OF UNITED STATES TAX ON UNITED KINGDOM RESIDENTS

.01 *Refunds of U.S. Tax.* Certain provisions of the Convention reduce U.S. tax of United Kingdom residents below the amount due under the provisions of the 1945 Convention. For example, dividends paid by a U.S. corporation to a corporation which is a resident of the United Kingdom which owns 10 percent or more of the voting stock of the U.S. corporation paying the dividend is subject to a U.S. tax of 5 percent of the dividend pursuant to paragraph (2)(b)(i) of Article 10 (Dividends). Under paragraph (1) of Article VI of the 1945 Convention, dividends beneficially owned by a resident of the United Kingdom were subject to U.S. tax at a rate of 15 percent. Article 28 (Entry Into Force) provides that the Convention applies in the United States to taxes withheld at source after January 1, 1975. Consequently, a resident of the United Kingdom which previously qualified for the 15-percent rate under paragraph (1) of Article VI of the 1945 Convention and which qualifies for the 5-percent rate under paragraph (2)(b)(i) of Article 10 is entitled to a refund of U.S. tax. The reduction to 5 percent applies to dividends paid on or after January 1, 1975.

The benefits of Article 10 are not available to a United Kingdom resident which is a U.S. corporation.

Another reduction in U.S. tax is provided by virtue of paragraph (2)(a) of Article 2 (Taxes Covered) and paragraphs (1) and (6A) of Article 7 (Business Profits). These provisions of the Convention state that insurance or reinsurance premiums received by certain United Kingdom enterprises are entitled to exemption from U.S. taxes otherwise imposed on insurance premiums paid to foreign insurers or reinsurers. The term "United Kingdom enterprise" includes a corporation, but only if the corporation is organized outside of the United States and is managed and controlled in the United Kingdom.

Other provisions of the Convention, such as paragraph (1) of Article 17 (Artistes and Athletes), paragraph (1) of Article 20 (Teachers) (with respect to researchers), and paragraph (2) of Article 18 (Pensions) (with respect to alimony), may also give rise to refunds of U.S. tax to certain United Kingdom residents.

A United Kingdom resident seeking a refund of U.S. income taxes pursuant to the Convention may obtain such refund by filing Forms 1040NR, 1040X, 1120F or 1120X, as the case may be, with the Philadelphia Service Center. Pursuant to paragraph (7) of Article 28, refunds may be obtained by filing the appropriate income tax form with the Philadelphia Service Center for certain U.S. taxable years with respect to which the U.S. statute of limitations has expired. A separate income tax form must be filed for each taxable year.

.02 *Additional U.S. Tax Due.* Certain provisions of the Convention eliminate U.S. tax benefits previously available to United Kingdom residents under the provisions of the 1945 Convention; thus, certain United Kingdom residents are subject to additional U.S. tax liability. (No provision of the Convention increases the U.S. tax of a United Kingdom resident above the amount due under the Code in the absence of the Convention.) For example, Article 6 (Income from Immovable Property (Real Property)) allows the United States to impose the 30-percent tax of Code sections 871(a) and 881 on fixed or determinable income from real property that is not effectively connected with the conduct of a trade or business in the United States. In contrast, Article IX of the 1945 Convention limited the U.S. tax on certain mineral royalties and real property rents to 15 percent if derived by a United Kingdom resident not engaged in trade or business in the United States. The 30-percent U.S. tax is due pursuant to the Convention with respect to any taxable year beginning on or after January 1, 1976. Thus, certain mineral royalties and real property rents paid for a U.S. taxable year beginning on or after January 1, 1976 are subject to an increase in U.S. tax (15 percent of the remittance) under the Convention. Other provisions of the Convention which may result in an increase in U.S. tax due include the provisions of Articles 13 (Capital Gains) and 17 (Artistes and Athletes).

The additional U.S. tax due for all open U.S. taxable years must be remitted to the Philadelphia Service Center along with Form 1040NR, 1040X, 1120F or 1120X, as the case may be, for each such taxable year.

.03 *Withholding.* Every person required to withhold any U.S. tax pursuant to the Code must, with respect to payments entitled to the benefits of the Convention, withhold U.S. tax pursuant to the provisions of the Convention only with respect to amounts paid on or after April 25, 1980. A nonresident alien or foreign corporation claiming the benefits of the Convention and seeking a reduction in or exemption from withholding of U.S. tax must satisfy any applicable requirements of the Code such as sections 1441, 1442, and 1461, and the regulations thereunder.

.04 *Interest.* Pursuant to Article 28 (Entry Into Force) and for purposes of section 6601 of the Code, the last date prescribed for payment of U.S. tax due for U.S. taxable years ending on or before April 24, 1980 shall be April 26, 1980, but only with respect to any additional U.S. tax due solely because the provisions of the Convention provide less relief from U.S. taxes than do the provisions of the 1945 Convention. Pursuant to Article 28 and for purposes of section 6611, the date of overpayment shall be considered to be April 25, 1980, but only with respect to refunds of U.S. tax due solely because the provisions of the Convention are more favorable than the provisions of the 1945 Convention.

SECTION 5. INQUIRIES

Inquiries regarding this revenue procedure may generally be addressed to the Commissioner of Internal Revenue, Attention: T:C:C:3, 1111 Constitution Avenue, NW, Washington, DC 20224. Inquiries concerning the filing of forms may be addressed to the Taxpayer Service Division of the I.R.S. Office of International Operations (address stated in section 3.07 of this revenue procedure), 202-566-5941 (not a toll-free number).

SECTION 6. EFFECTIVE DATE OF THIS REVENUE PROCEDURE

This revenue procedure is effective on the date of its publication and applies to the taxable years affected by the Convention.

Part IV. Items of General Interest

Clarification of the Rules for Deducting Club Dues Relating to an Entertainment Facility

Announcement 80-66

Recently enacted Public Law 96-222, 1980-20 I.R.B. 5, clarifies the rules for deducting club dues for entertainment facilities under section 274 (a)(2)(C) of the Internal Revenue Code. Previously, only country club due that met the business use test were deductible. For items paid or incurred after December 31, 1978, all social, athletic and sporting club dues or fees that satisfy the business use test and other applicable rules under section 274 are deductible.

Taxpayers who are entitled to this deduction could not claim it when they filed their income tax returns for fiscal year 1978-79, calendar year 1979, or fiscal year 1979-80. These taxpayers should file amended returns, using Form 1120X, Form 1040X, or the appropriate amended return.

Availability of Schedule B (Form 3468)-FY 1979-80

Announcement 80-67

Schedule B (Form 3468)-FY 1979-80, Computation of Business Energy Investment Credit, is available in Internal Revenue Service district offices. This new schedule incorporates the business energy investment credit provisions contained in the Crude Oil Windfall Profit Tax Act of 1980 (Public Law 96-223).

In general, these provisions apply to qualified investment in certain energy property acquired or built after December 31, 1979. Major changes to the business energy investment tax credit are as follows: the 10% credit was increased to 15% for solar, wind, and geothermal properties; a 15% credit is allowed for ocean thermal property; an 11% credit is allowed for qualified hydroelectric generating property; and the existing 10% credit is extended to cogeneration property, qualified intercity buses, and some new kinds of alternative energy property. The Act also provides that the refundable solar and wind energy credit becomes a nonrefundable credit, effective for tax years beginning after December 31, 1979.

Schedule B (Form 3468)-FY 1979-80 is to be used by taxpayers who have tax years beginning in 1979 and ending in 1980. Taxpayers who have already filed their fiscal year 1979-80 income tax returns without claiming the business energy credit to which they are now entitled should file amended returns. These taxpayers should use Form 1120X, 1040X, or the appropriate amended return; they should attach a completed Schedule B (Form 3468)-FY 1979-80 to show the computation of the credit.

Taxpayers filing for calendar year 1979 are not to use the 1979-80 schedule, but must use the 1979 Schedule B (Form 3468).

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

By decision on appeal from an initial decision in an administrative hearing, the following individuals have been suspended or disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Sydney M. Eisenberg	Milwaukee, WI	Attorney	April 17, 1980 Disbarment
Leon Feldt	El Paso, TX	Certified Public Accountant	March 26, 1980 Disbarment
David I. Kali	Tucson, AZ	Attorney	Indefinite Suspension from April 1, 1980
Angelos P. Romas	Endicott, NY	Attorney	April 9, 1980 Disbarment

After due notice and opportunity for hearing, the following individual was disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
William A. Carbaugh	Greenville, SC	Enrolled Agent	March 21, 1980

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Frank H. Abernathy	Richmond, VA	Certified Public Accountant	Indefinite effective April 9, 1980
Carl L. Harthun	Denver, CO	Attorney	Indefinite effective April 9, 1980
John T. Kelly, Jr.	Virginia Beach, VA	Certified Public Accountant	Indefinite effective April 15, 1980
Fran A. Moor	Fort Worth, TX	Certified Public Accountant	Indefinite effective April 15, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 150.0 through 150.6402-1 added; published as temporary regulations in T.D. 7690, 1980-16 I.R.B. 11.	Crude Oil Windfall Profit Tax Act of 1980.	Apr. 4, 1980	June 3, 1980
26 CFR 1.166-9, 1.482-2, 1.1371-1, amended; 1.385-1 through 1.385-12, added.	Treatment of certain interests in corporations as stock or indebtedness.	Mar. 24, 1980	June 23, 1980
26 CFR 1.1371-1, 1.1372-1 through 1.1372-4, amended; 1.1371, 1.1372, 1.1373, 1.1374, 1.1375, 1.1376, 1.1377, 1.1378, Part 14, deleted.	Certain shareholder reqiurements and related matters for electing small business corporations.	April 17, 1980	June 13, 1980
26 CFR 1.411(d)-1 added.	Coordination of vesting and discrimination requirements for qualified plans.	April 9, 1980	June 9, 1980
26 CFR 1.1502-12, amended; 1.1502-44, added.	Consolidated returns for percentage depletion for independent producers and royalty owners.	April 9, 1980	June 9, 1980
26 CFR 1.21-1—53.4940-1 and intermediate sections amended.	Changes in the holding period required for gains or losses on transactions in capital assets to be treated as long-term capital gains or losses and changes in certain terms relating to transactions in capital assets.	April 9, 1980	June 9, 1980
26 CFR 1.1402(c)-3, 301.6652-1, amended; 1.6050A-1, 31.3121(b)(20)-1, 31.3401(a)(17)-1, 301.6050 A-1 added.	Treatment of certain crewmen on boats engaged in catching fish as self-employed rather than as employees.	April 9, 1980	June 9, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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80-55, 1980-18 I.R.B. **20**
80-56, 1980-16 I.R.B. **34**
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80-49, 1980-8 I.R.B. **13**
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80-51, 1980-8 I.R.B. **23**
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80-63, 1980-10 I.R.B. **7**
80-64, 1980-10 I.R.B. **9**
80-65, 1980-10 I.R.B. **10**
80-66, 1980-10 I.R.B. **10**
80-67, 1980-10 I.R.B. **11**
80-68, 1980-10 I.R.B. **12**
80-69, 1980-11 I.R.B. **5**
80-70, 1980-11 I.R.B. **5**
80-71, 1980-11 I.R.B. **7**
80-72, 1980-11 I.R.B. **9**
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80-88, 1980-13 I.R.B. **9**
80-89, 1980-13 I.R.B. **10**
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[1] See footnote at end of list.

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80-103, 1980-15 I.R.B. **12**
80-104, 1980-15 I.R.B. **13**
80-105, 1980-16 I.R.B. **5**
80-106, 1980-16 I.R.B. **6**
80-107, 1980-16 I.R.B. **7**
80-108, 1980-16 I.R.B. **8**
80-109, 1980-16 I.R.B. **8**
80-110, 1980-16 I.R.B. **10**
80-111, 1980-16 I.R.B. **10**
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80-115, 1980-17 I.R.B. **12**
80-116, 1980-17 I.R.B. **13**
80-117, 1980-17 I.R.B. **15**
80-118, 1980-17 I.R.B. **20**
80-119, 1980-18 I.R.B. **5**
80-120, 1980-18 I.R.B. **6**
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80-122, 1980-18 I.R.B. **8**
80-123, 1980-18 I.R.B. **10**
80-124, 1980-18 I.R.B. **12**
80-125, 1980-18 I.R.B. **16**
80-126, 1980-19 I.R.B. **5**
80-127, 1980-19 I.R.B. **5**
80-128, 1980-19 I.R.B. **6**
80-129, 1980-19 I.R.B. **7**
80-130, 1980-19 I.R.B. **10**
80-131, 1980-19 I.R.B. **11**
80-132, 1980-19 I.R.B. **12**
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7657, 1980-2 I.R.B. **13**
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7659, 1980-3 I.R.B. **8**
7660, 1980-4 I.R.B. **9**
7661, 1980-5 I.R.B. **6**
7662, 1980-5 I.R.B. **9**
7663, 1980-6 I.R.B. **6**
7664, 1980-7 I.R.B. **10**
7665, 1980-8 I.R.B. **17**
7666, 1980-8 I.R.B. **15**
7667, 1980-9 I.R.B. **7**
7668, 1980-10 I.R.B. **8**
7669, 1980-11 I.R.B. **11**
7670, 1980-11 I.R.B. **15**
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7677, 1980-14 I.R.B. **16**
7678, 1980-15 I.R.B. **14**
7679, 1980-15 I.R.B. **7**
7680, 1980-15 I.R.B. **9**
7681, 1980-17 I.R.B. **19**
7682, 1980-17 I.R.B. **17**
7683, 1980-17 I.R.B. **6**
7684, 1980-18 I.R.B. **13**
7685, 1980-18 I.R.B. **9**
7686, 1980-18 I.R.B. **17**
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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1, dated January 7, 1980.

Finding List of Current Action on Previously Published Rulings[1]

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* Denotes entry since last publication

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4 (Rev. 9)
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4 (Rev. 10), 1980-10 I.R.B. **13**

35 (Rev. 10)
Superseded by
35 (Rev. 11), 1980-19 I.R.B. **15**

42 (Rev. 12)
Superseded by
42 (Rev. 13), 1980-4 I.R.B. **40**

57 (Rev. 3)
Superseded by
57 (Rev. 4), 1980-17 I.R.B. **22**

66 (Rev. 9)
Superseded by
66 (Rev. 10), 1980-14 I.R.B. **27**

77 (Rev. 13)
Superseded by
77 (Rev. 14), 1980-19 I.R.B. **15**

93 (Rev. 6)
Superseded by
93 (Rev. 7), 1980-19 I.R.B. **15**

97 (Rev. 16)
Superseded by
97 (Rev. 17), 1980-17 I.R.B. **22**

97 (Rev. 17)
Superseded by
97 (Rev. 18), 1980-19 I.R.B. **16**

152
Superseded by
152 (Rev. 1), 1980-10 I.R.B. **14**

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66-53
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68-23
Amplified by
Rev. Proc. 80-14, 1980-16 I.R.B. **32**

70-6
Amplified by
Rev. Proc. 80-4, 1980-6 I.R.B. **17**

74-23
Superseded by
Rev. Proc. 80-7, 1980-8 I.R.B. **24**

74-24
Superseded by
Rev. Proc. 80-7, 1980-8 I.R.B. **24**

74-25
Superseded by
Rev. Proc. 80-7, 1980-8 I.R.B. **24**

75-3
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77-15
Modified by
Rev. Proc. 80-17, 1980-19 I.R.B. **17**

77-36
Superseded by
Rev. Proc. 80-7, 1980-8 I.R.B. **24**

77-40
Superseded by
Rev. Proc. 80-7, 1980-8 I.R.B. **24**

77-47
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78-32
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79-12
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79-21
Superseded by
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79-53
Superseded by
Rev. Proc. 80-13, 1980-16 I.R.B. **32**

80-5
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54-193
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80-105, 1980-16 I.R.B. **5**

56-249
Distinguished by
80-124, 1980-18 I.R.B. **12**

56-252
Superseded by
80-49, 1980-8 I.R.B. **13**

56-432
Obsoleted by
80-27, 1980-4 I.R.B. **8**

56-497
Obsoleted by
80-16, 1980-3 I.R.B. **6**

60-330
Distinguished by
80-124, 1980-18 I.R.B. **12**

62-197
Distinguished by
80-17, 1980-3 I.R.B. **5**

Rev. Ruls.—Continued

63-180
Obsoleted by
80-16, 1980-3 I.R.B. **6**

64-149
Distinguished by
80-17, 1980-3 I.R.B. **5**

64-264
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80-20, 1980-3 I.R.B. **10**

65-16
Amplified by
80-4, 1980-1 I.R.B. **14**

66-16
Superseded by
80-128, 1980-19 I.R.B. **6**

66-307
Clarified by
80-80, 1980-12 I.R.B. **10**

67-25
Superseded by
80-49, 1980-8 I.R.B. **13**

67-431
Amplified by
80-7, 1980-1 I.R.B. **17**

68-89
Obsoleted by
80-16, 1980-3 I.R.B. **6**

68-382
Distinguished by
80-30, 1980-5 I.R.B. **7**

68-608
Modified by
80-78, 1980-12 I.R.B. **8**

69-368
Obsoleted after 6/30/69 by
80-76, 1980-12 I.R.B. **6**

69-369
Obsoleted after 6/30/69 by
80-76, 1980-12 I.R.B. **6**

70-190
Clarified by
80-115, 1980-17 I.R.B. **12**

70-336
Modified by
80-109, 1980-16 I.R.B. **8**

71-89
Superseded by
80-126, 1980-19 I.R.B. **5**

71-252
Distinguished by
80-71, 1980-11 I.R.B. **7**

71-312
Modified & Superseded by
80-47, 1980-8 I.R.B. **11**

71-399
Further amplified by
80-96, 1980-14 I.R.B. **22**

72-395
Modified by
80-123, 1980-18 I.R.B. **10**

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[1] See footnote at end of list.

Finding List of Current Action on Previously Published Rulings[1]—Continued

Bulletins 1980-1 through 1980-20

Rev. Ruls.—Continued

73-17
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80-129, 1980-19 I.R.B. **7**

73-198
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73-413
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80-129, 1980-19 I.R.B. **7**

74-96
Superseded by
80-47, 1980-8 I.R.B. **11**

74-99
Clarified by
80-63, 1980-10 I.R.B. **7**

74-206
Amplified & Clarified by
80-65, 1980-10 I.R.B. **10**

74-433
Superseded by
80-62, 1980-8 I.R.B. **9**

74-512
Revoked by
80-53, 1980-8 I.R.B. **15**

75-296
Distinguished by
80-34, 1980-6 I.R.B. **9**

75-368
Modified by
80-6, 1980-1 I.R.B. **16**

75-461
Amplified by
80-124, 1980-18 I.R.B. **12**

76-415
Clarified by
80-59, 1980-9 I.R.B. **18**

76-439
Revoked by
80-85, 1980-13 I.R.B. **6**

76-567
Superseded by
80-36, 1980-6 I.R.B. **11**

77-40
Amplified by
80-134, 1980-19 I.R.B. **10**

77-392
Revoked by
80-31, 1980-5 I.R.B. **8**

77-410
Superseded by
80-62, 1980-8 I.R.B. **9**

77-489
Amplified by
80-70, 1980-11 I.R.B. **5**

Rev. Ruls.—Continued

78-110
Clarified by
80-22, 1980-3 I.R.B. **15**

78-161
Distinguished by
80-9, 1980-2 I.R.B. **5**

78-427
Superseded by
80-114, 1980-17 I.R.B. **11**

79-309
Distinguished by
80-131, 1980-19 I.R.B. **11**

80-36
Amplified by
80-98, 1980-14, I.R.B. **25**

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1 I.R.B., dated January 7, 1980.

INTERNAL REVENUE CUMULATIVE BULLETINS

______	1927–1	$6.90
______	*1927–2*	*2.95*
______	1928–1	6.95
______	1928–2	9.50
______	*1929–1*	*2.50*
______	*1929–2*	*3.15*
______	1930–1	7.30
______	1930–2	9.50
______	*1931–1*	*3.60*
______	*1931–2*	*3.25*
______	*1932–1*	*2.80*
______	1932–2	8.65
______	*1933–1*	*3.35*
______	*1933–2*	*3.45*
______	*1934–1*	*3.70*
______	*1934–2*	*4.10*
______	1935–1	6.90
______	*1935–2*	*4.00*
______	*1936–1*	*3.55*
______	*1936–2*	*3.90*
______	*1937–1*	*3.75*
______	1937–2	7.70
______	*1938–1*	*4.05*
______	*1938–2*	*3.50*
______	1939–1–1	8.25
______	1939–1–2	10.90
______	1939–2	9.40
______	1940–1	5.55
______	1940–2	14.00
______	1941–1	*$6.95*
______	*1941–2*	*3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
______	*1944*(*)	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*2.65*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$10.10
______	1957–2	13.00
______	1958–1	9.60
______	1958–2	13.00
______	1958–3	15.00
______	1959–1	15.00
______	1959–2	9.60
______	1960–1	9.00
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June 2, 1980
Bulletin No. 1980-22

9258

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENTS

Announcement 80-69, page 15.
A public hearing will be held on July 23, 1980, concerning proposed regulations relating to the treatment of certain interests in corporations as stock or indebtedness.

Announcement 80-70, page 15.
A public hearing will be held on July 8, 1980, concerning proposed regulations relating to limitations on benefits and contributions under qualified pension plans.

Announcement 80-71, page 16.
A public hearing will be held on June 24, 1980, concerning proposed regulations relating to self-insured medical reimbursement plans.

Announcement 80-72, page 16.
A public hearing will be held on June 19, 1980, concerning proposed regulations relating to the gas guzzler tax.

Announcement 80-73, page 16.
A public hearing will be held on July 10, 1980, concerning proposed regulations relating to rules for determining if the vesting schedule of a qualified plan discriminates in favor of employees who are officers, shareholders, or highly compensated.

Announcement 80-74, page 17.
Certain items will be published as numbered Notices in Part III of the weekly Bulletin and retained in the Cumulative Bulletin.

INCOME TAX

Rev. Rul. 80-135, page 5.
Municipal bond loaned to cover short sale; payment received in lieu of interest. The lender of a municipal bond to a broker who borrowed the bond to cover a short sale is not entitled to exclude from gross income under section 103(a)(1) of the Code an amount received from the broker that is equal to the interest the lender would have received on the bond.

Rev. Rul. 80-136, page 5.
Industrial development bonds; townships and towns; incorporated municipalities. Townships and towns that have substantial governmental powers qualify as "incorporated municipalities" as that term is used in section 103(b)(6)(E)(i) of the Code if a state statute or the highest court of the state recognizes the entities as being municipal corporations; Rev. Rul. 74-381 modified.

Rev. Rul. 80-137, page 6.
Workmen's compensation; disabled police officer assigned to light duty. Payments made by a municipality to a disabled police officer who has returned to work, but is assigned to light duty because the injury keeps the officer from performing regular police duties, are not excludable from gross income under section 104(a)(1) of the Code.

Rev. Rul. 80-141, page 10.
Inventories; service fees paid to supplier. A sales-service fee equal to a percentage of a customer's

(Continued on page 4)

Finding Lists begin on page 23.
Announcement of Disbarments and Suspensions begins on page 20.
Announcement of Notice of Proposed Rulemaking on page 22.
Monthly Index for May begins on page 27.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

purchases that a wholesale grocer charges retail grocers under franchise agreements, whether or not the retailers use any services provided by the wholesaler, must be included in the cost of the retailers' inventories. Other service fees that the wholesaler charges retailers only for services that are actually rendered are deductible by the retailers under section 162 of the Code.

T.D. 7689, page 7.
Amendments to the regulations under section 217(g) of the Code relate to moving expenses of members of the Armed Forces incurred in connection with termination of active duty.

Announcement 80-75, page 17.
The disaster areas announcement for the State of California has been amended to add to the list of counties in which losses qualify for the special tax treatment under section 165(h) of the Code.

Announcement 80-76, page 17.
Various areas of the States of Alabama, Arkansas, Louisiana, and Mississippi have been declared disaster areas in which losses qualify for the special tax treatment under section 165(h) of the Code.

EMPLOYEE PLANS

Rev. Rul. 80-138, page 8.
Employer securities; transferred to new trust; basis. The transfer of employer securities (consisting of stock in the parent corporation) from an exempt employees' trust that is maintained by the parent corporation and its subsidiary to a newly established exempt employees' trust of the subsidiary corporation will not change the basis of the securities for purposes of computing the net unrealized appreciation in such securities; Rev. Rul. 67-181 superseded.

Rev. Rul. 80-139, page 9.
Annuity contracts; staff of teachers' retirement system. Amounts contributed by a state teachers' retirement system to purchase annuity contracts for the employees of the retirement system are not excludable from the employees' gross income under section 403(b) of the Code; Rev. Rul. 68-178 superseded.

Rev. Rul. 80-140, page 9.
Employer's contribution; term promissory note. The delivery of an employer's own term promissory note to an employees' trust does not constitute payment for purposes of section 404(a) of the Code, and the issuance of such a note to a plan is a prohibited transaction within the meaning of section 4975; Rev. Rul. 71-95 superseded.

EXEMPT ORGANIZATIONS

Announcement 80-77, page 18.
A listing is given of organizations now classified as private foundations.

ESTATE TAX

Rev. Rul. 80-142, page 11.
Jointly owned stock; stock dividend. An individual acquired common stock of a corporation and placed it in a joint tenancy with rights of survivorship. Before the individual's death, the corporation distributed a one-share-for-four stock dividend and another dividend that was paid in stock in lieu of cash at the joint tenants' election. The value of all the stock except one-half the elective stock dividend is includible in the decedent's gross estate.

EMPLOYMENT TAXES

T.D. 7691, page 12.
Amendments to the regulations under sections 1402, 3121, and 3506 of the Code relate to the exemption of companion-sitting placement services from employer status.

ADMINISTRATIVE

Del. Order No. 149 (Rev. 1) Revocation Notice, page 14.
Levy on property in hands of third parties. Del. Order No. 149 (Rev. 1), which delegated the authority to levy on wages, salaries, other income, and bank deposits held by third parties, to issue final demand for enforcement of levy, and to release levy and return property to the Chief, Collection Branch in the Compliance Division, Cincinnati Service Center, is revoked.

Announcement 80-78, page 19.
The procedure is provided for claiming a refund of excise tax paid on gasoline mixed with alcohol beginning January 1, 1979.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-2: Compensation for services, including fees, commissions, and similar items.

Whether compensation received by a taxpayer disabled in the line of duty, when the taxpayer is performing "light duty" for the municipality making the payments, is includible in gross income. See Rev. Rul. 80-137, page 6.

26 CFR 1.61-7: Interest.

Whether the lender of a municipal bond is entitled to exclude from gross income an amount, equal to the interest on the bond, received from a broker who borrowed the bond to cover a short sale. See Rev. Rul. 80-135, below.

Section 103.—Interest on Certain Governmental Obligations

26 CFR 1.103-1: Interest upon obligations of a State, Territory, etc.
(Also Section 61; 1.61-7.)

Municipal bond loaned to cover short sale; payment received in lieu of interest. The lender of a municipal bond to a broker who borrowed the bond to cover a short sale is not entitled to exclude from gross income under section 103(a)(1) of the Code an amount received from the broker that is equal to the interest the lender would have received on the bond.

Rev. Rul. 80-135

ISSUE

Is the lender of a municipal bond entitled to exclude from gross income under section 103(a)(1) of the Internal Revenue Code an amount, equal to the interest on the bond, received from a broker who borrowed the bond to cover a short sale?

FACTS

A, an individual, owned a municipal bond (bearer bond) the interest on which was excludable from *A*'s gross income under the provisions of section 103(a)(1) of the Code. A broker asked to borrow *A*'s bond to cover a short sale between two of the broker's clients. *A* delivered the bond to the broker and the broker subsequently delivered the bond to the purchaser under the short sale. The purchaser, as the new owner, is excluding from gross income the interest received on the bond. Under the agreement with the broker, *A* is entitled to receive a similar bond from the broker upon demand. In addition, the broker will pay *A* an amount equal to the interest that would have been received by *A* on the bond transferred until a similar bond is returned to *A*.

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that interest on the obligations of a state or political subdivision of a state is excludable from the gross incomes of the holders of the obligations.

A short sale transaction involves the borrowing by the seller of the securities delivered to the buyer. Subsequently, the seller must deliver similar securities to the lender in order to close the transaction. Short sales are ordinarily made through a broker who borrows the securities for delivery to the purchaser. The character of gain or loss from short sales is determined under the provisions of section 1233 of the Code.

Rev. Rul. 74-482, 1974-2 C.B. 267, holds that interest accrued on tax-exempt municipal bonds after ownership of the bonds had been transferred by a dealer in municipal bonds is not excludable from the gross income of the dealer under the provisions of section 103(a)(1) of the Code because only the owner of obligations described in section 103 may treat the interest accruing on such obligations as excludable from gross income.

Rev. Rul. 60-177, 1960-1 C.B. 9, holds that an amount equal to a cash dividend, paid to a lender of stock by a "short-seller" with respect to the stock borrowed to cover a short sale, is not a dividend within the meaning of section 316(a) of the Code. Section 316(a) provides that the term "dividend" means any distribution of property made by a corporation to its shareholders out of its earnings and profits accumulated after February 28, 1913, or out of its earnings and profits of the taxable year. The phrase in section 316(a) "to its shareholders" means the owners of stock. Rev. Rul. 60-177 states that the purchaser, rather than the lender, is the real owner of the stock because title to the stock passed to the purchaser as a result of the short sale.

In this case the lender delivered the bond to the broker for transfer to the purchaser in the short sale transaction. Because title passed to the purchaser as a result of the short sale, the lender is no longer the owner of the bond. Therefore, the amount received by the lender is not interest on an obligation of a state or political subdivision of a state within the meaning of section 103 of the Code.

HOLDING

The lender of the municipal bond is not entitled to exclude from gross income under section 103(a)(1) of the Code the amount, equal to the interest on the bond, received from the broker who borrowed the bond to cover the short sale.

26 CFR 1.103-10: Exemption for certain small issues of industrial development bonds.

Industrial development bonds; townships and towns; incorporated municipalities. Townships and towns that have substantial governmental powers qualify as "incorporated municipalities" as that term is used in section 103(b)(6)(E)(i) of the Code if a state statute or the highest court of the state recognizes the entities as being municipal corporations; Rev. Rul. 74-381 modified.

Rev. Rul. 80-136

ISSUE

Do townships and towns qualify as "incorporated municipalities" as such term is used in section 103(b)(6)(E)(i) of the Internal Revenue Code in the situations described below?

Situation 1. Under state statute, townships of certain populations have corporate powers that are vested in an elected Board of Commissioners. Such townships may purchase and hold property, establish a police force, adopt ordinances and resolutions regulating the governmental affairs of the township, exercise the power of eminent domain, and levy taxes. The statutes of the state also provide that the term "municipal corporations" and "municipalities" include townships. The townships may not elect to incorporate.

Situation 2. Under state statute, a town is a governmental unit comprising the inhabitants within its boundaries and formed for the purpose of exercising such powers and discharging such duties of local government conferred or imposed on it by law.

State law provides that a town may acquire real property by condemnation, establish a police department and provide for enforcement of local laws by legal or equitable proceedings, and cause real property taxes to be levied for town purposes. Although the county government performs the act of levying and extending the taxes on the assessment roll, the town government evaluates real property for tax purposes, prepares the assessment roll, determines the amount of taxes to be levied for town purposes, and requires the County to levy such taxes by adopting and presenting a town budget to the county governing body. Taxes are collected by the town tax collector.

The highest court of the state recognizes the towns as municipal corporations.

Situation 3. The facts are the same as in Situation 2, except that neither the state statutes nor the highest court of the state recognizes the towns as municipal corporations.

LAW

Section 103(b)(6)(D) of the Code, as amended by the Revenue Act of 1978, section 331(a), Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, 73, provides that for purposes of determining if the exempt small issue limitation of $10,000,000 ($5,000,000 for obligations issued before January 1, 1979) has been exceeded, capital expenditures made with respect to facilities described in section 103(b)(6)(E) must be aggregated with the face amount of the obligations. The $10,000,000 limitation also applies to capital expenditures made after December 31, 1978, with respect to bonds issued before January 1, 1979. The facilities described in section 103(b)(6)(E) are those located in the same incorporated municipality or located in the same county (but not in any incorporated municipality) and the principal user is the same person or two or more related persons.

HOLDING

The townships described in Situation 1 and the towns described in Situation 2 qualify as "incorporated municipalities" as that term is used in section 103(b)(6)(E)(i) of the Code because the state recognizes such entities as being municipal corporations and because the entities have substantial governmental powers. The towns described in Situation 3 do not qualify as "incorporated municipalities" as such term is used in section 103(b)(6)(E)(i) because the towns are not recognized either by the state statutes or the highest court of the state as being municipal corporations.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 74-381, 1974-2 C.B. 34, holds that townships that could have elected to become incorporated towns but did not do so, fail to qualify as "incorporated municipalities" as that term is used in section 103(c)(6)(E)(i) of the Code (redesignated as 103(b)(6)(E)(i)); that revenue ruling is modified to hold that such townships will be treated as incorporated municipalities if they possess substantial governmental powers and the state statute or the highest court of the state recognizes the townships as municipal corporations or as municipalities.

Section 104.—Compensation for Injuries or Sickness

26 CFR 1.104-1: Compensation for injuries or sickness.
(Also Section 61; 1.61-2.)

Workmen's compensation; disabled police officer assigned to light duty. Payments made by a municipality to a disabled police officer who has returned to work, but is assigned to light duty because the injury keeps the officer from performing regular police duties, are not excludable from gross income under section 104(a)(1) of the Code.

Rev. Rul. 80-137

ISSUE

Are payments made by a municipality to a disabled police officer performing "light duty" excludable from gross income under section 104(a)(1) of the Internal Revenue Code?

FACTS

B, a police officer employed by City *M* in the State of New York, was injured in the line of duty on January 5, 1979, and hospitalized. On March 1, 1979, *B* returned to work and, because *B* was unable to perform regular police duties as a result of the injury, *B* was assigned to "light duty." Since the date of *B*'s injury, including the period *B* has been assigned to "light duty," *M* has paid to *B* the full amount of *B*'s regular salary pursuant to the New York General Municipal Law section 207-c (McKinney 1974).

Section 207-c of the New York Law provides, under certain circumstances, for the payment of the full amount of salary or wages to a police officer, employed by a municipality, who is absent from work due to an injury or sickness incurred during, or resulting from, the performance of duties.

Section 207-c.2 of the Law provides that the payment of the full amount of regular salary shall be discontinued with respect to any police officer who is permanently disabled as a result of an injury or sickness incurred in, or resulting from, the performance of duties if the police officer is granted an accidental disability retirement allowance or pension.

Section 207-c.3 of the Law provides that if the disabled police officer is not eligible for, or is not granted, an accidental disability retirement allowance or pension and is nevertheless, in the opinion of the applicable health authorities, unable to perform regular police duties because of a job incurred injury or sickness, but is able to perform specified types of light police duty, payment of the full amount of regular salary shall be discontinued with respect to such police officer if the police officer should refuse to perform the light police duty if the same is available and offered.

LAW AND ANALYSIS

Section 61 of the Code provides that gross income means all income from whatever source derived, including compensation for services.

Section 104(a)(1) of the Code provides that, except in the case of amounts attributable to (and not in excess of) deductions allowed under section 213 (relating to medical, etc., expenses) for any prior taxable year, gross income does not include amounts received under workmen's compensation acts as compensation for personal injuries or sickness.

Section 1.104-1(b) of the Income Tax Regulations provides that the exclusion under section 104(a)(1) of the Code applies not only to amounts received under workmen's compensation acts but also to amounts received under a statute in the nature of a workmen's compensation act which provides compensation to employees for personal injuries or sickness incurred in the course of their employment.

Section 104(a)(1) of the Code and the regulations thereunder do not allow the exclusion from gross income of payments of salary. Even though the services performed by *B* are limited because of a job incurred disability, the payments received by *B* are salary payments.

HOLDING

The payments made by *M* to *B* during the period *B* is performing "light duty" are not excludable from the gross income under section 104(a)(1) of the Code because such payments are salary payments made in return for services performed by *B*.

Section 162.—Trade or Business Expenses

26 CFR 1.162-1: Business expenses.

Whether sales-service fee and charges on a per-service rendered basis paid by a taxpayer to its supplier, a wholesale grocer, are deductible as a trade or business expense under the provisions of section 162 of the Code. See Rev. Rul. 80-141, page 10.

Section 217.—Moving Expenses

26 CFR 1.217-2: Deduction for moving expenses paid or incurred in taxable years beginning after December 31, 1969.

T.D. 7689

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Moving expenses of members of the Armed Forces of the United States

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the moving expenses of members of the Armed Forces of the United States. The final regulations amend the rules under section 217(g) of the Internal Revenue Code of 1954 to make them consistent with the rules in the Joint Travel Regulations, promulgated by the Departments of Defense and Transportation under the authority contained in sections 404 through 411 of title 37 of the United States Code.

DATE: The amendments are effective for taxable years beginning after December 31, 1975.

FOR FURTHER INFORMATION CONTACT: Barbara B. Coughlin of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-6618).

SUPPLEMENTARY INFORMATION:

BACKGROUND

Since this Treasury decision will not be detrimental to any taxpayer, it is found unnecessary to issue this Treasury decision with notice and public procedure thereon under subsection (b) of section 553 of title 5 of the United States Code.

EXPLANATION OF PROVISIONS

Section 217(g) of the Internal Revenue Code provides special moving expense rules for members of the Armed Forces of the United States on active duty who move pursuant to a military order and incident to a permanent change of station. For these military members, moving expenses furnished in kind or by reimbursement need not be included in gross income, and the Secretary of Defense and the Secretary of Transportation are not required to make information reports with respect to these expenses. The regulations under section 217(g) presently provide that a permanent change of station includes a move in connection with and within 90 days of retirement or other termination of active duty.

This regulation project amends § 1.217-2(g)(3)(ii) to provide that a permanent change of station includes a move in connection with and within 1 year of retirement or other termination of active duty. The Joint Travel Regulations extend the 1-year period for members undergoing hospitalization, medical treatment, education, or training, or in other deserving cases approved by the Secretary of the appropriate branch of the Armed Forces or by the Secretary's representative. The Income Tax Regulations as amended provide a corresponding extension.

DRAFTING INFORMATION

The principal author of these regulations is Barbara B. Coughlin of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing these regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended by revising § 1.217-2(g)(3)(ii) to read as follows:

§ 1.217-2 Deduction for moving expenses paid or incurred in taxable years beginning after December 31, 1969.

* * * * *

(g) *Rules for members of the Armed Forces of the United States.* * * *

(3) Permanent change of station. * * *

(ii) A move from the last post of duty to home or a nearer point in the United States in connection with retirement, discharge, resignation, separation under honorable conditions, transfer, relief from active duty, temporary disability retirement, or transfer to a Fleet Reserve, if such move occurs within 1 year of such termination of active duty or within the period prescribed by the Joint Travel Regulations promulgated under the authority contained in sections 404 through 411 of title 37 of the United States Code.

* * * * *

Because this Treasury decision will not be detrimental to any taxpayer, it is found unnecessary to issue this Treasury decision with notice and public procedure thereon under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in sections 217(j) and 7805 of the Internal Revenue Code of 1954 (78 Stat. 50 and 68A Stat. 917; 26 U.S.C. 217(j) and 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved March 24, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on March 28, 1980, 8:45 a.m., and published in the issue of the Federal Register for March 31, 1980, 45 F.R. 20795)

Section 402.—Taxability of Beneficiary of Employees' Trust

26 CFR 1.402(a)-1: Taxability of beneficiary under a trust which meets the requirements of section 401(a).

Employer securities; transferred to new trust; basis. The transfer of employer securities (consisting of stock in the parent corporation) from an exempt employees' trust that is maintained by the parent corporation and its subsidiary to a newly established exempt employees' trust of the subsidiary corporation will not change the basis of the securities for purposes of computing the net unrealized appreciation in such securities; Rev. Rul. 67-181 superseded.

Rev. Rul. 80-138

The purpose of this revenue ruling is to restate the position in Rev. Rul. 67-181, 1967-1 C.B. 91, in view of the enactment of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 1974-3 C.B. 1.

The issue presented in Rev. Rul. 67-181 is whether the transfer of employer securities (consisting of stock in the parent corporation) from an exempt employees' trust maintained by a corporation and its subsidiary to a newly established exempt employees' trust of the subsidiary, under the circumstances described below, changed the basis of these securities for the purpose of computing the net unrealized appreciation in such securities.

A wholly owned subsidiary corporation was a participating employer under the parent's qualified profit-sharing trust. Pursuant to an amendment to its plan, the subsidiary discontinued participation under the parent's trust, established its own trust, limited coverage to its own employees, and restricted future benefits to a share of its own profits. The trustees of the parent's trust transferred to the subsidiary's trust all assets held for the benefit of the subsidiary's employees. Under this arrangement no amounts were distributed or made available to the subsidiary's employees. The assets transferred to the trustees of the subsidiary's trust included securities of the parent corporation.

Section 402(a)(1) of the Internal Revenue Code provides that the amount actually distributed or made available to any distributee by any employees' trust described in section 401(a), which is exempt from tax under section 501(a), shall be taxable to the distributee in the year in which so distributed or made available under section 72 (relating to annuities). Section 402(a)(1) further provides that the net unrealized appreciation in securities of an employer corporation attributable to the amount contributed by an employee is excludable from a distributee's income at the time amounts are made available or distributed.

Section 1.402(a)-1(b)(1)(i) of the Income Tax Regulations sets forth the extent to which the amount of net appreciation in the securities of the employer corporation may be excluded from the gross income of the distributee where such securities are included in a distribution made by a trust described in section 401(a) of the Code and exempt under section 501(a).

Section 1.402(a)-1(b)(1)(ii) of the regulations provides that "securities of the employer corporation" includes securities of a parent corporation.

Section 1.402(a)-1(b)(2) of the regulations provides that the amount of net unrealized appreciation in securities of the employer corporation which are distributed by the trust is the excess of the market value of the securities at the time of distribution over the cost or other basis of such securities to the trust.

The only significant changes for the participants in this case were that their benefits were restricted to a share of the subsidiary's profits, and assets held on their behalf were separated from those held for employees of the parent. The amounts previously credited to their accounts were unchanged and no taxable event occurred.

Since no taxable event occurred upon the transfer of assets to the newly established trust, such transfer did not change the basis of the securities of the parent for the purpose of computing net unrealized appreciation in such securities.

Rev. Rul. 67-181 is superseded because the position stated therein is restated under current law in this revenue ruling.

Section 403.—Taxation of Employee Annuities

26 CFR 1.403(b)-1: Taxability of beneficiary under annuity purchased by a section 501(c)(3) organization or public school.

Annuity contracts; staff of teachers' retirement system. Amounts contributed by a state teachers' retirement system to purchase annuity contracts for the employees of the retirement system are not excludable from the employees' gross income under section 403(b) of the Code; Rev. Rul. 68-178 superseded.

Rev. Rul. 80-139

The purpose of this revenue ruling is to update and restate, under current law, Rev. Rul. 68-178, 1968-1 C.B. 177.

The issue in Rev. Rul. 68-178 is whether amounts contributed by a state teachers' retirement system to purchase annuity contracts for employees of the retirement system are excludable from the gross income of the employees under section 403(b) of the Internal Revenue Code under the circumstances described below.

A state established a teachers' retirement system for the purpose of administering a retirement program established for the benefit of the teachers and administrators of the state public schools. The retirement system is a qualified employees' trust within the meaning of section 401(a) of the Code. It makes all the rules and regulations necessary for the functioning of the teachers' retirement program and invests the funds contributed to the system. The retirement system entered into an arrangement with its employees, intended to meet the requirements of section 403(b), under which the retirement system purchased annuity contracts for those employees.

Section 403(b) of the Code provides that certain amounts contributed by an employer to purchase an annuity contract shall be excluded from the gross income of the employee for the taxable year if the conditions set forth therein are met. Amounts may not be excluded under that section unless the annuity is purchased (1) for an employee by an employer described in section 501(c)(3) which is exempt from tax under section 501(a), or (2) for an employee (other than one described in clause (1)), who performs services for an educational organization described in section 170(b)(1)(A)(ii), by an employer which is a state, a political subdivision of a state, or an agency or instrumentality of any one or more of the foregoing.

An educational organization described in section 170(b)(1)(A)(ii) of the Code is one which normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

A person is considered an employee who performs services for an educational organization if he or she is performing services directly or indirectly for such an organization. The principal, clerical employees, custodial employees, and teachers at a public school are employees performing services directly for such educational organization. An employee who performs services involving the operation or direction of a state's education program, as carried on through educational organizations, is an employee performing services indirectly for such organizations. An employee participating in an "in-home" teaching program is included because such program is merely an extension of the activities carried on by such educational organization. See section 1.403(b)-1(b)(5) of the Income Tax Regulations.

The purpose of the state teachers' retirement system in this case is to administer the retirement program established for the benefit of the teachers and administrators of the state public schools. Since it is a qualified trust under section 401(a) of the Code, the retirement system is neither an organization described in section 501(c)(3) which is exempt from tax under section 501(a), nor is it an educational organization, or a part thereof, described in section 170(b)(1)(A)(ii). Further, since the employees' services are limited to the administration of the retirement program, they do not perform services directly or indirectly for an educational organization.

Accordingly, amounts contributed by the state teachers' retirement system to purchase annuity contracts for employees of the retirement system are not excludable from the employees' gross income under section 403(b) of the Code.

Rev. Rul. 68-178 is superseded because the position stated therein is updated and restated, under current law, in this revenue ruling.

Section 404.—Deduction for Contributions of an Employer to an Employees' Trust or Annuity Plan and Compensation Under a Deferred-Payment Plan

26 CFR 1.404(a)-1: Contributions of an employer to an employees' trust or annuity plan and compensation under a deferred payment plan; general rule.
(Also Section 4975.)

Employer's contribution; term promissory note. The delivery of an employer's own term promissory note to an employees' trust does not constitute payment for purposes of section 404(a) of the Code, and the issuance of such a note to a plan is a prohibited transaction within the meaning of section 4975; Rev. Rul. 71-95 superseded.

Rev. Rul. 80-140

The purpose of this revenue ruling is to restate and expand Rev. Rul. 71-95, 1971-1 C.B. 130, in light of the enactment of the Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 1974-3 C.B. 1, and the decision of the United States Supreme Court in *Don E. Williams Co. v. Commissioner,* 429 U.S. 569 (1977), Ct. D. 1984, 1977-1 C.B. 109.

Held, the delivery of a taxpayer's own term promissory note to an employees' trust does not constitute payment for purposes of section 404(a) of the Internal Revenue Code.

Furthermore, the employer's issuance of such a note to a plan constitutes a "prohibited transaction" within the meaning of section 4975 of the Code and is subject to the penalties set out in that section.

Rev. Rul. 71-95 is superseded because the position stated therein is restated and expanded in this Revenue Ruling.

Section 471.—General Rule for Inventories

26 CFR 1.471-3: Inventories at cost.
(Also Section 162; 1.162-1.)

Inventories; service fees paid to supplier. A sales-service fee equal to a percentage of a customer's purchases that a wholesale grocer charges retail grocers under franchise agreements, whether or not the retailers use any services provided by the wholesaler, must be included in the cost of the retailers' inventories. Other service fees that the wholesaler charges retailers only for services that are actually rendered are deductible by the retailers under section 162 of the Code.

Rev. Rul. 80-141

ISSUE

Are the sales-service fee and charges on a per-service-rendered basis paid by the taxpayer to its supplier, a wholesale grocer, necessary charges incurred in acquiring inventory within the meaning of section 1.471-3(b) of the Income Tax Regulations and therefore part of the cost of inventory?

FACTS

W, a wholesale grocer, holds the exclusive *Y* franchise rights for the area in which *M*, an independent grocer, operates. *M* and *W* enter into an agreement (the "Agreement") whereby *M* receives a *Y* franchise and the right to advertise itself as a *Y* food store. Pursuant to the Agreement, *M* may, together with other food stores holding *Y* franchises from *W*, purchase grocery items from *W*'s warehouse distribution facility.

In addition to selling groceries to holders of a *Y* franchise, *W* offers certain services to such franchise-holders, but the decision to use these services is up to each franchise-holder. These services include the following:

1. Store engineering service and assistance.
2. Merchandising programs in general.
3. Merchandising bulletins.
4. Merchandising programs for *Y* meat.
5. Produce, dairy, and frozen foods merchandising.
6. Printed order form books.
7. Comparative price checking.
8. Store supervision and operations evaluation.
9. Management counseling and membership meetings.
10. Product placement and relocation.

To cover the cost of these services, *W* charges a sales-service fee that is based on the volume of purchases through the warehouse distribution facility of *W* rather than on a "per-service-rendered basis." For example, the sales-service fee ranges from a maximum of 4.5 percent for purchases of 400*x* dollars or less to a minimum of 2 percent for purchases over 3,750*x* dollars.

M cannot purchase grocery items from *W* without being charged a sales-service fee. *M* is not required to use the services provided by *W*. Therefore, it is possible that *M* could elect to receive only the grocery items from *W* in return for its payment of the warehouse cost and the sales-service fee to *W*.

W also offers to the holders of *Y* franchises the following services for which *W* charges on a per-service-rendered basis.

1. Circular and newspaper advertising program.
2. Weekly window poster and special sales material.
3. Store retail accounting program.

The amount charged for these services depends on the amount of services utilized by a *Y* franchise-holder. The volume of purchases from *W*'s warehouse distribution facility has no effect upon the amount charged for these services.

LAW

Section 1.162-1(a) of the regulations provides that business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except items that are used as the basis for a deduction or a credit under provisions of the Code other than section 162. The cost of goods purchased for resale, with proper adjustment for opening and closing inventories, is deducted from gross sales in computing gross income. No item shall be included in business expenses to the extent that it is used by the taxpayer in computing the cost of property included in its inventory or used in computing the gain or loss basis of its plant, equipment or other property.

Section 1.471-2(c) of the regulations provides that the basis of inventory valuation most commonly used by business concerns and that meets the requirements (clear reflection of income) of section 471 of the Code are (1) cost and (2) cost or market, whichever is lower.

Section 1.471-3 of the regulations provides that the term "cost" means: (a) in the case of merchandise on hand at the beginning of the taxable year, the inventory price of such goods; (b) in the case of merchandise purchased since the beginning of the taxable year, the invoice price less trade or other discounts, except strictly cash discounts approximating a fair interest rate, which may be deducted or not at the option of the taxpayer, provided a consistent course is followed. To this net invoice price should be added transportation or other necessary charges incurred in acquiring possession of the goods.

ANALYSIS

The cost of goods in inventory is defined in section 1.471-3(b) of the regulations to be the net invoice price of the goods purchased plus transportation or other necessary charges incurred in acquiring possession of the goods. In order for *M* to purchase goods from *W*, *M* must pay the sales-service fee, whether or not *M* wants the services and whether or not *M* receives any service. Furthermore, the service fee is directly incurred as a result of the acquisition of *M*'s inventory, and the amount of the fee is exclusively dependent upon the volume of *M*'s purchases rather than the amount of services provided by *W*. These facts indicate that the payment of the sales-service fee is a necessary charge incurred in acquiring possession of the goods and not a charge incurred to obtain services.

W also provides *M* with certain services for which *W* charges on a per-service-rendered basis. It is not necessary for *M* to incur this separately stated and independently determined service charge in order to purchase goods from *W*. Thus, the amount charged on a per-service-rendered basis is not a necessary charge incurred in acquiring possession of the goods.

HOLDING

The sales-service fee paid by *M* to *W* is a necessary charge incurred in acquiring inventory within the meaning of section 1.471-3(b) of the regulations. Therefore, it must be included in the cost of such inventory and it is not deductible under section 162 of the Code.

The amount charged on a per-service-rendered basis is not a necessary charge incurred in acquiring inventory within the meaning of section 1.471-3(b) of the regulations. This amount is deductible as an ordinary and necessary business expense under section 162 of the Code.

Section 2040.—Joint Interests

26 CFR 20.2040-1: Joint interests.

Jointly owned stock; stock dividend. An individual acquired common stock of a corporation and placed it in a joint tenancy with rights of survivorship. Before the individual's death, the corporation distributed a one-share-for-four stock dividend and another dividend that was paid in stock in lieu of cash at the joint tenants' election. The value of all the stock except one-half the elective stock dividend is includible in the decedent's gross estate.

Rev. Rul. 80-142

ISSUE

What is the amount includible in the decedent's gross estate with respect to jointly owned stock, under the following circumstances?

FACTS

The decedent, *D*, died in 1976. In 1970, *D* purchased 800 shares of *X* corporation common stock and placed the shares in a joint tenancy, with rights of survivorship, with *A*. The stock of *X* corporation is publicly traded.

In 1972, *X* corporation distributed a stock dividend of one share of *X* corporation common stock for every four shares of *X* corporation common stock owned.

Thereafter, *D* and *A* owned 1,000 shares jointly.

In 1974, *X* corporation declared a cash dividend of two dollars with respect to each share of stock held by the shareholders. The company offered to distribute additional shares of common stock in lieu of the cash dividends at the rate of forty dollars per share. *D* and *A* elected to receive additional shares rather than the cash dividend, and therefore, jointly acquired an additional fifty shares of stock.

At *D*'s death, 1,050 shares of *X* corporation common stock, with a value of 50 dollars per share, were owned jointly by *D* and *A*.

Under applicable local law, income produced by property held jointly is regarded as belonging to the joint tenants in equal shares.

LAW AND ANALYSIS

Under section 2040(a) of the Code, in pertinent part, the gross estate includes the value of property held jointly at the time of the decedent's death by the decedent and another person with the right of survivorship, except the portion of the property or the consideration therefor that originally belonged to the other joint owner and was not acquired by the other joint owner from the decedent for less than adequate and full consideration in money or money's worth.

The 1972 common stock dividend represents a fragmentation of the original interest in the corporation which *D* transferred into joint tenancy rather than an increased interest therein. This reasoning, which is the basis for not taxing the dividends as income, is also the basis for including them in *D*'s estate under section 2040. Inclusion of the stock dividends on this basis is supported by the analysis of *Estate of Schlosser v. Commissioner*, 277 F. 2d 268 (3rd Cir. 1960), *cert. denied*, 364 U.S. 819 (1960).

In *Schlosser*, the court stated that ordinary dividends, which change the shareholder's proportionate interest in the corporation or give him something different in kind from the original stock, would not be included in the property valued in the gross estate. See *Tuck v. United States*, 282 F. 2d 405 (9th Cir. 1960), and *English v. United States*, 270 F. 2d 876 (7th Cir. 1959).

In the situation of a common stock dividend issued with regard to common stock, the period to which the capitalized profits are attributable should not be controlling, and the analysis of *McGehee v. Commissioner*, 260 F. 2d 818 (5th Cir. 1958), will not be followed.

In contrast to the 1972 dividend, the 1974 elective stock dividend constitutes something different in kind from the shares originally transferred by *D* into joint tenancy. Like a cash dividend, which is treated as the contribution by the survivor under section 20.2040-1(c)(5), an elective stock dividend constitutes income to the recipient under section 305(b)(1), and income tax considerations are relevant to the determination of includibility for estate tax purposes in this case. If a shareholder has the option to take cash or stock and decides to take stock the result is the same as if he had received a cash dividend and purchased additional stock. See, for example, Rev. Rul. 76-53, 1976-1 C.B. 87.

Under local law, each joint tenant is entitled to an equal share of the elective stock dividend. Therefore, each joint tenant would be taxed on the value of this property as income. See Rev. Rul. 56-519, 1956-2 C.B. 123.

HOLDING

The amount includible in *D*'s gross estate is $51,250 or the value of 1,025 shares of the *X* corporation stock. The value of twenty-five shares, which constitute *A*'s share of the 1974 elective stock dividend, or $1,250, is excluded as the contribution of *A*.

Section 3506.—Individuals Providing Companion Sitting Placement Services

26 CFR 31.3506-1: Companion sitting placement services.

T.D. 7691

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 31—EMPLOYMENT TAXES; APPLICABLE ON OR AFTER JANUARY 1, 1955

Companion Sitting Placement Services

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the exemption of companion sitting placement services from employer status. Changes in the applicable tax law were made by the Act of November 12, 1977 [Pub. L. 95-171, 1978-1 C.B. 457]. The regulations provide the public with the guidance needed to comply with the applicable part of this Act.

EFFECTIVE DATE: The regulations apply to remuneration received after December 31, 1974.

FOR FURTHER INFORMATION CONTACT: David B. Cubeta of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3926).

SUPPLEMENTARY INFORMATION:

BACKGROUND AND EXPLANATION OF PROVISIONS

On May 30, 1979, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) and Employment Tax Regulations (26 CFR Part 31) to conform the regulations to section 10 of the Act of November 12, 1977 (Public Law 95-171, 31 Stat. 1356) which added section 3506 to the Internal Revenue Code of 1954. No public hearing was requested or held. This Treasury decision adopts the amendments as proposed.

These regulations add a new § 31.3506-1 under section 3506. Section 31.3506-1 provides that, for purposes of employment taxes, a companion sitting placement service shall not be treated as the employer of its sitters if the placement service neither pays nor receives the salary or wages of the sitters. A "companion sitting placement service" is an individual, trust, estate, partnership, association, company, or corporation engaged in the trade or business of placing sitters with individuals who desire the sitters' services. "Sitters" are individuals who provide companionship, personal attendance, or household care services to children, the elderly, or the disabled.

The principal concern expressed in the comments received on the notice of proposed rulemaking was that the proposed regulations would result in the loss of social security coverage of the sitters. However, a sitter who is deemed by § 31.3506-1 not to be the employee of a placement service is then deemed to be self-employed and becomes liable for the tax imposed by section 1401 on self-employment income earned after 1974. Except where net earnings from self-employment for the taxable year are less than $400, the sitter will be liable for tax and will continue to have earnings reported on which social security benefits may be based.

It is also important to note that the general rule of § 31.3506-1 only operates to remove sitters and placement services from the employee-employer relationship when, under §§ 31.3121(d)-1 and 31-3121(d)-2, that relationship would otherwise exist. Therefore, if under the common law a sitter is the employee of the individual for whom the sitting is performed rather than the employee of the placement service, that employee-employer relationship remains intact.

DRAFTING INFORMATION

The principal author of these regulations is David B. Cubeta of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the proposed amendments to 26 CFR Parts 1 and 31, as set forth in the notice of proposed rulemaking published in the Federal Register on May 30, 1979 (44 F.R. 31025), are hereby adopted as follows:

INCOME TAX REGULATIONS

(26 CFR Part 1)

Paragraph 1. Paragraph (a) of § 1.1402(c)-3 is amended by revising the parenthetical sentence at the end thereof to read as follows:

§ 1.1402(c)-3 Employees.

(a) *General rule.* * * * (As to when an individual is an employee, see section 3121(d) and (o) and section 3506 and the regulations under those sections in part 31 of this chapter (Employment Tax Regulations).)

* * * * *

EMPLOYMENT TAX REGULATIONS

(26 CFR Part 31)

Par. 2. Paragraph (a)(1) of § 31.3121(d)-1 is amended by revising the first sentence thereof to read as follows:

§ 31.3121(d)-1 Who are employees.

(a) *In general.* (1) Whether an individual is an employee with respect to services performed after 1954 is determined in accordance with section 3121(d) and (o) and section 3506. * * *

* * * * *

Par. 3. A new § 31.3506-1 is added immediately after § 31.3505-1. This new section reads as follows:

§ 31.3506-1 Companion sitting placement services.

(a) *Definitions*—(1) *Companion sitting placement service.* For purposes of this section, the term "companion sitting placement service" means a person (whether or not an individual) engaged in the trade or business of placing sitters with individuals who wish to avail themselves of the sitters' services.

(2) *Sitters.* For purposes of this section, the term "sitters" means individuals who furnish personal attendance, companionship, or household care services to children or to individuals who are elderly or disabled.

(b) *General rule.* For purposes of subtitle C of the Internal Revenue Code of 1954 (relating to employment taxes), a companion sitting placement service shall not be treated as the employer of its sitters, and the sitters shall not be treated as the employees of the placement service. However, the rule of the proceding sentence shall apply only if the companion sitting placement service neither pays nor receives (directly or through an agent) the salary or wages of the sitters, but is compensated, if at all, on a fee basis by the sitters or the individuals for whom the sitting is performed.

(c) *Individuals deemed self-employed.* Any individual who, by reason of this section, is deemed not to be the employee of a companion sitting placement service shall be deemed to be self-employed for purposes of the tax on self-employment income (see sections 1401-1403 and the regulations thereunder in part 1 of this chapter (Income Tax Regulations)).

(d) *Scope of rules.* The rules of this section operate only to remove sitters and companion sitting placement services from the employee-employer relationship when, under §§ 31.3121(d)-1 and 31.3121(d)-2, that relationship would otherwise exist. Thus, if, under §§ 31.3121(d)-1 and 31.3121(d)-2, a sitter is considered to be the employee of the individual for whom the sitting is performed rather than the employee of the companion sitting placement service, this section has no effect upon that employee-employer relationship.

(e) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). X is an agency that places babysitters with individuals who desire babysitting services. X furnishes all the sitters with an instruction manual regarding their conduct and appearance, requires them to file semimonthly reports, and determines the total fee to be charged the individual for whom the sitting is performed. Individuals who need a babysitter contact the agency, are informed of the charges, and, if agreement is reached, a sitter is sent to perform the services. The sitter collects the entire amount of the charges and remits a percentage to X as a fee for the placement. X is a companion sitting placement service within the meaning of paragraph (a)(1) of this section. Therefore, since the agency does not actually pay or receive the wages of the sitters, X is not treated as the employer of the sitters for purposes of this subtitle. The sitters are deemed to be self-employed for the purpose of the tax imposed by section 1401.

Example (2). Assume the same facts as in example (1), except that the individual for whom the sitting is performed pays to X the entire amount of the charges. X retains a percentage and pays the difference to the sitter. Since X actually receives and pays the wages of the sitters, X is the employer of the sitters.

Example (3). As a service to the community a neighborhood association maintains a list of individuals who are available to babysit. Parents in need of a sitter contact the association and are provided with a list of names and telephone numbers. The association charges no fee for the service and takes no action other than compiling the list of sitters and making it available to members of the community. Issues such as hours of work, amount of payment, and the method by which the services are performed are all resolved between the sitter and parent. A, a parent, used the list to hire B to sit for A's child. B performs the services four days a week in A's home and follows specific instructions given by A. Under § 31.3121(d)-1, B is the employee of A rather than the employee of the neighborhood association. Consequently, this section does not apply and B remains the employee of A.

(f) *Effective date.* This section shall apply to remuneration received after December 31, 1974.

This Treasury decision is issued under the authority contained in sections 3506 and 7805 of the Internal Revenue Code of 1954 (91 Stat. 1356, 26 U.S.C. 3506; 68A Stat. 917, 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved March 25, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on April 8, 1980, 8:45 a.m., and published in the issue of the Federal Register for April 9, 1980, 45 F.R. 24128)

Section 4975.—Tax on Prohibited Transactions

Whether the delivery of a taxpayer's own term promissory note to an employee's trust constitutes payment for purposes of section 404(a) of the Code, and whether the employer's issuance of such a note to a plan constitutes a "prohibited transaction" within the meaning of section 4975 of the Code. See Rev. Rul. 80-140, page 9.

Part III. Administrative, Procedural, and Miscellaneous

Delegation Order No. 149 (Rev. 1) Revocation Notice (Effective February 29, 1980)

Delegation of Authority to Levy on Property in Hands of Third Parties

1. Delegation Order No. 149 (Rev. 1) [1979-43 I.R.B. 25], issued July 11, 1979, granted authority to the Chief, Collection Branch in the Compliance Division, Cincinnati Service Center, to levy on wages, salaries, other income and bank deposits in the possession of third parties; to issue final demand for enforcement of levy; and to release levy and return property. Authority to redelegate to Collection Branch personnel in the GS-1169 series and selected GS-592-7 and GS-592-6 Tax Examiners the authority to levy on wages, salaries, other income and bank deposits in the possession of third parties; and to release levy and return property, was also granted. Redelegation authority to issue final demand for enforcement of levy was restricted to GS-1169 series personnel in the Collection Branch.

2. The taxpayer delinquent account batch processing operation, which required this authority, transferred November 1, 1979 from the Cincinnati Service Center to the district offices.

3. Accordingly, Delegation Order No. 149 (Rev. 1) issued July 11, 1979, is revoked.

JEROME KURTZ,
Commissioner.

(Filed by the Office of the Federal Register on March 4, 1980, 8:45 a.m., and published in the issue of the Federal Register for March 5, 1980, 45 F.R. 14358)

Part IV: Items of General Interest

Treatment of Certain Interests in Corporations as Stock or Indebtedness—Public Hearing

Announcement 80-69 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to the treatment of certain interests in corporations as stock or indebtedness.

DATES: The public hearing will be held on July 23, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by July 9, 1980.

ADDRESS: The public hearings will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-1661), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-6870, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under sections 166, 385, 482 and 1371 of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Monday, March 24, 1980 (45 FR 18957).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of oral comments to be presented at the hearing and the time they wish to devote to each subject by July 9, 1980.

Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive on improving government regulations appearing in the Federal Register for Wednesday, November 8, 1978.

Treatment of Certain Interests in Corporations as Stock or Indebtedness—Public Hearing

Announcement 80-70 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to limitations on benefits and contributions under qualified pension plans.

DATES: The public hearing will be held on July 8, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by June 24, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (EE-24-78), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-6870, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under sections 401(a)(16), 403(b)(2) and 415 of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Thursday, January 24, 1980, at page 5754 (45 FR 5754).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of oral comments to be presented at the hearing and the time they wish to devote to each subject by June 24, 1980.

Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the

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[1] Filed by the Office of the Federal Register on April 28, 1980, 8:45 a.m., and published in the issue of the Federal Register for April 29, 1980, 45 F.R. 28365.

[1] Filed by the Office of the Federal Register on April 28, 1980, 8:45 a.m., and published in the issue of the Federal Register for April 29, 1980, 45 F.R. 28365.

criteria for significant regulations set forth in paragraph 8 of the Treasury Directive on improving government regulations appearing in the Federal Register for Wednesday, November 8, 1978.

Self-Insured Medical Reimbursement Plans—Public Hearing

Announcement 80-71 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to self-insured medical reimbursement plans.

DATES: The public hearing will be held on June 24, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by June 10, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (EE-167-78), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-6870, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under section 105(h) of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Thursday, February 28, 1980, at page 13123 (45 FR 13123).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of oral comments to be presented at the hearing and the time they wish to devote to each subject by June 10, 1980.

Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive appearing in the Federal Register for Wednesday, November 8, 1978.

Gas Guzzler Tax—Public Hearing

Announcement 80-72 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to the gas guzzler tax.

DATES: The public hearing will be held on June 19, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by June 5, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-205-78), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-6870, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under sections 4064 and 4222 of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Friday, February 8, 1980 (45 FR 8589).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of oral comments to be presented at the hearing and the time they wish to devote to each subject by June 5, 1980.

Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive on improving government regulations appearing in the Federal Register for Wednesday, November 8, 1978.

Coordination of Vesting and Discrimination Requirements for Qualified Plans—Public Hearing

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[1] Filed by the Office of the Federal Register on April 22, 1980, 8:45 a.m., and published in the issue of the Federal Register for April 23, 1980, 45 F.R. 27454.

[1] Filed by the Office of the Federal Register on May 1, 1980, 8:45 a.m., and published in the issue of the Federal Register for May 2, 1980, 45 F.R. 29309.

Announcement 80-73 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to rules for determining if the vesting schedule of a qualified plan discriminates in favor of employees who are officers, shareholders, or highly compensated.

DATES: The public hearing will be held on July 10, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by June 26, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (EE-164-78), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-6870, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under section 411(d)(1) of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Wednesday, April 9, 1980, at page 24201 (45 FR 24201).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of oral comments to be presented at the hearing and the time they wish to devote to each subject by June 26, 1980.

Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive on improving government regulations appearing in the Federal Register for Wednesday, November 8, 1978.

Publication of Notices

Announcement 80-74

Department of the Treasury Proclamations dealing with the percentage to be used by foreign life insurance companies in computing income tax and estimated tax, the inflation adjustment factor used in computing the windfall profit tax, international boycott lists of countries, and certain other items shall, henceforth, be published as numbered Notices in Part III of the weekly Internal Revenue Bulletin and retained in the Cumulative Bulletin.

Disaster Areas

Announcement 80-75

Additional counties, etc., are listed for areas previously announced as adversely affected by disasters of sufficient severity and magnitude to warrant Federal disaster assistance.

Taxpayers who suffered losses in these areas as a result of these disasters may elect the special tax treatment provided under section 165(h) of the Internal Revenue Code. Section 1.165-11 of the Income Tax Regulations, T.D. 7224, 1973-1 C.B. 71, sets forth the procedure for making this election. Losses not incurred with respect to a trade or business or any transaction entered into for profit will not qualify for treatment under section 165(h) unless such losses qualify as casualty losses.

State: California

Counties affected: Santa Cruz

Type of disaster: Severe storms, mudslides and flooding

Begun on or about: January 8, 1980

Disaster Areas

Announcement 80-76

The President of the United States has determined that the areas listed below were adversely affected by disasters of sufficient severity and magnitude to warrant federal disaster assistance.

Taxpayers who suffered losses in these areas as a result of these disasters may elect the special tax treatment provided under section 165(h) of the Internal Revenue Code. Section 1.165-11 of the Income Tax Regulations sets forth the procedure for making this election. Losses not incurred with respect to a trade or business or any transaction entered into for profit will not qualify for treatment under section 165(h) unless such losses qualify as casualty losses.

State: Alabama

Counties affected: Lee, Mobile

Type of disaster: Severe storms, tornadoes, and flooding

Begun on or about: April 12, 1980

State: Arkansas

Counties affected: Crittenden, Faulkner, Johnson, Lonoke, Pulaski

Type of disaster: Severe storms and tornadoes

Begun on or about: April 7, 1980

State: Louisiana

Parishes affected: Assumption, Iberville, Jefferson, Lafourche, Orleans, St. Bernard, St. Charles, St. Martin, St. Mary, St. Tammany, Terrebonne, Washington

Type of disaster: Severe storms and flooding

Begun on or about: March 26-31, 1980

State: Mississippi

Counties affected: Adams, Forrest, George, Harrison, Jackson, Marion, Pike, Walthall

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[1] Filed by the Office of the Federal Register on May 1, 1980, 8:45 a.m., and published in the issue of the Federal Register for May 2, 1980, 45 F.R. 29309.

Type of disaster: Severe storms, flooding, mudslides, tornadoes and high winds

Begun on or about: March 28, 1980

Foundation Status of Certain Organizations

Announcement 80-77

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501 (c) (3) of the Code, eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

A.D.A. Center, Inc., d/b/a First Step, Nashville, TN
Acropolis Theatre Arts, Inc., Wayland, MA
Agape Club, Columbus, GA
American Institute of Fencing, Inc., Denver, CO
American Youth Association, Ogden, UT
Anne Arundel Optimist Foundation, Inc., North Linthicum, MD
Apostles for Christian Evangelism, Colorado Springs, CO
Apple Valley Wrestling Club, Inc., Apple Valley, MN
Appling Volunteer Fire Department, Inc., Appling, GA
Arcturus String Quartet Foundation, Inc., The, Chicago, IL
Art Workshops Alliance, Inc., The, Columbia, SC
Associated Production Services, Inc., Doylestown, PA
Austin East High School Alumni Association, Knoxville, TN
Baldwin Continental Baton and Drum Corps, Inc., Pittsburgh, PA
Berksiana Foundation, Reading, PA
Bible Based Ministries (formerly Maximum Missions Evangelistic Association, Inc.), Fort Worth, TX
Brattleboro Hockey Association, Inc., Brattleboro, VT
Bureau of Youth Services, San Antonio, TX
Carmelite Sisters for the Aged and Infirm Fernbrook, Inc., Centerville, MA
Castle Paws and Taws Pavilion Fund, New Castle, PA
Center for the Study of Violence, Inc., Denver, CO
Central Pennsylvania Alliance for the Eradication of Venereal Disease, Mechanicsburg, PA
Central Region Emergency Medical Services Council, Inc., The, Gabbs, NV
Charter Oak Chapter Charitable Fund, Hartford, CT
Citizens Environment Committee for Delaware, Inc., Wilmington, DE
Colorado Conservation Fund, Inc., Denver, CO
Colorado Youth Services Institute, Denver, CO
Community Aid Association, Newark, NJ
Community Organization Acting Together, Philadelphia, PA
Concern, Inc., Elgin, IL
Cumberland York Committee on the Employment of the Handicapped, Portland, ME
Daynes Family Association, John Frederick Nicholas, Salt Lake City, UT
Eden Child Development Corp., Hayward, CA
Edgewater Residents Together in Action, Chicago, IL
Ellington Research and Development Corp., Ellington, CT
Gay Community Center of Baltimore, Ltd., The, Baltimore, MD
Gypsy Society of Chicago, Chicago, IL
Hamden Community Child Care Center, Inc., Hamden, CT
High Point Womens Shelter, Inc., High Point, NC
Hope House of Memphis, Inc., Memphis, TN
Information Resources Management Association, Ltd., Chicago, IL
Initium Domus, Inc., Providence, RI
Inner Theatre Youth Repertory Troupe, Inc., New Haven, CT
Institute for Journalism Education School of Journalism, The, Berkeley, CA
Institute for Psychodrama and Sociometry, Chicago, IL
Italian-American Cultural Society of Bucks County, Levittown, PA
Intercultural Center for Advanced Studies in Education, San Francisco, CA
International Women's Film Project, Inc., Washington, DC
Lakeland Wrestling Club, Inc., Woodruff, WI
Machinery Equipment and Tool Charity Fund, Cornwells Heights, PA
Manning Fried Dance Theatre, Long Beach, CA
Maryvale Phoenix Girls Club, Inc., Glendale, AZ
McDaniel Youth Ranch, Inc., The Tommie, Los Angeles, CA
Mecklenburg Aquatic Club, Inc., Charlotte, NC
Messengers of Love, Bacliff, TX
Mexican-American Urban Coalition League, Pomona, CA
Mid-America Dance Theater, Inc., Milwaukee, WI
Momma, The Organization for Single Mothers, Inc., Venice, CA
Monroe C. B. Club, Inc., Monroe, GA
Montessori Mainstreaming Project, Santa Fe, NM
Moore Memorial Fund, Emory, Philomath, OR
Mostly Opera-Concerts in Teaneck, Inc., Teaneck, NJ
National Association for Metric Education, Roscoe, IL
National Concert Band of America, The, Washington, DC
New Approach, Inc., San Francisco, CA
New Hampshire Association of Working Women, Concord, NH
New Jersey BPU, The, Newark, NJ
New Life Ministries, Inc., Raleigh, NC
Newport County Volunteers, Inc., Newport, RI
North Central Human Services, Inc., Gardner, MA
Norwood Nuggets Youth Hockey Program, Inc., Norwood, MA
Odyssey House, Inc., Texas, Corpus Christi, TX

Pasadena Clinic League, Inc., Pasadena, MD

Police Consultants Research, Inc., Chicago, IL

Polk-Rutherford Detoxification Center, Tryon, NC

Potomac Center for Research and Education in Government, Inc., Washington, DC

Presbyterian Foundation of Lumberton, Inc., The, Lumberton, NC

Project Life Lines, Inc., Clinton, SC

Public Advocate Review of Texas, Austin, TX

Ranchos Parent-Teachers Organization, Albuquerque, NM

Research for Rehabilitation Corp., Chicago, IL

Residential and Employment Alternatives for Citizens with, Belmont, MA

Return to Life, Inc., Harrisonburg, VA

Riverside Houses, Inc., Atlanta, GA

Rocking Iron Ranch, Inc., Rocky Ford, CO

San Francisco LULAC Council 2008, Inc., San Francisco, CA

Santa Clara County Asian Law Alliance, Inc., San Jose, CA

Second Story Theatre, Inc., Scranton, PA

Senior Resources and Benefits, Inc., Hoopa, CA

Senior Set, Inc., Belmont, MA

Sheffield Concert Choir, Inc., Chicago, IL

Son Beams, Wahpeton, ND

Summerville Public Library Association, The, Summerville, SC

Sussex House, Inc., Laurel, DE

Ten Southern Indian Pueblos, Albuquerque, NM

Washington Committee for Pretrial Justice, Inc., Washington, DC

West Columbia-Pine View Palmetto Youth League, Inc., West Columbia, SC

Western Pennsylvania Ski Racing Association, Inc., Latrobe, PA

Wharton Education Association Philanthropic Fund, Inc., Wharton, NJ

World Evanagelization Association, Chesterfield, IN

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Tax Paid on Gasoline Used to Produce Certain Alcohol Fuels

Announcement 80-78

Beginning January 1, 1979, a taxpayer who mixed alcohol with gasoline on which the 4 cents a gallon federal excise tax had been imposed is eligible for a credit or refund of the gasoline tax. The alcohol must have been made from other than petroleum, natural gas, or coal and the mixture must have included at least 10% of 190 proof alcohol and have been sold or used in the taxpayer's trade or business.

Gasoline used in the mixture from January 1, 1979, through April 2, 1980, is considered sold or used on April 2, 1980, for purposes of claiming a refund or credit.

To claim a refund, a taxpayer must be able to claim at least $200 a quarter for the tax on the gasoline. Form 843, Claim, is used to file a claim for any of the first three quarters of the claimant's taxable year and must be filed before the end of the next quarter. The taxpayer checks the box "Other" on line 9 and specifies "gasoline/alcohol mixture" and the number of gallons of gasoline used on line 10. Taxpayers qualifying to use Form 843 for tax paid on gasoline which is mixed with alcohol and sold or used between January 1, 1979, and June 30, 1980, should file for refund on or after July 1, 1980, and on or before September 30, 1980. Those taxpayers not eligible to file Form 843 for any given quarter, or who did not file the form, and all taxpayers for the fourth quarter of their taxable year can claim a credit on Form 4136, Computation of Credit for Federal Tax on Gasoline, Special Fuels, and Lubricating Oil. This is to be attached to their income tax return. The taxpayer enters on line 1c the number of gallons of gasoline used, identifies it as "gasoline/alcohol mixture," and completes the rest of the form. If the credit exceeds the income tax liability, the excess will be refunded.

The amount of refund or credit claimed is includible in the taxpayer's gross income.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

By decision on appeal from an initial decision in an administrative hearing, the following individuals have been suspended or disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Sydney M. Eisenberg	Milwaukee, WI	Attorney	April 17, 1980 Disbarment
Leon Feldt	El Paso, TX	Certified Public Accountant	March 26, 1980 Disbarment
David I. Kali	Tucson, AZ	Attorney	Indefinite Suspension from April 1, 1980
Angelos P. Romas	Endicott, NY	Attorney	April 9, 1980 Disbarment

After due notice and opportunity for hearing, the following individuals have been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
William A. Carbaugh	Greenville, SC	Enrolled Agent	March 21, 1980
Robert B. Clarkson	Anderson, SC	Attorney	April 25, 1980

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Frank H. Abernathy	Richmond, VA	Certified Public Accountant	Indefinite effective April 9, 1980
Carl L. Harthun	Denver, CO	Attorney	Indefinite effective April 9, 1980
John T. Kelly, Jr.	Virginia Beach, VA	Certified Public Accountant	Indefinite effective April 15, 1980
Fran A. Moor	Fort Worth, TX	Certified Public Accountant	Indefinite effective April 15, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 150.0 through 150.6402-1 added; published as temporary regulations in T.D. 7690, 1980-16 I.R.B. 11.	Crude Oil Windfall Profit Tax Act of 1980.	April 4, 1980	June 3, 1980
26 CFR 1.166-9, 1.482-2, 1.1371-1, amended; 1.385-1 through 1.385-12, added.	Treatment of certain interests in corporations as stock or indebtedness.	March 24, 1980	June 23, 1980
26 CFR 1.1371-1, 1.1372-1 through 1.1372-4, amended; 1.1371, 1.1372, 1.1373, 1.1374, 1.1375, 1.1376, 1.1377, 1.1378, Part 14, deleted.	Certain shareholder reqiurements and related matters for electing small business corporations.	April 17, 1980	June 13, 1980
26 CFR 1.411(d)-1 added.	Coordination of vesting and discrimination requirements for qualified plans.	April 9, 1980	June 9, 1980
26 CFR 1.1502-12, amended; 1.1502-44, added.	Consolidated returns for percentage depletion for independent producers and royalty owners.	April 9, 1980	June 9, 1980
26 CFR 1.21-1—53.4940-1 and intermediate sections amended.	Changes in the holding period required for gains or losses on transactions in capital assets to be treated as long-term capital gains or losses and changes in certain terms relating to transactions in capital assets.	April 9, 1980	June 9, 1980
26 CFR 1.1402(c)-3, 301.6652-1, amended; 1.6050A-1, 31.3121(b)(20)-1, 31.3401(a)(17)-1, 301.6050 A-1 added.	Treatment of certain crewmen on boats engaged in catching fish as self-employed rather than as employees.	April 9, 1980	June 9, 1980
26 CFR 1.50A-1, 1.50A-2, 1.50B-1 through 1.50B-5, amended; 1.50A-3 through 1.50A-7, deleted; 1.280C-1 redesignated as 1.280C-2; 1.50B-6, 1.280C-1, added.	Work incentive program (WIN) credit.	April 30, 1980	June 30, 1980
26 CFR 1.120-1 deleted; 1.120-1, 1.120-2, 1.501(c)(20)-1, added.	Qualified group legal services plans.	April 29, 1980	June 30, 1980

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Key to Abbreviations:

RR	Revenue Ruling
RP	Revenue Procedure
TD	Treasury Decision
CD	Court Decision
PL	Public Law
EO	Executive Order
DO	Delegation Order
TDO	Treasury Department Order
TC	Tax Convention
SPR	Statement of Procedural Rules
PTE	Prohibited Transaction Exemption

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Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-143, page 6.

Municipal bonds redeemed prior to maturity; discount. Unearned original issue discount received upon redemption of municipal bonds before maturity is not interest income excludable from gross income under section 103(a)(1) of the Code but is gain from the sale or exchange of a capital asset. The provisions of this revenue ruling will not be applied to municipal obligations issued prior to June 9, 1980. Rev. Rul. 72-587 modified.

Rev. Rul. 80-144, page 7.

Foreign tax credit carryover; acquiring corporation. A foreign corporation, all of whose income was effectively connected with a U.S. business, transferred substantially all of its properties to a related domestic corporation in a reorganization under section 368(a)(1)(D) of the Code. Any unused foreign income taxes of the transferor foreign corporation may be carried over and used in computing the foreign tax credit of the acquiring domestic corporation under section 901(a). Rev. Ruls. 68-350 and 72-452 obsoleted for reorganizations described in section 381(a)(2) occurring after December 10, 1971, pursuant to a plan of reorganization or contract entered into on or after September 29, 1971.

Rev. Rul. 80-150, page 24.

Liquidating trust. A trust established under state law for the purpose of liquidating and distributing assets (land, a heating plant located thereon, a right-of-way to the land, and mining claims) that were transferred by a liquidating corporation and that could not be sold other than under distress conditions within the 12-month period following the corporation's adoption of a plan of liquidation is classified as a liquidating trust under section 301.7701-4(d) of the regulations. The shareholders of the liquidating corporation are considered the owners of the trust and are taxable on the trust income.

Announcement 80-80, page 27.

As a result of the passage of the Technical Corrections Act of 1979, the computation of adjusted itemized deductions for an estate or trust using Form 6251, Alternative Minimum Tax Computation, has been changed.

EMPLOYEE PLANS

Rev. Rul. 80-145, page 9.

Profit-sharing; contributions; deduction limitation. In determining the deduction limitations under section 404(a)(3)(A) and (a)(7) of the Code for employer contributions to a qualified profit-sharing plan, including the computation of credit carryovers and contribution carryovers, the definition of compensation provided in sections 1.404(a)-9(b) and 1.404(a)-13(a) of the regulations applies regardless of the definition of compensation used in the plan; Rev. Rul. 71-542 superseded.

Rev. Rul. 80-146, page 10.

Profit-sharing; contributions; discontinuance. The

(Continued on page 4)

Finding Lists begin on page 31.
Announcement Relating to Decisions of the Tax Court on page 5.
Announcement of Disbarments and Suspensions begins on page 28.
Announcement of Notice of Proposed Rulemaking on page 30.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

EMPLOYEE PLANS—Cont'd

failure of an employer to make contributions to its profit-sharing plan for five consecutive years due solely to the absence of current or accumulated earnings or profits is not a complete discontinuance of contributions within the meaning of section 411(d)(3) of the Code in a situation in which the employer is required to resume contributions as soon as it does have profits; Rev. Rul. 74-419 superseded.

EXEMPT ORGANIZATIONS

T.D. 7692, page 10.

Amendments to the regulations under section 528 of the Code relate to the qualification of homeowners associations.

ESTATE TAX

Rev. Rul. 80-148, page 17.

Formula marital deduction clause; pre-1977 will. An individual executed a will containing a maximum formula marital deduction clause in 1975, transferred $210,000 to the spouse in 1977, died in 1978, and left an adjusted gross estate valued at $300,000. The will was not amended after 1976, and the decedent's state of residence has not enacted a statute construing formula marital deduction clauses with respect to the provisions in the Tax Reform Act of 1976. The estate is allowed a marital deduction for the entire $210,000.

EMPLOYMENT TAXES

Rev. Rul. 80-149, page 18.

Transportation services; transit authority. A transit authority was created as a political subdivision of a state in 1965. The authority covered its employees for social security purposes by means of an agreement with HEW under section 218 of the Social Security Act. In 1972 the authority acquired a private transit company, which was its first acquisition from private ownership of any part of its system, and all of the company's employees became employees of the authority. At the time of the acquisition there was no general retirement system covering the employees of the authority, and the services performed by all of its employees became "covered transportation service" within the meaning of section 3121(j) of the Code.

EXCISE TAXES

T.D. 7694, page 19.

Temporary regulations relate to withholding and depositing of windfall profit tax when the producer is an integrated oil company.

TAX CONVENTIONS

Rev. Rul. 80-147, page 16.

Canada; contract carrier; waiver of exemption. A Canadian corporation engaged in business as a contract carrier of goods between points in the U.S. and Canada through a permanent establishment in the U.S. may annually choose whether to include in gross income for federal income tax purposes service income that is effectively connected with its U.S. business and deduct the allocable expenses, even though the income is exempt from federal income tax under a reciprocal provision of Article V of the United States-Canada Income Tax Convention.

ADMINISTRATIVE

T.D. 7693, page 22.

Amendments to the regulations under section 6103 of the Code relate to procedures for administrative review of a Service determination that a state tax agency failed to safeguard federal tax returns or return information received from the Service.

Social Security contribution and benefit base, page 26.

The Secretary of Health, Education, and Welfare has announced that the contribution and benefit base for 1980 that would have been in effect under pre-1977 law is $20,400. This "old-law" base is used for certain RRTA and ERISA purposes and for computing special minimum benefits for workers with many years of low earnings.

Announcement 80-81, page 27.

The 13⅞ percent Treasury Notes of Series P-1982, the 14⅜ percent Treasury Notes of Series D-1985, the 15 percent Treasury Notes of Series Q-1982, the 14¼ percent Treasury Notes of Series D-1984, the 12⅝ percent Treasury Bonds of 1995, and the 11⅜ percent Treasury Notes of Series R-1982 will not be acceptable in payment of taxes.

Announcement Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issue or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by Revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the Court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the Tax Court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Bolnick, Ted, et ux[1]	3503-62	44	245
Buse, Delmer H., et ux	5619-76	71	1129
Buse, Norman M., et ux	5618-76		
Koch, Carl E., et ux	8953-74	67	71

The Commissioner does NOT ACQUIESCE in the following decision:

Taxpayer	Docket No.	Report	
		Volume	Page
Warren Jones Co.	424-71	60	663

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[1] Nonacquiescence published in 1967-1 C.B. 3 is withdrawn and acquiescence is substituted therefore. See Rev. Rul. 80-143, page 6, this Bulletin.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-7: Interest.

Whether unearned discount on a municipal bond that was redeemed prior to maturity is exempt from tax. See Rev. Rul. 80-143, below.

Section 103.—Interest on Certain Governmental Obligations

26 CFR 1.103-1: Interest upon obligations of a State, Territory, etc.
(Also Sections 61, 7805; 1.61-7, 301.7805-1.)

Municipal bonds redeemed prior to maturity; discount. Unearned original issue discount received upon redemption of municipal bonds before maturity is not interest income excludable from gross income under section 103(a)(1) of the Code but is gain from the sale or exchange of a capital asset. The provisions of this revenue ruling will not be applied to municipal obligations issued prior to June 9, 1980. Rev. Rul. 72-587 modified.

Rev. Rul. 80-143

ISSUE

Is the unearned portion of original issue discount received upon redemption of municipal bonds before maturity interest income that is excludable from the gross income of the bondholder under the provisions of section 103(a)(1) of the Internal Revenue Code?

FACTS

An individual taxpayer acquired a 20-year, 6-percent municipal bond with a face amount of $1,000 for a price of $800 on the date of issue, January 2, 1969. The $200 discount ($1,000 less $800) was original issue discount. At the time the bond was issued, the issuer had no intention of redeeming the bond before maturity. The terms of the bond provided that it was callable at its face amount 10 years after the issue date. The bond was not an industrial development bond within the meaning of section 103(b)(2) of the Code or an arbitrage bond described in section 103(c)(2).

On January 2, 1979, the issuer redeemed the bond for its face amount of $1,000 plus accrued annual interest of $60. The bond qualified as a capital asset as defined in section 1221 of the Code during the period held by the taxpayer.

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include interest on an obligation of a state or political subdivision of a state.

Rev. Rul. 73-112, 1973-1 C.B. 47, holds that the discount at which obligations described in section 103(a)(1) of the Code are originally issued (original issue discount), whether they are interest bearing or not, is treated as tax-exempt interest income apportioned ratably over the term of the obligations. It further states that this tax-exempt income is apportioned among the original holders of the obligations and subsequent purchasers and each respective holder is entitled to treat as exempt from federal income tax that proportion of the amount of the discount at which the obligations were issued that the number of days (computed on an actual calendar day basis) the obligations were owned by him bears to the total number of days from the date of issuance of the obligation to the date of maturity.

Rev. Rul. 72-587, 1972-2 C.B. 74, holds that when bonds described in section 103(a)(1) of the Code are redeemed prior to maturity the amount designated as "discount" may be classified as earned discount and unearned discount. Although not defined in Rev. Rul. 72-587, the term "earned discount" referred to the proportion of original issue discount that under the principles of Rev. Rul. 73-112, would have been considered as interest to the holder of the bonds if they were sold instead of redeemed. Rev. Rul. 72-587 concludes that both earned and unearned discount are tax-exempt interest.

Section 1232(a)(2)(B)(ii) of the Code provides that on the sale, exchange or redemption before maturity (see section 1232(a)(1)) of bonds issued by a government or political subdivision thereof and held by the taxpayer more than 1 year, any gain realized that does not exceed an amount that bears the same ratio to the original issue discount as the number of complete months that the bond was held by the taxpayer bears to the number of complete months from the date of original issue to the date of maturity, shall be considered ordinary income if at the time of issuance there was no intention to call the bonds before maturity. Gain in excess of such amount shall be considered gain from the sale or exchange of a capital asset held more than one year.

Section 1232(a)(2)(C)(i) of the Code provides that the provisions of section 1232(a)(2) do not apply to obligations the interest on which is not includable in gross income under section 103.

Congress' intent in enacting section 1232(a)(2)(B)(ii) was to distinguish between the portion of proceeds received upon the sale, exchange or retirement of an obligation that represented interest income and the portion that represented capital gain. *See* H. Rep. No. 1337, 83d Cong., 2d Sess. 83, A276 (1954); S. Rep. No. 1622, 83d Cong., 2d Sess. 112, 434 (1954).

In three cases dealing with the treatment of original issue discount under the Internal Revene Code of 1939, but decided after the enactment of section 1232(a)(2) of the 1954 Code, the courts' conclusions as to the portion of original issue discount that represented interest were consistent with the rules contained in section 1232(a)(2)(B)(ii). In *United States v. Midland-Ross Corporation,* 381 U.S. 54 (1965), 1965-2 C.B. 474, the Supreme Court of the United States held that earned original issue discount on promissory notes issued by a private corporation must be treated as interest taxable as ordinary income upon the sale of such notes. The Court stated that earned discount was unlike capital appreciation because it is earned in a "predict-able and measurable" manner. 381 U.S. at 57.

In *Leavin v. Commissioner,* 37 TC. 766 (1962) the Tax Court of the United States concluded that the entire original issue discount was interest income where the facts indicated that at the time of issuance of certain debentures with a 6-year maturity there had been an understanding between the issuer and the purchaser that the debentures would be redeemed as soon as the issuer had completed and marketed the project for which the debentures provided financing.

In *Bolnick v. Commissioner,* 44 T.C. 245 (1965), *acq. on this issue,* page 5, this Bulletin, *withdrawing nonacq.,* 1967-1 C.B. 3, the Tax Court of the United States held that only the earned portion of original issue discount on corporate debentures redeemed before maturity was interest income and the remainder was capital gain. The court found that there had not been any understanding that the debentures would be redeemed before maturity. The court specifically noted that although section 1232(a)(2) of the Code was not applicable, it evidenced "congressional recognition of the distinction between the situation in which there is no plan for early redemption and that in which there is an understanding that debentures will be redeemed prior to maturity." 44 T.C. at 256.

On the basis of the cases discussed above, it may reasonably be concluded that the rules contained in section 1232(a)(2)(B)(ii) of the Code are consistent with the definition of interest as "compensation for the use or forbearance of money." *Deputy v. duPont,* 308 U.S. 488, 498 (1940), 1940-1 C.B. 118, 122. There is no reason why amounts that are not treated as interest under section 1232(a)(2)(B)(ii) should be treated as interest for purposes of section 103(a). Compare Rev. Rul. 119, 1953-2 C.B. 95. Accordingly, upon the redemption before maturity of an obligation described in section 103(a)(1), only the earned portion of original issue discount will be treated as tax-exempt interest.

In this case the issuer redeemed the bond after it had been held by the taxpayer for 120 months. Therefore, $100, representing one-half (120 months/240 months) of the original issue discount is interest earned during the period the municipal bond was held by the taxpayer. Such interest is excludable from the gross income of the taxpayer pursuant to the provisions of section 103(a)(1) of the Code. The $60 of annual accrued interest also is excludable from gross income. The $100 unearned portion of the original issue discount does not represent interest earned on the bonds during the period they were held by the taxpayer.

HOLDING

The $100 unearned portion of the original issue discount is not interest income excludable from the gross income of the taxpayer under the provisions of section 103(a)(1) of the Code. Such amount is gain from the sale or exchange of a capital asset held for more than one year.

EFFECT ON OTHER DOCUMENTS

To the extent that Rev. Rul. 72-587 holds that the unearned discount on state bonds that were redeemed before maturity is interest that is excludable from the gross income of the bondholder, such revenue ruling is modified.

PROSPECTIVE APPLICATION

Pursuant to the authority contained in section 7805(b) of the Code, the conclusions of this revenue ruling will not be applied to municipal obligations issued prior to June 9, 1980, the date this revenue ruling is published in the Internal Revenue Bulletin.

Section 368.—Definitions Relating to Corporate Reorganizations

26 CFR 1.368-1: Purpose and scope of exception of reorganization exchanges.

Whether certain foreign taxes paid by a foreign corporation are available to an acquiring domestic corporation for foreign tax credit purposes as a result of a reorganization under section 368(a)(1)(D) of the Code. See Rev. Rul. 80-144, this page.

Section 382.—Special Limitations on Net Operating Loss Carryovers

26 CFR 1.382(b)-1: Change of ownership as the result of a reorganization.

Whether certain foreign taxes paid by a foreign corporation are available to an acquiring domestic corporation for foreign tax credit purposes as a result of a reorganization under section 368(a)(1)(D) of the Code. See Rev. Rul. 80-144, below.

Section 383.—Special Limitations on Unused Investment Credits, Work Incentive Program Credits, New Employee Credits, Foreign Taxes, and Capital Losses

26 CFR 1.383-3: Change in ownership as the result of a reorganization.
(Also Sections 368, 382, 901, 904, 906; 1.368-1, 1.382(b)-1, 1.901-1, 1.904-1).

Foreign tax credit carryover; acquiring corporation. A foreign corporation, all of whose income was effectively connected with a U.S. business, transferred substantially all of its properties to a related domestic corporation in a reorganization under section 368(a)(1)(D) of the Code. Any unused foreign income taxes of the transferor foreign corporation may be carried over and used in computing the foreign tax credit of the acquiring domestic corporation under section 901(a). Rev. Ruls. 68-350 and 72-452 obsoleted for reorganizations described in section 381(a)(2) occurring after December 10, 1971, pursuant to a plan of reorganization or contract entered into on or after September 29, 1971.

Rev. Rul. 80-144

ISSUE

Are certain foreign taxes paid by a foreign corporation available to an acquiring domestic corporation for foreign tax credit purposes as a result of a reorganization under section 368(a)(1)(D) of the Internal Revenue Code?

FACTS

P, a foreign corporation, owns all the stock of corporations *S-1* and *S-2*. *S-1* is a foreign corporation that is incorporated in country *X* and engaged in trading, syndicating and investing in foreign notes and loans with third parties in the United States. *S-2* is a domestic corporation engaged in the banking business in the United States. *S-1* is not subject to any income tax in country *X*. *S-1* is a holder of notes from obligors in country *Y* from which *S-1* derives foreign source interest income. *S-1* is engaged in the active conduct of a financing business within the United States within the meaning of section 864 of the Code and all of its income, including the interest on the foreign notes, is effectively connected with that United States business. It files its United States returns on a calendar year basis. Country *Y*, which has no tax treaty with the United States, taxes interest received by financial entities domiciled outside country *Y* from business concerns resident within Country *Y*.

In January 1976, for valid business reasons, *S-1* transferred substantially all of its properties to *S-2* solely in exchange for additional stock in *S-2*. *S-1* distributed the *S-2* stock to *P*, and then *S-1* dissolved. The transaction was a nondivisive reorganization under section 368(a)(1)(D) of the Code because it met the requirements of section 354(b)(1)(A) and (B). Because the transaction is of a type described in section 367(b), the notice requirement of section 7.367(b)-1(c) of the Temporary Income Tax Regulations under the Tax Reform Act of 1976 were complied with by *S-1* in a timely manner.

In the years preceding the transfer, *S-1* was required to pay income tax to country *Y* with respect to interest income it earned on the notes it held that originated in Country *Y*. This tax qualified as an income tax within the meaning of section 901 of the Code. *S-1* and *S-2* have always computed their respective section 904 limitations on the foreign tax credit under the overall limitation method. As of the date of the transfer, *S-1* had paid foreign taxes for 1975 for which it had not taken a United States tax credit for foreign taxes.

LAW AND ANALYSIS

Section 901(a) and (b)(1) of the Code provides that a domestic corporation may claim a credit against the tax imposed by chapter 1 of the Code for income taxes paid or accrued to foreign countries.

Section 901(b)(4) of the Code provides that in the case of foreign corporations, the amount determined pursuant to section 906 shall be allowed as the credit under subsection (a), subject to the provisions of section 904.

Section 906(a) of the Code provides that a foreign corporation engaged in a trade or business within the United States during the taxable year shall be allowed a credit under section 901, subject to certain limitations contained in section 906(b) that are not here relevant, for the amount of any income, war profits, and excess profits taxes paid or accrued during the taxable year to any foreign country with respect to income effectively connected with the conduct of a trade or business within the United States.

Section 904(c) of the Code provides that to the extent taxes paid or accrued to foreign countries exceed the limitations under section 904(a), such taxes may be carried back to certain preceding taxable years or carried forward to certain succeeding taxable years in accordance with the rules described therein.

Section 904(d)(1)(A) of the Code provides that the provisions of subsections (a), (b), and (c) of section 904 shall be applied separately with respect to the interest income described in section 904(d)(2). Section 904(d)(2)(B) provides that the interest income described in section 904(d) is interest other than interest derived in the conduct by the taxpayer of a banking, financing, or similar business.

Section 381(a)(2) of the Code provides that in acquisitions described in section 381(a), such as a reorganization within the meaning of section 368(a)(1)(D) (but only if the requirements of subparagraphs (A) and (B) of section 354(b)(1) are met), the acquiring corporation shall succeed to and take account of the items described in section 381(c). Unused foreign tax credits is not one of the items listed in section 381(c).

Since unused foreign tax credits is not listed in section 381(c) of the Code, the Service, prior to the effective date of section 383, continued to apply certain restrictions developed under pre-1954 Code case law in determining whether unused foreign tax credits could be carried over in reorganizations under the 1954 Code. Thus, Rev. Rul. 68-350, 1968-2 C.B. 159, provides that any foreign taxes for which a United States tax credit has not been taken that belong to a domestic transferor corporation involved in a statutory merger under section 368(a)(1)(A) may be carried over by an acquiring corporation to a post-merger taxable year of the acquiring corporation. However, Rev. Rul. 68-350 also provides that the foreign taxes carried over by the acquiring corporation can only be credited against United States income taxes imposed on the foreign taxable income of the acquiring corporation attributable to the pre-fusion business of the transferor corporation. This restriction on the carryover of foreign tax credits is based on *Libson Shops v. Koehler,* 353 U.S. 382 (1957), 1957-2 C.B. 891, which involved the carryover of a net operating loss in a reorganization under the 1939 Code.

Rev. Rul. 72-452, 1972-2 C.B. 438, applies the holding in Rev. Rul. 68-350 to a reorganization described in section 368(a)(1)(C) of the Code. Rev. Rul. 68-350 and Rev. Rul. 72-452 involve the carryover of foreign tax credits in reorganizations occurring prior to the effective date of section 383. Section 383 applies to carryovers of unused foreign tax credits in cases of reorganizations described in section 381(a)(2) occurring after December 10, 1971, pursuant to a plan of reorganization or contract entered into on or after September 29, 1971.

Section 383 of the Code provides that if, in the case of a reorganization specified in section 381(a)(2), there is a change in ownership described in section 382(b)(1)(B), then the limitations provided in section 382 in such cases with respect to net operating losses shall apply in the same manner with respect to any excess foreign taxes of the corporation which can otherwise be carried forward under section 904(c).

By enacting section 383 of the Code, Congress has preempted the application of pre-1954 Code case law in determining whether unused foreign tax credits may be carried over by the acquiring corporation in reorganizations described in section 381(a)(2) occurring after the effective date of section 383. *See* section 1.383-3(b)(1) of the Income Tax Regulations, which provides that the unused foreign tax credit carried over by the acquiring corporation is to be determined in accordance with the principles of section 381(c)(23) and the regulations thereunder (relating to the carryover of unused investment credit).

Rev. Rul. 58-603, 1958-2 C.B. 147, provides that the Service will not apply the *Libson Shops* principle to transactions described in section 381(a) to disallow the carryover of net operating losses. The rationale underlying this ruling was that the enactment of section 381 had preempted pre-1954 Code case law on this point. Similarly, section 383 preempted prior law regarding certain carryovers of foreign tax credits. Therefore, Rev. Rul. 68-350, Rev. Rul. 72-452, and the *Libson Shops* principle no longer apply to the carryover of unused foreign tax credits with respect to reorganizations described in section 381(a)(2) occurring after the 1971 effective date of section 383. Consequently, the amount of a transferor corporation's unused foreign tax credit that the acquiring corporation in such reorganizations can use is no longer limited to the amount of United States income tax imposed on the foreign taxable income of the acquiring corporation attributable to the continuation of the transferor's pre-fusion business.

For reorganizations described in section 381(a)(2) of the Code and thus section 383, section 1.383-3(b)(2) of the regulations provides rules for computing the amount of the reduction in the carryover of unused foreign taxes if section 382 requires a reduction. However, because immediately before the reorganization *P* owned all the stock of corporations *S-1* and *S-2* within the meaning of section 382(b)(3), sections 382(b)(1) and 383 do not require a reduction in *S-1*'s unused foreign taxes that can be carried over by *S-2*.

HOLDING

As a result of the nondivisive section 368(a)(1)(D) reorganization, any unused foreign income taxes of *S-1* may be used by *S-2* in computing its foreign tax credit under section 901(a) of the Code, subject to the limitations of section 904.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 68-350 and Rev. Rul. 72-452 are obsoleted in the case of reorganizations described in section 381(a)(2) occurring after December 10, 1971, pursuant to a plan of reorganization or contract entered into on or after September 29, 1971.

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401-1: Qualified pension, profit-sharing and stock bonus plans.

Whether a complete discontinuance of contributions has occurred in a qualified profit-sharing plan. See Rev. Rul. 80-146, page 10.

Section 404.—Deduction for Contributions of an Employer to an Employees' Trust or Annuity Plan and Compensation Under a Deferred-Payment Plan

26 CFR 1.404(a)-9: Contributions of an employer to an employees' profit-sharing or stock bonus trust that meets the requirements of section 401(a); application of section 404(a)(3)(A).

Profit-sharing; contributions; deduction limitation. In determining the deduction limitations under section 404(a)(3)(A) and (a)(7) of the Code for employer contributions to a qualified profit-sharing plan, including the computation of credit carryovers and contribution carryovers, the definition of compensation provided in sections 1.404(a)-9(b) and 1.404(a)-13(a) of the regulations applies regardless of the definition of compensation used in the plan; Rev. Rul. 71-542 superseded.

Rev. Rul. 80-145

The purpose of this revenue ruling is to restate Rev. Rul. 71-542, 1971-2 C.B. 214, pursuant to the enactment of the Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 1974-3 C.B. 1.

The issue presented in Rev. Rul. 71-542 is whether, in determining the deduction limitations for contributions under a qualified profit-sharing plan, including the computation of credit and contribution carryovers, the definition of compensation provided in section 1.404(a)-9(b) of the Income Tax Regulations applies regardless of the definition used in the plan.

A qualified profit-sharing plan provides that annual contributions thereunder shall be limited to profits, but shall not exceed a specified percentage of the participants' compensation. "Compensation" is defined in the plan to mean basic pay, exclusive of bonuses, commissions, and overtime.

Section 404(a)(3)(A) of the Internal Revenue Code limits the deduction for contributions under a qualified profit-sharing plan to fifteen percent of compensation otherwise paid or accrued during the taxable year to all employees under the plan except for years to which credit carryovers are available, in which case the deduction may be as high as twenty-five percent. For purposes of applying the limitations of section 404(a)(3) of the Code, section 1.404(a)-9(b) of the regulations defines "compensation otherwise paid or accrued" to mean all of the compensation paid or accrued except that for which a deduction is allowable under a plan that qualifies under section 401(a) of the Code. Section 404(a)(7) of the Code and section 1.404(a)-13(a) of the regulations also contain limits on deductions that use the same definition of compensation.

Accordingly, for purposes of determining the deduction limitations under section 404(a)(3)(A) and (a)(7) of the Code, including the computation of credit carryovers and contribution carryovers, the definition of compensation set forth in sections 1.404(a)-9(b) and 1.404(a)-13(a) of the regulations applies regardless of the definition of compensation used in the plan.

Rev. Rul. 71-542 is superseded because the position stated therein is updated and restated in this revenue ruling.

Section 411.—Minimum Vesting Standards

26 CFR 1.411(d)-2: Termination or partial termination; discontinuance of contributions.
(Also Section 401; 1.401-1.)

Profit-sharing; contributions; discontinuance. The failure of an employer to make contributions to its profit-sharing plan for five consecutive years due solely to the absence of current or accumulated earnings or profits is not a complete discontinuance of contributions within the meaning of section 411(d)(3) of the Code in a situation in which the employer is required to resume contributions as soon as it does have profits; Rev. Rul. 74-419 superseded.

Rev. Rul. 80-146

The purpose of this revenue ruling is to restate the position of Rev. Rul. 74-419, 1974-2 C.B. 135, in view of the enactment of the Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 1974-3 C.B. 1.

The issue to be considered is whether, under the circumstances described below, employer contributions were completely discontinued within the meaning of section 411(d)(3) of the Internal Revenue Code.

A corporation established a profit-sharing plan that met the requirements for qualification under section 401(a) of the Code. The plan provides for annual employer contributions of 15 percent of the participants' compensation to be made from the employer's current or accumulated profits. During each of the first three years of the plan's existence, the corporation contributed, out of its profits, 15 percent of the participating employees' annual compensation. For the next five years, however, the corporation sustained net operating losses. As a result of these losses, the corporation had no current or accumulated profits at the end of any of those five years. No contributions were made to the profit-sharing plan during the five-year period. The plan requires the employer to resume contributions as soon as it has profits.

Section 411(d)(3 of the Code provides that in the case of a plan to which section 412 does not apply, such as a profit-sharing plan, the plan must provide that upon complete discontinuance of contributions under the plan the rights of all employees to benefits accrued to the date of such discontinuance, to the extent then funded, or the amounts credited to the employees' accounts, are nonforfeitable.

Section 1.401-1(b)(1)(ii) of the Income Tax Regulations states that a profit-sharing plan is a plan established and maintained by an employer to provide for participation in profits by employees or their beneficiaries. Section 1.401-1(b)(2) provides that, in the case of a profit-sharing plan, it is not necessary that the employer contribute every year or that it contribute the same amount or contribute in accordance with the same ratio every year. To be a profit-sharing plan, there must be recurring and substantial contributions out of profits for the employees.

Section 1.411(d)-2(d)(1) of the regulations provides that whether a complete discontinuance of contributions has occurred will depend on the facts and circumstances in the particular case.

The regulations require that contributions to a profit-sharing plan be made out of profits. Failure by an employer to make contributions solely because there are no current or accumulated profits does not constitute a discontinuance of contributions in a situation where it is reasonable to expect profits to exist in future years.

In this case, failure to make plan contributions was due solely to the absence of current or accumulated profits. In addition, the plan requires the employer to resume contributions as soon as it has profits.

Accordingly, in the instant case, there was not a complete discontinuance of contributions by the employer under the profit-sharing plan within the meaning of section 411(d)(3) of the Code.

Rev. Rul. 74-419 is superseded because the position stated therein is restated under current law in this revenue ruling.

Section 528.—Certain Homeowners Associations

26 CFR 1.528-1: Homeowners associations.

T.D. 7692 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 7.—TEMPORARY INCOME TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1976

Homeowners associations

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to homeowners associations. Changes to the applicable tax law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1]. These regulations provide necessary guidance to the public to determine whether a particular organization qualifies as a homeowners association. If an organization qualifies as a homeowners association, its tax liability may be reduced as a result of the new provision under the Act.

DATE: The regulations are effective for taxable years beginning after December 31, 1973.

FOR FURTHER INFORMATION CONTACT: Phoebe A. Mix of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3671, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On January 9, 1979, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 528 of the Internal Revenue Code of 1954 (44 FR 1985). The amendments were proposed to conform the regulations to section 2101(a) of the Tax Reform Act of 1976 (90 Stat. 1897). After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision.

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[1] This publication of the Treasury Decision contains the complete text of amendments to the regulations. The instructions for modifying the notice of proposed rulemaking have been omitted.

EXPLANATION OF THE REGULATIONS

For taxable years beginning after December 31, 1973, howeowners associations described in section 528 of the Code may elect to be subject to the tax imposed by section 528 and to be otherwise exempt from Federal income taxes. To be considered a homeowners association an organization must be either a condominium management association or a residential real estate management association and must meet a number of specific additional requirements. Cooperative housing corporations are not eligible to be treated as homeowners associations.

For an organization to qualify as a homeowners association it must be organized and operated to provide for the acquisition, construction, management, maintenance, and care of association property. In addition, a homeowners association must meet both a source of income test (which generally requires that at least 60 percent of its gross income consists of membership dues, fees, or assessments from members of the association) and an expenditure test (which generally requires that at least 90 percent of its expenditures be in furtherance of its exempt purposes). If an association meets the required tests and makes the election under section 528, it will not be taxable on that portion of its income which consists of dues, fees, and assessments from its members. To the extent that a homeowners association does have taxable income, it will be taxed (with certain modifications described in section 528 and these regulations) as a corporation taxable under section 11.

ADDITIONAL CONSIDERATIONS

These regulations are needed in order to provide guidance to the public as well as government employees responsible for the implementation of section 528 of the Internal Revenue Code of 1954. Considering both the direct and indirect effects of these regulations, it is believed that they satisfactorily implement section 2101(a) of the Tax Reform Act of 1976. These regulations do not institute new recordkeeping or recording burdens. Evaluation of the effectiveness of the regulations after issuance will be based upon comments received from offices within the Internal Revenue Service and the Treasury Department, other govermental agencies, State and local governments, and the public.

PUBLIC COMMENTS

A number of comments were received which suggested that the provisions relating to the use for residential purposes are too restrictive. This has not resulted in any change to the regulations because it is felt that such a change would be in conflict with the statute.

A suggestion was made that § 1.528-8(e) should be amended to provide that organizations exempt under section 501(c)(4) may not have their exempt status revoked retroactively, just prospectively. The standards for revoking an organization's exempt status are beyond the scope of the proposed regulations. Section 1.528-8(e) simply permits an organization whose exempt status has been revoked retroactively to make a timely election under section 528.

Another criticism of the proposed regulations was that they did not adequately take into account the existence of separate subdivisions within the same homeowners association. The final regulations permit the use of association property to be allocated to certain members of the association provided that all members are treated in an equitable manner and have access to comparable facilities. The final regulations require equal access to the same or comparable property because the legislative history indicates that this was the intent of Congress.

Comments were also received which suggested that the final regulations provide that investment income and income from unrelated activities not be taxed. The final regulations do not reflect these suggestions because to do so would be inconsistent with the statute.

Finally, comments were received which suggested changes that either conflicted with the express statutory language or would have made the regulations unreasonably long and complex. Those suggestions were rejected.

DRAFTING INFORMATION

The principal author of these regulations is Phoebe A. Mix of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of the regulations

Accordingly 26 CFR Part 1 and Part 7 are amended as follows:

Paragraph 1. The following sections are inserted in the appropriate places:

§ 1.528-1 Homeowners associations.

(a) *In general.* Section 528 only applies to taxable years of homeowners associations beginning after December 31, 1973. To qualify as a homeowners association an organization must either be a condominium management association or a residential real estate management association. For the purposes of section 528 and the regulations under that section, the term "homeowners association" shall refer only to an organization described in section 528. Cooperative housing corporations and organizations based on a similar form of ownership are not eligible to be taxed as homeowners associations. As a general rule, membership in either a condominium management association or a residential real estate management association is confined to the developers and the owners of the units, residences, or lots. Furthermore, membership in either type of association is normally required as a condition of such ownership. However, if the membership of an organization consists of other homeowners associations, the owners of units, residences, or lots who are members of such other homeowners associations will be treated as the members of the organization for the purposes of the regulations under section 528.

(b) *Condominium.* The term "condominium" means an interest in real property consisting of an undivided interest in common in a portion of a parcel of real property (which may be a fee simple estate or an estate for years, such as a leasehold or subleasehold) together with a separate interest in space in a building located on such property. An interest in property is not a condominium unless the undivided interests in the common elements are vested in the unit holders. In addition, a condominium must meet the requirements of applicable state or local law relating to condominiums or horizontal property regimes.

(c) *Residential real estate management association.* Residential real estate management associations are normally composed of owners of single-family residential units located in a subdivision, development, or similar area. However, they may also include as members owners of multiple-family dwelling units located in such areas. They are commonly formed to administer and enforce covenants relating to the architecture and appearance of the real estate development as well as to perform certain maintenance duties relating to common areas.

(d) *Tenants.* Tenants will not be considered members for purposes of meeting the source of income test under section 528(c)(1)(B) and § 1.528-5. However, the fact that tenants of members of a homeowners association are permitted to be members of the association will not disqualify an association under section 528(c)(1) if it otherwise meets the requirements of section 528(c) and these regulations.

§ 1.528-2 Organized and operated to provide for the acquisition, construction, management, maintenance and care of association property.

(a) *Organized and operated*—(1) *Organized.* To be treated as a homeowners association an organization must be organized and operated primarily for the purpose of carrying on one or more of the exempt functions of a homeowners association. For the purposes of section 528 and these regulations, the exempt functions of a homeowners association are the acquisition, construction, management, maintenance, and care of association property. In determining whether an organization is organized and operated primarily to carry on one or more exempt functions, all the facts and circumstances of each case shall be considered. For example, when an organization provides in its articles of organization that its sole purpose is to carry on one or more exempt functions, in the absence of other relevant factors it will be considered to have met the organizational test. (The term "articles of organization" means the organization's corporate charter, trust instruments, articles of association or other instruments by which it is created.)

(2) *Operated.* An organization will be treated as being operated for the purpose of carrying on one or more of the exempt functions of a homeowners association if it meets the provisions of § 1.528-5 and § 1.528-6.

(b) *Terms to be interpreted according to common meaning and usage.* As used in section 528 and these regulations, the terms acquisition, construction, management, maintenance, and care are to be interpreted according to their common meaning and usage. For example, maintenance of association property includes the painting and repairing of such property as well as the gardening and janitorial services associated with its upkeep. Similarly, the term "construction" of association property includes covenants or other rules for preserving the architectural and general appearance of the area. The term also includes regulations relating to the location, color and allowable building materials to be used in all structures. (For the definition of association property see § 1.528-3.)

§ 1.528-3 Association property.

(a) *Property owned by the organization.* "Association property" includes real and personal property owned by the organization or owned as tenants in common by the members of the organization. Such property must be available for the common benefit of all members of the organization and must be of a nature that tends to enhance the beneficial enjoyment of the private residences by their owners. If two or more facilities or items of property of a similar nature are owned by a homeowners association, and if the use of any particular facility or item is restricted to fewer than all association members, such facilities or items nevertheless will be considered association property if all association members are treated equitably and have similar rights with respect to comparable items or facilities. Among the types of property that ordinarily will be considered association property are swimming pools and tennis courts. On the other hand, facilities or areas set aside for the use of nonmembers, or in fact used primarily by nonmembers, are not association property for the purposes of this section. For example, property owned by an organization for the purpose of leasing it to groups consisting primarily of nonmembers to be used as a meeting place or a retreat will not be considered association property.

(b) *Property normally owned by a governmental unit.* "Association property" also includes areas and facilities traditionally recognized and accepted as being of direct governmental concern in the exercise of the powers and duties entrusted to governments to regulate community health, safety and welfare. Such areas and facilities would normally include roadways, parklands, sidewalks, streetlights and firehouses. Property described in this paragraph will be considered association property regardles of whether it is owned by the organization itself, by its members as tenants in common or by a governmental unit and used for the benefit of the residents of such unit including the members of the organization.

(c) *Privately owned property.* "Association property" may also include property owned privately by members of the organization. However, to be so included the condition of such property must affect the overall appearance or structure of the residential units which make up the organization. Such property may include the exterior walls and roofs of privately owned residences as well as the lawn and shrubbery on privately owned land and any other privately owned property the appearance of which may directly affect the appearance of the entire organization. However, privately owned property will not be considered association property unless—

(1) There is a covenant or similar requirement relating to exterior appearance or maintenance that applies on the same basis to all such property (or to a reasonable classification of such property);

(2) There is a pro rata mandatory assessment (at least once a year) on all members of the association for maintaining such property; and

(3) Membership in the organization is a condition of ownership of such property.

§ 1.528-4 Substantially test.

(a) *In general.* In order for an organization to be considered a condominimum management association or a residential real estate management association (and therefore in order for it to be considered a homeowners association), substantially all of its units, lots or buildings must be used by individuals for residences. For the purposes of applying paragraph (b) or (c) of this section, an organization which has attributes of both a condominium management association and a residential real estate management association shall be considered that association which, based on all the facts and circumstances, it more closely resembles. In addition, those paragraphs shall be applied based on conditions existing on the last day of the organization's taxable year.

(b) *Condominium management associations.* Substantially all of the units of a condominium management association will be considered as used by individuals for residences if at least 85% of the total square footage of all units within the project is used by individuals for residential purposes. If a completed unit has never been occupied, it will nonetheless be considered as used for residential purposes if, based on all the facts and circumstances, it appears to have been constructed for use as a residence. Similarly, a unit which is not occupied but which has been in the past will be considered as used for residential purposes if, based on all the facts and circumstances, it appears that it was constructed for use as a residence, and the last individual to occupy it did in fact use it as a residence. Units which are used for purposes auxiliary to residential use (such as laundry areas, swimming pools, tennis courts, storage rooms and areas used by maintenance personnel) shall be considered used for residential purposes.

(c) *Residential Real Estate Management Associations.* Substantially all of the lots or buildings of a residential real estate management association (including unimproved lots) will be considered as used by individuals as residences if at least 85% of the lots are zoned for residential purposes. Lots shall be treated as zoned for residential purposes even if under such zoning lots may be used for parking spaces, swimming pools, tennis courts, schools, fire stations, libraries, churches and other similar purposes which are auxiliary to residential use. However, commercial shopping areas (and their auxiliary parking areas) are not lots zoned for residential purposes.

(d) *Exception.* Notwithstanding any other provisions of this section, a unit, or building will not be considered used for residential purposes, if for more than one-half the days in the association's taxable year, such unit, or building is occupied by a persons or series of persons, each of whom so occupies such unit, or building for less than 30 days.

§ 1.528-5 Source of income test.

An organization cannot qualify as a homeowners association under section 528 for a taxable year unless 60 percent or more of its gross income for such taxable year is exempt function income as defined in § 1.528-9. The determination of whether an organization meets the provisions of this section shall be made after the close of the organization's taxable year.

§ 1.528-6 Expenditure test.

(a) ***In general.*** An organization cannot qualify as a homeowners association under section 528 for a taxable year unless 90 percent or more of its expenditures for such taxable year are qualifying expenditures as defined in paragraphs (b) and (c) of this section. The determination of whether an organization meets the provisions of this section shall be made after the close of the organization's taxable year. Investments or transfers of funds to be held to meet future costs shall not be taken into account as expenditures. For example, transfers to a sinking fund account for the replacement of a roof would not be considered an expenditure for the purposes of this section even if the roof is association property. In addition, excess assessments which are either rebated to members or applied against the members' following year's assessments will not be considered an expenditure for the purposes of this section.

(b) *Qualifying expenditures.* Qualifying expenditures are expenditures by an organization for the acquisition, construction, management, maintenance, and care of the organization's association property. They include both current operating and capital expenditures on association property. Qualifying expenditures include expenditures on association property despite the fact that such property may produce income which is not exempt function income. Thus expenditures on a swimming pool are qualifying expenditures despite the fact that fees from guests of members using the pool are not exempt function income. Where expenditures by an organization are used both for association property as well as other property, an allocation shall be made between the two uses on a reasonable basis. Only that portion of the expenditures which is properly allocable to the acquisition, construction, management, maintenance or care of association property, shall constitute qualifying expenditures.

(c) *Examples of qualifying expenditures.* Qualifying expenditures may include (but are not limited to) expenditures for—

(1) Salaries of an association manager and secretary;

(2) Paving of streets;

(3) Street signs;

(4) Security personnel;

(5) Legal fees;

(6) Upkeep of tennis courts;

(7) Swimming pools;

(8) Recreation rooms and halls;

(9) Replacement of common buildings, facilities, air conditioning, etc.;

(10) Insurance premiums on association property;

(11) Accountant's fees;

(12) Improvement of private property to the extent it is association property; and

(13) Real estate and personal property taxes imposed on association property by a State or local government.

§ 1.528-7 Inurement.

An organization is not a homeowners association if any part of its net earnings inures (other than as a direct result of its engaging in one or more exempt functions) to the benefit of any private person. Thus, to the extent that members receive a benefit from the general maintenance, etc. of association property, this benefit generally would not constitute inurement. If an organization pays rebates from amounts other than exempt function income, such rebates will constitute inurement. In general, in determining whether an organization is in violation of this section, the principles used in making similar determinations under section 501(c) will be applied.

§ 1.528-8 Election to be treated as a homeowners association.

(a) *General rule.* An organization wishing to be treated as a homeowners association under section 528 and this section for a taxable year must elect to be so treated. Except as otherwise provided in this section, such election shall be made by the filing of a properly completed Form 1120-H (or such other form as the Secretary may prescribe). A separate election must be made for each taxable year.

(b) *Taxable years ending after December 30, 1976.* For taxable years ending after December 30, 1976, the election must be made not later than the time, including extensions, for filing an income tax return for the year in which the election is to apply.

(c) *Taxable years ending before December 31, 1976, for which a return was filed before January 31, 1977.* For taxable years ending before December 31, 1976, for which a return was filed before January 31, 1977, the election must be made not later than the time provided by law for filing a claim for credit or refund of overpayment of taxes for the year in which the election is to apply. Such an election shall be made by filing an amended return on Form 1120-H (or such other form as the Secretary may prescribe).

(d) *Taxable years ending before December 31, 1976, for which a return was not filed before January 31, 1977.* For taxable years ending before December 31, 1976, for which a return was not filed before January 31, 1977, the election must be made by October 20, 1980. Instead of making such an election in the manner described in paragraph (a) of this section, such an election may be made by a statement attached to the applicable income tax return or amended return for the year in which the election is made. The statement should identify the election being made, the period for which it applies and the taxpayer's basis for making the election.

(e) *Revocation of exempt status.* If an organization is notified after the close of a taxable year that its exemption for such taxable year under section 501(a) is being revoked retroactively, it may make a timely election under section 528 for such taxable year. Notwithstanding any other provisions of this section, such an election will be considered timely if it is made within 6 months after the date of revocation. The preceding sentence shall apply to revocations made after April 18, 1980. If the revocation was made on or before April 18, 1980, the election will be considered timely if it is made before the expiration of the period for filing a claim for credit or refund for the taxable year for which it is to apply.

(f) *Effect of election*—(1) *Revocation.* An election to be treated as an organization described in section 528 is binding on the organization for the taxable year and may not be revoked without the consent of the Commissioner.

(2) *Exception.* Notwithstanding paragraph (f)(1) of this section, an election under this section may be revoked prior to July 18, 1980. Such a revocation shall be made by filing a statement with the director of the Internal Revenue Service Center with whom the return of the organization for the year in which the revocation is to apply was filed. The statement shall include the following information.

(i) The name of the organization.

(ii) The fact that it is revoking an election made under section 528.

(iii) The taxable year for which the revocation is to apply.

§ 1.528-9 Exempt function income.

(a) *General rule.* For the purposes of section 528 exempt function income consists solely of income which is attributable to membership dues, fees, or assessments of owners of residential units or residential lots. It is not necessary that the source of income be labeled as membership dues, fees, or assessments. What is important is that such income be derived from owners of residential units or residential lots in their capacity as owner-members rather than in some other capacity such as customers for services. Generally, for the membership dues, fees, or assessments with respect to a residential unit or lot to be exempt function income, the unit must be used for (or the unit or lot must be expected to be used) for residential purposes. However, dues, fees, or assessments paid to an organization by a developer with respect to unfinished or finished but unsold units or lots shall be exempt function income even though the developer does not use the units or lots. If an assessment is more in the nature of a fee for the provision of services in the course of a trade or business than a fee for a common activity undertaken by a collective group of owners for the purpose of enhancing or maintaining the value of their residences, the assessment will not be considered exempt function income to the organization. Furthermore, income attributable to dues, fees, or assessments will not be considered exempt function income unless each member's liability for payment arises solely from membership in the association. Dues, fees, or assessments that are based on the extent, if any, to which a member avails him or herself of a facility or facilities are not exempt function income. For the purposes of section 528, dues, fees, or assessments which are based on the assessed value or size of property will be considered as arising solely as a result of membership in the organization. Regardless of the organization's method of accounting, excess assessments during a taxable year which are either rebated to the members or applied to their future assessments are not considered gross income and therefore will not be considered exempt function income for such taxable year. However, if such excess assessments are applied to a future year's assessments, they will be considered gross income and exempt function income for that future year. In addition, assessments in a taxable year, such as an assessment for a capital improvement, which are not treated as gross income do not enter into the determination of whether the organization meets the source of income test for that taxable year.

(b) *Examples of exempt function income.* Assessments which are considered more in the nature of a fee for common activity than for the providing of services and which will therefore generally be considered exempt function income include assessments made for the purpose of—

(1) Paying the principal and interest on debts incurred for the acquisition of association property;

(2) Paying real estate taxes on association property;

(3) Maintaining association property;

(4) Removing snow from public areas; and

(5) Removing trash.

(c) *Examples of receipts which are not exempt function income.* Exempt function income does not include—

(1) Amounts which are not includible in the organization's gross income other than by reason of section 528 (for example, tax-exempt interest);

(2) Amounts received from persons who are not members of the association;

(3) Amounts received from members for special use of the organization's facilities, the use of which is not available to all members as a result of having paid the dues, fees or assessments required to be paid by all members;

(4) Interest earned on amounts set aside in a sinking fund;

(5) Amounts received for work done on privately owned property which is not association property; or

(6) Amounts received from members in return for their transportation to or from shopping areas, work location, etc.

(d) *Special Rule.* Notwithstanding paragraph (a) and (c)(3) of this section, amounts received from members or from tenants of residential units owned by members (notwithstanding § 1.528-1(d)) for special use of an association's facilities will be considered exempt function income if—

(1) The amounts paid by the members are not paid more than once in any 12 month period; and

(2) The privilege obtained from the payment of such amounts lasts for the entire 12 month period or portion thereof in which the facility is commonly in use.

Thus, amounts received as the result of payments by members of a yearly fee for use of tennis courts or a swimming pool shall be considered exempt function income. However, amounts received for the use of a building for an evening, weekend, week, etc. shall not be considered exempt function income.

§ 1.528-10 Special rules for computation of homeowners association taxable income and tax.

(a) *In general.* Homeowners association taxable income shall be determined according to the provisions of section 528(d) and the rules set forth in this section.

(b) *Limitation on capital losses.* If for any taxable year a homeowners association has a net capital loss, the rules of sections 1211(a) and 1212(a) shall apply.

(c) *Allowable deductions*—(1) *In general.* To be deductible in computing the unrelated business taxable income of a homeowners association, expenses, depreciation and similar items must not only qualify as items of deduction allowed by chapter 1 of the Code but must also be directly connected with the production of gross income (excluding exempt function income). To be "directly connected with" the production of gross income (excluding exempt function income), an item of deduction must have both proximate and primary relationship to the production of such income and have been incurred in the production of such income. Items of deduction attributable solely to items of gross income (excluding exempt function income) are proximately and primarily related to such income. Whether an item of deduction is incurred in the production of gross income (excluding exempt function income) is determined on the basis of all the facts and circumstances involved in each case.

(2) *Dual use of facilities or personnel.* Where facilities are used both for exempt functions of the organization and for the production of gross income (excluding exempt function income), expenses, depreciation, and similar items attributable to such facilities (for example, items of overhead) shall be allocated between the two uses on a reasonable basis. Similarly, where personnel are employed both for exempt functions and for the production of gross income (excluding exempt function income), expenses and similar items attributable to such personnel (for example, items of salary) shall be allocated between the two activities on a reasonable basis. The portion of any such item so allocated to the production of gross income (excluding exempt function income) is directly connected with such income and shall be allowable as a deduction in computing homeowners association taxable income to the extent that it qualifies as an item of deduction allowed by chapter 1 of the Code. Thus, for example, assume that X, a homeowners association, pays its manager a salary of $10,000 a year and that it derives gross income other than exempt function income. If 10 percent of the manager's time during the year is devoted to deriving X's gross income (other than exempt function income), a deduction of $1,000 (10 percent of $10,000) would generally be allowable for purposes of computing X's homeowners association taxable income.

(d) *Investment credit.* A homeowners association is not entitled to an investment credit.

(e) *Cross reference.* For the definition of exempt function income, see § 1.528-9.

Par. 2. Section 7.0 of this chapter (26 CFR Part 7), promulgated by Treasury Decision 7459, 1977-1 C.B. 587, is hereby revoked to the extent it applies to elections under section 528.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved March 31, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on April 17, 1980, 8:45 a.m., and published in the issue of the Federal Register for April 18, 1980, 45 F.R. 26319)

Section 861.—Income from Sources within the United States

26 CFR 1.861-8: Computation of taxable income from sources within the United States and from other sources and activities.

Whether a foreign corporation can annually choose to remain subject to federal income tax on an item of income when a tax convention grants a reciprocal exemption for this item of income that otherwise would be subject to federal income tax. See Rev. Rul. 80-147, this page.

Section 882.—Tax on Income of Foreign Corporations Connected with United States Business

26 CFR 1.882-1: Taxation of foreign corporations engaged in U.S. business or of foreign corporations treated as having effectively connected income.

Whether a foreign corporation can annually choose to remain subject to federal income tax on an item of income when a tax convention grants a reciprocal exemption for this item of income that otherwise would be subject to federal income tax. See Rev. Rul. 80-147, this page.

Section 894.—Income Affected by Treaty

26 CFR 1.894-1: Income affected by treaty. *(Also Sections 861, 882; 1.861-8, 1.882-1.)* *(Also Part II T.D. 5206, 1943 C.B. 526.)*

Canada; contract carrier; waiver of exemption. A Canadian corporation engaged in business as a contract carrier of goods between points in the U.S. and Canada through a permanent establishment in the U.S. may annually choose whether to include in gross income for federal income tax purposes service income that is effectively connected with its U.S. business and deduct the allocable expenses, even though the income is exempt from federal income tax under a reciprocal provision of Article V of the United States-Canada Income Tax Convention.

Rev. Rul. 80-147

ISSUE

If a tax convention grants a reciprocal exemption for an item of income that otherwise would be subject to federal income tax, can the taxpayer, a foreign corporation, annually choose whether to remain subject to federal income tax on that item?

FACTS

M, a corporation organized in Canada, owns and operates contract carriers. *M* operates a carrier service in Canada and also transports goods between points in the United States and Canada. *M* maintains a branch of its operations in the United States. Because of its branch activities, *M* was engaged in business through a permanent establishment in the United States for its 1978 taxable year. During 1978 *M* received 100*x* dollars of service income that was effectively connected with its United States branch and incurred 225*x* dollars in expenses allocable to that income. *M* also received 125*x* dollars of interest income that was effectively connected with its U.S. business. *M* included the 125*x* dollars of interest income in gross income on its federal income tax return for 1978, without the benefit of a reduced income tax rate because such income was effectively connected with its U.S. business. Compare Rev. Rul. 73-562, 1973-2 C.B. 434.

LAW AND ANALYSIS

Section 882(a)(1) of the Internal Revenue Code provides that a foreign corporation engaged in trade or business within the United States during the taxable year shall be taxable on its taxable income which is effectively connected with the conduct of a trade or business within the United States.

Section 882(c)(1)(A) of the Code provides that a foreign corporation shall be allowed deductions to the extent they are connected with income which is effectively connected with the conduct of a trade or business within the United States; and the proper apportionment and allocation of the deductions for this purpose shall be determined as provided in regulations prescribed by the Secretary.

Section 1.861-8(d)(2) of the Income Tax Regulations provides that no deduction shall be allowed under this section, for any amount, or part thereof, allocable and apportionable to a class of exempt, excluded, or eliminated income, if such amount is not allowed as a deduction under another section of the Code. See section 265 and the regulations thereunder.

Section 265(1) of the Code provides that no deduction shall be allowed for any expense (other than interest) that is otherwise allowable as a deduction and is allocable to one or more classes of exempt income.

Section 894(a) of the Code provides that income of any kind, to the extent required by any treaty obligation of the United States, shall not be included in gross income and shall be exempt from taxation under the income tax provisions of the Code.

Article I of the United States-Canada Income Tax Convention, signed March 4, 1942, 1943 C.B. 526 (Convention), provides that an enterprise of one of the contracting States is not subject to taxation by the other contracting State in respect to its industrial and commercial profits except in respect of such profits allocable to its permanent establishment in the latter State.

Article V of the Convention, as amended by the supplementary convention, signed August 8, 1956, 1957-2 C.B. 1014 (supplementary convention), provides that an enterprise of one of the contracting States engaged in the operation of motor vehicles, as a common carrier or as a contract carrier, shall be exempt from tax by the other contracting State in respect of income (if taxed by the former State in respect of such income) arising from the transportation of property for hire between points in one State and points in the other State.

Paragraph 10 of the Protocol accompanying the Convention, as renumbered by the supplementary convention, provides that the provisions of the Convention shall not be construed to restrict in any manner any exemption, deduction, credit or other allowance accorded by the laws of one of the contracting States in the determination of the tax imposed by such State.

The Service views the language of paragraph 10 of the Protocol to mean that the amount of the tax paid by an enterprise of the foreign contracting state to the United States under a tax treaty should not result in a higher amount than would be due under the Code. See "Hearings on S. Exec. Doc. A Before a Subcommittee of the Senate Foreign Relations Committee," 80th Cong., 1st Sess. 153-154 (1947), 1. U.S. Tax Conv. 945, 1091-1092 and Treasury Department's Technical Memorandum accompanying the United States-Thailand proposed treaty before the Senate in 1965, "Hearings on S. Exec. Doc. E Before a Subcommittee of the Senate Foreign Relations Subcommittee," 89th Cong., 1st Sess. 48-49 (1965).

Article V of the Convention, as amended, and section 894 of the Code allow *M* to exclude from its federal income tax return the service income it received that is effectively connected to its United States business.

For federal income tax purposes, *M* can only claim expense allocable to its service income if that income is subject to United States tax, because section 1.861-8(d)(2) of the regulations and section 265(1) of the Code disallow a deduction for any expense (other than interest) allocable to the earnings of tax-exempt income. Therefore, *M* could not exclude the 100*x* dollars of service income under Article V of the Convention and deduct the 225*x* dollars of expenses attributable thereto against the 125*x* dollars of interest income still subject to tax.

To carry out the intent of paragraph 10 of the Protocol accompanying the Convention, *M* must be allowed to report on its federal income tax return the income it derives from transporting goods between points in the United States and Canada even though under Article V that income is exempt from tax.

HOLDING

A taxpayer may annually choose to remain subject to federal income tax if a tax convention grants a reciprocal exemption for an item of income that otherwise would be subject to federal income tax. Therefore, *M* for its 1978 taxable year, may choose to report in gross income for federal income tax purposes the 100*x* dollars of service income that is effectively connected with its United States business, and claim 225*x* dollars of related deductions. If *M* chooses to report such income and claim the related deductions for federal income tax purposes, *M* will have taxable income of zero.

Section 901.—Taxes of Foreign Countries and of Possessions of United States

26 CFR 1.901-1: Allowance of credit for taxes.

Whether certain foreign taxes paid by a foreign corporation are available to an acquiring domestic corporation for foreign tax credit purposes as a result of a reorganization under section 368(a)(1)(D) of the Code. See Rev. Rul. 80-144, page 7.

Section 904.—Limitation on Credit

26 CFR 1.904-1: Limitation on credit for foreign taxes.

Whether certain foreign taxes paid by a foreign corporation are available to an acquiring domestic corporation for foreign tax credit purposes as a result of a reorganization under section 368(a)(1)(D) of the Code. See Rev. Rul. 80-144, page 7.

Section 906.—Nonresident Alien Individuals and Foreign Corporations

Whether certain foreign taxes paid by a foreign corporation are available to an acquiring domestic corporation for foreign tax credit purposes as a result of a reorganization under section 368(a)(1)(D) of the Code. See Rev. Rul. 80-144, page 7.

Section 2056.—Bequests, Etc., to Surviving Spouse

26 CFR 20.2056(c)-1: Marital deduction; limitation on aggregate of deductions; in general.

Formula marital deduction clause; pre-1977 will. An individual executed a will containing a maximum formula marital deduction clause in 1975, transferred $210,000 to the spouse in 1977, died in 1978, and left an adjusted gross estate valued at $300,000. The will was not amended after 1976, and the decedent's state of residence has not enacted a statute construing formula marital deduction clauses with respect to the provisions in the Tax Reform Act of 1976. The estate is allowed a marital deduction for the entire $210,000.

Rev. Rul. 80-148

ISSUE

For purposes of section 2056 of the Internal Revenue Code, as amended by the Tax Reform Act of 1976, Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, what is the allowable marital deduction with respect to property received by the decedent's spouse if the decedent died after December 31, 1976, and before January 1, 1979, and the decedent's will, executed before January 1, 1977, contained a formula provision for property passing to the surviving spouse, under the circumstances described below?

FACTS

On June 1, 1975, the decedent, *D*, a resident of State *X*, executed a will with a formula clause providing that the spouse is to receive the amount of property that would qualify for the maximum allowable marital deduction, taking into account all other property passing to the spouse. The formula in the will was not subsequently amended at any time after December 31, 1976, and before the death of the decedent.

D transferred cash of $210,000 to the spouse on March 20, 1977, and died on April 7, 1978. The $210,000 was included in the gross estate under section 2035 of the Code. The value of the adjusted gross estate was $300,000.

State *X* has not enacted any statute construing formula marital deduction clauses with respect to the provisions in the Tax Reform Act of 1976.

LAW AND ANALYSIS

Section 2056(a) of the Code allows a marital deduction for the value of any interest in property that is included in the gross estate and that passes from the decedent to the decedent's surviving spouse.

Prior to the Tax Reform Act of 1976, section 2056(c) limited the amount of the allowable marital deduction to one-half of the value of the adjusted gross estate. The Tax Reform Act of 1976 generally changed the limitation of section 2056(c) to the greater of $250,000 or one-half of the value of the adjusted gross estate. The change in the maximum allowable marital deduction is effective for decedents dying after December 31, 1976.

Section 2002(d)(1)(B) of the Tax Reform Act of 1976 provides a transitional rule regarding the application of section 2056(c). Section 2002(d)(1)(B) provides that the change shall not apply to estates if:

> (i) the decedent dies after December 31, 1976, and before January 1, 1979, (ii) by reason of the death of the decedent *property passes* from the decedent or is acquired from the decedent *under a will* executed before January 1, 1977, *or a trust* created before such date, *which contains a formula* expressly providing that the spouse is to receive the maximum amount of property qualifying for the marital deduction allowable by Federal law, (iii) the formula referred to in clause (ii) was not amended at any time after December 31, 1976, and before the death of the decedent, and (iv) the State does not enact a statute applicable to such estate which construes this type of formula as referring to the marital deduction allowable by Federal law as amended by subsection (a). . . . [Emphasis added.]

The transitional rule is intended to prevent the distortion of a decedent's disposition of property to the surviving spouse, under a will or a trust agreement executed before January 1, 1977. H. R. Rep. No. 94-1380, 94th Cong., Sess. 18 (1976), 1976-3 C.B. (Vol. 3) 752, explains the purposes of the transitional rule:

> Because, under [prior] law the maximum marital estate tax deduction [was] limited to one-half the adjusted gross estate, many existing wills and trusts provide a maximum marital deduction formula clause. Your committee is concerned that many testators, although using the formula clause, may not have wanted to pass more than one-half the estate (recognizing the [prior] law limitation) to the spouse. For this reason, a [two] year transition rule has been added to provide that the increased estate tax marital deduction, as provided by this bill, will not apply to *transfers resulting from a* will executed or trust created before January 1, 1977. . . . [Emphasis supplied.]

Pursuant to the transitional rule, if the instrument provides for distribution under a formula clause referring to the maximum allowable marital deduction, if the formula was not amended after December 31, 1976, and if there is no specific indication under the terms of the instrument that the decedent intended that changes in the federal estate tax law relating to the marital deduction should apply to his estate, property passing to the spouse under the instrument qualifies for the marital deduction only in such amount that, along with all of the assets passing to the spouse outside of the will or trust, does not exceed fifty percent of the adjusted gross estate. The amended provision of section 2056 allowing a marital deduction to $250,000 is not generally applicable with respect to property distributed under the formula clause. Since the value of property passing to a surviving spouse outside of a will or trust agreement is not limited by a formula clause, the transitional rule does not apply to such property.

In the present situation, the transitional rule does not apply to *D*'s cash gift of $210,000 to the spouse. Consequently, the full value of the gift, or $210,000, qualifies for the marital deduction. Since the will was executed before January 1, 1977, and the value of property passing to the spouse outside of the will exceeds fifty percent of the adjusted gross estate, no additional marital deduction is allowable. This result carries out the intent of Congress, as explained in the House Committee Report. The amount of property passing to the surviving spouse under the will is the same amount that would have passed under the will prior to the enactment of the Tax Reform Act of 1976.

HOLDING

Because the cash gift of $210,000 does not pass to the surviving spouse under a will or trust agreement, the transitional rule does not apply to the cash gift. Therefore, the marital deduction allowed to *D*'s estate is $210,000.

Section 3121.—Definitions [Federal Insurance Contributions Act]

26 CFR 31.3121(b)(7)-1: Services in employ of States or their political subdivisions or instrumentalities.
(Also Section 31.3121(j)-1.)

Transportation services; transit authority. **A transit authority was created as a political subdivision of a state in 1965. The authority covered its employees for social security purposes by means of an agreement with HEW under section 218 of the Social Security Act. In 1972 the authority acquired a private transit company, which was its first acquisition from private ownership of any part of its system, and all of the company's employees became employees of the authority. At the time of the acquisition there was no general retirement system covering the employees of the authority, and the services performed by all of its employees became "covered transportation service" within the meaning of section 3121(j) of the Code.**

Rev. Rul. 80-149

ISSUE

Are the services performed by employees of a transit authority excepted from employment under section 3121(b)(7) of the Internal Revenue Code, under the circumstance described below?

FACTS

The transit authority was created in 1965 by an act of the state legislature as a political subdivision of the state for the purpose of planning, designing, leasing (as lessee), maintaining, administering, and operating a rapid transit system within a metropolitan area. From 1965 to 1971 the authority was involved only in planning and designing a system.

From 1965 to 1971 the authority had employees who were covered for social security purposes by means of an agreement between the state and the Secretary of Health, Education, and Welfare, entered into pursuant to section 218 of the Social Security Act, as amended, 42 U.S.C. 418 (1976).

In 1972 the authority acquired all of the stock of a privately owned transit company. The private company was immediately liquidated and all of its employees became employees of the authority. At the time of the acquisition of the privately owned company neither the state nor the political subdivision had a general retirement system covering substantially all the services performed in connection with the operation of the transportation system. This was the first acquisition from private ownership by the authority of any part of its transportation system.

LAW AND ANALYSIS

Section 3121(b)(7) of the Code excepts from the definition of employment, for purposes of the Federal Insurance Contributions Act, service performed in the employ of a state or any of its political subdivisions, unless the service is covered transportation service as defined in section 3121(j).

Section 3121(j)(3) of the Code provides that all service performed in the employ of a state or a political subdivision in connection with its operation of a public transportation system is "covered transportation service," if the transportation system was not operated by the state or political subdivision prior to 1951 and, at the time of its first acquisition (after 1950) from private ownership of any part of its transportation system, the state or political subdivision did not have a general retirement system covering substantially all service performed in connection with the operation of the transportation system.

Section 3121(j)(4)(A) of the Code defines "general retirement system" as any pension, annuity, retirement, or similar fund or system established by a state or by a political subdivision thereof for its employees.

An agreement for social security coverage under section 218 of the Social Security Act is not a "general retirement system" within the meaning of section 3121(j)(4)(A) of the Code.

Services that are "covered transportation service" within the meaning of section 3121(j) of the Code are excluded from coverage under a 218 agreement. 42 U.S.C. 418(c)(6)(C).

In this case the conditions of section 3121(j)(3) of the Code are met because the transportation system was not in operation prior to 1951, and at the time of the acquisition of the privately owned transit company there was no "general retirement system" covering the employees of the authority.

HOLDING

The service performed by all of the employees of the transit authority became "covered transportation service" within the meaning of section 3121(j) of the Code at the time of the acquisition of the privately owned company and is not excepted from employment under section 3121(b)(7).

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26 CFR 31.3121(j)-1: Covered Transportation Service.

Whether services performed for a transit authority, a political subdivision of a state, is "covered transportation service" within the meaning of section 3121(j) of the Code when the first acquisition from private ownership of any part of its transportation system is after 1950 and the employees of the authority are covered for social security purposes under a "218 agreement" with the Secretary of Health, Education, and Welfare. See Rev. Rul. 80-149, page 18.

Section 4995.—Withholding; Depositary Requirements [Windfall Profit Tax]

26 CFR 150.4995-1: Requirement of withholding.
(Also Section 6050C; 150.6050C-1.)

T.D. 7694

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 150.—TEMPORARY EXCISE TAX REGULATIONS UNDER THE CRUDE OIL WINDFALL PROFIT TAX ACT OF 1980

Withholding and depositing of windfall profit tax where the producer is an integrated oil company

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides temporary excise tax regulations relating to the windfall profit tax on domestic crude oil imposed by title I of the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223]. The temporary regulations provide rules to be followed by purchasers of domestic crude oil and integrated oil companies. In addition, the text contained in the temporary regulations set forth in this document serves as the comment document for the notice of proposed rulemaking published in the Proposed Rules section of this issue of the Federal Register.

DATES: These temporary regulations are effective with respect to oil removed after February 29, 1980. Written comments and requests for a public hearing must be delivered or mailed by June 24, 1980.

ADDRESS: Send comments and requests for a public hearing to: Commissioner of Internal Revenue, Attention: CC:LR:T (LR-71-80), Washington, DC 20224.

FOR FURTHER INFORMATION CONTACT: David B. Cubeta of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224 (Attention: CC:LR:T) (202-566-3926 or 202-566-3299).

SUPPLEMENTARY INFORMATION

BACKGROUND

On April 4, 1980, the Federal Register published temporary regulations (45 FR 23384) under sections 4986, 4987, 4988, 4989, 4991, 4992, 4993, 4994, 4995, 4996, 4997, 6050C, 6076, and 6402 of the Internal Revenue Code of 1954. The temporary regulations were required to implement various sections of the Crude Oil

Windfall Profit Tax Act of 1980. This document contains amendments to those temporary regulations.

The regulations promulgated in this document are also proposed to be prescribed as final Excise Tax Regulations (26 CFR Part 51).

EXPLANATION OF PROVISIONS

Under the rules contained in the temporary regulations published on April 4, 1980 to implement the windfall profit tax (26 CFR Part 150), the first purchaser of domestic crude oil generally is responsible for withholding tax from the purchase price, depositing the tax, and filing quarterly tax returns. However, withholding is not required when the oil is removed from the premises before sale or refined on the premises, or when the producer of the oil is an integrated oil company. When withholding is not required, each producer of the oil is required to make deposits of the windfall profit tax liability and file quarterly tax returns.

After publication of the temporary regulations, purchasers of crude oil have commented that in certain instances they may have difficulty determining whether any of the producers (as defined in the temporary regulations) of oil produced from a property are integrated oil companies and hence not subject to withholding.

Furthermore, it has been suggested that when an integrated oil company holds an interest in the production from a property but is not the operator of the property, there is frequently a substantial passage of time between the removal of oil and the receipt by the company of information necessary to properly compute its windfall profit tax due on that removal. As a result, the estimation of tax deposits and the timely filing of accurate quarterly tax returns may be difficult.

The amendments to the regulations made by this document are intended to ease these administrative difficulties without imposing new administrative burdens on purchasers who have developed the techniques necessary to comply with the original rules.

As amended, the regulations provide the general rule that the producer of oil produced by an integrated oil company is required to withhold unless the purchaser has received a certificate identifying the producer as an integrated oil company. Withholding is improper after receipt of a certificate. The certificate is required to be furnished to the purchaser if the integrated oil company is the operator of the property. In other cases, it may be furnished at the option of the integrated oil company.

However, an interim rule is provided for oil payments made during the period ending 30 days after the publication of final regulations (which will occur after written comments are received and a public hearing, if requested, is held). The interim rule provides that purchasers are not required to withhold tax from payments made to an integrated oil company if the purchaser does not, in fact, deduct, withhold, and deposit. Thus, in effect, the interim rule provides purchasers with the option of withholding or not withholding tax from payments made to an integrated oil company prior to receipt of the company's certificate, if any. After the receipt of a certificate, the purchaser no longer has the option to withhold.

The respective obligations of purchasers or producers to make windfall profit tax deposits flow from the withholding requirement. If withholding is required, the purchaser is required to deposit the amount required to be withheld, and the producer is not required to deposit tax with respect to that oil. If withholding is not required, the producer must deposit the tax liability with respect to that oil.

In sum, the amended regulations provide the following rules:

1. Every integrated oil company that is the producer of oil from a property of which the company is the operator (as determined in the temporary regulations) must submit a certificate to each purchaser of its oil from that property (unless the operator and purchaser have made the election permitted in § 150.4995-4). In other cases, integrated oil companies, at their option, may furnish a certificate.

2. It is improper for a purchaser to withhold tax from payments made for an integrated oil company's share of production after receipt of a certificate.

3. Prior to the receipt of a certificate, the purchaser must withhold except in the case of oil payments made during the interim period. During the interim period the purchaser, at its option, may treat withholding from payments for an integrated oil company's share of production either as required or not required. Withholding is considered to be required if the purchaser deducts, withholds, and deposits the tax. Withholding is considered not to be required if the purchaser does not deduct, withhold, and deposit. If the purchaser has withheld but chooses before depositing the withheld amount to treat withholding as not required, the withheld amount should be refunded to the producer.

4. The obligation of the integrated oil company producer to deposit is imposed if withholding is not required. Thus, the producer must generally deposit the tax imposed upon its production if the company is the operator of the property. However, during the interim period, if the purchaser treats withholding as required the producer need not deposit prior to the receipt by the purchaser of the integrated oil company's certificate. In the case of an integrated oil company that is not the operator, the company is required to deposit the tax on its production if the company furnishes a certificate to the purchaser or if, during the interim period, the purchaser treats withholding as not required. Accordingly, it is necessary for such companies to determine the practice of the purchaser for the interim period so that the company can meet its deposit responsibilities in the absence of withholding.

WAIVER OF PROCEDURAL REQUIREMENTS OF TREASURY DIRECTIVE

The expeditious adoption of the provisions contained in this document is necessary because of the need for immediate guidance to taxpayers liable for the windfall profit tax on domestic crude oil and to other persons required to withhold and deposit tax, file returns, provide information, etc. For this reason, Jerome Kurtz, Commissioner of Internal Revenue, has determined that the provisions of paragraphs 8 through 14 of the Treasury Department directive implementing Executive Order 12044 must be waived.

COMMENTS AND REQUESTS FOR A PUBLIC HEARING

Before adoption of the final regulations proposed in this document, consideration will be given to any written comments that are submitted (preferably six copies) to the Commissioner of Internal Revenue. All comments will be available for public inspection and copying. A public hearing will be held upon written request to the Commissioner by any person who has submitted written comments. If a public hearing is held, notice of the time and place will be published in the Federal Register.

DRAFTING INFORMATION

The principal author of these regulations is David B. Cubeta of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, part 150, Temporary Excise Tax Regulations under the Crude Oil Windfall Profit Tax Act of 1980, is amended as follows:

Paragraph 1. Paragraph (a) of § 150.4995-1 is amended by revising subparagraph (3). Amended paragraph (a) reads as follows:

§ 150.4995-1 Requirement of withholding.

(a) *General rule; when required.* Except as otherwise provided in this section, the purchaser (as defined in § 150.4996-1(a)) of domestic crude oil shall deduct and withhold tax from amounts payable by that purchaser for the oil. However, the preceding sentence shall not apply if—

(1) The crude oil is removed from the premises (as defined in § 150.4996-1(d)) before it is sold, or

(2) The manufacture or conversion of crude oil into refined products begins before the oil is removed from the premises, or

(3) The producer of the oil is an integrated oil company (as defined in § 150.4996-1(g)) that has furnished a certificate to the purchaser pursuant to paragraph (c)(2) of § 150.4995-2 (or, in the case of any payment for oil produced by an integrated oil company made before the date that is 30 days after the date of publication of final regulations under this paragraph, the purchaser does not in fact deduct, withhold, and deposit the tax).

The amount of tax to be deducted and withheld shall be determined in accordance with the rules of paragraphs (b) and (c) of this section. See, however, paragraph (d) of this section for rules applicable to certain payments made prior to June 4, 1980. The producer shall be treated as having paid on the last day of the first February after the calendar year in which the oil is removed from the premises the amount deducted and withheld with respect to such oil by the purchaser under this section.

* * * * *

Par. 2. Section 150.4995-2 is amended by adding a sentence to paragraph (a) and by revising paragraph (c). These added and revised provisions read as follows:

§ 150.4995-2 Producer's certificate.

(a) *In general.* The producer of "exempt Indian oil", as defined in section 4994(d), or the holder of any interest in crude oil that is a "qualified governmental interest" as defined in section 4994(a) or is a "qualified charitable interest" as defined in section 4994(b), may furnish an exemption certificate with respect to such oil to the purchaser of the oil or to the operator of the property from which the oil is produced (or, if the producer is a partner, to the partnership (see paragraph (e) of this section)), in accordance with the rules of paragraph (b) of this section. Any producer of "independent producer oil", as defined in section 4992, may furnish a certificate with respect to such oil to the purchaser of the oil or to the operator of the property from which the oil is produced (or, if the producer is a partner, to the partnership (see paragraph (e) of this section)), in accordance with the rules of paragraph (c) of this section. Every integrated oil company shall follow the rules of paragraph (c)(2) of this section (relating to mandatory and optional withholding exemption certificates). Any certificate provided under this section must set forth the facts that establish entitlement to the exemption or lower rates claimed. The certificate (or any revocation of a certificate) shall identify the producer by name, address, and employer identification (or social security) number and shall be signed by the producer (under the penalties of perjury except in the case of a revocation). For the requirement that the operator of a property who has received such a certificate furnish a copy of the certificate, or certify as to its contents, to each purchaser of oil from that property, see § 150.6050C-1(f). For the effect of the furnishing of such a certificate, see § 150.4995-1(b)(3) (relating to the withholding requirement). For the criminal penalty applicable to the furnishing of a false statement, see section 7206.

* * * * *

(c) *Other producers' certificates*—(1) *Independent producer's certificate.* An independent producer's certificate is a written statement certifying that the entire amount of the producer's oil expected to be sold to the purchaser is subject to the rates of tax provided in section 4987(b)(2) because the oil constitutes "independent producer oil" as defined in section 4992. No certificate may be furnished with respect to oil if it is reasonable to believe that the number of barrels to be affected by the certificate, taken together with all other oil with respect to which a certificate has been furnished by the producer to any operator, purchaser, or partnership, will exceed the producer's independent producer amount (see section 4992(c) and (e)).

(2) *Integrated oil company's certificate*—(i) *Mandatory certificates.* Every integrated oil company that is a producer of oil from a property of

which that company is the operator (or would be the operator in the absence of a designation under § 150.4996-1(c)) shall furnish the statement described in paragraph (c)(2)(iii) of this section to each purchaser of oil from that property no later than the date by which the first statement by the operator to the purchaser under § 150.6050C-1 is required to be furnished (or May 12, 1980, if later).

(ii) *Optional certificate.* Any integrated oil company that is a producer of oil from a property of which that company is not the operator may, at its option, furnish such a statement with respect to such oil to the purchaser of the oil or to the operator of the property from which the oil is produced (or, if the producer is a partner, to the partnership (see paragraph (e) of this section)).

(iii) *Contents of certificate.* The certificate furnished pursuant to this subparagraph shall state that the producer is an integrated oil company (as defined in § 150.4996-1(g)), that the producer will deposit its own windfall profit tax liability, and that the producer's share of production is not to be withheld upon under §150.4995-1.

(iv) *Date certificate becomes effective.* Any certificate furnished pursuant to this subparagraph shall apply to all payments for oil of which the integrated oil company is the producer made after the date on which the purchaser received the certificate.

* * * * *

Par. 3. So much of paragraph (a)(1) of § 150.4995-3 as precedes subdivision (i) is amended to read as follows:

§ 150.4995-3 Depositary requirements.

(a) *Deposits by integrated oil companies other than independent refiners*—(1) *In general.* Every integrated oil company (as defined in § 150.4996-1(g)) other than an independent refiner (as defined in § 150.4996-1(h)) that is either liable as a producer for the tax imposed by section 4986 (unless such tax is required by § 150.4995-1 to be deducted and withheld by the purchaser) or is required as a purchaser to deduct and withhold tax pursuant to §150.4995-1 shall make deposits with respect to semimonthly periods (as defined in subparagraph (3)(i) of this paragraph). The amount to be deposited for each semimonthly period is the amount of tax imposed by section 4986 that is not required to be withheld under § 150.4995-1 on oil removed from the premises during that semimonthly period for which the company is liable as a producer, plus the amount required to be withheld by the company as a purchaser pursuant to § 150.4995-1 from payments that have been or will be made for oil removed from the premises during that semimonthly period. The deposits shall be made on or before the depositary date (as defined in subparagraph (3)(ii) of this paragraph) for the semimonthly period in which the oil was removed. These depositary requirements will be considered to have been met for a semimonthly period with respect to estimated deposits only if—

* * * * *

Par. 4. Section 150.6050C-1 is amended by deleting a sentence in the portion of paragraph (b) that precedes subparagraph (1) and by revising paragraph (f). The revised provisions read as follows:

§ 150.6050C-1 Information furnished by operator for purposes of windfall profit tax.

* * * * *

(b) *Information to be certified.* In the case of exempt Alaskan oil or exempt front-end oil, the statement shall certify that the oil is exempt from tax. In all statements not certifying exemption, the following information is to be certified in the statement required under paragraph (a) of this section:

* * * * *

(f) *Producer's certificate.* If, pursuant to §150.4995-2, the operator receives a producer's certificate certifying a share of production to be exempt from tax, subject to a lower rate of tax, or not to be withheld upon, the operator shall either (1) furnish a copy of that certificate to each purchaser of oil from that property by the 15th day of the month following the month in which the certificate was received, or (2) if payment is to be received by the operator on behalf of the producers, furnish a certificate that summarizes the contents of the producers' certificates and states that the operator has received and has such certificates available for inspection.

* * * * *

There is need for the immediate guidance provided by the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 4995, 6050C, and 7805 of title 26 of the United States Code and section 101(i)(2) of the Crude Oil Windfall Profit Tax Act of 1980.

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved April 21, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on April 22, 1980, 12:30 p.m., and published in the issue of the Federal Register for April 25, 1980, 45 F.R. 27929)

Section 6050C.—Information Regarding Windfall Profit Tax on Domestic Crude Oil

26 CFR 150.6050C-1: Information furnished by operator for purposes of windfall profit tax.

Temporary regulations relating to withholding and depositing of windfall profit tax when producer is an integrated oil company. See T.D. 7694, page 19.

Section 6103.—Confidentiality and Disclosure of Returns and Return Information

26 CFR 301.6103(p)(7)-1: Procedures for administrative review of a determination that a State tax agency has failed to safeguard Federal tax returns or return information.

T.D. 7693

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Administrative review procedure for determination of a State tax agency's failure to safeguard Federal tax information

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations concerning procedures for administrative review of a Service determination that a State tax agency has failed to safeguard Federal tax returns or return information received from the Service. Changes to the applicable tax law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 (Vol. 1) 1]. The regulations provide State tax agencies with guidance needed to comply with that Act.

DATES: The regulations are effective immediately upon publication as a Treasury decision [April 18, 1980].

FOR FURTHER INFORMATION CONTACT: John A. Tolleris of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3294).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On October 2, 1979, the Federal Register published proposed amendments to the Regulations on Procedure and Administration (26 CFR Part 301) under section 6103(p)(7) of the Internal Revenue Code of 1954 (44 FR 56715). These amendments were proposed to conform the regulations to certain provisions under section 1202(a)(1) of the Tax Reform Act of 1976 (90 Stat. 1667). After consideration of all comments received in response to the notice of proposed rulemaking, those amendments are adopted by this Treasury decision as proposed.

EXPLANATION OF PROVISIONS

The final regulations provide procedures required by section 6103(p)(7) of the Internal Revenue Code for administrative review by the Commissioner of a determination by the Internal Revenue Service that a State tax agency has failed to safeguard Federal tax returns or return information in accordance with the requirements of section 6103(p)(4). Notwithstanding section 6103(d), such a determination may result in the Service's terminating the disclosure of Federal tax returns or return information to the State tax agency concerned.

The final regulations establish procedures under which a State tax agency may appeal the above-described adverse determination directly to the Commissioner within 30 days after receiving notice thereof. These amendments also provide that, within 45 days after receiving such an appeal, the Commissioner or Deputy Commissioner will personally hold a conference with representatives of the State tax agency.

Several comments were received in response to the notice published in the Federal Register for October 2, 1979. One commentator urged that the Service not discontinue disclosure until the Commissioner reaches a final determination. Another urged that the regulations impose a 45-day deadline within which the Commissioner must make the final determination. After consideration of these comments, the Service concluded that the suggested changes would be inappropriate. Under the final regulations, disclosure of Federal tax returns and return information will not be discontinued following a preliminary determination unless Federal tax administration would otherwise be seriously impaired, in which case disclosure clearly should not continue pending the Commissioner's final determination.

Evaluation of the effectiveness of these regulations will be based on comments received from offices within the Treasury and the Internal Revenue Service, other governmental agencies, State and local governments, and the public. These regulations will impose no new reporting or recordkeeping requirements.

DRAFTING INFORMATION

The principal author of these regulations is John A. Tolleris of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 301 is amended as follows:

A new § 301.6103(p)(7)-1 is added immediately after § 301.6103(f)-1 to read as follows:

§ 301.6103(p)(7)-1 Procedures for administrative review of a determination that a State tax agency has failed to safeguard Federal tax returns or return information.

(a) *Notice of Service's intention to terminate disclosure to a State tax agency.* Notwithstanding subsection (d) of section 6103, the Internal Revenue Service may terminate disclosure of Federal returns and return information to a State agency, body, or commission described in section 6103(d) (hereinafter in this section referred to as a State tax agency) if the Service makes a determination that—

(1) A State tax agency has made unauthorized disclosure of Federal returns or return information received from the Service and that the State tax agency has not taken adequate corrective action to prevent repetition of the unauthorized disclosure, or

(2) A State tax agency does not satisfactorily maintain the safeguards described in subsection (p)(4) of section 6103, and has made no adequate plan to improve its system to main-

tain those safeguards satisfactorily. Prior to terminating disclosure, the Service will notify the State tax agency in writing of the Service's preliminary determination and of the Service's intention to discontinue disclosure of Federal returns and return information to the State tax agency. Upon so notifying the State tax agency, the Service, if it determines that Federal tax administration would otherwise be seriously impaired, may suspend further disclosure of Federal returns and return information to the State tax agency pending a final determination by the Commissioner or Deputy Commissioner described in subparagraph (2) of paragraph (c).

(b) *State tax agency's right to appeal.* A State tax agency shall have 30 days from the date of receipt of a notice described in paragraph (a) to appeal the preliminary determination described in paragraph (a). The appeal shall be made directly to the Commissioner.

(c) *Procedures for administrative review.* (1) To appeal a preliminary determination described in paragraph (a), the State agency shall send a written request for a conference to: Commissioner of Internal Revenue (Attention: C), 1111 Constitution Avenue, N.W., Washington, D.C. 20224. The request must include a complete description of the State tax agency's present system of safeguarding Federal returns or return information received from the Service. The request must then state the reason or reasons that the State agency believes that such system, including improvements, if any, to such system expected to be made in the near future, is or will be adequate to safeguard Federal returns or return information received from the Service.

(2) Within 45 days of the receipt of a request made in accordance with the provisions of subparagraph (1) of this paragraph, the Commissioner or Deputy Commissioner will personally hold a conference with representatives of the State tax agency, after which the Commissioner or Deputy Commissioner will make a final determination with respect to the appeal.

This Treasury decision is issued under the authority contained in sections 6103(p)(7) and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1685, 26 U.S.C. 6103(p)(7); 68A Stat. 917, 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of Internal Revenue.

Approved April 7, 1980.

DONALD C. LUBICK,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on April 17, 1980, 8:45 a.m., and published in the issue of the Federal Register for April 18, 1980, 45 F.R. 26324)

Section 7701.—Definitions

26 CFR 301.7701-4: Trusts.

Liquidating trust. A trust established under state law for the purpose of liquidating and distributing assets (land, a heating plant located thereon, a right-of-way to the land, and mining claims) that were transferred by a liquidating corporation and that could not be sold other than under distress conditions within the 12-month period following the corporation's adoption of a plan of liquidation is classified as a liquidating trust under section 301.7701-4(d) of the regulations. The shareholders of the liquidating corporation are considered the owners of the trust and are taxable on the trust income.

Rev. Rul. 80-150

ISSUE

Under the circumstances described below, will an arrangement be classified as a liquidating trust?

FACTS

M, a corporation, has been in the business of owning and managing real property and interests in real property for a number of years. In 1979, the board of directors of *M* adopted a plan of complete liquidation for *M*. Within the 12-month period beginning on the date of adoption of the plan of liquidation, *M* was able to sell all of its assets except land on which is located a heating plant, a related right of way to that plant and certain mining claims. These assets represent less than 20 percent of *M*'s total net assets as of the date of adoption of the plan of liquidation.

The heating plant is substantially landlocked except for a narrow right-of-way. This significantly restricts the marketability of the property primarily to those owners of adjoining parcels. The heating plant had been used to provide heat to tenants of *M;* however, the users of the heating plant found alternative energy sources and the plant has not been used for some time. Although one offer has been made for the heating plant, it was unreasonably low. The mining claims are inactive and were contributed to the company many years ago. Because of this inactivity questions have arisen as to the value of these properties as well as factual and legal questions as to the nature and extent of the claims. No offers have been made for these properties.

Within the 12-month period beginning on the date of adoption of the plan of liquidation, the board of directors called a meeting of the shareholders of *M* to amend the plan of liquidation to provide for distribution of the land, heating plant, right-of-way, and mining claims to a trust, established under state law, together with a sum not exceeding 500*x* dollars. This amount is anticipated to be necessary to pay for taxes, insurance, and costs related to the maintenance and sale of the properties transferred to the trust. The shareholders approved the amendment of the plan, selected a trustee of the trust and transferred the land, heating plant, right of way, mining claim and cash to the trust.

The trust instrument provides that the trust is organized for the primary purpose of liquidating the assets transferred to it with no objective to continue or engage in the conduct of a trade or business. The trust will terminate three years from the date of its creation or, if sooner, within 30 days after sale of the last of the property transferred to it. The investment powers of the trustee are limited to demand and time deposits in federally insured banks and savings institutions, and short-term certificates of deposit. Under the terms of the trust instrument the trustee is required to distribute at least semi-annually to known shareholders any proceeds from the sale of assets and income from investments. The trustee is to make continuing efforts to dispose of the trust assets, make timely distributions, and not unduly prolong the duration of the trust.

LAW AND ANALYSIS

Section 301.7701-4(d) of the Procedure and Administration Regulations provides, in part, that certain organizations that are commonly known as liquidating trusts are treated as trusts for purposes of the Internal Revenue Code. An organization will be considered a liquidating trust if it is organized for the primary purpose of liquidating and distributing the assets transferred to it, and if its activities are all reasonably necessary to, and consistent with, the accomplishment of that purpose. A liquidating trust is treated as a trust for purposes of the Internal Revenue Code because it is formed with the objective of liquidating particular assets and not as an organization having as its purpose the carrying on of a profit-making business which normally would be conducted through business organizations classified as corporations or partnerships. However, if the liquidation is unreasonably prolonged or if the liquidation purpose becomes so obscured by business activities that the declared purpose of liquidation can be said to be lost or abandoned, the status of the organization will no longer be that of a liquidating trust.

In this case, because of the landlocked nature of the land and heating plant, it was not possible for *M* to sell that property other than under distress conditions within the 12-month period following the adoption of the plan of liquidation. Because of the factual and legal questions relating to the mining claims, they also could not be sold other than under distress conditions within the 12-month period. The transfer of the heating plant, right-of-way, mining claims, and cash to the trust does not evidence an objective to carry on a profit-making business. The primary purpose of the trust is the liquidation and distribution of the assets transferred to it.

HOLDING

The trust is classified as a liquidating trust for federal income tax purposes.

In addition, the shareholders of *M* will be considered the owners of the trust and will be taxable on the income therefrom under subpart E of subchapter J, chapter 1 of the Internal Revenue Code (section 671-687). See Rev. Rul. 72-137, 1972-1 C.B. 101.

Also under the circumstances described, the land, the heating plant, the related right-of-way to that plant and the mining claims will not be considered "readily marketable assets" within the meaning of section 3.05 of Rev. Proc. 79-1, 1979-1 C.B. 481.

Section 7805.—Rules and Regulations

26 CFR 301.7805-1: Rules and regulations.

Nonretroactive application of a Revenue Ruling relating to federal income tax treatment of unearned discount on municipal bonds redeemed prior to maturity. See Rev. Rul. 80-143, page 6.

Part III. Administrative, Procedural, and Miscellaneous

Social Security Contribution and Benefit Base

Under provisions of the Social Security Amendments of 1977, Pub. L. 95-216, 1978-1 C.B. 462, the Secretary, Department of Health, Education, and Welfare, has announced (45 F.R. 21715) that the contribution and benefit base for 1980 that would have been in effect under pre-1977 law is $20,400. This "old-law" base is used only for certain purposes under the railroad retirement program and the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 1974-3 C.B. 1, and for computing special minimum social security benefits for workers with many years of low earnings.

Part IV. Items of General Interest

Form 6251, Alternative Minimum Tax Computation

Announcement 80-80

The computation of adjusted itemized deductions for an estate or trust using Form 6251, Alternative Minimum Tax Computation, has been changed as a result of the passage of the Technical Corrections Act of 1979, Pub. L. 96-222, 1980-20 I.R.B. 5.

Step 2 of the line 4a instructions for an estate or trust should be changed to read as follows:

Subtract from adjusted gross income the items in (3) through (7) of step 1.

The deduction for personal exemption (item (2) of Step 1) should not be used in the computation for Step 2.

Estates and trusts that have already filed their 1980 income tax returns following the Step 2 instructions should file amended returns if the revision has any effect on their alternative minimum tax liability.

13⅞ Percent Treasury Notes of Series P-1982
14⅜ Percent Treasury Notes of Series D-1985
15 Percent Treasury Notes of Series Q-1982
14¼ Percent Treasury Notes of Series D-1984
12⅝ Percent Treasury Bonds of 1995
11⅜ Percent Treasury Notes of Series R-1982

Announcement 80-81

The Secretary of the Treasury announced the offering of Treasury Bonds and Treasury Notes as follows:

Treasury Department Circular, Public Debt Series 8-80, dated February 14, 1980, and published in the Federal Register for February 19, 1980, 45 F.R. 10997, and the supplement published in the Federal Register for February 26, 1980, 45 F.R. 12577; 13⅞ percent Treasury Notes of February 28, 1982, Series P-1982.

Treasury Department Circular, Public Debt Series 9-80, dated February 20, 1980, and published in the Federal Register for February 25, 1980, 45 F.R. 12349, and the supplement published in the Federal Register for March 3, 1980, 45 F.R. 13860; 14⅜ percent Treasury Notes of May 15, 1985, Series D-1985.

Treasury Department Circular, Public Debt Series 10-80, dated March 13, 1980, and published in the Federal Register for March 17, 1980, 45 F.R. 17105, and the supplement published in the Federal Register for March 26, 1980, 45 F.R. 19743; 15 percent Treasury Notes of March 31, 1982, Series Q-1982.

Treasury Department Circular, Public Debt Series 11-80, dated March 13, 1980, and published in the Federal Register for March 17, 1980, 45 F.R. 17107, and the supplement published in the Federal Register for March 31, 1980, 45 F.R. 21072; 14¼ percent Treasury Notes of March 31, 1984, Series D-1984.

Treasury Department Circular, Public Debt Series 12-80, dated March 21, 1980, and published in the Federal Register for March 26, 1980, 45 F.R. 19741, and the supplement published in the Federal Register for April 8, 1980, 45 F.R. 23847; 12⅝ percent Treasury Bonds of 1995.

Treasury Department Circular, Public Debt Series 13-80, dated April 17, 1980, and published in the Federal Register for April 21, 1980, 45 F.R. 16875, and the supplement published in the Federal Register for April 28, 1980, 45 F.R. 28247; 11⅜ percent Treasury Notes of April 30, 1982, Series R-1982.

The income derived from the bonds and notes is subject to all taxes imposed by the Internal Revenue Code. The bonds and notes are subject to estate, inheritance, gift, or other excise taxes whether federal or state, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any state, any possession of the United States, or any local taxing authority.

The bonds and notes will be acceptable to secure deposits of public moneys. They will not be acceptable in payment of taxes.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

By decision on appeal from an initial decision in an administrative hearing, the following individuals have been suspended or disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Sydney M. Eisenberg	Milwaukee, WI	Attorney	April 17, 1980 Disbarment
Leon Feldt	El Paso, TX	Certified Public Accountant	March 26, 1980 Disbarment
David I. Kali	Tucson, AZ	Attorney	Indefinite Suspension from April 1, 1980
Angelos P. Romas	Endicott, NY	Attorney	April 9, 1980 Disbarment

After due notice and opportunity for hearing, the following individual has been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
Robert B. Clarkson	Anderson, SC	Attorney	April 25, 1980

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Frank H. Abernathy	Richmond, VA	Certified Public Accountant	Indefinite effective April 9, 1980
Carl L. Harthun	Denver, CO	Attorney	Indefinite effective April 9, 1980
John T. Kelly, Jr.	Virginia Beach, VA	Certified Public Accountant	Indefinite effective April 15, 1980
Fran A. Moor	Fort Worth, TX	Certified Public Accountant	Indefinite effective April 15, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.166-9, 1.482-2, 1.1371-1, amended; 1.385-1 through 1.385-12, added.	Treatment of certain interests in corporations as stock or indebtedness.	March 24, 1980	June 23, 1980
26 CFR 1.1371-1, 1.1372-1 through 1.1372-4, amended; 1.1371, 1.1372, 1.1373, 1.1374, 1.1375, 1.1376, 1.1377, 1.1378, Part 14, deleted.	Certain shareholder reqiurements and related matters for electing small business corporations.	April 17, 1980	June 13, 1980
26 CFR 150.4995-1 through 150.4995-3, 150.6050C-1, added; published as temporary regulations in T.D. 7694, page 19, this Bulletin.	Withholding and depositing windfall profit tax when producer is integrated oil company.	April 25, 1980	June 24, 1980
26 CFR 1.50A-1, 1.50A-2, 1.50B-1 through 1.50B-5, amended; 1.50A-3 through 1.50A-7, deleted; 1.280C-1 redesignated as 1.280C-2; 1.50B-6, 1.280C-1, added.	Work incentive program (WIN) credit.	April 30, 1980	June 30, 1980
26 CFR 1.120-1 deleted; 1.120-1, 1.120-2, 1.501(c)(20)-1, added.	Qualified group legal services plans.	April 29, 1980	June 30, 1980

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1, dated January 7, 1980.

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* Denotes entry since last publication

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[1] See footnote at end of list.

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80-62, 1980-8 I.R.B. **9**

74-512
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80-53, 1980-8 I.R.B. **15**

75-296
Distinguished by
80-34, 1980-6 I.R.B. **9**

75-368
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80-124, 1980-18 I.R.B. **12**

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76-439
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78-110
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80-22, 1980-3 I.R.B. **15**

78-161
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80-9, 1980-2 I.R.B. **5**

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1 I.R.B., dated January 7, 1980.

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______	*1929–2*	*3.15*
______	1930–1	7.30
______	1930–2	9.50
______	*1931–1*	*3.60*
______	1931–2	13.00
______	*1932–1*	*2.80*
______	1932–2	8.65
______	*1933–1*	*3.35*
______	*1933–2*	*3.45*
______	*1934–1*	*3.70*
______	1934–2	14.00
______	1935–1	6.90
______	*1935–2*	*4.00*
______	*1936–1*	*3.55*
______	*1936–2*	*3.90*
______	*1937–1*	*3.75*
______	1937–2	7.70
______	*1938–1*	*4.05*
______	*1938–2*	*3.50*
______	1939–1–1	8.25
______	1939–1–2	10.90
______	1939–2	9.40
______	1940–1	5.55
______	1940–2	14.00
______	1941–1	*$6.95*
______	*1941–2*	*3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
______	*1944*(*)	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*2.65*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$10.10
______	1957–2	13.00
______	1958–1	9.60
______	1958–2	13.00
______	1958–3	15.00
______	1959–1	15.00
______	1959–2	9.60
______	1960–1	9.00
______	1960–2	11.50
______	1961–1	14.00
______	1961–2	10.00
______	1962–1	14.00
______	1962–2	13.00
______	1962–3	20.00
______	1963–1	9.00
______	1963–2	10.75
______	1964–1–1	10.00
______	1964–1–2	11.00
______	1964–2	9.80
______	1965–1	10.70
______	1965–2	12.25
______	1966–1	14.00
______	1966–2	14.05
______	1967–1	10.00
______	1967–2	15.00
______	1968–1	14.00
______	1968–2	11.75
______	1969–1	7.50
______	1969–2	6.50
______	1969–3	$12.50
______	1970–1	11.00
______	1970–2	14.00
______	1971–1	10.55
______	1971–2	8.50
______	1972–1	13.50
______	1972–2	13.70
______	1973–1	16.00
______	1973–2	8.30
______	1974–1	11.00
______	1974–2	9.95
______	*1974–3*	*8.20*
______	1974–3 Supp.	10.00
______	1975–1	16.00
______	1975–2	13.00
______	1976–1	11.00
______	1976–2	10.25
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______	1977–1	10.75
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______	1978–2	13.00
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Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENT

Announcement 80-82, page 22.
A public hearing will be held on July 16, 1980, concerning proposed regulations relating to Title I of the Crude Oil Windfall Profit Tax Act of 1980.

INCOME TAX

Rev. Rul. 80-151, page 6.
Investment credit; outdoor advertising displays. Examples illustrate how the Service will apply the criteria set forth in *Whiteco Industries, Inc.*, in determining whether outdoor advertising displays are inherently permanent structures or tangible personal property that qualifies as section 38 property; Rev. Rul. 68-62 revoked.

Rev. Rul. 80-152, page 7.
Investment credit; livestock auctioning; holding pens. The business of livestock auctioning does not fall within the meaning of either "manufacturing" or "production" as used in section 1.48-1(d)(1) or (2) of the regulations, and holding pens used in the auctioning business do not qualify as section 38 property.

Rev. Rul. 80-153, page 8.
"Bottom hole" contribution. A "bottom hole" contribution is includible in the recipient's gross income and must be treated as a capital expenditure by the payor.

Rev. Rul. 80-154, page 10.
Dividends; cash; required investment in stock. Section 305(a) of the Code applies to the distribution from profits of a foreign corporation to two U.S. corporations, its only shareholders, pursuant to a shareholder resolution that declared a cash dividend and provided that the dividend was to be used to increase capital investment in the foreign corporation. The distribution is not includible in the shareholders' gross incomes.

Rev. Rul. 80-156, page 12.
DISC; qualified export assets; PEFCO obligations. The Private Export Funding Corporation (PEFCO), which makes direct export loans guaranteed by the Export-Import Bank, notified a DISC that it was considering the implementation of a loan purchase program under a supplemental agreement with the Export-Import Bank to purchase outstanding loans that U.S. banks had made to finance sales of export property. The implementation of the program will not disqualify, as qualified export assets, PEFCO debt obligations owned or to be purchased by the DISC.

Rev. Rul. 80-157, page 13.
Interest; unmatured savings certificates. Rev. Rul. 79-72, which explains the treatment of interest that is not credited or made available for withdrawal before maturity without penalty on 6-month nonnegotiable time deposit certificates having a term that overlaps the end of a taxable year, is superseded effective December 31, 1978, for certain taxpayers, and for tax years beginning after September 18, 1979, for other taxpayers. The treatment of interest on other types of certifi-

(Continued on page 4)

Finding Lists begin on page 27.
Announcement Relating to Decisions of the Tax Court on page 5.
Announcement of Suspensions and Disbarments begins on page 23.
Announcement of Notice of Proposal Rulemaking on page 25.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

cates on which the interest is credited monthly or quarterly and can be withdrawn without penalty is explained.

Rev. Rul. 80-161, page 9.

Municipal bonds; interest; benefits of the Department of Energy Act of 1978. Interest on municipal bonds that are otherwise tax exempt and that are issued to develop geothermal energy is includible in the gross income of the bondholder if the municipality issuing the bonds elects to receive a federal guarantee of the bonds and interest differential payments as provided by Title V of the Department of Energy Act of 1978.

EMPLOYEE PLANS

Rev. Rul. 80-155, page 11.

Valuation and allocation of trust assets. A defined contribution plan does not qualify where trust earnings are allocated to participants, and the valuation of trust investments are made, at infrequent or irregular intervals or different valuation methods are used for different participants. However, a plan provision allowing interim valuations at the trustee's discretion in addition to a constant annual valuation will not disqualify a plan, provided the use of the interim valuations does not result in prohibited discrimination. Rev. Ruls. 70-125 and 71-27 superseded.

Pub. L. 96-239, page 20.

The effective date of automatic coverage for multiemployer plans under the termination insurance program provided by the Employee Retirement Income Security Act of 1974 is deferred from May 1, 1980, to July 1, 1980.

ESTATE TAX

Rev. Rul. 80-158, page 13.

Profit-sharing plan; guaranteed payments received by designated beneficiary. The provisions of an annuity with a guaranteed period of payments that was purchased by the trustee of a noncontributory qualified profit-sharing plan gave the annuitant the right to receive the commuted value of the guaranteed payments, which would have been less than the amount required to purchase an annuity of comparable value. The value of the guaranteed payments received by the designated beneficiary had not been constructively received by the decedent and was excludable from the decedent's gross estate under section 2039 of the Code.

Rev. Rul. 80-159, page 15.

Marital deduction; installment payment of tax; interest. A decedent's will provided for a specific legacy to the decedent's parents with the balance of the estate to be divided equally between the decedent's spouse and child. The will stipulated that the parents' legacy was to be free of all death taxes. State law provides that property passing to the surviving spouse does not generate any death taxes and that interest payable with respect to death taxes must be apportioned in the same fashion as the taxes themselves. Interest paid on taxes deferred under section 6166A of the Code does not reduce the value of property passing to the surviving spouse for purposes of the marital deduction.

EXCISE TAXES

Rev. Rul. 80-160, page 16.

Exemption certificates; international organizations; extension of period. Exemption certificates covering all tax-exempt sales by manufacturers and retailers to the International Bank for Reconstruction and Development, the Inter-American Development Bank, the International Development Association, the International Finance Corporation, and the International Monetary Fund will be acceptable for specified periods of up to 12 calendar quarters; Rev. Rul. 62-55 modified.

T.D. 7695, page 17.

Amendments to Part 403 of the regulations change the rate of compensation that is paid to an appraiser of property seized as subject to forfeiture from three dollars per hour to fifteen dollars per hour.

Notice 80-6, page 21.

Windfall profit tax; inflation adjustment factor. For purposes of computing the windfall profit tax, the inflation adjustment for the quarter ending September 30, 1980, is .0649 for tier 1 or tier 2 oil and .0810 for tier 3 oil.

ADMINISTRATIVE

Pub. L. 96-205, page 18.

Amendments are made to the provisions for administration of the Northern Mariana Islands and the Virgin Islands tax systems.

TAX CONVENTIONS

Announcement 80-85, page 22.

The Technical Explanation of the United States-United Kingdom Income Tax Convention will be republished in the 1980-25 Bulletin to reflect changes.

Announcement Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issue or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by Revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the Court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the Tax Court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
United Telecommunications, Inc.[1]	7866-72	65 67	278 760
Wendle Ford Sales, Inc.	7614-76	72	447
Whiteco Industries, Inc.[2]	3918-73 3919073 7188-74	65	664
Whiteco Industries, Inc., & Subs.[2]			

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[1] Acquiescence in result. Acquiescence "in result" means acceptance of the decision of the Court but disagreement with some or all the reasons assigned for the decision.

[2] See Rev. Rul. 80-151, page 6, this Bulletin.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 48.—Definitions, Special Rules [Rules for Computing Credit for Investment in Certain Depreciable Property]

26 CFR 1.48-1: Definition of section 38 property.
(Also Section 1033.)

Investment credit; outdoor advertising displays. Examples illustrate how the Service will apply the criteria set forth in *Whiteco Industries, Inc.*, in determining whether outdoor advertising displays are inherently permanent structures or tangible personal property that qualifies as section 38 property; Rev. Rul. 68-62 revoked.

Rev. Rul. 80-151

ISSUE

Are outdoor advertising displays tangible personal property for purposes of the investment tax credit?

FACTS

The taxpayer is in the business of erecting, maintaining, and renting, but not selling, outdoor advertising displays. These sign structures vary in cost, size, materials of construction, and complexity and are located on sites that have been purchased or leased. Of the many types of advertising displays used in taxpayer's business, structure *X* and structure *Y*, discussed herein, are representative of two types of sign structures that are classified differently for investment credit purposes.

Structure X—This sign assembly consists of a single sign face nailed to a wooden support frame and attached to wooden poles 30 feet in length. The sign face, made of exterior grade plywood, is 12 by 32 feet in size and $\frac{5}{16}$ inch in thickness. The poles are set in the ground and are secured in place with a ring of concrete. Dismantling and moving a sign structure of this type is a relatively quick and easy process. After the sign face and frame are removed, the poles are then pulled from the ground by the use of a truck mounted winch.

The taxpayer makes a practice of erecting signs of this type only after a contract, usually for a period of three years, has been entered into with an advertiser. However, in many cases, the contracts are renewed. The contracts permit the movement of the signs to new locations, in the event: (1) the view of the sign becomes obstructed, (2) a location is no longer available because, for example, a change takes place in the ownership of the leased property, or (3) the ground lease requires the taxpayer to move its signs in the event the owner of the land terminates the lease. Frequently it is necessary to remove and renovate the sign assembly after the initial contract period because of rotted, decayed, or damaged wood. The taxpayer's experience with this type of sign indicates that it normally remains in one location for a period of 5 years or less. Thus, these sign structures are designed and installed in such a manner so as to be easily moved.

Structure Y—This sign assembly has one illuminated 25 by 80 foot rectangular display panel that is attached to a welded steel frame. The frame is bolted to the top of a steel support column that is 5 feet in diameter. The overall height of the sign and its support structure is 74 feet. The steel support column is bolted to a steel reinforced concrete foundation fully embedded in the soil to a depth of 5 feet. Design specifications for this sign structure were based on an assumed maximum wind of 100 miles per hour. The sign is located on property leased for a period of one year with automatic extensions unless terminated by either party on 30-days written notice served prior to the end of any lease period.

None of these structures has ever been moved and the oldest has been in place for 18 years. Even though the location site is subject to a one year renewable lease, it is anticipated that the sign structures will remain in place for an indeterminate number of years. The advertising space is sold by the taxpayer for periods of varying duration.

LAW AND ANALYSIS

Reconsideration has been given to Rev. Rul. 68-62, 1968-1 C.B. 365, which considered whether certain outdoor advertising displays are "section 1245 property" within the meaning of section 1245 of the Internal Revenue Code.

Rev. Rul. 68-62 provides that outdoor advertising displays, commonly known as "billboards," are inherently permanent structures by their nature and use and are not, therefore, tangible personal property within the meaning of section 1.1245-3(b) of the Income Tax Regulations. That revenue ruling also states that the business of advertising a client's products and services is not one of the specified qualifying activities in section 1245(a)(3) of the Code. Therefore, the taxpayer's outdoor advertising displays were held not to be section 1245 property. The displays were held to be "real property" and therefore "section 1250 property" for purposes of determining gain or loss for dispositions of such property. Tangible personal property is defined the same for purposes of section 38 and section 1245. See section 1.1245-3(b)(1).

The Unted States Tax Court, in *Whiteco Industries, Inc. v. Commissioner*, 65 T.C. 664 (1975), *acq.*, page 5, this Bulletin, held that the outdoor advertising displays at issue in that case were tangible personal property rather than inherently permanent structures and thus qualified for the investment tax credit. The displays were constructed entirely of wood, were leased to customers for a term, on the average, of 3 to 5 years, and were erected, in general, on property not owned by the taxpayer. In making its determination, the court applied criteria in the form of the following questions to be considered in deciding whether property (other than items in the nature of machinery) is to be classified as tangible personal property: (1) Is the property capable of being moved, and has it in fact been moved? (2) Is the property designed or constructed to remain permanently in place? (3) Are there circumstances that tend to show the expected or intended length of affixation, that is, are there circumstances that show the property may or will have to be moved? (4) How substantial a job is removal of the property, and how time-consuming is it? (5) How much damage will the property sustain upon its removal? (6) What is the manner of affixation of the property to the land?

The Internal Revenue Service will apply the criteria set forth by the tax court in *Whiteco* in determining whether outdoor advertising displays are tangible personal property. Outdoor advertising displays will not be categorically treated as being either tangible personal property or inherently permanent structures. Rather, the criteria set forth by the tax court in *Whiteco* will be applied on a case-by-case basis.

Each of the questions set forth by the court in *Whiteco* has been considered to determine whether sign structures *X* and *Y* should be treated as tangible personal propety:

(1) The evidence indicates that structure *X*-type signs are capable of being moved and have in fact been moved. However, taxpayer's structure *Y*-type signs have never been moved and the economics of moving such signs make it impractical.

(2) Structure *X*-type signs are not designed or constructed to last permanently and it is anticipated that they will be removed and require substantial renovation within 5 years. Structure *Y*-type sign structures, on the other hand, are designed to remain in place for an indeterminate number of years. Even though the location sites for these structures are subject to renewable short-term leases, the sites have been selected so that it is unlikely that the signs will have to be moved or removed at the expiration of the lease term.

(3) As indicated above, a structure *X*-type sign is erected only after a contract has been entered into with an advertiser. The taxpayer's experience indicates that there can be numerous situations that would require the sign to be removed at, or prior to, the expiration of the contract. The sign may have to be moved because the owner of the leased land does not renew the lease, or the owner exercises the option to develop the land, or because there is a change in location of the road or the occurrence of some other condition that makes the position of the sign no longer desirable. For structure *Y*, however, a location site was selected that is expected to be available to the taxpayer for an extended period of time. The economics of constructing, erecting, and removing this type of sign structure requires that careful consideration be given to the prospect for long-term availability and viability of the site for advertising purposes.

(4) The disassembly and removal of a structure *X*-type sign is a relatively quick and easy process. All that is needed is a truck with a winch and some small hand tools. The removal of a structure *Y*-type sign, on the other hand, would be a substantial operation. Although the taxpayer has not had to remove a sign structure of this kind, it is clear that special crane and transportation equipment would be required. The taxpayer will also have to sever the steel support column into smaller sections for ease of transportation.

(5) The taxpayer has been able to move structure *X* signs with little or no damage to the support structure. Except in those cases in which the wood has deteriorated, only the sign faces require occasional replacement when the sign structure is moved. For a structure *Y*-type sign, however, the concrete foundation would be abandoned and the steel support column will have to be cut into smaller sections for ease of transportation.

(6) The poles of a structure *X*-type sign are placed in the ground and require little additional foundation support. Such poles can easily be removed from the ground, and as a matter of practice, they are so moved. Structure *Y* on the other hand has been designed to withstand 100-mile-per-hour winds and is bolted to a steel reinforced concrete foundation that is fully embedded in the soil. This structure would be extremely difficult to move.

HOLDING

1. The outdoor advertising displays described above as structure *X* are tangible personal property and qualify as section 38 property.

2. The outdoor advertising displays described above as structure *Y* are inherently permanent structures and do not qualify as section 38 property.

3. Section 1033(g)(3) of the Code permits a taxpayer to elect to treat property that constitutes an oudoor advertising display as real property for purposes of nonrecognition of gain on involuntary conversions, effective for taxable years begining after December 31, 1970. This election is not permissible with respect to property that has been treated as tangible personal property subject to the investment credit or additional first-year depreciation.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 68-62 is revoked.

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26 CFR 1.48-1: Definition of section 38 property.

Investment credit; livestock auctioning; holding pens. The business of livestock auctioning does not fall within the meaning of either "manufacturing" or "production" as used in section 1.48-1(d)(1) or (2) of the regulations, and holding pens used in the auctioning business do not qualify as section 38 property.

Rev. Rul. 80-152

ISSUE

Is the auctioning of livestock an activity included in the activities specified in section 48(a)(1)(B)(i) of the Internal Revenue Code so that the holding pens used by the taxpayer in the business of auctioning would qualify as section 38 property for investment credit purposes?

FACTS

The taxpayer, in the business of livestock auctions, made several improvements to its facilities for the purpose of increasing its capacity to conduct these auctions. These additions included, among other things, holding pens where the livestock are retained for sale. These holding pens are inherently permanent structures that are depreciable property and have a useful life of more than three years.

The taxpayer's facilities provide a place where local livestock producers may bring their animals for sale. The taxpayer does not take title to the livestock, but merely acts as an agent between buyer and seller. The taxpayer charges a commission for its services, plus whatever incidental costs are involved in holding the animals. Animals are identified by numbered tags so that identification can be made of each animal throughout the auction. No livestock are retained in the holding pens for any extended periods of time.

LAW AND ANALYSIS

Section 38 of the Code allows a credit against federal income tax for qualified investment in "section 38 property." The determination of what qualifies as section 38 property is made in accordance with the rules provided in section 48.

Section 48(a)(1) of the Code and section 1.48-1(a) of the Income Tax Regulations provide that the term section 38 property means tangible personal property or other tangible property (not including a building and its structural components), but only if such other tangible property is used as an integral part of certain specified activities, including manufacturing and production, or constitutes research or storage facilities used in connection with those activities.

Section 1.48-1(d)(2) of the regulations provides that for purposes of the credit allowed by section 38 the terms "manufacturing," "production," and "extraction" include construction, reconstruction, or making property out of used or new materials by processing, manipulating, refining, or changing the form of an article or by combining or assembling articles. Also included are the cultivation of the soil, the raising of livestock and the mining of minerals. Therefore, section 38 property would include property used as an integral part of extracting, processing, or refining metallic and nonmetallic minerals, construction of roads, processing of meat, cultivation of orchards, production of lumber or lumber products, and the fabrication or treatment of textiles, paper, and glass.

The basic question here is whether the business of conducting livestock auctions is an activity that falls within the terms "manufacturing" or "production" as used in section 1.48-1(d)(1) of the regulations. Section 1.48-1(d)(2) discusses these terms and names certain activities that are included in those terms, among which is the raising of livestock. The included activities produce a product or property or are preparatory to production of a product that becomes physically available for sale or use in producing another product. However, the activity of selling the resultant product is not included. Rev. Rul. 68-345, 1968-2 C.B. 30, which deals with canopies erected over gasoline station pumps, states that certain other tangible property may qualify as "section 38 property" if used by the taxpayer as an integral part of its business in one of the activities specified in section 1.48-1(d)(1). However, the retail selling of gasoline is not one of the specified qualifying activities.

Similarly, the auctioning (selling) of livestock, like the selling of gasoline in Rev. Rul. 68-345, is not an activity specified in section 1.48-1(a)(1) or (2) of the regulations.

Although the raising of livestock qualifies as a production activity under section 1.48-1(d)(2) of the regulations, it is distinguishable from the auctioning of livestock, which is neither a production activity in itself, nor necessary for the completeness of the production activity of raising livestock. Therefore, other tangible property used in the activity of selling is not used as an integral part of manufacture or production and does not qualify as section 38 property under section 1.48-1(d)(1).

HOLDING

The auctioning of livestock is not an activity included in the activities specified in section 48(a)(1)(B)(i) of the Code. Therefore, the holding pens do not qualify as section 38 property for investment tax credit purposes.

Section 61.—Gross Income Defined

26 CFR 1.61-1: Gross income.
(Also Sections 263, 612; 1.263(a)-1, 1.612-4.)

"Bottom hole" contribution. A "bottom hole" contribution is includible in the recipient's gross income and must be treated as capital expenditure by the payor.

Rev. Rul. 80-153

ISSUES

1. Is a "bottom hole" contribution includible in the gross income of the recipient or is it to be treated as a reduction of the recipient's cost of drilling the well?

2. Must the payor of a bottom hole contribution capitalize such contribution or may the payor elect to expense such contribution under the provisions of section 1.612-4 of the Income Tax Regulations?

FACTS

Taxpayers *A* and *B* leased adjacent tracts of land for exploration and development of hydrocarbons. *A* proposes to drill a well on its tract, the drilling and testing of which will provide specific information on any potential producing horizons encountered in addition to general geologic information. *A* and *B* entered into a bottom hole agreement whereby *A* agreed to furnish *B* the geological and testing information that was obtained during drilling to a specific depth in return for a contribution by *B* of 25*x* dollars. *B* wanted the information for use in determining whether to develop or retain the property. *A* and *B* did not enter into a joint venture or cost sharing arrangement.

A furnished *B* the geological information obtained during drilling and testing of specific horizons. *B* then paid *A* 25*x* dollars.

The well was determined to be nonproductive when drilled to the specified depth and was plugged as a dry hole.

Neither *A* nor *B* abandoned any leases in any adjacent tracts of land during the taxable year the well was plugged.

LAW AND ANALYSIS

Section 61(a)(1) of the Internal Revenue Code provides that gross income means all income from whatever source derived including compensation for services.

Section 263(a) of the Code provides that no deduction shall be allowed for permanent improvements made to increase the value of property.

Section 1.612-4(a) of the regulations provide that intangible drilling and development costs incurred by an operator in the development of oil and gas properties may be chargeable to capital or expense at the option of the operator and that this option applies to all expenditures made by an operator incident to and necessary for the drilling of wells and the preparation of wells for the production of oil or gas.

In *Island Creek Coal Co. v Commissioner*, 30 T.C. 370, 384-85 (1958), amounts received for scrap materials were not permitted to be credited to an expenditure account, because this netting process reduced the expenditure and indirectly increased the operator's percentage depletion allowance. The Tax Court reasoned that reducing an expenditure increased the taxable income from the mineral property and that such increase allowed the operator to increase the maximum amount permitted as a percentage depletion allowance.

Upon payment of a bottom hole contribution, the payor does not enter into a joint venture or sharing arrangement with the recipient, because the payor does not intend to contribute to the recipient's reservoir of capital. The recipient is paid for the service of providing information to the payor and not as a reimbursement for a capital expenditure that the recipient may elect to expense in part under section 263(c) of the Code and section 1.612-4(a) of the regulations. Thus, a recipient of a bottom hold contribution may not utilize such payment to reduce the recipient's cost of drilling a well.

In addition, if a recipient of a bottom hole contribution was permitted to utilize such payment to reduce drilling costs, such reduction might indirectly increase the recipient's maximum percentage depletion allowance under section 613(a) of the Code. This is because if a recipient elects to expense the intangible costs of drilling a well and a bottom hole contribution is utilized to reduce such intangible drilling costs, the amount of the recipient's taxable income from the mineral property would be increased and thus the maximum amount of the recipient's percentage depletion allowance would also be increased. *See* Rev. Rul. 77-136, 1977-1 C.B. 167, for specific situations in which the intangible costs of drilling a nonproductive well would be deductible from gross income from the mineral property in determining taxable income for purposes of the limitation on the percentage depletion allowance.

The payor of a bottom hole contribution receives information relating to the retention of the payor's interest in mineral property. Such information is in the nature of a capital expenditure under section 263 of the Code. A bottom hole contribution is not the type of expenditure that may be expensed at the option of the payor under secion 1.612-4(a) of the regulations. The information received by the payor is exploratory in nature and is not incident to or necessary for the drilling of wells on the payor's mineral property or for the preparation of wells for the production of oil or gas on the payor's mineral property. In fact, the payor may decide not to drill wells on the payor's mineral property.

HOLDING

The recipient, *A*, is not permitted to use the bottom hole contribution to reduce or offset the cost of drilling the well but must include the 25*x* dollar bottom hole contribution in income.

The payor, *B*, must capitalize the 25*x* dollar bottom hole contribution because such payment relates to the retention of *B*'s leasehold interest in mineral property. *B* may not elect to expense the bottom hole contribution, because such expenditure is for exploratory purposes and because such expenditure is not one of the types of expenditures that is described in section 1.612-4(a) of the regulations.

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26 CFR 1.61-7: Interest.

Whether interest to be paid on obligations of a city will be exempt from tax. See Rev. Rul. 80-161, this page.

Section 103.—Interest on Certain Governmental Obligations

26 CFR 1.103-1: Interest upon obligations of a State, Territory, etc.
(Also Section 61; 1.61-7.)

Municipal bonds; interest; benefits of the Department of Energy Act of 1978. Interest on municipal bonds that are otherwise tax exempt and that are issued to develop geothermal energy is includible in the gross income of the bondholder if the municipality issuing the bonds elects to receive a federal guarantee of the bonds and interest differential payments as provided by Title V of the Department of Energy Act of 1978.

Rev. Rul. 80-161

ISSUE

Will the interest on municipal bonds that would otherwise be excludable from the gross incomes of the bondholders under section 103(a)(1) of the Internal Revenue Code become includible if the issuer obtains the benefits of the Department of Energy Act of 1978—Civilian Applications, Pub. L. 95-238, section 509 of Title V, 92 Stat. 87 (Act)?

FACTS

A city has decided to develop a project to produce energy from geothermal resources. The city will own and operate the power plant and the energy produced will be used within the city by the general public. The city proposes to issue bonds to finance the cost of constructing the project. The city also will apply for a federal guarantee of the bonds and for interest differential payments as provided by Title V of the Act.

LAW

The Geothermal Energy Research, Development, and Demonstration Act of 1974, Pub. L. 93-410, sections 201 through 204, 88 Stat. 1086, established a Geothermal Loan Guarantee Program to foster geothermal development by guaranteeing repayment of principal and interest on loans to qualified borrowers. Section 790.4(c) of the Department of Energy Regulations implementing the 1974 Act provides that no loan shall be guaranteed if the income from the loan is excludable from the recipients' gross incomes.

Section 509 of the 1978 Act amended the 1974 Act to provide a loan differential payment with respect to obligations issued by, or in behalf of, any state, political subdivision, or any Indian tribe that are guaranteed under Title V of the Act and "for which the interest paid on such obligations and received by the purchaser thereof is included in gross income for purposes of chapter 1 of the Internal Recenue Code of 1954. . . ."

H.R. Rep. No. 95-349, 95th Cong., 1st Sess. (1978), made applicable to the Act by statements contained on pages S1487 and S1488 of the Congressional Record of February 8, 1978, indicates at page 199 that the provisions of section 509 of the 1978 Act are intended to enable states, municipalities, or Indian tribes to benefit from the loan guarantee program and to receive interest differential payments whenever the income from such loans are subject to federal income tax. The legislative intent is to authorize the Department of Energy to guarantee otherwise tax-exempt municipal obligations for qualifying geothermal projects provided that the interest on the obligations is includible in the gross incomes of the recipients. The payment of the interest differential to the issuer is to compensate the issuer for its increased borrowing cost since the interest on its obligation will not be tax-exempt.

HOLDING

The interest on the city's bonds will not be excludable from the gross incomes of the bondholders under section 103(a)(1) of the Code if the city obtains the benefits of Title V of the Act.

Section 163.—Interest

26 CFR 1.163-4: Deduction for original issue discount on certain obligations issued after May 27, 1969.

Supersession of Rev. Rul. 79-72, 1979-1 C.B. 278, discussing the treatment of interest for federal income tax purposes, on a 6-month nonnegotiable time deposit certificate having a term that overlaps the end of a taxable year. See Rev. Rul. 80-157, page 13.

Section 263.—Capital Expenditures

26 CFR 1.263(a)-1: Capital expenditures; in general.

Whether the payor of a bottom hole contribution must capitalize such contribution. See Rev. Rul. 80-153, page 8.

Section 305.—Distributions of Stock and Stock Rights

26 CFR 1.305-2: Distribution in lieu of money.

Dividends; cash; required investment in stock. Section 305(a) of the Code applies to the distribution from profits of a foreign corporation to two U.S. corporations, its only shareholders, pursuant to a shareholder resolution that declared a cash dividend and provided that the dividend was to be used to increase capital investment in the foreign corporation. The distribution is not includible in the shareholders' gross incomes.

Rev. Rul. 80-154

ISSUE

Does section 305(a) of the Internal Revenue Code apply to a distribution by a foreign corporation to its shareholders, who are two United States corporations, under the circumstances described below?

FACTS

X and *Y*, both of which are United States manufacturing corporations, owned all of the outstanding stock (common) of *Z*, a business entity organized under the law of *M*, a foreign country, as an *M* limited liability corporation and classified as an association taxable as a corporation for federal income tax purposes. It is engaged in the manufacturing business in *M*. *X* owns 80 percent of the *Z* stock and *Y* owns 20 percent. Under *M* law the shareholders of an *M* limited liability corporation declare dividends or otherwise direct the disposition of the profits of the corporation. Furthermore, under *M* income tax law, corporate profits of a business year that are not capitalized and are not distributed to shareholders are taxed to the corporation at a higher rate than if they are capitalized. The capitalized profits are taxed under *M* capital yield tax law to the shareholders as dividends. In 1978, *X* and *Y* directed *Z*, pursuant to written resolution, to increase its capital by the amount of its previous year's profits and to distribute this amount. The resolution stated that "the payment will be made in cash without any delay" and that "the dividend shall be utilized to cover a new share" that will "participate in the profit earned by the company beginning with the current business year." No cash or shares of stock or certificates of participation were distributed by *Z* to *X* or *Y*. Accounting entries recorded the reduction of undistributed profits and the increase in the capital of *Z*.

LAW AND ANALYSIS

Section 305(a) of the Code provides that gross income does not include the amount of any distribution of the stock of a corporation made by such corporation to its shareholders with respect to its stock, except as otherwise provided in section 305. Section 305(b)(1) provides that section 305(a) does not apply and that the distribution will be treated as a distribution of property to which section 301 applies, if the distribution is, at the election of any of the shareholders (whether exercised before or after the declaration thereof), payable either in stock or in property.

A resolution declaring a cash dividend raises the presumption that a cash dividend is intended. However, this presumption is rebutted when the corporate resolution ties up the "cash" dividend so effectively that the shareholders never receive it, never exercise any control with respect to it, and the dividend is used to pay for additional stock. See *Maverick-Clarke Litho Company v. Commissioner*, 11 T.C. 1087 (1948), *acq.*, 1949-1 C.B. 3, *aff'd.*, 108 F.2d 587 (5th Cir. 1950), and *Teehan v. United States*, 25 F.2d 884 (D. Mass. 1928). In the instant case, the dividend declared was for the sole purpose of capitalizing the profits of *Z* and could not be taken out in cash at the option of *X* or *Y*. Thus, the capitalization of the profits of *Z* had the effect of a stock dividend.

Furthermore, the fact that *X* and *Y* could have initially directed *Z* to distribute its profits to them in cash or other property rather than have *Z* capitalize this amount is not an election within the meaning of section 305(b)(1) of the Code. This choice is not provided by corporate action but instead is a result of *M* law which provides that the shareholders of an *M* limited liability corporation declare dividends or otherwise direct the disposition of the profits of the corporation. Once the initial choice to capitalize was made, *X* and *Y* could not elect to receive cash or other property.

The distribution by *Z* to *X* and *Y* represents a distribution by *Z* of its common stock to its shareholders, *X* and *Y*, with respect to the *Z* common stock held by *X* and *Y*, and section 305(b)(1) is not applicable.

HOLDING

Under the facts described, section 305(a) of the Code is applicable to the distribution by *Z* to *X* and *Y*. Consequently, the distribution is not includible in *X* or *Y's* gross income.

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401-1: Qualified pension, profit-sharing, and stock bonus plans.

Valuation and allocation of trust assets. A defined contribution plan does not qualify where trust earnings are allocated to participants, and the valuation of trust investments are made, at infrequent or irregular intervals or different valuation methods are used for different participants. However, a plan provision allowing interim valuations at the trustee's discretion in addition to a constant annual valuation will not disqualify a plan, provided the use of the interim valuations does not result in prohibited discrimination. Rev. Ruls. 70-125 and 71-27 superseded.

Rev. Rul. 80-155

The purpose of this revenue ruling is to restate the position in Rev. Rul. 70-125, 1970-1 C.B. 87, and Rev. Rul. 71-27, 1971-1 C.B. 121, in view of the Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 1974-3 C.B. 1 .

The issue in Rev. Rul. 70-125 is whether a defined contribution plan that contains a definite formula for crediting the employer's contributions to the participants' accounts but with no specific provision for allocation of trust earnings to participants' accounts or for the periodic valuation of trust investments is a qualified plan under section 401(a) of the Internal Revenue Code.

The issue in Rev. Rul. 71-27 is whether a plan provision allowing interim valuations in addition to an annual valuation will result in a plan's disqualification.

Section 414(i) of the Code states that a defined contribution plan is a plan that provides for an individual account for each participant and for benefits based solely on the amount contributed to the participant's account, and any income, expenses, gains and losses, and any forfeitures of acounts of other participants which may be allocated to such participant's account.

Section 1.401-1(b)(1)(ii) of the Income Tax Regulations states that a profit-sharing plan must provide a definite predetermined formula for allocating the contributions made to the plan among the participants and for distributing the funds accumulated under the plan. Section 1.401-1(b)(1)(iii) states that, for purposes of allocating and distributing the stock of the employer, a stock bonus plan is subject to the same requirements as a profit-sharing plan.

A pension plan of the money purchase type provides for fixed contributions that are not geared to profits. See section 1.401-1(b)(1)(i) of the regulations. Contributions under such a pension plan are accumulated under the plan and, along with the earnings thereon, distributed to participants in accordance with the terms of the plan.

Because profit-sharing, stock bonus and pension plans of the money purchase type (i.e., defined contribution plans) are required to provide for distributions in accordance with amounts stated or ascertainable and credited to participants, the funds under such a trust must be allocated to participants' accounts in accordance with a definite formula (although certain exceptions are allowed, such as the use of a suspense account in accordance with the requirements of section 415 of the Code).

Furthermore, if the amounts to be allocated or distributed to a particular participant are to be ascertainable, such plans must provide for a valuation of investments held by the trust, at least once a year, on a specified inventory date, in accordance with a method consistently followed and uniformly applied. The fair market value on the inventory date is to be used for this purpose. The respective accounts of participants are to be adjusted in accordance with the valuation.

In the case of a plan in which trust earnings, unrealized changes in the value of trust investments, and losses realized on the sale of trust assets may be valued and allocated to participants' accounts at infrequent or irregular intervals or different valuation methods may be used for different participants, the plan does not provide a definite formula for allocating and distributing the funds, as required by the regulations.

Accordingly, such a plan does not qualify under section 401(a) of the Code.

However, a plan provision allowing interim valuations at the trustee's discretion in addition to a consistent annual valuation does not disqualify the plan so long as the use of the interim valuations does not result in discrimination prohibited by section 401(a)(4) of the Code.

Rev. Ruls. 70-125 and 71-27 are superseded because the positions stated therein are restated under current law.

Section 451.—General Rule for Taxable Year of Inclusion

26 CFR 1.451-2: Constructive receipt of income.

Supersession of Rev. Rul. 79-72, 1979-1 C.B. 278, discussing the constructive receipt of income by a holder of a 6-month nonnegotiable time deposit certificate having a term that overlaps the end of the taxable year. See Rev. Rul. 80-157, page 13.

Section 591.—Deduction for Dividends Paid on Deposits

26 CFR 1.591-1: Deduction for dividends paid on deposits.

Supersession of Rev. Rul. 79-72, 1979-1 C.B. 278, discussing the application of section 591 of the Code with respect to issues of a 6-month nonnegotiable time deposit certificate having a term that overlaps the end of the taxable year. See Rev. Rul. 80-157, 13.

Section 612.—Basis for Cost Depletion

26 CFR 1.612-4: Charges to capital and to expense in case of oil and gas wells.

Whether the amount received from a bottom hole contribution can be used by the recipient to offset or reduce the costs of drilling the well. See Rev. Rul. 80-153, page 8.

Section 992.—Requirements of a Domestic International Sales Corporation

26 CFR 1.992-1: Requirements of a DISC.

Whether implementation by Private Export Funding Corporation (PEFCO) of a loan purchase program will disqualify, as qualified export assets, the debt obligations of PEFCO that a DISC either now owns or will purchase in the future. See Rev. Rul. 80-156, below.

Section 993.—Definitions

26 CFR 1.993-2: Definition of qualified export assets.
(Also Section 992; 1.992-1.)

DISC; qualified export assets; PEFCO obligations. The Private Export Funding Corporation (PEFCO), which makes direct export loans guaranteed by the Export-Import Bank, notified a DISC that it was considering the implementation of a loan purchase program under a supplemental agreement with the Export-Import Bank to purchase outstanding loans that U.S. banks had made to finance sales of export property. The implementation of the program will not disqualify, as qualified export assets, PEFCO debt obligations owned or to be purchased by the DISC.

Rev. Rul. 80-156

ISSUE

Whether implementation by Private Export Funding Corporation (PEFCO) of a proposed loan purchase program will disqualify, as qualified export assets, the debt obligations (securities) of PEFCO that a Domestic International Sales Corporation (DISC) now owns, or which the DISC will purchase in the future.

FACTS

The taxpayer is a corporation that has elected to be taxable as a DISC. It currently owns 100*x* dollars in principal amount of debt obligations (securities) issued by PEFCO and expects to acquire additional debt obligations of PEFCO in the future. PEFCO is a domestic corporation organized as a medium for raising funds for the financing of United States exports from private business. It is designed to supplement the financing available for exports through commercial banks and the Export-Import Bank of the United States. To finance its activities, PEFCO issues its own debt obligations (securities).

PEFCO has notified the taxpayer that it is considering the implementation of a loan purchase program. Under the program, PEFCO will purchase outstanding loans that United States banks have made to finance the sales of export property. The Export-Import Bank will have guaranteed every loan that PEFCO buys.

The loan purchase program will not be implemented until PEFCO has made supplemental agreements with the Export-Import Bank. These supplemental agreements will require the Export-Import Bank's approval of all the loans that PEFCO purchases under the program. However, PEFCO will continue the making of export loans guaranteed by the Export-Import Bank as a significant activity.

LAW AND ANALYSIS

Section 993(b)(8) of the Internal Revenue Code provides that qualified export assets include obligations issued by a domestic corporation organized solely for the purpose of financing sales of export property pursuant to an agreement with the Export-Import Bank of the United States under which such corporation makes export loans guaranteed by such bank.

Section 1.993-2(i)(1) of the Income Tax Regulations classifies the obligations described in section 993(b)(8) of the Code as financing obligations and uses identical language to describe the domestic corporation whose obligations qualify.

H.R. Rep. No. 92-533, 92d Cong., 1st Sess. 67 (1971), 1972-1 C.B. 498, 534 and S. Rep. No. 92-437, 92d Cong., 1st Sess. 100 (1971), 1972-1 C.B. 559, 614 both state that qualified export assets include the obligations of domestic corporations organized solely to finance sales of export property under an agreement with the Export-Import Bank, where the loans are guaranteed by that bank.

Rev. Rul. 75-564, 1975-2 C.B. 314, concludes that PEFCO obligations are qualified export assets within the meaning of section 993(b)(8) of the Code, provided the basis of those obligations satisfies certain requirements relating to accumulated DISC income, where the DISC acquired PEFCO obligations directly from PEFCO.

Rev. Rul. 79-153, 1979-1 C.B. 262, *amplifying* Rev. Rul. 75-564, concludes that PEFCO obligations are qualified export assets where the DISC acquired PEFCO obligations on the secondary market from parties other than PEFCO.

Section 993(b)(8) of the Code focuses on the type of corporation whose obligations will qualify as qualified export assets. It requires that the corporation: (1) be a domestic corporation; (2) be organized solely for the purpose of financing sales of export property pursuant to an agreement with the Export-Import Bank; and (3) under that agreement make export loans guaranteed by the Export-Import Bank.

Neither section 993(b)(8) of the Code nor the committee reports indicate that the domestic corporation is precluded under the Code from engaging in activities in addition to making direct loans as long as they are solely for the purpose of financing sales of export property under an agreement with the Export-Import Bank.

The above cited revenue rulings establish that PEFCO obligations were qualified export assets under section 993(b)(8) of the Code prior to PEFCO's implementation of its loan purchase program.

Since the loan purchase program will also be conducted under an agreement with the Export-Import Bank and will require approval of the Export-Import Bank, PEFCO will continue to satisfy the requirements of the domestic corporation under section 993(b)(8) of the Code, and thus its debt obligations (securities) will continue to qualify as qualified export assets.

HOLDING

PEFCO's implementation of the proposed loan purchase program will not disqualify, as qualified export assets, the PEFCO debt obligations (securities) that a DISC now holds or which the DISC will acquire in the future.

Section 1033.—Involuntary Conversions

Whether outdoor advertising displays are inherently permanent structures or tangible personal property. See Rev. Rul. 80-151, page 6.

Section 1232.—Bonds and Other Evidences of Indebtedness

26 CFR 1.1232-1: Bonds and other evidences of indebtedness; scope of section. (Also Sections 163, 451, 591, 6049; 1.163-4, 1.451-2, 1.591-1, 1.6049-1.)

Interest; unmatured savings certificates. Rev. Rul. 79-72, which explains the treatment of interest that is not credited or made available for withdrawal before maturity without penalty on 6-month nonnegotiable time deposit certificates having a term that overlaps the end of a taxable year, is superseded effective December 31, 1978, for certain taxpayers, and for tax years beginning after September 18, 1979, for other taxpayers. The treatment of interest on other types of certificates on which the interest is credited monthly or quarterly and can be withdrawn without penalty is explained.

Rev. Rul. 80-157

Rev. Rul. 79-72, 1979-1 C.B. 278, states that holders of 6-month nonnegotiable time deposit certificates constructively receive at the end of their taxable year the amount of interest that they would have received if the certificate had been redeemed at that time even though such redemption would have reduced the interest rate from 9 to 5 percent and also caused forfeiture of 3 months' interest. Rev. Rul. 79-72 also holds that the 6-month certificate is issued with original issue discount that is deductible ratably by the issuer under section 1.163-4 of the Income Tax Regulations over the term of the certificate.

Section 1.451-2(a)(2) of the regulations, adopted by T.D. 7663, 1980-6 I.R.B. 6, provides that the fact that the taxpayer, by withdrawing the earnings during the taxable year, would receive earnings that are substantially less in comparison with the earnings for the corresponding period to which the taxpayer would be entitled had the taxpayer left the account on deposit until a later date is a substantial limitation on the taxpayer's control over the receipt of such earnings and would preclude constructive receipt thereof.

Section 1.1232-3(b)(1)(iii) of the regulations, adopted by T.D. 7663, provides, in effect, that amounts earned on the 6-month certificates in Rev. Rul 79-72 will not generally be treated as original issue discount.

Therefore, in view of the amendments to the regulations set out above, interest income on the type of 6-month certificates described in Rev. Rul. 79-72 which is not credited or made available for the holder to withdraw before maturity of the certificate without penalty, is not includible in the gross income of holders who use the cash receipts and disbursements method of accounting before the certificates are redeemed or mature. Furthermore, issuers who use the cash receipts and disbursements method of accounting will not be allowed to deduct this interest until it is paid or credited to the holders.

However, in other types of certificates in which interest is credited monthly or quarterly and can be withdrawn immediately without penalty, even though the principal cannot be withdrawn without penalty until maturity of the certificates, the interest must be included in the holder's gross income for the taxable year credited to the account of the holder or made available for withdrawal by the holder.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 79-72 is superseded effective December 31, 1978, except for those taxpayers that used the ratable deduction rule pursuant to section 1.163-4 of the regulations with respect to the obligations described in Rev. Rul. 79-72 for their last taxable year beginning before September 19, 1978, as well as those taxpayers that properly applied for and received permission to change to this method of accounting with respect to such obligations for their last taxable year beginning before September 19, 1978. For those taxpayers Rev. Rul. 78-72 is superseded for taxable years beginning after September 18, 1979.

For those taxpayers who for the first time issued short-term obligations described in Rev. Rul. 79-72 and who use the ratable deduction rule in taxable years beginning after December 31, 1978, Rev. Rul. 79-72 is superseded as of December 31, 1978.

Any change in the taxpayer's present method of accounting to comply with the amendments made to the above cited regulations by T.D. 7663 is a change in the method of accounting to which the provisions of section 446 of the Code and the applicable regulations thereunder apply.

Section 2039.—Annuities

26 CFR 20.2039-2: Annuities under "qualified plans" and section 403(b) annuity contracts.

Profit-sharing plan; guaranteed payments received by designated beneficiary. The provisions of an

annuity with a guaranteed period of payments that was purchased by the trustee of a noncontributory qualified profit-sharing plan gave the annuitant the right to receive the commuted value of the guaranteed payments, which would have been less than the amount required to purchase an annuity of comparable value. The value of the guaranteed payments received by the designated beneficiary had not been constructively received by the decedent and was excludable from the decedent's gross estate under section 2039 of the Code.

Rev. Rul. 80-158

ISSUE

Does the exclusion allowable under section 2039(c) of the Internal Revenue Code apply to the decedent's interest in a "qualified" profit sharing plan, under the circumstances described below?

FACTS

The decedent, prior to retirement, was an employee of *X* company and a participant in the company's noncontributory, profit-sharing plan that was qualified under section 401(a) of the Code. The plan provided for the purchase of ordinary paid up life insurance policies on the lives of all participating employees. If a participant terminated employment other than by death, the trustee of the plan was required at the request of the participant to convert the life insurance contracts of that participant into annuities payable for life with ten years certain or to surrender the contracts for their cash values and distribute the lump sum to the participant.

On the decedent's retirement date in 1975, two policies that had been purchased by the trustee of the plan on decedent's life were surrendered for two supplemental policies. Under the terms of the supplemental contracts, the decedent as primary payee was to receive monthly annuity payments for life with ten years of payments guaranteed in any event. In addition, although the supplemental policies were not distribtued to the decedent, the decedent had the right to designate a contingent beneficiary as payee of any proceeds payable at death and had the right to surrender the supplemental contracts and receive the commuted value of the guaranteed payments. Upon the decedent's death in 1977, the remaining guaranteed installments under the supplemental contracts were paid to the designated contingent beneficiary.

LAW AND ANALYSIS

Section 2033 of the Code and the regulations thereunder provide that the gross estate of a decedent includes the value of all property beneficially owned by the decedent at the time of death.

Section 2039(a) and (b) of the Code provides that a decedent's gross estate includes the value of an annuity or other payment receivable by any beneficiary by reason of surviving the decedent, under certain contracts or agreements, to the extent that the value of the annuity or other payment is attributable to contributions made by the decedent or decedent's employer. Section 2039(c), however, provides an exclusion from the gross estate for an annuity or other payment receivable by any beneficiary (other than the executor) under a profit-sharing plan which, at the time of the decedent's separation from employment, met the requirements of section 401(a). Section 2039(c) further provides that, if the amounts payable after the death of the decedent are attributable to any extent to contributions made by the decedent, no exclusion is allowable for the proportionate value of such payments.

Section 20.2039-2(b), Example 4, of the Estate Tax Regulations indicates that if an employee is considered as having constructively received the amount credited to the employee's account under a qualified plan, such amount is not considered as receivable by the designated beneficiary under the plan and the exclusion under section 2039(c) of the Code is not applicable. See *Northern Trust Co. v. United States,* 389 F.2d 731 (7th Cir. 1968); *First Trust Co. v. United States,* 321 F. Supp. 1025 (D.C. Minn. 1970); *Estate of Harold S. Brooks,* 50 T.C. 585 (1968), *acq.,* 1961-1 C.B. 20; Rev. Rul. 67-37, 1967-1 C.B. 271.

An amount that is otherwise excludable from the gross estate by virtue of section 2039(c) of the Code is nevertheless includible under section 2033, if the deceased constructively received all or a portion of the benefits under the plan. Under such circumstances, the amount receivable by the designated beneficiary is considered as passing from the deceased employee rather than under the plan. Constructive receipt, however, does not occur where the taxpayer's control of the benefits is subject to substantial limitations or restrictions not imposed by the taxpayer. *See* Rev. Rul. 77-34, 1977-1 C.B. 276.

In the present case, the decedent had the right during the ten year period of guaranteed payments to surrender the rights under the profit-sharing plan for the commuted value of the remaining guaranteed payments. If the decedent had exercised the right to receive the commuted value of the guaranteed payments, the decedent would have suffered a significant economic penalty, because the amount required to purchase a new annuity of comparable value would have been greater than the commuted value of the remainder of the ten year certain payments. *See* Rev. Rul. 68-482, 1968-2 C.B. 186. Thus, the decedent's control over the guaranteed payments was subject to a substantial limitation or restriction, and the decedent's interest in the profit-sharing trust was not constructively received by the decedent prior to death.

HOLDING

The designated beneficiary is considered to have received the remaining guaranteed payments from the noncontributory, qualified profit-sharing trust rather than from the decedent, and the value of these payments is excluded from the decedent's gross estate under section 2039(c) of the Code.

Section 2053.—Expenses, Indebtedness, and Taxes

26 CFR 20.2053-3: Deductions for expenses of administering estate.

Whether interest expense paid on federal estate taxes deferred under section 6166A of the Code and deductible under section 2053, is taken into account in determining the value of the property passing to the surviving spouse. See Rev. Rul. 80-159, below.

Section 2056.—Bequests, Etc., to Surviving Spouse

26 CFR 20.2056(b)-4: Marital deduction; valuation of interest passing to surviving spouse.
(Also Sections 2053, 6166A; 20.2053-3, 20.6166-1.)

Marital deduction; installment payment of tax; interest. A decedent's will provided for a specific legacy to the decedent's parents with the balance of the estate to be divided equally between the decedent's spouse and child. The will stipulated that the parents' legacy was to be free of all death taxes. State law provides that property passing to the surviving spouse does not generate any death taxes and that interest payable with respect to death taxes must be apportioned in the same fashion as the taxes themselves. Interest paid on taxes deferred under section 6166A of the Code does not reduce the value of property passing to the surviving spouse for purposes of the marital deduction.

Rev. Rul. 80-159

ISSUE

For purposes of determining the amount of the marital deduction allowable under section 2056 of the Internal Revenue Code, is the value of property bequeathed and devised to the surviving spouse reduced by the payment of interest accrued on unpaid federal estate tax, under the circumstances described below?

FACTS

D, a resident of State *X*, died in 1977. The will provides for a legacy of $50,000 to *D*'s parents and for the balance of the estate to be divided equally between *D*'s child and surviving spouse. The will states that the parents' legacy is to be free of any federal or state taxes imposed as a result of *D*'s death. Aside from this provision, the will does not direct how such taxes, debts, and funeral and administration expenses are to be paid.

Under the law of State *X*, in the absence of an express contrary direction in a decedent's will, all death taxes are to be equitably apportioned against those beneficial interests in the estate that give rise to such taxes. Any of such taxes that are payable with respect to beneficial interests from which the decedent has expressly removed the tax burden are payable pro rata by those beneficial interests which give rise to such taxes and which are not exonerated. Interest payable to government authorities with respect to death taxes is payable in the same fashion as the death taxes themselves. Such interest is allowable as a probate expense.

The law of State *X* provides that in the absence of a contrary expression by the testator, all debts of the decedent and all administration expenses are payable from the general assets of the probate estate.

Because ninety percent of *D*'s gross estate consists of the value of a closely held business, the estate has elected, under section 6166A of the Code, to make 10 annual installment payments of that portion of the federal estate tax liability that is attributable to the closely held business. The estate has paid two installments of estate tax and has also paid interest on the deferred tax.

The provisions of the death tax statute in State *X* are identical to the federal estate tax provisions. Therefore, the property passing to the surviving spouse does not generate any death taxes.

The estate has claimed a deduction, under section 2053 of the Code, with respect to the interest paid with the federal tax installments. Although the interest is treated as an administration expense for estate tax deduction purposes, the interest expense has not been paid from the general probate assets, from which other administration expenses are payable. Instead, the interest payment has been apportioned among the taxable beneficial interests in the estate in the same manner as the underlying taxes.

LAW AND ANALYSIS

Section 2056 of the Code provides for a deduction, with certain limitations, of the value of property that passes from the decedent to the surviving spouse. Section 2056(b)(4) requires that the value of property passing to the spouse shall be determined (A) by taking into account the effect that any estate or inheritance tax has on the net value of the interest passing to the surviving spouse, and (B) by taking into account any encumbrance or obligation with respect to such interest.

In this case, the property passing to the surviving spouse does not generate any death taxes and therefore is not burdened with the payment of the taxes.

Under section 2053(a)(2) of the Code and the applicable regulations, the amount of administration expenses, that are allowable under local law and that are actually and necessarily incurred, is deductible in determining the value of the taxable estate. Accrued interest that is payable on estate tax deferred under section 6166A of the Code is a necessary administration expense and is deductible to the extent allowable under local law. See *Estate of Bahr v. Commissioner,* 68 T.C. 74 (1977), *acq.,* 1978-1 C.B. 1; Rev. Rul. 78-125, 1978-1 C.B. 292, revoking Rev. Rul. 75-239, 1975-1 C.B. 304.

Although the interest payment is an administration expense for purposes of the federal estate tax deduction, local law governs the source from which the executor must make the interest payment. Under the law of State *X*, interest payable with respect to death taxes must be apportioned in the same fashion as the taxes themselves. Therefore, the interest paid on deferred federal estate tax in the present case is payable only from those assets that pass to the child.

HOLDING

Pursuant to the application of the law of State *X*, the interest paid on federal estate taxes deferred under section 6166A of the Code does not require a reduction to the net value of property passing to the surviving spouse, for purposes of determining the amount of the federal estate tax marital deduction allowable under section 2056.

Section 4041.—Imposition of Tax

26 CFR 48.4041-1: Tax on diesel fuel and special motor fuel.
(Also Sections 4061, 4071, 4081, 4091, 4121, 4161, 4181; 48.4061(a)-1, 48.4061(b)-1, 48.4071-1, 48.4081-1, 48.4091-1, 139.4121-1, 48.4161(a)-1, 48.4161(b)-1, 48.4181-1.)

Exemption certificates; international organizations; extension of period. Exemption certificates covering all tax-exempt sales by manufacturers and retailers to the International Bank for Reconstruction and Development, the Inter-American Development Bank, the International Development Association, the International Finance Corporation, and the International Monetary Fund shall be acceptable for specified periods of up to 12 calendar quarters; Rev. Rul. 62-55 modified.

Rev. Rul. 80-160

FACTS

Rev. Rul. 62-55, 1962-1 C.B. 188, holds that the manufacturers and retailers excise taxes imposed by Chapters 31 and 32 of the Internal Revenue Code do not apply to otherwise taxable sales made to the International Bank for Reconstruction and Development and certain other designated international organizations established under substantially similar international agreements that provide immunity from taxation. Those organizations are: Inter-American Development Bank, International Development Association, International Finance Corporation, and International Monetary Fund.

Rev. Rul. 62-55 requires that to support an exempt sale to one of these organizations, a manufacturer or retailer must obtain an exemption certificate, and where sales to an organization are regularly or frequently made, a certificate covering all orders for a specified period not to exceed four calendar quarters will be acceptable.

The Manufacturers and Retailers Excise Tax Regulations, as recently amended, provide that where sales are regularly or frequently made to a purchaser for an exempt use described therein, an exemption certificate covering all orders for a specified period not to exceed 12 calendar quarters will be acceptable.

HOLDING

In order to achieve uniformity among manufacturers and retailers who make tax-exempt sales, the Internal Revenue Service has determined that where exempt sales are regularly or frequently made to one of the international organizations described above, an exemption certificate covering all orders for a specified period not to exceed 12 calendar quarters will be acceptable.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 62-55 is modified.

Section 4061.—Imposition of Tax

26 CFR 48.4061(a)-1: Imposition of tax; exclusion for light-duty trucks, etc.

Extension of period that may be covered by exemption certificates from 4 to 12 calendar quarters for exempt sales by manufacturers and retailers to certain international organizations described in Rev. Rul. 62-55, 1962-1 C.B. 188. See Rev. Rul. 80-160, this page.

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26 CFR 48.4061(b)-1: Imposition of tax.

Extension of period that may be covered by exemption certificates from 4 to 12 calendar quarters for exempt sales by manufacturers and retailers to certain international organizations described in Rev. Rul. 62-55, 1962-1 C.B. 188. See Rev. Rul. 80-160, this page.

Section 4071.—Imposition of Tax

26 CFR 48.4071-1: Imposition and rates of tax.

Extension of period that may be covered by exemption certificates from 4 to 12 calendar quarters for exempt sales by manufacturers and retailers to certain international organizations described in Rev. Rul. 62-55, 1962-1 C.B. 188. See Rev. Rul. 80-160, this page.

Section 4081.—Imposition of Tax

26 CFR 48.4081-1: Imposition and rates of tax.

Extension of period that may be covered by exemption certificates from 4 to 12 calendar quarters for exempt sales by manufacturers and retailers to certain international organizations described in Rev. Rul. 62-55, 1962-1 C.B. 188. See Rev. Rul. 80-160, this page.

Section 4091.—Imposition of Tax

26 CFR 48.4091-1: Tax on lubricating oils.

Extension of period that may be covered by exemption certificates from 4 to 12 calendar quarters for exempt sales by manufacturers and retailers to certain international organizations described in Rev. Rul. 62-55, 1962-1 C.B. 188. See Rev. Rul. 80-160, this page.

Section 4121.—Imposition of Tax

26 CFR 139.4121-1: Questions and answers relating to the excise tax on coal.

Extension of period that may be covered by exemption certificates from 4 to 12 calendar quarters for exempt sales by manufacturers and retailers to certain international organizations described in Rev. Rul. 62-55, 1962-1 C.B. 188. See Rev. Rul. 80-160, this page.

Section 4161.—Imposition of Tax

26 CFR 48.4161(a)-1: Imposition and rates of tax; fishing equipment.

Extension of period that may be covered by exemption certificates from 4 to 12 calendar quarters for exempt sales by manufacturers and retailers to certain international organizations described in Rev. Rul. 62-55, 1962-1 C.B. 188. See Rev. Rul. 80-160, this page.

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26 CFR 48.4161(b)-1: Imposition and rates of tax; bows and arrows.

Extension of period that may be covered by exemption certificates from 4 to 12 calendar quarters for exempt sales by manufacturers and retailers to certain international organizations described in Rev. Rul. 62-55, 1962-1 C.B. 188. See Rev. Rul. 80-160, this page.

Section 4181.—Imposition of Tax

26 CFR 48.4181-1: Imposition and rates of tax.

Extension of period that may be covered by exemption certificates from 4 to 12 calendar quarters for exempt sales by manufacturers and retailers to certain international organizations described in Rev.

Rul. 62-55, 1962-1 C.B. 188. See Rev. Rul. 80-160, page 16.

Section 6049.—Returns Regarding Payments of Interest

26 CFR 1.6049-1: Returns of information as to interest paid in calendar years after 1962 and original issue discount includible in gross income for calendar years after 1970.

Supersession of Rev. Rul. 79-72, 1979-1 C.B. 278, discussing the filing of Form 1096 and Form 1099 in accordance with section 6049 of the Code, with respect to 6-month nonnegotiable time deposit certificates having a term that overlaps the end of a taxable year. See Rev. Rul. 80-157, page 13.

Section 6166A.—Extension of Time for Payment of Estate Tax Where Estate Consists Largely of Interest in a Closely Held Business

26 CFR 20.6166-1: Extension of time for payment of estate tax where estate consists largely of interest in closely held business.

Whether interest expense paid on federal estate taxes deferred under section 6166A of the Code and deductible under section 2053, is taken into account in determining the value of the property passing to the surviving spouse. See Rev. Rul. 80-159, page 15.

Section 7805.—Rules and Regulations

26 CFR 403.50: Rate of compensation.

T.D. 7695

TITLE 26.—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER F, PROCEDURE AND ADMINISTRATION, PART 403.—DISPOSITION OF SEIZED PERSONAL PROPERTY

Compensation paid to appraisers

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the rate of compensation that is paid to appraisers of property seized as subject to forfeiture. These regulations provide necessary guidance to the public for compliance with the law, and affect appraisers of such property.

DATE: The regulations are effective from April 25, 1980.

FOR FURTHER INFORMATION CONTACT: Kyllikki Kusma of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, LR-2-80, 202-566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

The regulations at § 403.50 currently set the rate of compensation that is paid to an appraiser of property seized as subject to forfeiture at $3.00 per hour or portion thereof. Because this rate is inadequate, these regulations change the rate of compensation that is paid from $3.00 per hour to "a reasonable fee not to exceed $15.00 per hour or a portion thereof." Because this regulation is nonsubstantive and essentially procedural, it is found unnecessary to issue this Treasury decision with notice and public procedure. For the same reasons, this regulation is not a significant regulation under paragraph 8 of the Treasury Directive appearing in the Federal Register for November 8, 1978 (43 FR 52120).

DRAFTING INFORMATION

The principal author of this regulation is Kyllikki Kusma of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 403.50 is amended as follows.

§ 403.50 Rate of compensation.

Each appraiser selected under § 403.26(a)(2) shall receive as compensation a reasonable fee not to exceed $15.00 per hour or portion thereof for the performance of such appraiser's duties in appraising property seized as subject to forfeiture under the internal revenue laws and this part.

Because this regulation is nonsubstantive, liberalizing and essentially procedural, it is found unnecessary to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of Internal Revenue.

Approved April 11, 1980.

Donald C. Lubick,
Assistant Secretary of the Treasury.

Subpart B.—Legislation and Related Committee Reports

Public Law 96-205 [1]
96th Congress, H.R. 3756
March 12, 1980

An Act to authorize appropriations for certain insular areas of the United States, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

* * * * *

TITLE II—NORTHERN MARIANA ISLANDS

* * * * *

Sec. 204. (a) Section 3(d) of the Act entitled "An Act to authorize appropriations for certain insular areas of the United States and for other purposes" (Public Law 95-348; 92 Stat. 487) is amended by inserting "(1)" after "(d)" and by inserting "or upon receipt of a resolution adopted by both houses of the legislature of the Northern Mariana Islands accompanied by a letter of request from either the Governor or the Lieutenant Governor of the Northern Mariana Islands," after "Constitution of the Northern Mariana Islands," the first place it appears, and by adding at the end of "(d)" the following new paragraphs:

"(2) For purposes of carrying out any administration and enforcement required by this subsection, the Secretary of the Treasury (hereinafter in this subsection referred to as the 'Secretary'), or his delegate, at no cost to the Northern Marianas government, may (A) employ citizens of the Northern Mariana Islands (as defined by Article III of the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States (approved, Public Law 94-241; 90 Stat. 265, 1976-1 C.B. 513)), or (B) use the services of employees of the government of the Northern Mariana Islands, upon agreement to pay such government for the use of such services. In addition, the Secretary, or his delegate, shall make every effort to assure that citizens of the Northern Mariana Islands (as so defined) are trained to ultimately assume the administration and enforcement duties required of the Secretary or his delegate under this section. Notwithstanding any other provision of law, the Secretary or his delegate is authorized to the maximum extent feasible in administering and enforcing the requested sections of the Covenant, to employ and train Northern Mariana Islands' citizens without regard to United States Civil Service hiring or job classification laws or any employment ceilings imposed upon the Secretary. The preceding sentence shall not exempt such Northern Mariana Islands' citizens so hired from any other laws affecting Federal or Internal Revenue Service employees and shall remain in effect until the end of the third full fiscal year following the date of enactment.

"(3) As part of the administration of taxes required by this subsection, the Secretary or his delegate shall establish, at no cost to the Northern Marianas government, a taxpayers information service to provide such information and assistance to citizens of the Northern Mariana Islands (as so defined) as may be necessary for the filing of returns and the payment of such taxes.".

(b) The Secretary shall take such steps as are necessary to ensure that the proceeds of taxes collected under the provisions of sections 601, 602, 603, and 604 of the Covenant (Public Law 94-241) are covered directly upon collection into the treasury of the Commonwealth of the Northern Mariana Islands.

Sec. 205. (a) Except as provided in subsection (c), any person, including an individual, trust, estate, partnership, association, company, or corporation, which is a resident of or which is organized under the laws of the Commonwealth of the Northern Mariana Islands and which is subject to the provisions of section 601 of the Covenant to Establish the Commonwealth of the Northern Mariana Islands in Political Union with the United States (Public Law 94-241), shall be exempted from the requirements of such section with respect to income derived from sources within the Commonwealth of the Northern Mariana Islands for taxable years beginning after December 31, 1978, and before January 1, 1981. Nothing in this section shall be construed as relieving such person from the obligation to comply with the requirements of section 601 with respect to income derived from sources outside of the Commonwealth of the Northern Mariana Islands.

(b) Except as provided in subsection (c), any person, including an individual, trust, estate, partnership, association, company, or corporation, which is a resident of or which is organized under the laws of the Commonwealth of the Northern Mariana Islands and which is subject to the provisions of section 601 of the Covenant to Establish the Commonwealth of the Northern Mariana Islands (Public Law 94-241), shall be exempt from the requirements of such section with respect to income from sources within the Northern Mariana Islands for its taxable year beginning after December 31, 1980, and before January 1, 1982: *Provided,* That the Secretary receives written notice from the Governor of the Northern Mariana Islands not later than September 30, 1980, that sections 1, 2, 3, 4, and 5 of chapter 2 of Public Law 1-30 of the Commonwealth of the Northern Mariana Islands or its successor, have been repealed in their entirety, effective December 31, 1981.

(c) It is the sense of Congress that the term "rebate" as used in section 602 of Public Law 94-241 does not permit the abatement of taxes.

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TITLE IV—VIRGIN ISLANDS

* * * * *

Sec. 403. (a) Subsection 28(a) of the Revised Organic Act of the Virgin

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[1] This publication of the law is restricted to excerpts involving tax matters; House Report No. 96-120, page 19; Senate Report No. 96-467 is not published.

Islands, [Pub. L. 517, 1954-2 C.B. 595] is amended by inserting after the words "and naturalization fees collected in the Virgin Islands," the following: "(less the cost of collecting such duties, taxes and fees as may be directly attributable (as certified by the Comptroller of the Virgin Islands) to the importation of petroleum products until January 1, 1982: *Provided,* That any other retained cost not heretofore remitted pursuant to the Act of August 18, 1978, shall be immediately remitted to the Treasury of the Virgin Islands notwithstanding any other provision of law)."

* * * * *

SEC. 405. Any excise taxes levied by the Legislature of the Virgin Islands may be levied and collected as the Legislature of the Virgin Islands may direct as soon as the articles, goods, merchandise, and commodities subject to said tax are brought into the Virgin Islands.

* * * * *

SEC. 407. Subsection (f) of section 2 of the Act entitled "An Act to authorize the government of the Virgin Islands to issue bonds in anticipation of revenue receipts and to authorize the guarantee of such bonds by the United States under specified conditions, and for other purposes" (90 Stat. 1193; Public Law 94-392; 48 U.S.C. 1574b) is amended by striking out the last sentence and inserting in lieu thereof the following language: "No commitment to guarantee may be issued by the Secretary, and no guaranteed but unobligated funds may be obligated by the government of the Virgin Islands after October 1, 1984. After October 1, 1984, any unobligated proceeds of bonds or other obligations issued by the government of the Virgin Islands pursuant to this section shall be repaid immediately by the government of the Virgin Islands to the lenders with the agreed upon interest. Should there be any delay in the government of the Virgin Islands' making such repayment, the Secretary shall deduct the requisite amounts from moneys under his control that would otherwise be paid to the government of the Virgin Islands under section 28(b) of the Revised Organic Act of the Virgin Islands.".

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House Report No. 96-120

[Bracketed numerals indicate official page numbers]

AUTHORIZING APPROPRIATIONS FOR CERTAIN INSULAR AREAS OF THE UNITED STATES, AND FOR OTHER PURPOSES

MAY 4, 1979

Mr. UDALL, from the Committee on Interior and Insular Affairs, submitted the following report to accompany H.R. 3756.[1]

The Committee on Interior and Insular Affairs, to whom was referred the bill (H.R. 3756) to authorize appropriations for certain insular areas of the United States, and for other purposes, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendments are as follows:

* * * * *

[2] Page 12, following line 18, insert the following new sections 404 and 405:

* * * * *

SEC. 405. (a) Subsection 28(a) of the Revised Organic Act of the Virgin Islands, Pub. L. 517, 1954-2 C.B. 595, as amended by subsection 4(c)(3) of the Act of August 18, 1978 (92 Stat. 487, 491) is amended by inserting after the phrase "and naturalization fees collected in the Virgin Islands," the phrase "less the cost of collecting, except any costs for preclearance operations which shall not be deducted, of all of said duties, taxes, and fees from August 18, 1978, until January 1, 1982,".

(b) Section 4(c)(2) of the Act of August 18, 1978, is amended by inserting the phrase "less the cost of collecting all of said duties, taxes, and fees, occurring before January 1, 1982," after the phrase "the amount of duties, taxes, and fees."

* * * * *

PURPOSE

The purpose of H.R. 3756 is to amend the necessary appropriations, make certain amendments to existing laws, and to provide needed legislation relating to the insular areas of American Samoa, Guam, the Northern Mariana Islands, the Trust Territory of the Pacific Islands, and the Virgin Islands in their economic and political development.

BACKGROUND

The 1979 Insular Areas bill was unanimously approved by the Subcommittee on National Parks and Insular Affairs on Monday, April 30. On May 2, 1979, the House Committee on Interior and Insular Affairs reported out H.R. 3756, as amended, by unanimous voice vote.

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[3] SECTION-BY-SECTION ANALYSIS

* * * * *

TITLE II—NORTHERN MARIANA ISLANDS

* * * * *

Section 204.—Implementation of the IRC is delayed until January 1, 1982, by which time the NMI government will be better prepared to implement and enforce it. This represents no tax loss to the U.S. Treasury.

Section 205.—This is a technical amendment which brings into conformity the costs as distinguished from development for the American Memorial Park on Saipan.

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[4] TITLE IV—VIRGIN ISLANDS

* * * * *

Section 403.—Title to some small parcels of land is conveyed from the U.S. Government to the VI government.

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Section 405.—Section 4 of Public Law 95-348 is amended to correct a situation involving customs collections in the Virgin Islands.

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[1] Pub. L. 96-205, page 18.

Public Law 96-239 [1]
96th Congress, H.R. 7140
April 30, 1980

An Act to amend title IV of the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1] to postpone for two months the date on which the Pension Benefit Guaranty Corporation must pay benefits under terminated multiemployer plans.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 4082(c) of title IV of the Employee Retirement Income Security Act of 1974 (relating to effective dates; special rules) as amended by Public Law 95-214 and Public Law 96-24 [1979-32 I.R.B. 13], is further amended—

(1) by striking "May 1, 1980" in paragraphs (1), (2), and (4) and substituting "July 1, 1980", in each such paragraph; and

(2) by striking "April 30, 1980" in paragraphs 2(B) and 4(D) and substituting "June 30, 1980" in each such paragraph.

Approved April 30, 1980.

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[1] House Report No. 96-215 published in part, 1979-32 I.R.B. 13.

Part III. Administrative, Procedural, and Miscellaneous

Notice 80-6

Inflation Adjustment for Computation of Windfall Profit Tax

Section 4989(b) of the Internal Revenue Code requires the determination of an inflation adjustment factor for use in computing the windfall profit tax.

The Service has determined that, for oil removed during the July-September quarter of 1980, the inflation adjustments are as follows:

Tier 1 or Tier 2 oil	0.0649
Tier 3 oil	0.0810

Worksheets for computation of the windfall profit tax are included in the Instructions for Form 6047, Windfall Profit Tax, and an explanation of the inflation adjustment may be found in the Specific Instructions for Line 4 of the worksheets.

Part IV. Items of General Interest

Crude Oil Windfall Profit Tax Public Hearing on Proposed Regulations

Announcement 80-82 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to title I of the Crude Oil Windfall Profit Tax Act of 1980, Pub. L. 96-223.

DATES: The public hearing will be held on July 16, 1980, beginning at 10:00 a.m., and if necessary, on July 17, 1980. Outlines of oral comments must be delivered or mailed by July 2, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-48-80), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations published in two notices of proposed rulemaking appearing in the Federal Register for Friday, April 4, 1980 (45 FR 23384) and Friday, April 25, 1980 (45 FR 27929). These regulations were proposed under title 1 of the Crude Oil Windfall Profit Tax Act of 1980.

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notices of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of oral comments to be presented at the hearing and the time they wish to devote to each subject by July 2, 1980.

Each speaker will be limited to one 10 minute oral presentation, whether on one or both notices, exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive on improving government regulations appearing in the Federal Register for Wednesday, November 8, 1978.

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[1] Filed by the Office of the Federal Register on May 22, 1980 and published in the issue of the Federal Register for May 23, 1980, 45 FR 34899.

Republication of the Technical Explanation of the U.S.-U.K. Income Tax Convention

Announcement 80-85 [1]

The Technical Explanation of the United States-United Kingdom Income Tax Convention, which appeared beginning on page 62 of Internal Revenue Bulletin No. 1980-21, dated May 27, 1980, does not reflect amendments submitted to the United States Senate prior to ratification of the Convention. The Technical Explanation reflecting the amendments will appear in Internal Revenue Bulletin No. 1980-25, dated June 23, 1980.

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[1] Based on News Release IR-80-68 dated June 6, 1980.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

By decision on appeal from an initial decision in an administrative hearing, the following individuals have been suspended or disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Sydney M. Eisenberg	Milwaukee, WI	Attorney	April 17, 1980 Disbarment
Leon Feldt	El Paso, TX	Certified Public Accountant	March 26, 1980 Disbarment
David I. Kali	Tucson, AZ	Attorney	Indefinite Suspension from April 1, 1980
Angelos P. Romas	Endicott, NY	Attorney	April 9, 1980 Disbarment

After due notice and opportunity for hearing, the following individuals have been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Date of Disbarment
Robert B. Clarkson	Anderson, SC	Attorney	April 25, 1980
John E. DeSantis	Belmont, CA	Certified Public Accountant	May 12, 1980

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Frank H. Abernathy	Richmond, VA	Certified Public Accountant	Indefinite effective April 9, 1980
Carl L. Harthun	Denver, CO	Attorney	Indefinite effective April 9, 1980
John T. Kelly, Jr.	Virginia Beach, VA	Certified Public Accountant	Indefinite effective April 15, 1980
Fran A. Moor	Fort Worth, TX	Certified Public Accountant	Indefinite effective April 15, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.166-9, 1.482-2, 1.1371-1, amended; 1.385-1 through 1.385-12, added.	Treatment of certain interests in corporations as stock or indebtedness.	March 24, 1980	June 23, 1980
26 CFR 150.4995-1 through 150.4995-3, 150.6050C-1, added; published as temporary regulations in T.D. 7694, 1980-23 I.R.B. 19.	Withholding and depositing windfall profit tax when producer is integrated oil company.	April 25, 1980	June 24, 1980
26 CFR 1.50A-1, 1.50A-2, 1.50B-1 through 1.50B-5, amended; 1.50A-3 through 1.50A-7, deleted; 1.280C-1 redesignated as 1.280C-2; 1.50B-6, 1.280C-1, added.	Work incentive program (WIN) credit.	April 30, 1980	June 30, 1980
26 CFR 1.120-1 deleted; 1.120-1, 1.120-2, 1.501(c)(20)-1, added.	Qualified group legal services plans.	April 29, 1980	June 30, 1980
26 CFR 1.6073-1 through 1.6073-3, amended.	Time for filing declarations of estimated tax by farmers, fishermen, and certain nonresident aliens.	May 21, 1980	July 21, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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80-49, 1980-8 I.R.B. **13**

56-432
Obsoleted by
80-27, 1980-4 I.R.B. **8**

56-497
Obsoleted by
80-16, 1980-3 I.R.B. **6**

60-330
Distinguished by
80-124, 1980-18 I.R.B. **12**

Rev. Ruls.—Continued

62-197
Distinguished by
80-17, 1980-3 I.R.B. **5**

63-180
Obsoleted by
80-16, 1980-3 I.R.B. **6**

64-149
Distinguished by
80-17, 1980-3 I.R.B. **5**

64-264
Clarified & Superseded by
80-20, 1980-3 I.R.B. **10**

65-16
Amplified by
80-4, 1980-1 I.R.B. **14**

66-16
Superseded by
80-128, 1980-19 I.R.B. **6**

66-307
Clarified by
80-80, 1980-12 I.R.B. **10**

67-25
Superseded by
80-49, 1980-8 I.R.B. **13**

67-181
Superseded by
80-138, 1980-22 I.R.B. **8**

67-431
Amplified by
80-7, 1980-1 I.R.B. **17**

68-89
Obsoleted by
80-16, 1980-3 I.R.B. **6**

68-178
Superseded by
80-139, 1980-22 I.R.B. **9**

68-350
Obsoleted in part by
80-144, 1980-23 I.R.B. **7***

68-382
Distinguished by
80-30, 1980-5 I.R.B. **7**

68-608
Modified by
80-78, 1980-12 I.R.B. **8**

69-368
Obsoleted after 6/30/69 by
80-76, 1980-12 I.R.B. **6**

69-369
Obsoleted after 6/30/69 by
80-76, 1980-12 I.R.B. **6**

70-190
Clarified by
80-115, 1980-17 I.R.B. **12**

70-336
Modified by
80-109, 1980-16 I.R.B. **8**

71-89
Superseded by
80-126, 1980-19 I.R.B. **5**

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[1] See footnote at end of list.

Finding List of Current Action on Previously Published Rulings[1]—Continued

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71-95
Superseded by
80-140, 1980-22 I.R.B. **9**

71-252
Distinguished by
80-71, 1980-11 I.R.B. **7**

71-312
Modified & Superseded by
80-47, 1980-8 I.R.B. **11**

71-399
Further amplified by
80-96, 1980-14 I.R.B. **22**

71-542
Superseded by
80-145, 1980-23 I.R.B. **9***

72-395
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80-123, 1980-18 I.R.B. **10**

72-452
Obsoleted in part by
80-144, 1980-23 I.R.B. **7***

72-587
Modified by
80-143, 1980-23 I.R.B. ***6**

73-17
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80-129, 1980-19 I.R.B. **7**

73-198
Amplified by
80-89, 1980-13 I.R.B. **10**

73-413
Superseded by
80-129, 1980-19 I.R.B. **7**

74-96
Superseded by
80-47, 1980-8 I.R.B. **11**

74-99
Clarified by
80-63, 1980-10 I.R.B. **7**

74-206
Amplified & Clarified by
80-65, 1980-10 I.R.B. **10**

74-381
Modified by
80-136, 1980-22 I.R.B. **5**

74-419
Superseded by
80-146, 1980-23 I.R.B. **10***

74-433
Superseded by
80-62, 1980-8 I.R.B. **9**

74-512
Revoked by
80-53, 1980-8 I.R.B. **15**

Rev. Ruls.—Continued

75-296
Distinguished by
80-34, 1980-6 I.R.B. **9**

75-368
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80-6, 1980-1 I.R.B. **16**

75-461
Amplified by
80-124, 1980-18 I.R.B. **12**

76-415
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80-59, 1980-9 I.R.B. **18**

76-439
Revoked by
80-85, 1980-13 I.R.B. **6**

76-567
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80-36, 1980-6 I.R.B. **11**

77-40
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80-134, 1980-19 I.R.B. **10**

77-392
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80-31, 1980-5 I.R.B. **8**

77-410
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80-62, 1980-8 I.R.B. **9**

77-489
Amplified by
80-70, 1980-11 I.R.B. **5**

78-110
Clarified by
80-22, 1980-3 I.R.B. **15**

78-161
Distinguished by
80-9, 1980-2 I.R.B. **5**

78-427
Superseded by
80-114, 1980-17 I.R.B. **11**

79-309
Distinguished by
80-131, 1980-19 I.R.B. **11**

80-36
Amplified by
80-98, 1980-14, I.R.B. **25**

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1 I.R.B., dated January 7, 1980.

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———	*1937–1*	*3.75*
———	1937–2	7.70
———	*1938–1*	*4.05*
———	*1938–2*	*3.50*
———	1939–1–1	8.25
———	1939–1–2	10.90
———	1939–2	9.40
———	1940–1	5.55
———	1940–2	14.00
———	1941–1	*$6.95*
———	*1941–2*	*3.55*
———	1942–1	7.25
———	*1942–2*	*5.55*
———	*1943*(*)	*9.55*
———	*1944*(*)	*7.85*
———	1945(*)	9.40
———	*1946–1*	*2.55*
———	1946–2	5.20
———	*1947–1*	*1.80*
———	1947–2	3.40
———	*1948–1*	*3.15*
———	1948–2	7.50
———	*1949–1*	*6.90*
———	*1949–2*	*2.80*
———	1950–1	6.35
———	*1950–2*	*4.70*
———	*1951–1*	*2.65*
———	*1951–2*	*5.05*
———	*1952–1*	*2.55*
———	1952–2	7.05
———	*1953–1*	*4.25*
———	1953–2	12.00
———	1954–1	12.00
———	1954–2	12.00
———	1955–1	10.25
———	1955–2	13.00
———	1956–1	15.00
———	1956–2	18.00
———	1957–1	$10.10
———	1957–2	13.00
———	1958–1	9.60
———	1958–2	13.00
———	1958–3	15.00
———	1959–1	15.00
———	1959–2	9.60
———	1960–1	9.00
———	1960–2	11.50
———	1961–1	14.00
———	1961–2	10.00
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———	1962–2	13.00
———	1962–3	20.00
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———	1963–2	10.75
———	1964–1–1	10.00
———	1964–1–2	11.00
———	1964–2	9.80
———	1965–1	10.70
———	1965–2	12.25
———	1966–1	14.00
———	1966–2	14.05
———	1967–1	10.00
———	1967–2	15.00
———	1968–1	14.00
———	1968–2	11.75
———	1969–1	7.50
———	1969–2	6.50
———	1969–3	$12.50
———	1970–1	11.00
———	1970–2	14.00
———	1971–1	10.55
———	1971–2	8.50
———	1972–1	13.50
———	1972–2	13.70
———	1973–1	16.00
———	1973–2	8.30
———	1974–1	11.00
———	1974–2	9.95
———	*1974–3*	*8.20*
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———	1977–2	11.75
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June 23, 1980
Bulletin No. 1980-25

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENT

Announcement 80-84, page 51.
A public hearing will be held on July 15, 1980, concerning proposed regulations relating to a special rule for the deduction of certain charitable contributions of inventory and other property.

INCOME TAX

Rev. Rul. 80-162, page 5.
Industrial development bonds; exempt small issue; capital expenditures; leased equipment. A corporation cancelled an order to purchase equipment when it discovered that the purchase would cause the exempt small issue limitation of section 103(b)(6)(D) of the Code to be exceeded. Prior to cancellation, the corporation entered into an agreement with an unrelated corporation whereby the other corporation would purchase the equipment from the same vendors and lease it to the first corporation. The downpayments and deposits on the purchase, which were later refunded, are not capital expenditures. Rev. Rul. 79-248 distinguished.

Rev. Rul. 80-163, page 8.
Transfers to avoid taxes; foreign corporation; branch with initial losses. The amount of ordinary foreign source income that a corporation must include in its income in accordance with Rev. Rul. 78-201 is not limited to the amount of gain that the corporation would have recognized if all of the transferred assets had been transferred in a taxable sale or exchange; Rev. Rul. 78-201 amplified.

Rev. Rul. 80-164, page 9.
Income tax withholding, FICA, and FUTA; when deductible. An employer who uses the cash receipts and disbursements method of accounting should deduct, under section 162 of the Code, as wages paid, federal taxes withheld from employees' wages in the year such taxes are withheld. FICA and FUTA taxes imposed on the employer are deductible in the year paid to the U.S.

Rev. Rul. 80-165, page 10.
Simple trust; distribution; formula for allocating expenses. A corporate distribution received by a simple trust that was not paid from earnings and profits, but was subject to section 301(c)(2) of the Code, and was used to reduce the basis of the stock cannot be used in the formula for allocating expenses of the trust to tax-exempt income under section 652.

Rev. Rul. 80-166, page 11.
Life insurance companies; distributions; accumulated earnings and profits acquired in merger. Distributions to shareholders by a stock life insurance company should be treated as being first out of the shareholders surplus account, and then out of the policyholders surplus account, as provided by section 815(a) of the Code, without regard to accumulated earnings and profits acquired in a merger with a real estate company.

(Continued on page 4)

Finding Lists begin on page 55.
Announcement of Disbarments on page 52.
Announcement of Notice of Proposed Rulemaking on page 53.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

Rev. Rul. 80-167, page 12.

Northern Mariana Islands; status. Pursuant to the terms of the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the U.S., the Northern Mariana Islands are not considered a possession of the U.S. within the meaning of section 931 of the Code, the Government of the Northern Mariana Islands is not a foreign government for purposes of section 892 for years beginning after 1978, and the Northern Mariana Islands are not a foreign country for purposes of sections 911 and 913; Rev. Ruls. 68-608, 70-193, 73-46, and 80-78 modified.

Rev. Rul. 80-168, page 13.

Puerto Rico and possession tax credit election; "F" reorganization. A mere change in place of incorporation, qualifying under section 368(a)(1)(F) of the Code, does not terminate a corporation's election to be treated as a possessions corporation under section 936.

Rev. Rul. 80-169, page 14.

Small business corporation; acquired in reorganization; election terminated. All of the stock of an electing small business corporation was acquired by a corporation before the start of business on October 16, 1978, in a reorganization qualifying under section 368(a)(1)(B) of the Code. They filed a consolidated return for the acquiring corporation's taxable year ended December 31, 1978. The small business corporation's election is not terminated for the separate taxable year ending October 15, 1978, but is terminated for taxable years beginning after that date. Rev. Rul. 72-201 revoked.

Rev. Rul. 80-170, page 15.

Nonresident alien; joint return; living expenses abroad; foreign earned income exclusion. A nonresident alien spouse of a U.S. citizen who joins with the citizen in making an election, under section 6013(g) of the Code, to be treated as a U.S. resident is eligible for the deduction provided in section 913(a)(2) for certain expenses of living abroad and for the foreign earned income exclusion for residents of camps located in hardship areas provided in section 911(a)(2).

Announcement 80-83, page 51.

Revised instructions are provided for users of Forms 6199 and 5884 to reflect the jobs credit provisions of Pub. L. 96-222 that raise the age limit to age 20 for youths who participate in cooperative education programs.

EMPLOYEE PLANS

Notice 80-7, page 44.

ERISA noncompliance enforcement program. A relief procedure is provided for certain employee benefit plans that were not amended timely to comply with ERISA. Authority to grant the relief is delegated to certain officials.

EXEMPT ORGANIZATIONS

T.D. 7696, page 5.

Amendments to the regulations under section 120 of the Code relate to the application for recognition as a qualified group legal services plan.

EXCISE TAXES

Rev. Proc. 80-19, page 45.

Tires and tubes; method for determining weights; avarage weight basis. The method by which tire manufacturers, producers, and importers may determine tire and tube weights on an average weight basis for the purpose of computing the tax imposed by section 4071(a) of the Code is modified; Rev. Proc. 79-9 modified and superseded.

TAX CONVENTIONS

Page 20.

The Technical Explanation of the U.S.-U.K. Income Tax Convention is republished to reflect amendments submitted to the U.S. Senate prior to ratification of the Convention.

ADMINISTRATIVE

T.D. 7697, page 16.

Amendments to the regulations relate to the collection of fees for the purpose of funding an Offshore Oil Pollution Compensation Fund.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-7: Interest.

Whether interest paid on obligations of a political subdivision of a state is exempt from tax. See Rev. Rul. 80-162, below.

Section 103.—Interest on Certain Governmental Obligations

26 CFR 1.103-10: Exemption for certain small issues of industrial development bonds.
(Also Section 61; 1.61-7.)

Industrial development bonds; exempt small issue; capital expenditures; leased equipment. A corporation cancelled an order to purchase equipment when it discovered that the purchase would cause the exempt small issue limitation of section 103(b)(6)(D) of the Code to be exceeded. Prior to cancellation, the corporation entered into an agreement with an unrelated corporation whereby the other corporation would purchase the equipment from the same vendors and lease it to the first corporation. The downpayments and deposits on the purchase, which were later refunded, are not capital expenditures. Rev. Rul. 79-248 distinguished.

Rev. Rul. 80-162

ISSUE

Are certain downpayments and deposits on the purchase of equipment that were later refunded considered "capital expenditures" within the meaning of section 103(b)(6)(D)(ii) of the Internal Revenue Code for purposes of determining if the exempt small issue limitation of $10,000,000 has been exceeded?

FACTS

In January 1979, City *M* issued industrial development bonds as defined in section 103(b)(2) of the Code in the amount of $9,500,000. Substantially all of the bond proceeds were used to acquire an existing manufacturing facility located within *M*. The facility was leased to corporation *X*, a nonexempt person, for use in *X*'s manufacturing operation. Prior to the issuance of the bonds, *M* made an election to have the bonds treated as a $10,000,000 exempt small issue under section 103(b)(6)(D). Neither *M* nor *X* had made any capital expenditures with respect to the facilities during the three years before the date of the issuance of the bonds. Prior to the issuance of the bonds, *X* did not own, lease, or operate any facilities in *M*. The bonds are not arbitrage bonds as described in section 103(c), and it was determined that the interest on the bonds was excludable from the gross incomes of the bondholders under the provisions of section 103(a)(1).

X decided to expand its operations at the facilities located in *M* by purchasing additional equipment. In February 1980, *X* ordered custom-made equipment and paid $600,000 to vendors from its own funds as downpayments and deposits. *X* discovered that the purchase of the equipment would be treated as a capital expenditure within the meaning of section 103(b)(6)(D)(ii) of the Code and would cause the aggregate face amount of the bonds to exceed the $10,000,000 limitation for exempt small issues. With the consent of the vendors, *X* immediately entered into an arrangement with corporation *Y*, an unrelated person, under which *Y* will purchase the custom-made equipment ordered by *X* from the vendors. Pursuant to a valid lease agreement between *X* and *Y*, *Y* will install the equipment in *X*'s facility and lease it to *X*. The vendors terminated their contracts with *X* and refunded the downpayments and deposits to *X*. *Y* is in the business of leasing custom-made manufacturing equipment. The equipment to be leased by *X* is the type that is ordinarily the subject of a lease.

HOLDING

The downpayments and deposits made by *X* are not capital expenditures by *X* within the meaning of section 103(b)(6)(D)(ii) of the Code because *X* did not purchase, acquire, or take delivery of any of the equipment prior to the termination of the purchase contracts. The equipment purchased by *Y* is not treated as a capital expenditure attributable to *X* because section 1.103-10(b)(2)(iv) of the Income Tax Regulations specifically excludes expenditures for leased tangible personal property under the circumstances described above. Therefore, *M*'s bonds will not exceed the exempt small issue limitation under section 103(b)(6)(D), and the interest on the bonds will continue to be excludable from the gross incomes of the bondholders under the provisions of section 103(a)(1).

EFFECT ON OTHER REVENUE RULINGS

The facts in Rev. Rul. 79-248, 1979-2 C.B. 41, are distinguishable from the facts in this revenue ruling. In Rev. Rul. 79-248 the completed purchase of equipment by a corporation is held to be a capital expenditure even though the corporation sold the equipment before placing it in service, while in this revenue ruling the corporation did not actually complete the purchase of the equipment.

Section 120.—Amounts Received Under Qualified Group Legal Services Plans

26 CFR 1.120-3: Notice of application for recognition of status of qualified group legal services plan.

T.D. 7696

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Application for recognition as a qualified group legal services plan

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains

final regulations relating to notice of application for recognition of the status of a qualified group legal services plan. Provisions relating to group legal services plans were added to the tax law by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1]. The regulations provide guidance to administrators or sponsors of group legal services plans in applying to the Internal Revenue Service for recognition of a plan's status as a qualified plan.

EFFECTIVE DATE: The amendments are effective for notices of application for recognition of the status of a qualified group legal services plan filed after May 29, 1980.

FOR FURTHER INFORMATION CONTACT: Richard L. Johnson of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T:EE-34-78, 202-566-3544 (Not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On July 14, 1978, the Federal Register published a proposed amendment to the Income Tax Regulations (26 CFR Part 1) under section 120(c)(4) of the Internal Revenue Code of 1954 (43 FR 30306). This amendment was proposed to conform the regulations to section 2134 of the Tax Reform Act of 1976 (90 Stat. 1926). After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision.

FORM 1024

Section 120(c)(4) provides that in order to be a qualified group legal services plan, the plan must give notice to the Secretary of the Treasury that it is applying for recognition of its status as a qualified plan. As described in the proposed regulations, the notice must be filed on Form 1024, Application for Recognition of Exemption under Section 501(a) or for Determination under Section 120, with the accompanying Schedule L. As a result of comments on the proposed regulations, certain revisions have been made to Form 1024 to identify those portions of the form that need not be completed when applying for recognition of the status as a qualified group legal services plan.

The final regulations also provide that if either the Form 1024 or Schedule L filed by or on behalf of an employer is incomplete, the Schedule will be considered filed with the Internal Revenue Service only when all required information is filed.

PLANS TO WHICH MORE THAN ONE EMPLOYER CONTRIBUTES

The proposed regulations have been revised to clarify the requirement for filing Form 1024 with the accompanying Schedule L where two or more employers contribute to the same plan. In general, the final regulations provide that the adoption of a plan by an employer will be treated as the adoption of a separate plan to which that employer alone contributes, notwithstanding that, in form, the employer purports to adopt a plan with respect to which the employer is one of two or more contributing employers. Those provisions in the proposed regulations that described an "abbreviated" filing with respect to additional adopting employers have been deleted in the final regulations, but continue to be reflected in the instructions accompanying Form 1024. Those instructions may be followed.

The "multiple filing" rules do not apply, however, to a plan to which more than one employer contributes, if the plan is maintained pursuant to a collective bargaining agreement. For these collectively-bargained plans, only one Form 1024 and accompanying Schedule L is required, regardless of the number of contributing employers.

PLANS IN EXISTENCE ON JUNE 4, 1976

As described in the proposed regulations, a written group legal services plan in existence on June 4, 1976, will be deemed a qualified plan until April 2, 1977, whether or not a notice of application is filed for the plan. If the plan is maintained pursuant to a collective bargaining agreement in effect on October 4, 1976, this period of deemed qualification will extend until the agreement terminates, but not beyond December 31, 1981. In order for a plan to be a qualified plan for any period after the period of deemed qualification, a notice of application must be filed pursuant to the regulations. The proposed regulations have been revised to provide that a plan will be a qualified plan for the period beginning on the day following the date on which the period of deemed qualification ends, if it otherwise satisfies the requirements for qualification and a Form 1024 with the accompanying Schedule L is filed for the plan no later than the end of the plan year following the plan year with or within which the period of deemed qualification ends.

DRAFTING INFORMATION

The principal author of this regulation is Richard L. Johnson of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matter of substance and style.

Adoption of amendment to the regulation

Accordingly, the following amendments to 26 CFR Part 1 are hereby adopted:

§ 1.120-3 Notice of application for recognition of status of qualified group legal services plan.

(a) *In general.* In order for a plan to be a qualified group legal services plan for purposes of the exclusion from gross income provided by section 120(a), the plan must give notice to the Internal Revenue Service that it is applying for recognition of its status as a qualified plan. Paragraph (b) of this section describes how the notice is to be filed for the plan. Paragraph (c) of this section describes the action that the Internal Revenue Service will take in response to the notice submitted for the plan. Paragraph (d) of this section describes the period of plan qualification.

(b) *Filing of notice*—(1) *In general.* A notice of application for recognition of the status of a qualified group legal services plan must be filed with the key district director of internal revenue as described in § 601.201(n). The notice must be filed on Form 1024, Application for Recognition of Exemption Under Section 501(a) or for Determination Under Section 120, with the accompanying Schedule L, and must contain the information required by the form and any accompanying instructions. The form may be filed by either the employer adopting the plan or the person administering the plan. No Form 1024 and Schedule L may be filed for a plan before an employer adopts the plan, or proposes to adopt the plan contingent only upon the recognition of the plan as a qualified plan.

(2) *Plans to which more than one employer contributes.* In general, for purposes of section 120 the adoption of a plan by an employer constitutes the adoption of a separate plan to which that employer alone contributes, notwithstanding that, in form, the employer purports to adopt a plan with respect to which the employer is one of two or more contributing employers. Accordingly, a separate Schedule L must be filed pursuant to the instruction accompanying Form 1024 for each employer adopting a plan.

(3) *Certain collectively bargained plans.* Notwithstanding subparagraph (2) of this paragraph, if a plan to which more than one employer contributes is a plan to which this subparagraph (3) applies, the plan is treated as a single plan for purposes of section 120. Accordingly, only one Form 1024 and Schedule L is required to be filed for the plan, regardless of the number of employers originally adopting the plan. In addition, once a Form 1024 and Schedule L is filed, no additional filing is required with respect to an employer who thereafter adopts the plan. In general, this subparagraph (3) applies to any plan that is maintained pursuant to a collective bargaining agreement between employee representatives and more than one employer who is required by the plan instrument or other agreement to contribute to the plan with respect to employees (or their spouses or dependents) participating in the plan. This subparagraph does not apply, however, if all employers required to contribute to the plan are corporations which are members of a controlled group of corporations within the meaning of section 1563(a), determined without regard to section 1563(e)(3)(C). If all employers required to contribute to the plan are corporations which are members of such a controlled group, the filing requirements described in subparagraph (2) of this paragraph apply, notwithstanding that the plan is maintained pursuant to a collective bargaining agreement.

(c) *Internal Revenue Service action on notice of application for recognition.* The Internal Revenue Service will issue to the person submitting Form 1024 and Schedule L a ruling or determination letter stating that the plan is or is not a qualified group legal services plan. For general procedural rules, see § 601.201(a) through (n), as that section relates to rulings and determination letters.

(d) *Period of plan qualification*—(1) *In general.* In the case of a favorable determination, the plan will be considered a qualified group legal services plan. If a Form 1024 and Schedule L required to be filed by or on behalf of an employer is filed before—

(i) The end of the first plan year (as determined under the plan),

(ii) The end of the plan year within which the employer adopts the plan, or

(iii) July 29, 1980,

the period of plan qualification with respect to the employer will begin on the date the plan is adopted by the employer (or, if later, January 1, 1977). If the form and schedule are not filed before the latest of the dates described in subdivisions (i), (ii) and (iii), the period of plan qualification with respect to the employer will begin on the date of filing. In any case in which either the Form 1024 or Schedule L filed by or on behalf of an employer is incomplete, the date of filing is the date on which the incomplete form or schedule is filed, if the necessary additional information is provided at the request of the Commissioner within the additional time period allowed by the Commissioner. If the additional information is not provided within the additional time period allowed, the date of filing is the date on which the additional information is filed. If no separate Form 1024 and Schedule L are required to be filed by or on behalf of an employer (see paragraph (b)(3) of this section), the period of plan qualification with respect to the employer will begin on the date the plan is adopted by the employer (or, if later, January 1, 1977). In any case in which a plan is materially modified to conform to the requirements of section 120, either before or after a Form 1024 and Schedule L are filed, the period of plan qualification will not include any period before the effective date of the modification.

(2) *Plans in existence on June 4, 1976.* (i) Notwithstanding paragraph (d)(1) of this section, a written group legal services plan providing for employer contributions which was in existence on June 4, 1976, will be considered a qualified group legal services plan for the period January 1, 1977, through April 2, 1977. However, if the plan is maintained pursuant to one or more agreements which were in effect on October 4, 1976, and which the Secretary of Labor finds to be collective bargaining agreements, the period of deemed qualification will extend beyond April 2, 1977, and end on the date on which the last of the collective bargaining agreements relating to the plan terminates. Extensions of a bargaining agreement which are agreed to after October 4, 1976, are to be disregarded. The period of deemed qualification for a plan maintained pursuant to a collective bargaining agreement will not, however, extend beyond December 31, 1981.

(ii) A written group legal services

plan will be considered to have been in existence on June 4, 1976, if on or before that date the plan was reduced to writing and adopted by one or more employers. No amounts need have been contributed under the plan as of June 4, 1976.

(iii) Notwithstanding that a plan is a qualified plan for the period of deemed qualification described in this paragraph (d)(2), the rules of paragraphs (c) and (d)(1) of this section still apply with respect to a Form 1024 and Schedule L filed for the plan. For example, if a Form 1024 and Schedule L filed by or on behalf of an employer are filed before the latest of the 3 dates described in paragraph (d)(1) of this section, in the case of a favorable determination the plan will be a qualified plan from the date the plan is adopted by the employer (or, if later, January 1, 1977), and any period of deemed qualification and the period of qualification based upon the favorable determination will overlap. However, in the case of a plan to which this paragraph (d)(2) applies, if a Form 1024 and Schedule L required to be filed by or on behalf of an employer is not filed before the latest of the 3 dates described in paragraph (d)(1) of this section, the following rules shall apply. In general, if Form 1024 and Schedule L are filed before the end of the plan year following the plan year with or within which the plan's period of deemed qualification expires, in the event of a favorable determination the plan will be a qualified plan with respect to the employer beginning on the earlier of the day following the date on which the period of deemed qualification expires or the date on which the Form 1024 and Schedule L are filed. The period of plan qualification with respect to an employer cannot, however, include any period before the employer adopts the plan. If the Form 1024 and Schedule L are not filed before the end of the plan year following the plan year with or within which the plan's period of deemed qualification expires, in the case of a favorable determination the plan will be a qualified plan with respect to an employer from the later of the date of filing or adoption of the plan by the employer. The rules described in paragraph (d)(1) of this section relating to incomplete filings and plan modifications apply with respect to a filing described in this paragraph (d)(2).

(e) *Effective date.* This section is effective for notices of application for recognition of the status of a qualified group legal services plan filed after May 29, 1980.

This Treasury decision is issued under the authority contained in sections 120(c)(4) and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1926, 68A Stat. 917; 26 U.S.C. 120 (c)(4), 7805).

JEROME KURTZ,
Commissioner of Internal Revenue.

Approved, April 17, 1980.

DONALD C. LUBICK,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on April 28, 1980, 8:45 a.m., and published in the issue of the Federal Register for April 29, 1980, 45 F.R. 28319)

Section 162.—Trade or Business Expense

26 CFR 1.162-1: Business expense.

Whether an employer who reports income and deductions on the cash receipts and disbursements method of accounting is entitled to deduct, under section 162 of the Code, as wages paid, amounts withheld as federal income taxes and taxes withheld under the Federal Insurance Contributions Act (FICA) even though such amounts have not been paid to the United States. See Rev. Rul. 80-164, page 9.

Section 301.—Distributions of Property

26 CFR 1.301-1: Rules applicable with respect to distributions of money and other property.

Whether a distribution subject to section 301(c)(2) of the Code should be included in the formula for allocating expenses of a trust to tax-exempt income. See Rev. Rul. 80-165, page 10.

Section 367.—Foreign Corporations

26 CFR 1.367-1: Foreign corporations.

Transfers to avoid taxes; foreign corporation; branch with initial losses. The amount of ordinary foreign source income that a corporation must include in its income in accordance with Rev. Rul. 78-201 is not limited to the amount of gain that the corporation would have recognized if all of the transferred assets had been transferred in a taxable sale or exchange; Rev. Rul. 78-201 amplified.

Rev. Rul. 80-163

ISSUE

Is the amount of ordinary foreign source income that a domestic transferor (*P*) must include in its income in accordance with Rev. Rul. 78-201, 1978-1 C.B. 91, limited to the amount of gain that the transferor would have recognized if all of the transferred assets were transferred in a taxable sale or exchange?

FACTS

The facts are the same as those set forth in Rev. Rul. 78-201. In addition, each asset transferred had a fair market value in excess of its basis, and, if the transferred assets were sold in the aggregate, in a taxable sale or exchange, the amount of gain that *P* would have realized would have been less than the aggregate amount of the net losses that were incurred by the branch.

LAW AND ANALYSIS

The specific sections of the Code that are applicable are section 351(a), relating to the nonrecognition of gain or loss on the transfer of property to a corporation controlled by the transferor, and, section 367(a)(1), relating to the requirement that a ruling be obtained that an exchange described in section 351 is not in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes in order for a foreign corporation to be considered a corporation for purposes of determining gain on the transfer.

Rev. Rul. 78-201 required the United States transferor (*P*) to include in income an amount of ordinary foreign source income (the sum of the branch losses previously incurred) as a condition for obtaining a ruling that the exchange was not in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes within the meaning of section 367(a)(1) of the Code. In the instant situation, the amount of ordinary foreign source income that *P* must include in its income in accordance with Rev. Rul. 78-201 will not be limited to the gain that would have been recognized if the transferred assets were sold in the aggregate, in a taxable sale or exchange, since such a limitation would not take into consideration the full amount of the losses associated with the transferred assets that *P* used to reduce its income subject to federal income tax, and therefore would not prevent the potential mismatching of related income and losses, the tax avoidance at which Rev. Rul. 78-201 is directed.

HOLDING

The amount of ordinary foreign source income that *P* must include in its income in accordance with Rev. Rul. 78-201 is not limited to the amount of gain that *P* would have recognized if all of the transferred assets were transferred in a taxable sale or exchange.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 78-201 is amplified.

Section 368.—Definitions Relating to Corporate Reorganizations

26 CFR 1.368-1: Purpose and scope of exception of reorganization exchanges.

Whether a mere change in the place of incorporation, qualifying under section 368(a)(1)(F) of the Code, terminates a corporation's election to be treated as a possessions corporation under section 936. See Rev. Rul. 80-168, page 13.

Section 381.—Carryovers in Certain Corporate Acquisitions

26 CFR 1.381(a)-1: General rule relating to carryovers in certain corporate acquisitions.

Whether a mere change in the place of incorporation, pursuant to section 368(a)(1)(F) of the Code, terminates a corporation's election to be treated as a possessions corporation under section 936. See Rev. Rul. 80-168, page 13.

Section 461.—General Rule for Taxable Year of Deduction

26 CFR 1.461-1: General rule for taxable year of deduction.
(Also Section 162; 1.162-1.)

Income tax withholding, FICA, and FUTA; when deductible. An employer who uses the cash receipts and disbursements method of accounting should deduct, under section 162 of the Code, as wages paid, federal taxes withheld from employees' wages in the year such taxes are withheld. FICA and FUTA taxes imposed on the employer are deductible in the year paid to the U.S.

Rev. Rul. 80-164

ISSUE

When is an employer who reports income and deductions on the cash receipts and disbursements method of accounting entitled to deduct under section 162 of the Internal Revenue Code, as wages paid, amounts withheld as federal income taxes and taxes withheld under the Federal Insurance Contributions Act (FICA)?

FACTS

The employer, *X*, is engaged in business in the United States. *X* uses the cash receipts and disbursements method of accounting and reports income on a calendar year basis. During 1978, *X* paid wages to its employees and withheld from those wages amounts representing federal income and FICA taxes. The amounts that *X* withheld on the wages paid during the last quarter of 1978 were timely paid to the United States in 1979.

LAW AND ANALYSIS

Section 162 of the Code provides that there will be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business including a reasonable allowance for salaries.

Section 461(a) of the Code provides general rules for the taxable year of deduction. Section 1.461-1(a) of the Income Tax Regulations provides that a taxpayer using the cash receipts and disbursements method of accounting shall, as a general rule, take amounts representing allowable deductions into account for the taxable year in which paid.

Section 3101 of the Code imposes a tax (FICA) on wages of an employee, and section 3102 provides that the tax imposed by section 3101 shall be collected by the employer by deducting the amount of the tax from the wages of the employee as and when paid.

Section 3402(a) of the Code provides that every employer making payment of wages shall deduct and withhold income tax from such wages.

Section 31.3401(a)-1(b)(5) of the regulations states that any amount deducted by an employer from the remuneration of an employee is considered to be a part of the employee's remuneration and is considered to be paid to the employee as remuneration at the time that the deduction is made.

In Rev. Rul. 74-75, 1974-1 C.B. 19, an employer, *X*, agreed to pay *A*, an individual, at a stated remuneration of $100 per week. In addition, *X* agreed to pay *A*'s employee tax under section 3101 of the Code without deducting it from *A*'s pay. For 1972, *X* paid *A* $5,000 and incurred liability for the taxes imposed on *A* by section 3101 in the amount of $260 without deducting those taxes from *A*'s remuneration. Rev. Rul. 74-75 holds that the arrangement is properly treated as if *A*'s wages paid were $5,260 and $260 thereof were withheld. Rev. Rul. 74-75 further holds that *A*'s gross income for 1972 is $5,260.

X, as an employer, is required by sections 3402 and 3102 of the Code to withhold income and FICA taxes from wage payments to employees. Under section 31.3401(a)-1(b)(5) of the regulations and Rev. Rul. 74-75, the withheld taxes are considered paid as salary to the employees at the time they are withheld and are therefore included in a cash method employee's income for the year in which withheld. Therefore, for deduction purposes, *X* is viewed as actually paying withheld taxes at the time withheld, and is thus entitled to a deduction for the year in which they are withheld under section 1.461-1(a).

HOLDING

An employer who reports income on the cash receipts and disbursements method of accounting should deduct under the provisions of section 162 of the Code the withheld federal taxes (imposed on the employee and withheld from the employee's wages) as wages for the taxable year in which such taxes are withheld. However, the FICA and Federal Unemployment Tax Act taxes (section 3301) imposed upon the employer with respect to wages paid employees are deductible when paid to the United States.

Section 641.—Imposition of Tax

26 CFR 1.641(a)-2: Gross income of estates and trusts.

Whether a distribution subject to section 301(c)(2) of the Code should be included in the formula for allocating expenses of a trust to tax-exempt income. See Rev. Rul. 80-165, this page.

Section 643.—Definitions Applicable to Subparts A, B, C, and D

26 CFR 1.643(a)-3: Capital gains and losses.

Whether a distribution subject to section 301(c)(2) of the Code should be included in the formula for allocating expenses of a trust to tax-exempt income. See Rev. Rul. 80-165, this page.

Section 652.—Inclusion of Amounts in Gross Income of Beneficiaries of Trust Distributing Current Income Only

26 CFR 1.652(a)-1: Simple trusts; inclusion of amounts in income of beneficiaries.

Whether a distribution subject to section 301(c)(2) of the Code should be included in the formula for allocating expenses of a trust to tax-exempt income. See Rev. Rul. 80-165, below.

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26 CFR 1.652(b)-3: Allocation of deductions.
(Also Sections 301, 641, 643; 1.301-1, 1.641(a)-2, 1.643(a)-3, 1.652(a)-1.)

Simple trust; distribution; formula for allocating expenses. A corporate distribution received by a simple trust that was not paid from earnings and profits, but was subject to section 301(c)(2) of the Code, and was used to reduce the basis of the stock cannot be used in the formula for allocating expenses of the trust to tax-exempt income under section 652.

Rev. Rul. 80-165

ISSUE

Whether a distribution to a trust from a corporation that is subject to section 301(c)(2) of the Internal Revenue Code should be included in the formula for allocating expenses of the trust to tax-exempt income under section 652.

FACTS

A simple trust owned shares of stock in a corporation and during the trust taxable year the corporation made a distribution to shareholders that was not paid from earnings and profits and was subject to section 301(c)(2) of the Code. The amount of the distribution did not exceed the trust's adjusted basis in the stock. The trust also received dividends and tax-exempt interest from other sources.

The fiduciary of the trust distributed the section 301(c)(2) distribution to the income beneficiary. The only expense of the trust was the fiduciary's compensation.

The fiduciary reduced the basis of the stock by the amount of the section 301(c)(2) distribution and also included the amount in the formula in section 1.652(b)-3 of the Income Tax Regulations for allocating deductible items among items of income, including nontaxable income, in computing distributable net income. The inclusion of the section 301(c)(2) distribution in the formula reduced the amount of fiduciary's compensation allocated to the tax-exempt interest.

LAW AND ANALYSIS

Section 301(c)(1) of the Code provides that any portion of a distribution that is a dividend (as defined in section 316) is included in gross income and section 301(c)(2) provides that any distribution which is not a dividend reduces the adjusted **basis of the** stock. Any excess of distribution over such basis is treated as a gain from the sale or exchange of property.

Section 641(b) of the Code provides that the taxable income of an estate or trust will be computed in the same maner as in the case of an individual, except as otherwise provided.

Section 643(a) of the Code defines the term "distributable net income" to mean the taxable income of the estate or trust computed with seven modifications specified in section 643(a).

Section 652(b) of the Code provides that the items of deduction entering into the computation of distributable net income shall be allocated among the items of distributable net income in accordance with the Income Tax Regulations.

Section 1.652(b)-3(b) of the Income Tax Regulations provides that deductions that are not directly attributable to a specific class of income may be allocated to any item of income (including capital gains) included in computing distributable net income, but a portion must be allocated to nontaxable income. An example in that section provides that deductions that are not directly attributable to a specific class of income are not to be allocated to the capital gains that are allocated to corpus because these capital gains are not taken into account in the computation of distributable net income.

Rev. Rul. 77-355, 1977-2 C.B. 82, holds that, for purposes of computing distributable net income, a simple trust that does not distribute capital gains because they are allocated to corpus under the trust instrument or applicable local law, may not include capital gains in the formula for allocating indirect expenses to tax-exempt income.

The section 301(c)(2) distribution is, in effect, a "return of capital" because it reduces the basis of the stock. Amounts received as a "return of capital" do not constitute income subject to taxation and, therefore, these amounts are not within the definition of gross income under section 61 of the Code.

Because the section 301(c)(2) distribution is not considered taxable income under section 61 of the Code, the distribution cannot be included in the computation of distributable net income unless section 643(a) provides for its inclusion and section 643(a) does not provide for the inclusion of a section 301(c)(2) distribution as one of the modifications.

The fiduciary properly used the amount of the section 301(c)(2) distribution to reduce the basis of the stock, but the additional use of the section 301(c)(2) distribution in the formula under section 652 of the Code for allocating deductions to the tax-exempt interest was erroneous because the distribution cannot be included in the computation of distribution net income under section 643(a). Items not included in the computation of distributable net income cannot be used in the formula for allocating deduction to tax-exempt interest. See Rev. Rul. 77-355.

HOLDING

The corporate distribution to the trust paid from other than earnings and profits and subject to section 301(c)(2) of the Code cannot be used in the formula for allocating expenses of the trust to tax-exempt income under section 652 of the Code.

Section 815.—Distributions to Shareholders

26 CFR 1.815-2: Distributions to shareholders.

Life insurance companies; distributions; accumulated earnings and profits acquired in merger. Distributions to shareholders by a stock life insurance company should be treated as being first out of the shareholders surplus account, and then out of the policyholders surplus account, as provided by section 815(a) of the Code, without regard to accumulated earnings and profits acquired in a merger with a real estate company.

Rev. Rul. 80-166

ISSUE

Should distributions to its shareholders by a life insurance company be treated as being first out of the shareholders surplus account, and then out of the policyholders surplus account as provided in section 815(a) of the Internal Revenue Code, regardless of accumulated earnings and profits acquired as a result of a merger with a real estate company?

FACTS

The taxpayer is a stock life insurance company subject to the tax imposed by section 802 of the Code.

During 1976, the taxpayer was the surviving corporation in a section 368(a)(1)(A) merger with a real estate company. As part of the merger, the real estate company exchanged all of its assets for stock in the taxpayer. At the time of the merger, the real estate company had accumulated earnings and profits of $8500x$ dollars. At the end of 1979, the taxpayer had $3000x$ dollars in its shareholders surplus account and $2000x$ dollars in its policyholders surplus account. During 1979, the taxpayer made distributions to its shareholders of $4000x$ dollars.

LAW AND ANALYSIS

Section 802(a) of the Code imposes a tax on the life insurance company taxable income of every life insurance company.

Section 802(b) of the Code defines "life insurance company taxable income" as the sum of—

(1) the taxable investment income (as defined in section 804) or, if smaller, the gain from operations (as defined in section 809),

(2) if the gain from operations exceeds the taxable investment income, an amount equal to 50 percent of such excess, plus

(3) the amount subtracted from the policyholders surplus account for the taxable year, as determined under section 815.

Section 815(a) of the Code provides that any distributions to shareholders after December 31, 1958, shall be treated as made—(1) first out of the shareholders surplus account, to the extent thereof, (2) then out of the policyholders surplus account, to the extent thereof, and (3) finally out of the other accounts.

Section 1.815-2(c)(1)(c) of the Income Tax Regulations provides that the term "distributions," as used in section 815(a) means any distribution of property made by a life insurance company to its shareholders. The term includes a distribution which is considered a dividend under section 316, but is not limited to the extent that such distribution must be made out of the accumulated or current earnings and profits of the company making the distribution.

The shareholders surplus account, as defined in section 815(b) of the Code, consists principally of life insurance company taxable income since January 1, 1958, less the tax imposed and distributions to shareholders. The policyholders surplus account, as defined in section 815(c), consists principally of the excess portion of gain from operations on which tax has been deferred. Additions to and subtractions from these accounts are limited to specific items set forth in section 815(b) and (c). These surplus accounts reflect the priority system for distributions to shareholders of the life insurance company.

The shareholders surplus account represents amounts that have been taxed to the life insurance company from its life insurance business and, therefore, distributions out of the account to shareholders of the life insurance company do not result in any further tax to the life insurance company.

The policyholder surplus account is a tax deferred account and distributions deemed to have been made out of this account are subject to tax pursuant to section 802(b)(3) of the Code. Distributions in excess of the amounts in these two accounts are deemed to be made out of other accounts and have no tax effect to the life insurance company.

When a life insurance company has distributed amounts to shareholders in excess of previously taxed income, it is assumed that the company itself has determined that these additional amounts constitute income that is not required to fulfill policyholders contracts. *See* S. Rep. No. 291, 86th Cong., 1st Sess. (1959), 1959-2 C.B. 788, 789.

Therefore, the cushion provided for by the deferred tax account, the policyholder surplus account, is no longer needed and becomes taxable when distributed or deemed to be distributed to shareholders notwithstanding that the taxpayer has other accounts such as the accumulated earnings and profits acquired in the merger with the real estate company. Such acquired earnings and profits is not an item that enters into either the shareholders surplus account or the policyholders surplus account. So long as there is any amount in the deferred tax account, distributions to shareholders cannot be considered as coming out of other accounts.

HOLDING

Distributions to shareholders by the taxpayer should be treated as being first out of the shareholders surplus account, and then out of the policyholders surplus account as provided in section 815(a) of the Code without regard to the accumulated earnings and profits acquired as a result of merger with a real estate company.

Section 892.—Income of Foreign Governments and of International Organizations

26 CFR 1.892-1: Income of foreign governments and international organizations.

A clarification of the status of the Northern Mariana Islands for federal income tax purposes in light of developments with respect to the relationship of the United States to the Northern Mariana Islands. See Rev. Rul. 80-167, this page.

Section 911.—Income Earned by Individuals in Certain Camps

26 CFR 5b.911-1: Individuals qualifying for the exclusion.

Whether a nonresident alien spouse of a United States citizen, who joins with such citizen in making an election under section 6013(g) of the Code to be treated as a United States resident for purposes of chapter 1 of the Code, is eligible for the foreign earned income exclusion provided in section 911(a)(2). See Rev. Rul. 80-170, page 15.

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26 CFR 5b.911-2: Qualifying earned income.

A clarification of the status of the Northern Mariana Islands for federal income tax purposes in light of developments with respect to the relationship of the United States to the Northern Mariana Islands. See Rev. Rul. 80-167, this page.

Section 913.—Deduction for Certain Expenses of Living Abroad

26 CFR 5b.913-1: Deduction for certain expenses of living abroad.

Whether a nonresident alien spouse of a United States citizen, who joins with such citizen in making an election under section 6013(g) of the Code to be treated as a United States resident for purposes of chapter 1 of the Code, is eligible for the deduction provided in section 913(a)(2) for certain expenses of living abroad. See Rev. Rul. 80-170, page 15.

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26 CFR 5b.913-3: General definitions.

A clarification of the status of the Northern Mariana Islands for federal income tax purposes in light of developments with respect to the relationship of the United States to the Northern Mariana Islands. See Rev. Rul. 80-167 this page.

Section 931.—Income from Sources Within Possessions of the United States

26 CFR 1.931-1: Citizens of the United States and domestic corporations deriving income from sources within a possession of the United States.

A clarification of the status of the Northern Mariana Islands for federal income tax purposes in light of developments with respect to the relationship of the United States to the Northern Mariana Islands. See Rev. Rul. 80-167, below.

Section 935.—Coordination of United States and Guam Individual Income Taxes

26 CFR 1.935-1: Coordination of U.S. and Guam individual income taxes.
(Also Sections 892, 911, 913, 931; 1.892-1, 5b.911-2, 5b.913-3, 1.931-1.)

Northern Mariana Islands; status. Pursuant to the terms of the Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the U.S., the Northern Mariana Islands are not considered a possession of the U.S. within the meaning of section 931 of the Code, the Government of the Northern Mariana Islands is not a foreign government for purposes of section 892 for years beginning after 1978, and the Northern Mariana Islands are not a foreign country for purposes of sections 911 and 913; Rev. Ruls. 68-608, 70-193, 73-46, and 80-78 modified.

Rev. Rul. 80-167

PURPOSE

The purpose of this revenue ruling is to clarify the status of the Northern Mariana Islands for federal income tax purposes.

FACTS—LAW—ANALYSIS

Under the trusteeship agreement between the United States and the Security Council of the United Nations (61 Stat. 3301), the United States administers certain former Japanese mandated islands, now known as the Trust Territory of the Pacific Islands. The Northern Mariana Islands (Marianas), together with the Marshall Islands and the Caroline Islands, make up such territory.

On February 15, 1975, the United States and the Marianas signed a Covenant to Establish a Commonwealth of the Northern Mariana Islands in Political Union with the United States (Covenant). The Covenant was approved by a Joint Resolution of Congress on March 24, 1976 (Pub L. 94-241, 90 Stat. 263, 1976-1 C.B. 513), and by the Marianas. The effect of the Covenant is the administrative separation of the Marianas from the Government of the Trust Territory of the Pacific Islands, and the eventual Commonwealth status for the Marianas as a territory of the United States.

Pursuant to the Covenant, the Marianas adopted a constitution, which was approved by Presidential Proclamation 4534, dated October 24, 1977 (42 F.R. 56593). This proclamation stated that the constitution, as well as several sections of the Covenant, were to take effect on January 9, 1978.

Sections 601 and 602 of the Covenant, dealing with revenue and taxation, were among the sections that became effective on January 9, 1978, although, as indicated below, these two sections were not to be applied until January 1, 1979.

Under section 601(a) of the Covenant, the income tax laws of the

United States will come into force in the Marianas as a local territorial income tax on January 1, 1979, in the same manner as those laws are in force in Guam. Thus, the words "Northern Mariana Islands" will be substituted for the words "United States" whereever they appear in the Code.

Under section 601(b) of the Covenant, any individual who is a citizen or resident of the United States, Guam, or the Marianas (including a national of the United States who is not a citizen), will file only one income tax return in a manner similar to the provisions of section 935 of the Internal Revenue Code, which concern Guam.

Under section 601(c) of the Covenant, references to Guam in the Code will be deemed to also refer to the Marianas, unless otherwise expressly provided or unless manifestly incompatible with the intent of the Code or the Covenant. Thus, the benefits available to Guam under the Code will also be available to the Marianas. *See also* the analysis of section 601(c) of the Covenant prepared by the Senate Committee on Interior and Insular Affairs which states, in part, as follows:

> Under (section 601(c)) the federal income tax laws will apply as a local territorial income tax in the same manner as those laws are in force in Guam. It is desirable that Guam and the Northern Mariana Islands have coordinated tax laws since they operate in the same economic and geographic sphere.
>
> * * * * *
>
> (Section 601(c)) provides that references in the Internal Revenue Code to Guam will be deemd to also refer to the Northern Mariana Islands, where not otherwise distinctly expressed or manifestly incompatible with the intent of such sections or of the Covenant. This assures that the benefits which are available to Guam under the Internal Revenue Code will also be available to the Northern Mariana Islands. *S. Rep. No. 94-433,* 94th Cong., 1st Sess. 79-80 (1975).

Under section 602 of the Covenant, the Marianas may impose additional taxes and may rebate any tax it collects on income derived from sources within the Marianas.

The provision of sections 601 and 602 of the Covenant are presently in effect. Thus, references in the Code to Guam now generally apply to the Marianas as well.

Under the terms of the trusteeship agreement, the Service has held that the Marshall Islands (and therefore implicitly the Marianas), were not possessions of the United States for purposes of section 931 of the Code because the trusteeship agreement did not grant the United States such sovereignty over the islands as would justify the position that they constitute United States possessions. Rev. Rul. 70-193, 1970-1 C.B. 163.

Based on the terms of the Covenant, the Marianas retain this status and are not United States possessions for purposes of section 931 of the Code. The Covenant provides that the Marianas are to be treated in the same manner as Guam for federal income tax purposes. Section 931(c) specifies that Guam is not a United States possession for purposes of that section.

The Service has also held that the Government of the Trust Territory of the Pacific Islands is a foreign government for purposes of section 892 of the Code and has characterized the Trust Territory of the Pacific Islands as a foreign country for purposes of section 911 of the Code. Rev. Rul. 73-46, 1973-1 C.B. 342; and Rev. Rul. 68-608, 1968-2 C.B. 309 as modified by Rev. Rul. 80-78, 1980-12 I.R.B. 8.

The Government of Guam is not a foreign government for purposes of section 892 of the Code as it is under *the sovereignty of the* United States and is considered as part of the governmental jurisdiction of the United States. *See* Organic Act of Guam, Pub. L. 630, 1950-2 C.B. 214, which declared Guam to be an unincorporated territory of the United States. Nor is Guam a foreign country for purposes of sections 911 and 913 of the Code as section 5b.913-3(d) of the Temporary Income Tax Regulations provides, in part, that the term "foreign country" means territory under the sovereignty of a government other than that of the United States and does not include a possession or territory of the United States. *See also* section 935(c)(1) of the Code which provides that for United States income tax purposes the United States shall be treated as including Guam. Because the Marianas are to be treated in the same manner as Guam for federal income tax purposes pursuant to the Covenant, the Government of the Marianas is not a foreign government for purposes of section 892 of the Code; and the Marianas are not a foreign country for purposes of sections 911 and 913 of the Code.

HOLDING

Pursuant to the terms of the Covenant, the Marianas are not considered a possession of the United States for purposes of section 931 of the Code. Pursuant to the terms of the Covenant and for taxable years beginning on or after January 1, 1979, the Government of the Marianas is not a foreign government for purposes of section 892 of the Code and the Marianas are not a foreign country for purposes of sections 911 and 913 of the Code.

EFFECT ON OTHER REVENUE RULINGS

For taxable years beginning on or after January 1, 1979, Rev. Ruls. 68-608, 70-193, 73-46, and 80-78 are modified to exclude the Marianas from their application.

Section 936.—Puerto Rico and Possession Tax Credit

(*Also Sections 368, 381; 26 CFR 1.368-1, 1.381(a)-1.*)

Puerto Rico and possession tax credit election; "F" reorganization. A mere change in place of incorporation, qualifying under section 368(a)(1)(F) of the Code, does not terminate a corporation's election to be treated as a possessions corporation under section 936.

Rev. Rul. 80-168

ISSUE

Does a mere change in place of incorporation, qualifying as a reorganization under section 368(a)(1)(F) of the Internal Revenue Code, terminate the corporation's election to be treated as a possessions corporation under section 936 of the Code under the facts described below?

FACTS

M, a corporation formed under the

laws of state *X* and manufacturing electronic equipment in Puerto Rico, has elected to be treated as a possessions corporation under section 936 of the Code, having qualified for such election under the requirements set forth in this section. For valid business reasons, *M* desires to change its place of incorporation to state *Y* by merging with and into *N*, a new corporation organized under the laws of state *Y* specifically for this transaction, pursuant to state law and qualifying as a reorganization under section 368(a)(1)(F). *N* will be the surviving corporation and will be engaged in the same business in Puerto Rico as *M* was engaged in. By operation of law, the properties, liabilities, business operations, and shareholders of *M* will become those of *N* and *M*'s corporate existence will be terminated.

LAW AND ANALYSIS

Section 936(a) of the Code generally provides that if a domestic corporation elects the application of this section and if certain conditions described therein are satisfied, there shall be allowed as a credit against the federal tax imposed an amount equal to the portion of the tax that is attributable to specified possession-source income.

Section 381 of the Code provides that in the case of the acquisition of the assets of a corporation by another corporation in connection with a reorganization described in section 368(a)(1)(F), that is, a mere change in identity, form, or place of organization, the acquiring corporation shall succeed to and take into account, as of the close of the day of transfer, the items described in section 381(c) of the transferor corporation.

Section 381(c) does not include in its description of items that the acquiring corporation succeeds to and takes into account an election to be treated as a possessions corporation under section 936 of the Code.

Section 1.381(a)-1(b)(3) of the Income Tax Regulations provides that section 381 of the Code does not apply to the carryover of an item or tax attribute not specified in section 381(c). This section of the regulations also provides, however, that in a case where section 381 does not apply to an item or tax attribute by reason of the preceding sentence, no inference is to be drawn from the provisions of section 381 as to whether any item or tax attribute shall be taken into account by the successor corporation.

In Rev. Rul. 64-250, 1964-2 C.B. 333, a corporation qualifying as a small business corporation under section 1371(a) of the Code that had elected not to be subject to tax under section 1372(a) was reorganized in another state under section 368(a)(1)(F). This reorganization was accomplished by the organization of a new corporation and the merger of the existing corporation into the new corporation. The surviving corporation also qualified as a small business corporation under section 1371(a). The revenue ruling holds that the reorganization qualifying under section 368(a)(1)(F) did not cause a termination of the election made under section 1372 by the existing corporation before its reorganization.

HOLDING

A mere change in place of incorporation, qualifying under section 368(a)(1)(F) of the Code, does not terminate the corporation's election to be treated as a possessions corporation under section 936 under the facts described above. *N* succeeds to *M*'s section 936 election since *N* would also qualify for treatment as a possessions corporation.

Section 1372.—Termination of Election [Election of Certain Small Business Corporations as to Taxable Status]

26 CFR 1.1372-4: Termination of election. (*Also Section 1502; 1.1502-76.*)

Small business corporation; acquired in reorganization; election terminated. All of the stock of an electing small business corporation was acquired by a corporation before the start of business on October 16, 1978, in a reorganization qualifying under section 368(a)(1)(B) of the Code. They filed a consolidated return for the acquiring corporation's taxable year ended December 31, 1978. The small business corporation's election is not terminated for the separate taxable year ending October 15, 1978, but is terminated for taxable years beginning after that date. Rev. Rul. 72-201 revoked.

Rev. Rul. 80-169

ISSUE

Is the election of a small business corporation terminated for its separate return year under the circumstances described below?

FACTS

S, an electing small business corporation, timely filed its federal income tax return for the fiscal year ended August 31, 1978. Before the start of business on October 16, 1978, *P*, a corporation, acquired all the stock of *S* in an exchange solely for the voting stock of *P* in a transaction that qualified as a reorganization under section 368(a)(1)(B) of the Internal Revenue Code. *P* filed a consolidated return with *S* for *P*'s taxable year ended December 31, 1978.

LAW AND ANALYSIS

Section 1372(e)(3) of the Code provides, in part, that an election made by an electing small business corporation under section 1372(a) terminates if, at any time, the corporation ceases to be a small business corporation as defined in section 1371(a). The termination is effective for the taxable year of the corporation in which it ceases to be a small business corporation and for all succeeding taxable years of the corporation.

Section 1371(a) of the Code provides that the term "small business corporation" means, in part, a domestic corporation that does not have as a shareholder a person (other than an estate and other than a trust described in section 1371(e)) who is not an individual.

Section 1.1371-1(e) of the Income Tax Regulations provides, in part, that a corporation in which any shareholder is a corporation does not qualify as a small business corporation.

Section 1.1372-4(c) of the regulations provides, in part, that the termination of an election is effective for the taxable year of the corporation in which occurs the event causing the termination and for all succeeding taxable years of the corporation.

Section 1.1502-76(b)(1) of the regulations provides, in part, that the consolidated return of an affiliated group of corporations must include the income of each subsidiary for the portion of the parent's taxable year during which the subsidiary was a member of the group.

Section 1.1502-76(b)(2) of the regulations provides that, if the consolidated return of a group properly includes the income of a corporation for only a portion of the corporation's taxable year (determined without regard to a change of its taxable year under section 1.1502-76(a)), the income for the portion of the taxable year not included in the consolidated return must be included in a separate return.

Example (1) of section 1.1502-76(b)(3) of the regulations illustrates the preceding as follows:

> **Corporations *X* and *Y* filed separate returns for the calendar year 1965. As of the close of June 30, 1966, *X* acquired all of the stock of *Y*. If *X* files a consolidated return for 1966, it must include in such return its income for the entire taxable year and the income of *Y* for the period July 1, 1966, through December 31, 1966. *Y* must include its income for the period January 1, 1966, through June 30, 1966, in a separate return.**

Section 1.1502-76(d) of the regulations provides that any period of less than 12 months for which either a separate return or a consolidated return is filed is considered as a separate taxable year.

In Example (1) of section 1.1502-76(b)(3) of the regulations, *X* acquired all the stock of *Y as of the close of* June 30, 1966. Because the stock was not acquired until the close of June 30, July 1 is the first day for which the income of *Y* is included in the consolidated return for the year ending December 31, 1966.

In the instant case, *P* acquired all the stock of *S* before the start of business on October 16, 1978, but after the close of October 15. Because *P* acquired the *S* stock on October 16, *S* became a member of the affiliated group on that date. Under section 1.1502-76(b) of the regulations, the consolidated return for *P*'s taxable year ended December 31, 1978, includes *S*'s income for the portion of *P*'s taxable year during which *S* was a member of the group. Thus, October 16, 1978, is the first day for which the income of *S* is included in the consolidated return for the year ended December 31, 1978. See also sections 1.1502-75(d)(1) and 1.1502-76(b)(5)(i).

Therefore, the consolidated return filed by *P* and *S* for the taxable year ended December 31, 1978, includes *S*'s income for the period beginning October 16, 1978, and ending December 31, 1978. *S* must file a separate return for its separate return year beginning September 1, 1978, and ending October 15, 1978. Because *S*'s separate return year ended prior to the date of acquisition, *S*'s separate return year includes no time during which *P* was a shareholder of *S*.

HOLDING

S's election is not terminated for its taxable year ended October 15, 1978. *S*'s election is terminated for the year beginning October 16, and ending December 31, 1978, and succeeding taxable years.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 72-201, 1972-1 C.B. 271, which holds that a small business corporation's election is terminated for the separate taxable year resulting from its acquisition by a corporation with which it filed a consolidated return, is revoked.

Section 1502.—Regulations [Consolidated Returns]

26 CFR 1.1502-76: Taxable year of members of group.

Determination of the taxable year of a corporation that became a new member of an affiliated group that files a consolidated return. See Rev. Rul. 80-169, page 14.

Section 4071.—Imposition of Tax [Tires and Tubes]

26 CFR 48.4071-2: Determination of weight.

Method of determining weight of tires and inner tubes. See Rev. Proc. 80-19, page 45.

Section 6013.—Joint Returns of Income Tax by Husband and Wife

26 CFR 301.6013-1: Joint returns of income tax by husband and wife.
(Also Sections 911, 913; 5b.911-1, 5b.913-1.)

Nonresident alien; joint return; living expenses abroad; foreign earned income exclusion. A nonresident alien spouse of a U.S. citizen who joins with the citizen in making an election, under section 6013(g) of the Code, to be treated as a U.S. resident is eligible for the deduction provided in section 913(a)(2) for certain expenses of living abroad and for the foreign earned income exclusion for residents of camps located in hardship areas provided in section 911(a)(2).

Rev. Rul. 80-170

ISSUE

Is a nonresident alien spouse of a United States citizen, who joins with such citizen in making an election under section 6013(g) of the Internal Revenue Code to be treated as a United States resident, eligible for the deduction provided in section 913(a)(2) for certain expenses of living abroad, under the circumstances described below?

FACTS

A, a citizen and resident of foreign country *X*, is a nonresident alien spouse of a United States citizen. In 1979, *A* received compensation for personal services that would qualify as earned income within the meaning of section 913(j)(1)(A) of the Code for purposes of the deduction from gross income provided by section 913(a)(2), if *A* were a citizen or resident of the United States. *A* also had certain expenses of living abroad that are within the scope of section 913(b). *A* and *A*'s spouse properly made an election under section 6013(g) for taxable year 1979.

LAW AND ANALYSIS

Section 6013(g) of the Code provides an election whereby a United

States citizen or resident married to a nonresident alien may file a joint return for taxable years ending on or after December 31, 1975. This election specifically provides that the nonresident alien be treated as a resident of the United States for purposes of federal income taxation (chapter 1 of the Code). Therefore, such alien is taxable on worldwide income. Section 6013(g)(1).

Section 913(a)(2) of the Code, which is effective for taxable years beginning after December 31, 1977, provides that in the case of an individual who is a citizen or *resident* of the United States, and who during any period of 18 consecutive months is present in a foreign country or countries during at least 510 full days in such period, there shall be allowed certain specified deductions for any taxable year which contains part of such period.

Section 6013(g)(1) of the Code expressly provides that an electing nonresident alien who is married to an electing United States citizen or resident alien "shall be treated as a resident of the United States for purposes of chapter . . . 1." Section 913(a)(2), which is expressly applicable to United States citizens or *residents,* is part of chapter 1.

A, as a result of making an election with *A*'s spouse under section 6013(g) of the Code to be treated as a United States resident for purposes of chapter 1 of the Code, thus is eligible for the deduction provided by section 913(a)(2) to the extent *A* otherwise meets the requirements of that section.

HOLDING

A nonresident alien spouse of a United States citizen, who joins with such citizen in making an election under section 6013(g) of the Code to be treated as a United States resident, is eligible for the deduction provided in section 913(a)(2) for certain expenses of living abroad, under the circumstances described above.

The holding of this revenue ruling is equally applicable to such nonresident alien's eligibility for the earned income exclusion for residents of camps located in hardship areas provided in section 911(a)(2) of the Code, effective for taxable years beginning after December 31, 1977. This effective date is extended to December 31, 1978, if a timely election is made to use the provisions of section 911 as in effect prior to its amendment by the Foreign Earned Income Act of 1978 (the "FEIA"), Pub. L. 95-615, 92 Stat. 3109, 1978-2 C.B. 416, as provided in section 209(c) of the FEIA. For taxable years to which the provisions of section 911 apply, as in effect prior to its amendment by the FEIA, a nonresident alien spouse of a United States citizen or resident, who elects to be treated as a United States resident pursuant to 6013(g), is eligible for the section 911 exclusion, pursuant to Rev. Rul. 72-330, 1972-2 C.B. 444, as amplified by Rev. Rul. 72-598, 1972-2 C.B. 451, if the nonresident alien spouse is a citizen of one of the foreign countries listed in these revenue rulings with which the United States has an income tax treaty in effect.

Miscellaneous Provisions

26 CFR 301.9001-1: Collection of fee.

T.D. 7697 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Offshore Oil Pollution Compensation Fund

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the collection of fees for the purpose of funding an Offshore Oil Pollution Compensation Fund. Changes to the applicable law were made by the Outer Continental Shelf Lands Act Amendments of 1978. The regulation will provide the public with the guidance needed to comply with the portion of the Act that relates to the collection of fees and will affect all owners of oil obtained from the Outer Continental Shelf.

DATE: The regulations at §§ 301.9001-1, 301.9001-2, and 301.9001-3 are effective on July 25, 1979, at 7:00 a.m., local time. If, however, the established practice has been to gauge oil production at a time other than 7:00 a.m. the effective date is July 25, 1979, at the time production has been gauged.

FOR FURTHER INFORMATION CONTACT: Kyllikki Kusma of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224, Attention: CC:LR:T, 202-566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On July 20, 1979, the Federal Register published proposed amendments to the Regulations on Procedure and Administration (26 CFR Part 301). The amendments were proposed to conform the regulations to section 302(d) of the Outer Continental Shelf Lands Act Amendments of 1978 (92 Stat. 672). After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision.

EXPLANATION OF THE REGULATIONS

Section 302 of the Outer Continental Shelf Lands Act Amendments of 1978 (Act) establishes an Offshore Oil Pollution Compensation Fund (Fund). Under section 302(d) of the Act, this fund consists of money generated by a fee of not more than 3 cents per barrel imposed on oil obtained from the Outer Continental Shelf (OCS), and is to be paid by the owner of the oil as defined in § 301.9001-1(a)(2) of these regulations. Failure to pay the fee subjects the owner of the oil to a civil penalty.

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[1] This publication of the Treasury Decision contains the complete text of the amendments to the regulations. The instructions for modifying the notice of proposed rulemaking have been omitted.

These regulations describe the collection procedure which is to be used in collecting this fee.

OWNER OF OIL

The proposed regulations stated that the owner of oil is the person in whom is vested ownership of the oil as it is produced at the wellhead without regard to the existence of contractual arrangements for the sale or other disposition of the oil. Under this rule, the Federal government is not an owner of oil at the time of production with respect to its entitlement to royalty oil. Several commentators suggested that the final regulations be amended to treat the Federal government as part owner of the OCS oil when it is produced and to exclude the portion of the OCS production that is attributable to the Federal government entitlement to royalty oil from calculations determining the amount of the fee to be paid by the owner of the oil.

This suggestion is not adopted. Under the Act, the Coast Guard has the major responsibility for establishing policies, procedures, and administrative practices regarding the overall management and general operation of the Fund. Their final regulations, which were promulgated prior to publication of this notice of proposed rulemaking, specify that the per barrel fee applies at the time OCS oil is produced and state that the Federal Government is not the owner of the oil at the time of production. See 33 CFR 135.103. Similar questions were raised by commentators with respect to the Coast Guard's position on this issue but were not adopted. See 44 FR 16860 for the Coast Guard's discussion of the issue.

CONDENSATE

One commentator believed that the term "oil" should not include condensate. Once again 33 CFR 135.5 (b)(6) includes condensate in the definition of "oil". See 44 CFR 16861 for the Coast Guard's discussion of this question.

BARRELS SUBJECT TO THE FEE

Two commentators suggested that a sentence be added to the regulations which would clarify that the data found on Form 9-153 (Monthly Report of Sales and Royalty) is the information to be utilized in computing the number of barrels subject to the fee. The final regulations reflect this comment at § 301.9001-1(a)(1) with the addition of a new sentence between sentence 2 and sentence 3.

SEMI-MONTHLY DEPOSIT

Under the proposed regulations a semi-monthly deposit of fees was required if the owner of oil is liable for more than $2,000 of fees for any month of a calendar quarter. Many commentators stated that this proposal creates numerous accounting problems because reliable data normally is not available. This means that two reports must be prepared in which estimated production data must be utilized. Because the semi-monthly deposit requirement is consistent with Treasury policy in related collection areas, the final regulations are not changed to reflect these comments.

POWER OF ATTORNEY

The regulations at § 301.9001-1(d) state that the fee must be paid either by the owner of the oil or by a person authorized to act for the owner under an acceptable power of attorney. Several of the commentators stated that the requirement of obtaining and filing a power of attorney with the Internal Revenue Service would be duplicative since the provisions of operating agreements between operators and nonoperator owners of oil-producing properties authorize the operator to make payments on behalf of nonoperator owners of oil. In accordance with these comments, the final regulations permit an operating agreement to be considered an acceptable power of attorney if it authorizes the payment by the operator of the fee imposed by the Act.

DRAFTING INFORMATION

The principal author of this regulation is Kyllikki Kusma of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service, Treasury Department, and Coast Guard participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to 26 CFR Part 301 are hereby adopted:

Paragraph 1. The following new sections are inserted to follow § 301.9000-1:

§ 301.9001 Statutory provisions; Outer Continental Shelf Lands Act Amendments of 1978.

Section 302 of the Outer Continental Shelf Lands Act Amendments of 1978 (92 Stat. 629) provides as follows:

> **Sec. 302. (a) There is hereby established in the Treasury of the United States an Offshore Oil Pollution Compensation Fund in an amount not to exceed $200,000,000, except that such limitation shall be increased to the extent necessary to permit any moneys recovered or collected which are referred to in subsection (b)(2) of this section to be paid into the Fund. The Fund shall be administered by the Secretary[1] and the Secretary of the Treasury as specified in this title. The Fund may sue and be sued in its own name.**
>
> **(b) The Fund shall be composed of—**
>
> **(1) all fees collected pursuant to subsection (d) of this section; and**
>
> **(2) all other moneys recovered or collected on behalf of the Fund under section 308 or any other provision of this title.**
>
> **(c) The Fund shall be immediately available for—**
>
> **(1) removal costs described in section 301(22);**
>
> **(2) the processing and settlement of claims under section 307 of this title (including the costs of assessing injury to, or destruction of, natural resources); and**
>
> **(3) subject to such amounts as are provided in appropriation Acts, all administrative and personnel costs of the Federal Government incident to the administration of this title, including, but not limited to, the claims settlement activities and adjudicatory and judicial proceedings, whether or not such costs are recoverable under section 308 of this title.**
>
> **The Secretary is authorized to promulgate regulations designating the person or persons who may obligate available money in the Fund for such purposes.**
>
> **(d)(1) The Secretary shall levy and the Secretary of the Treasury shall collect a fee of not to exceed 3 cents per barrel on oil obtained from the Outer Continental Shelf, which shall be imposed on the owner of the oil when such oil is produced.**
>
> **(2) The Secretary of the Treasury, after consulting with the Secretary, may promul-**

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[1] Secretary wherever used in this section means the Secretary of Transportation.

gate reasonable regulations relating to the collection of the fees authorized by paragraph (1) of this subsection and, from time to time, the modification thereof. Any modification shall become effective on the date specified in the regulation making such modification, but no earlier than the ninetieth day following the date such regulation is published in the Federal Register. Any modification of the fee shall be designed to insure that the Fund is maintained at a level of not less than $100,000,000 and not more than $200,000,000. No regulation that sets or modifies fees, whether or not in effect, may be stayed by any court pending completion of judicial review of such regulation.

(3)(A) Any person who fails to collect or pay any fee as required by any regulation promulgated under paragraph (2) of this subsection shall be liable for a civil penalty not to exceed $10,000, to be assessed by the Secretary of the Treasury, in addition to the fee required to be collected or paid and the interest on such fee at the rate such fee would have earned if collected or paid when due and invested in special obligations of the United States in accordance with subsection (e)(2) of this section. Upon the failure of any person so liable to pay any penalty, fee, or interest upon demand, the Attorney General may, at the request of the Secretary of the Treasury, bring an action in the name of the Fund against that person for such amount.

(B) Any person who falsifies records or documents required to be maintained under any regulation promulgated under this subsection shall be subject to prosecution for a violation of section 1001 of title 18, United States Code.

(4) The Secretary of the Treasury may, by regulation, designate the reasonably necessary records and documents to be kept by persons from whom fees are to be collected pursuant to paragraph (1) of this subsection, and the Secretary of the Treasury and the Comptroller General of the United States shall have access to such records and documents for the purpose of audit and examination.

(e)(1) The Secretary shall determine the level of funding required for immediate access in order to meet potential obligations of the Fund.

(2) The Secretary of the Treasury may invest any excess in the Fund, above the level determined under paragraph (1) of this subsection, in interest-bearing special obligations of the United States. Such special obligations may be redeemed at any time in accordance with the terms of the special issue and pursuant to regulations promulgated by the Secretary of the Treasury. The interest on, and the proceeds from the sale of, any obligations held in the Fund shall be deposited in and credited to the Fund.

(f) If at any time the moneys available in the Fund are insufficient to meet the obligations of the Fund, the Secretary shall issue to the Secretary of the Treasury notes or other obligations in the forms and denominations, bearing the interest rates and maturities, and subject to such terms and conditions as may be prescribed by the Secretary of the Treasury. Redemption of such notes or other obligations shall be made by the Secretary from moneys in the Fund. Such notes or other obligations shall bear interest at a rate determined by the Secretary of the Treasury, taking into consideration the average market yield on outstanding marketable obligations of comparable maturity. The Secretary of the Treasury shall purchase any notes or other obligations issued under this subsection and, for that purpose, he is authorized to use as a public debt transaction the proceeds from the sale of any securities issued under the Second Liberty Bond Act. The purpose for which securities may be issued under that Act are extended to include any purchase of such notes or other obligations. The Secretary of the Treasury may at any time sell any of the notes or other obligations acquired by him under this subsection. All redemptions, purchases, and sales by the Secretary of the Treasury of such notes or other obligations shall be treated as public debt transactions of the United States.

§ 301-9001-1 Collection of fee.

(a) *Imposition of fee*—(1) *In general.* Under section 302(d) of the Outer Continental Shelf Lands Act Amendments of 1978 (Act), the Internal Revenue Service is authorized to collect a fee of not more than 3 cents per barrel on oil that is obtained from the Outer Continental Shelf. This fee is established by the Commandant, United States Coast Guard, and is imposed on the owner of the oil as defined in paragraph (a)(2) of this section. The barrels subject to the fee shall be those barrels reported by the owner of the oil (§ 301.9001-1(a)(2)), or a person authorized to act for the owner, on the monthly royalty reports, Form 9-153, filed with the U.S. Geological Survey as required by 30 CFR 250.94. For the purpose of computing this fee, the owner of the oil shall measure the Outer Continental Shelf oil production by employing the criteria of the U.S. Geological Survey contained in 30 CFR 250.60 and Outer Continental Shelf Gulf of Mexico Order 13. No reduction in the amount due will be permitted by reason of theoretical or actual oil lost in transit. To ensure that the Fund is maintained at a level of not less than $100,000,000 and not more than $200,000,000, the Commandant, United States Coast Guard, may modify the amount of this fee.

(2) *Owner of oil.* For the purposes of §§ 301.9001-1, 301.9001-2, 301.9001-3, the owner of oil is the person in whom is vested ownership of the oil as it is produced at the wellhead without regard to the existence of contractual arrangements for the sale or other disposition of the oil between such a person and third parties. Under this rule, the Federal government entitlement to royalty oil does not constitute ownership of oil by the Federal government at the time of production.

(3) *Example.* The provisions of paragraph (a)(2) of this section may be illustrated by the following example:

Example. X is the owner of oil produced on the Outer Continental Shelf. During one reporting period, 10,000 barrels of oil were obtained from this location. X will use a portion of this oil to make a royalty payment to the United States government. X also has a contract with Y to sell Y the remaining barrels of oil. For the purpose of the Act, X is the owner of the oil and must pay a fee of 3 cents per barrel on all 10,000 barrels of oil.

(4) *Cross-references.* See § 301.9001-2(a) for the definition of barrel, § 301.9001-2(b) for the definition of oil, and § 301.9001-2(c) for the definition of person.

(5) *Effective date.* The provisions of §§ 301.9001-1, 301.9001-2, and 301.9001-3 are effective on July 25, 1979, at 7:00 a.m., local time. If, however, the established practice has been to gauge oil production at a time other than 7:00 a.m., the effective date is July 25, 1979, at the time production has been gauged.

(b) *Collection of fee.* The Internal Revenue Service shall collect the fee imposed by section 302(d) of the Act. Administrative procedures for the collection of this fee shall be prescribed from time to time by the Commissioner. The Commissioner may designate the reasonably necessary records and documents to be kept by the person or persons from whom the fee is collected. See also the regulations under 33 CFR 135.103 for additional rules relating to the implementation of the Act.

(c) *Time and place for payment of the fee*—(1) *In general.* Payment of the fee shall be made in accordance with the rules established in paragraph (c)(2), (3) and (4) of this section. When a deposit is required by these rules, it must be filed with the Internal Revenue Service Center, Austin, Texas 73301 using Form 6008, Fee Deposit for Offshore Oil. Adjustments required in the amount paid during the calendar quarter to reflect the actual amount due for the quarter shall be made on Form 6009, Quarterly Report of Fees Due. Form 6009 must be filed on or before the last day of the month following the end of the calendar quarter with the Austin Service Center. The rules under section 7502, relating to the treatment of timely mailing as timely filing and paying, and section 7503, relating to the time for performance of acts where the last day falls on Saturday, Sunday, or legal holiday are applicable to the filing of Form 6009.

(2) *$100 or less of fees.* If the owner of oil is liable in any calendar quarter for $100 or less of fees, the owner or a person authorized to act for the owner may either deposit this amount or pay the full amount of the fee when Form 6009 is filed.

(3) *More than $100 of fees.* If the owner of oil is liable in the first or second month of the calendar quarter for more than $100 of fees and is not required to make a semimonthly deposit (see paragraph (c)(4) of this section), the owner or a person authorized to act for the owner must deposit the amount on or before the last day of the following month following the month of production.

(4) *More than $2000 of fees.* The owner of oil who is liable for more than $2000 of fees for any month of a calendar quarter must deposit fees for the following quarter (regardless of amount) on a semimonthly basis. The deposit must be made on or before the ninth day following the semimonthly period for which it is reportable. The first deposit for a month may be reasonably estimated when an accounting of oil production is normally done by the month. Under these circumstances, the second for that month deposit should be adjusted to reflect the total barrels produced in that month.

(d) *Responsibility for payment of fee*—(1) *In General.* Form 6009, Quarterly Report of Fees Due, must be filed and the fee must be paid either by the owner of the oil (§ 301.9001-1(a)(2)) or by a person authorized to act for the owner of the oil under an acceptable power of attorney filed with the Austin Service Center. For the purposes of the regulations at §§ 301.9001-1, 301.9001-2, and 301.9001-3, an operating agreement between the operator of the oil-producing facility and the owner of the oil is considered an acceptable power of attorney if the operating agreement expressly states that the operator is authorized to pay the fee imposed by section 302(d) of the Outer Continental Shelf Lands Act Amendments of 1978.

(2) *Example.* The provisions of this paragraph may be illustrated by the following example:

Example. W, X, Y, and Z are oil companies that own equal interests in oil produced on the Outer Continental Shelf. W was selected to be the operator of the offshore facility. Additionally, X, Y, and Z authorized W to file Form 6009 and to pay the fee imposed by section 302(d) of the Act on the oil produced at this facility. Pursuant to this authorization, W paid a fee of $16,600. Since the ownership of the oil is divided equally among W, X, Y, and Z, each company's share of the fee is $4,150.

(e) *Penalty and Interest.* Failure to collect or pay the fee shall result in a civil penalty assessed by the Secretary of the Treasury. The amount of the penalty is not to exceed $10,000 in addition to the fee and the interest on the unpaid fee that would have been earned if paid when due and invested in the special Treasury securities which are to be purchased by the fund. The computation of the rate of interest to be levied on underpayment of fees shall be based on the average interest rate earned by the interest-bearing special obligations of the United States in the fund for each calendar quarter for which there is underpayment. Unless it can be shown that the failure to collect or pay the fee is due to reasonable cause and not due to willful neglect, the amount of the penalty is the lesser of—

(1) $10,000 or

(2) The amount of the fee.

§ 301.9001-2 Definitions.

The terms enumerated in this section are to be defined for the purposes of §§ 301.9001-1, 301.9001-2, 301.9001-3 in the following manner:

(a) "Barrel" means 42 United States gallons at 60 degrees Fahrenheit.

(b) "Oil" means petroleum, including crude oil or any fraction or residue therefrom, and natural gas condensate, except that the term does not include natural gas.

(c) "Person" means an individual firm, corporation, association, partnership, consortium, joint venture, or governmental entity.

(d) "Outer Continental Shelf" means all submerged lands lying seaward and outside of the area of lands beneath navigable waters as defined in section 1301 of title 43 and of which the subsoil and seabed appertain to the United States and are subject to its jurisdiction and control.

§ 301.9001-3 Cross Reference

See the Coast Guard regulations under 33 CFR Parts 135 and 136 for rules relating to the implementation of the Act.

This Treasury decision is issued under the authority contained in section 302(d) of the Outer Continental Shelf Lands Act Amendments of 1978 (92 Stat. 672) and in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of Internal Revenue.

Approved May 2, 1980.

DONALD C. LUBICK,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on May 20, 1980, 8:45 a.m., and published in the issue of the Federal Register for May 21, 1980, 45 F.R. 33973)

Section 7805.—Rules and Regulations

26 CFR 301.7805-1: Rules and regulations.

Method of determining weight of tires and inner tubes. See Rev. Proc. 80-19, page 45.

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions

Republication of the Technical Explanation of the U.S.-U.K. Income Tax Convention

The Technical Explanation of the United States-United Kingdom Income Tax Convention, which was published in 1980-21 I.R.B. 62, does not reflect amendments submitted to the United States Senate prior to ratification of the Convention. The Technical Explanation reflecting the amendments follows:

TECHNICAL EXPLANATION[1] OF THE CONVENTION BETWEEN THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE UNITED KINGDOM OF GREAT BRITAIN AND NORTHERN IRELAND FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON INCOME AND CAPITAL GAINS SIGNED AT LONDON, ON DECEMBER 31, 1975, AS AMENDED BY THE NOTES EXCHANGED AT LONDON ON APRIL 13, 1976, THE PROTOCOL SIGNED AT LONDON ON AUGUST 26, 1976, AND THE SECOND PROTOCOL SIGNED AT LONDON ON MARCH 31, 1977[2]

ARTICLE 1. PERSONAL SCOPE

This Article delineates the persons who come within the scope of the Convention. Paragraph (1) states the general rule that the Convention is applicable to residents of one or both of the Contracting States. The term "resident" of a Contracting State is defined in Article 4 (Fiscal Residence). In several cases, the Convention is also applicable to residents of third states because of their relationship with a resident of a Contracting State. For example, Articles 9 (Associated Enterprises), 25 (Mutual Agreement Procedure) or 26 (Exchange of Information and Administrative Assistance), may apply with respect to persons who are residents of neither Contracting State, and paragraph 5 of Article 10 (Dividends) and paragraph 6 of Article 11 (Interest) apply to dividends and interest derived by residents of third countries.

This paragraph is similar to Article 1 of the Draft Double Taxation Convention on Income and Capital developed by the Fiscal Committee of the Organization for Economic Cooperation and Development as published in 1963 and as thereafter revised (hereinafter referred to as the "OECD Model Convention").

Paragraph (2) deals with the treatment of a corporation which is a resident of both the United Kingdom within the meaning of paragraph (1)(a)(ii) of Article 4 (Fiscal Residence) and the United States (under paragraph (1)(b)(ii) of Article 4). Under those paragraphs, a corporation which is a United States corporation as defined by paragraph (1)(b) of Article 3 (General Definitions) and is managed and controlled in the United Kingdom would be a resident of both states. This Article clarifies the status of such corporations (hereinafter referred to as "dual-resident" corporations) for purposes of the Convention by providing that dual-resident corporations may not claim the benefits of this Convention which are otherwise available to residents of a Contracting State, including the benefits of Articles 7 (Business Profits), 10 (Dividends), 11 (Interest,) 12 (Royalties), 22 (Other Income) or 23 (Elimination of Double Taxation). However, a dual-resident corporation may claim the benefits of paragraph (2) of Article 8 (Shipping and Air Transport) with respect to profits derived from operating ships or aircraft, and of Article 23 (Elimination of Double Taxation) with respect to paragraph 1(c) thereof and with respect to payments of the United Kingdom petroleum revenue tax. A dual-resident corporation may also claim the benefits of Articles 24 (Nondiscrimination), and 28 (Entry Into Force), and the provisions of paragraph (7) of Article 11 (Interest) relating to the character of certain interest payments will apply to it. Thus, for example, a dual-resident corporation may not claim the exemption from tax with respect to interest derived from the United States under Article 11 (Interest) or claim a refund of advance corporation tax with respect to dividend received from a corporation which is a resident of the United Kingdom. In these cases, the dual-resident corporation is treated as a resident of neither Contracting State for purposes of the Convention.

On the other hand, interest, royalties, and dividends derived by a resident of a Contracting State from a dual-resident corporation will qualify for the exemptions or reductions in tax allowed by the Convention. For example, dividends received by a resident of the United Kingdom from a dual-resident corporation will qualify for the reductions in United States tax withholding under paragraph (1) of Article 10 (Dividends) and, a United States resident receiving dividends from a dual-resident corporation which, under the internal law of the United Kingdom, is a resident of the United Kingdom, will qualify for the refunds or credits of advance corporation tax under paragraph (2) of that Article.

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[1] It is the practice of the Treasury Department to prepare for the use of the Senate and other interested persons a Technical Explanation of the tax conventions and protocols, which are submitted to the Senate for its advice and consent to ratification. This Technical Explanation was submitted to the Senate Foreign Relations Committee at hearings held on July 19-20, 1977, and has been amended to reflect the testimony of the Treasury Department before the same Committee on June 6, 1979 (Treasury News Release M-145, dated October 25, 1979) and to make minor corrections.

An Income Tax Convention with the United Kingdom of Great Britain and Northern Ireland was signed December 31, 1975 and an Exchange of Notes was signed April 13, 1976, and submitted by the President to the Senate on June 24, 1976. Two Income Tax Protocols to the Convention were signed August 26, 1976 and March 31, 1977. The Senate voted its advice and consent on June 27, 1978 and instruments of ratification were exchanged on March 25, 1980.

[2] The Convention and the two Protocols were published in 1980-21 C.B. 5.

Paragraph (3) contains the traditional "saving clause" under which each Contracting States reserves the right to tax its nationals (as defined by paragraph (1)(k) of Article 3 (General Definitions)) and residents (as determined under Article 4 (Fiscal Residence)) as if the Convention had not come into effect. A similar provision exists in Article XIII of the Convention now in effect (hereinafter referred to as the "1945 Convention") [T.D. 5569, 1945-2 C.B. 100]. The saving clause is of principal importance to the United States because the United States taxes its citizens, residents, and corporations on a worldwide basis, regardless of where they reside or derive income.

Paragraph (4) sets forth certain exceptions to the application of the saving clause where other provisions of the Convention reflect overriding policies. Thus, the saving clause does not affect the provisions dealing with the determination of domicile for United Kingdom tax purposes (paragraph (4) of Article 4), the exemption from United Kingdom tax of profits derived by United States nationals and corporations from operating ships or aircraft (paragraph (2) of Article 8), associated enterprises (Article 9), the elimination of double taxation (Article 23), non-discrimination (Article 24) or the mutual agreement procedure (Article 25). Moreover, the saving clause does not affect benefits of the Convention which are extended to an individual performing functions as an employee of a government of a Contracting State, as a teacher, as a student or trainee, or as diplomatic and consular official, who is neither a national (as defined in Article 3) of, nor has immigrant status in, the Contracting State imposing the tax. See Articles 19 (Government Service), 20 (Teachers), 21 (Students and Trainees), and 27 (Effect on Diplomatic and Consular Officials and Domestic Laws). In the case of the United States, "immigrant status" means the individual has been admitted to the United States for permanent residence.

Although Article 1 is entitled "Personal Scope", the Convention is applicable to corporations and other persons as well as to individuals.

ARTICLE 2. TAXES COVERED

Paragraph (1) of this Article states the general rule that the Convention applies to taxes on income imposed by the governments of the Contracting States. The Convention also applies to taxes on income imposed by political subdivisions or local authorities of a Contracting State (as defined in paragraph (1)(i) of Article 3 (General Definitions)) where paragraph (4) of Article 9 (Associated Enterprises) applies. This Article is important because the relief from double taxation (i.e., tax credits) accorded by Article 23 (Elimination of Double Taxation) only extends to taxes covered by this Convention. Thus, credits for taxes paid to a Contracting State may be claimed under this Convention only with respect to the taxes specified in paragraphs (2) and (3) of this Article.

Paragraph (2) designates the existing taxes on income which are the subject of the Convention. In the case of the United States, the taxes on income included (referred to as "United States tax") are the Federal income taxes imposed by the Internal Revenue Code ("Code") and the tax under Code section 4371 on insurance company premiums paid to foreign insurers. The tax under Code section 4371 is not covered by the 1945 Convention. The Convention only applies to taxes on income contained in the Internal Revenue Code. Thus, the Convention does not, for example, apply to the excise tax under Code section 1491.

The Convention also does not apply to the taxes imposed under Code sections 531 (Accumulated Earnings Tax) or 541 (Personal Holding Company Tax), except as specified by paragraph (6) of Article 10 (Dividends). Under paragraph (6) of Article 10, a corporation which is a resident of the United Kingdom shall be exempt from the accumulated earnings or personal holding company tax if individuals (other than nationals of the United States) who are residents of the United Kingdom control, directly or indirectly, more than 50 percent of the voting power of such corporation.

In the case of the United Kingdom, paragraph (2) provides that the existing taxes on income covered by the Convention (referred to as "United Kingdom tax") are the income tax, the capital gains tax, the corporation tax, and the petroleum revenue tax.

For purposes of paragraph (4) of Article 9 (Associated Enterprises), this Convention also applies to taxes imposed on income by political subdivisions or local authorities of a Contracting State. For this purpose, the income taxes referred to include any franchise taxes measured by income which are imposed by a political subdivision or local authority of a Contracting State.

Under paragraph (3), the Convention will also apply to taxes substantially similar to those covered by paragraph (2), which are imposed in addition to, or in place of, the taxes referred to in paragraph (2) after the date of signature of the Convention (December 31, 1975).

The competent authorities of the Contracting States are to notify each other of any amendments of the laws imposing the existing taxes and of the adoption of any taxes which are imposed subsequent to the date of signature of the Convention.

For purposes of Article 24 (Nondiscrimination), the Convention will also apply to taxes of every kind and description (whether or not the taxes are on income) imposed by the Contracting States, political subdivisions or local authorities thereof.

ARTICLE 3. GENERAL DEFINITIONS

Paragraph (1) defines the principal terms used throughout the Convention. Unless the context otherwise requires, the terms defined in this paragraph shall have a uniform meaning throughout the Convention. It should be noted that a number of important terms are defined elsewhere in the Convention. For example, the term "resident" of a Contracting State and "permanent establishment" are defined in Articles 4 (Fiscal Residence) and 5 (Permanent Establishment), respectively. Moreover, certain terms which appear in Articles dealing with special categories of income, e.g., "Immovable Property" (Article 6), "Dividends" (Article 10), "Interest" (Article 11), and "Royalties" (Article 12), are defined within those Articles.

The Article defines the term "corporation" in subparagraph (a) as a United States corporation (defined in subparagraph (b)(i)) or a United Kingdom corporation (defined in subparagraph (b)(ii)), or any body corporate or entity of a third state which is treated as a body corporate for tax purposes by both Contracting States. Whether an entity is a corporation is relevant for purposes of paragraph (6) of Article 5 (Permanent Establishment), Article 10 (Dividends), Article 16 (Investment or holding companies), and Article 23 (Elimination of Double Taxation).

The term "United States corporation" means a corporation (or any unincorporated entity which is treated as a United States corporation for United States tax purposes) which is created or organized under the laws of the United States, any state thereof, or the District of Columbia.

A "United Kingdom corporation" is defined as any body corporate or unincorporated association created or organized under the laws of the United Kingdom, excluding for this purpose a partnership, a local authority, or a local authority association.

Whether a United States or United Kingdom corporation or any other corporation is a resident of a Contracting State for purposes of this Convention, or neither of them, or both of them, is to be determined in accordance with Article 4 (Fiscal Residence).

The term "person" includes an individual, a corporation, a partnership, an estate, a trust, or any other body of persons.

The term "enterprise of a Contracting State" means an industrial or commercial undertaking carried on by a resident of a Contracting State (as defined by Article 4).

The term "international traffic" is defined as any transport by a ship or aircraft operated by an enterprise of one of the Contracting States, except when the ship or aircraft is operated solely between places within a Contracting State. Thus, for example, coastal shipping along the Atlantic coast of the United States is not international traffic. However, if a ship operated by an enterprise of the United Kingdom transports goods from Canada to the United States, leaving some of the goods in New York and the remainder in Norfolk, the portion of the transport between New York and Norfolk is international traffic. The definition of this term is relevant for purposes of Article 8 (Shipping and Air Transport) which provides that profits derived by an enterprise of a Contracting State from the operation in international traffic of ships or aircraft shall be taxable only in that State.

With respect to the United States, the term "competent authority" means the Secretary of the Treasury or his delegate. With respect to the United Kingdom, the term "competent authority" refers to the Commissioners of Inland Revenue or their authorized representative.

The term "United States" means the United States of America. When used in the geographical sense, the term means the states thereof and the District of Columbia. Thus, the Convention does not apply to possessions of the United States or the Commonwealth of Puerto Rico. The term "United States" also includes the territorial sea and, in general accord with the principles of section 638 of the Code, the continental shelf of the United States.

The term "United Kingdom" means Great Britain and Northern Ireland, including the area of the continental shelf which has or may be designated by the United Kingdom, in accordance with international law, as an area within which the rights of the United Kingdom relating to the seabed and subsoil and their natural resources may be exercised. The Convention does not apply to the Channel Islands or the Isle of Man.

The 1945 Convention does not include the continental shelf areas in the definition of the terms United States or United Kingdom. It is understood that when compared to the 1945 Convention, the United Kingdom regards the reference to its continental shelf in this Convention as an expansion of the scope of the Convention with respect to operations in these areas.

The term "Contracting State" means the United States or the United Kingdom, as the context of the Convention requires.

The term "third State" means any State or territory other than the United States or the United Kingdom and the term "enterprise of a third State" is to be construed accordingly.

In relation to the United States, the term "national" means an individual who is a citizen of the United States. In relation to the United Kingdom, the term "national" means all citizens of the United Kingdom and colonies, British subjects under sections 2, 13(1) or 16 of the British Nationality Act of 1948, and British subjects by virtue of section 1 of the British Nationality Act of 1965, provided they are patrial within the meaning of the Immigration Act of 1971, so far as these provisions are in force on the date of entry into force of this Convention or have been modified in minor respects so as not to affect their general character.

Paragraph (2) provides that any term used in the Convention which is not defined therein shall, unless the context otherwise requires or unless the competent authorities agree to a definition of the term pursuant to Article 25 (Mutual Agreement Procedure), have the meaning which it has under the laws of the Contracting State where a tax is being determined. Under Article 25, where a term which is not defined in the Convention has a different meaning under the laws of the United Kingdom and the United States or where the meaning under the laws of one of the Contracting States is not readily determinable, the competent authorities may, for purposes of the Convention, establish a common meaning of the term in order to prevent double taxation or to further any other purpose of the Convention.

ARTICLE 4. FISCAL RESIDENCE

This Article sets forth rules for determining the residence of individuals, corporations, and other persons for purposes of the Convention. Residence is important because, except as otherwise provided in the Convention, only a resident may claim the benefits of the Convention.

The term "resident of the United Kingdom" is defined as a corporation (as defined in paragraph 1(a) of Article 3 (General Definitions)) whose business is managed and controlled in the United Kingdom, and any other person (except a corporation as defined in paragraph (1)(a) of Article 3), resident in the United Kingdom for purposes of its tax.

Similarly, the term "resident of the United States" is defined as a person (except a corporation as defined in paragraph (1)(a) of Article 3) who is resident in the United States for purposes of its tax. This includes a resident alien individual who is subject to tax in the United States on his worldwide income and a resident citizen. The term also includes a corporation (as defined in paragraph (1)(b)(i) of Article 3). A foreign corporation, regardless of the extent to which its income is effectively connected with the conduct of a United States trade or business, is not a resident of the United States.

It should especially be noted that an individual is not automatically a resident of the United States or the United Kingdom for the purposes of this Convention if he is a citizen of either country. To be a resident of a Contracting State, he must be subject to tax in that State on account of his residence therein. In the case of the United States, an individual will be considered to be a resident if, without regard to his citizenship, he would be taxable in the United States on his worldwide income as a resident. Residence for this purpose is to be determined in accordance with the principles of Treasury regulations under section 871 of the Internal Revenue Code.

The definition of a resident of a Contracting State in the Convention differs from the definition of a resident in the 1945 Convention. Under paragraph (1)(g) of Article II of the 1956 Convention a resident of the United Kingdom is defined, in pertinent part, as "any person (other than a citizen of the United States or a United States corporation) who is resident in the United Kingdom for purposes of United Kingdom tax . . ." and under paragraph (1)(h) of Article II a resident of the United States is defined, in pertinent part, as "any individual who is resident in the United States for the purposes of United States tax and not resident in the United Kingdom for the purposes of United Kingdom tax. . . ." In the case of Strathalmond (Lord) v. Inland Revenue (Ch. D. June 23, 1972), a British court interpreted this definition, in applying Article XV of the 1945 Convention, to prevent the United Kingdom from taxing the United States source dividend income of a United States citizen residing in the United Kingdom. This result is inconsistent with the principles of the OECD Model Convention. Accordingly, under this Article, a United States citizen who resides in the United Kingdom for purposes of its tax will be taxable therein as a resident and, subject to the provisions of United Kingdom law, the United Kingdom will be permitted to tax those citizens on their dividend and interest income regardless of the source of that income. However, where the income of the United States citizen has a source in the United States (as determined under the laws of the United Kingdom) the United Kingdom will allow a credit against the United Kingdom tax for any United States tax payable (on the basis of that person's United States citizenship) with respect to that income. See the discussion of paragraph (3) of Article 23 (Elimination of Double Taxation).

A corporation which is a resident of both Contracting States under this Article (i.e., a United States corporation whose business is managed or controlled in the United Kingdom), is dealt with by paragraph (2) of Article 1 (Personal Scope), and such a corporation may not claim any benefit under this Convention except as provided therein.

Paragraph (1) of this Article also provides that a partnership, estate, or trust is a resident of a Contracting State only to the extent that the income derived by such person is subject to tax in such Contracting State as the income of a resident. For example, under United States law, a partnership is never, and an estate or trust is often not, taxed as such. Under the Convention, income received by a partnership, estate, or trust will be treated for purposes of the Convention as income received by a resident of the United States only to the extent such income is subject to tax in the United States as the income of a resident. Thus, for United States tax purposes, the question of whether income received by a partnership is received by a resident will be determined by the residence of its partners rather than by whether the partnership is resident in the United States by reason of engaging in a trade or business here. To the extent the partners are subject to United States tax as residents of the United States, the income received by a partnership will be treated as income received by a resident of the United States. Similarly, the treatment of income received by a trust or estate will be determined by the residence and taxation of the person subject to tax on such income, which may be the grantor, the beneficiaries or the trust or estate itself, as the case may be.

The fact that a charitable organization or pension fund is exempt from tax in the country in which it is otherwise resident is not to be construed to deny such organization or fund resident status under this Convention.

Paragraph (2) provides that an individual who is a resident of *both* Contracting States under paragraph (1) will, for purposes of the Convention, be deemed to be a resident of the Contracting State in which he has a permanent home available to him (e.g., where an individual dwells with his family), his center of vital interests (e.g., close economic and personal relations), an habitual abode, or the State of which he is a national, in that order. If the issue cannot be settled by the application of these tests, the competent authorities shall decide by mutual agreement the one Contracting State of which he will be considered to be a resident. Thus, for purposes of the Convention, including paragraph 3 of Article 1 (Personal Scope) (the saving clause) an individual may be a resident of the United States or the United Kingdom, but not both.

Paragraph (3) provides that if an estate or trust (taxable as such) is a resident of both Contracting States under the provisions of paragraph (1), the competent authorities may settle the issue by mutual agreement.

Since the definitions of residence in this Article apply for purposes of the entire Convention, an individual who is deemed to be a resident of one Contracting State and not a resident of the other Contracting State by reason of paragraph (2) will be deemed to be a resident of the first-mentioned Contracting State for all purposes of the Convention. For example, if an individual is determined to be a resident of the United Kingdom under paragraph (2) but would apart from that paragraph also be considered a resident of the United States under the laws of the United States, such individual would continue to receive the exemptions and special benefits granted by the Convention to residents of the United Kingdom, unless the individual is a citizen of the United States (see the saving clause of paragraph (3) of Article 1 (Personal Scope)).

Paragraph (4) provides that for United Kingdom tax purposes the domicile, on or after April 6, 1976, of a woman who is a United States national and who was married before January 1, 1974 to a man domiciled in the United Kingdom will be determined as though such marriage had taken place on January 1, 1974. The foreign source income of a United Kingdom resident is subject to taxation in the United Kingdom to a different extent depending on the domicile of the resident. Thus, a United Kingdom resident domiciled in the United Kingdom is subject to full United Kingdom taxation on all income, whereas a United Kingdom resident domiciled outside the United Kingdom is generally subject to tax on foreign source income only to the extent that it is remitted to the United Kingdom.

Under United Kingdom law prior to January 1, 1974, the domicile of a woman was the same as the domicile of her husband. This rule has been repealed for future years. However, as a transitional rule, United Kingdom law treats a woman married before 1974 as retaining her husband's domicile unless and until she changes her domicile by acquisition or revival of another domicile after 1973.

As a consequence, under United Kingdom law a United States citizen woman married to a man domiciled in the United Kingdom prior to January 1, 1974 does not have the same opportunity to prove a domicile outside the United Kingdom as does a United States citizen man married to a woman domiciled in the United Kingdom. Paragraph (4) of the Convention puts the United States citizen woman in the same position as the United States citizen man.

Paragraph (5) provides a special rule for cases where income dealt with by this Convention (e.g., under Articles 7 (Business Profits), 8 (Shipping and Air Transport), 10 (Dividends), 11 (Interest), 12 (Royalties), and 22 (Other Income)), is taxable to a resident of a Contracting State only if, and to the extent, it is remitted to or received by that person. In certain cases, individuals who are residents of the United Kingdom are not taxable on foreign source investment income, unless it is remitted to or received by them in the United Kingdom. If such income is received outside of the United Kingdom, or accumulated by the payer, a United Kingdom resident may not be subject to tax on that income. If the reductions in rates or exemptions from tax were to apply to those items of income, the United States would be foregoing tax where double taxation does not in fact occur. Thus, this paragraph provides that if under the law in the other Contracting State income would only be taxed on a remittance basis, then any reduced rates of tax (e.g., as provided by Articles 10 (Dividends)), or relief from taxation (e.g., Articles 7 (Business Profits) and 8 (Shipping and Air Transport), 11 (Interest), or 12 (Royalties)) provided by this Convention shall apply only to the extent such income is remitted to or received by the person in the year in which it accrues to the benefit of that taxpayer. This rule applies to all persons, including individuals, corporations, partnerships and trusts or estates taxable as such.

This provision is similar to paragraph (4) of Article II of the 1945 Convention.

ARTICLE 5. PERMANENT ESTABLISHMENT

This Article defines the term "permanent establishment." The existence of a permanent establishment is relevant under Article 7 (Business Profits) where it is provided that the business profits of an enterprise of a Contracting State shall be taxable only in that State unless it carries on business in the other Contracting State through a permanent establishment situated therein.

Under paragraph (1), the term "permanent establishment" means a fixed place of business through which an enterprise of one of the Contracting States wholly or partly carries on business. Illustrations in paragraph (2) of a permanent establishment include a branch; an office; a factory; a workshop; a mine, oil or gas well, quarry or other place of extraction of natural resources; and a building site, or construction or installation project which exists for more than twelve months. Under the construction or installation project rule the twelve month period begins only when work physically commences in the other Contracting State. A series of contracts or projects which are interdependent both commercially and geographically is to be treated as a single project for the purpose of applying the twelve months test. As a general rule, any fixed facility or premises through which a resident carries on business for an indefinite or substantial period of time will be treated as a permanent establishment unless it is used only for one or more of the activities described in paragraph (3) of this Article.

Paragraph (3) specifically provides that a permanent establishment does not include a fixed place of business if it is used solely for one or more of the following activities:

"(a) the storage, display, or delivery of goods or merchandise belonging to the enterprise;

"(b) the maintenance of a stock of goods or merchandise belonging to the enterprise for the purpose of storage, display or delivery;

"(c) the maintenance of a stock of goods or merchandise belonging to the enterprise for the purpose of processing by another person;

"(d) the maintenance of a fixed place of business for the purpose of purchasing goods or merchandise, or for collecting information, for the enterprise;

"(e) the maintenance of a fixed place of business for the purpose of advertising, for the supply of information, for scientific research, or for similar activities which have a preparatory or auxiliary character, for the enterprise; or

"(f) a building or construction or installation project which does not exist for more than 12 months."

As noted, these exceptions are cumulative and a fixed place of business used only for one or more of these purposes will not be considered a permanent establishment under the Convention.

Under paragraph (4), a person acting in one Contracting State on behalf of a resident of the other Contracting State, other than an agent of an independent status to whom paragraph (5) applies, will be deemed to constitute a permanent establishment if such person has, and habitually exercises in that first-mentioned Contracting State, an authority to conclude contracts in the name of the resident, unless the contracts are limited to the activities described in paragraph (3) of this Article.

On the other hand, paragraph (5) provides that an enterprise of one Contracting State will not be deemed to have a permanent establishment in the other Contracting State merely because such enterprise carries on business in such other Contracting State through a broker, general commission agent, or any other agent of an independent status, where such broker or agent is acting in the ordinary course of his business.

Under paragraph (6), the fact that a corporation which is a resident of a Contracting State controls or is controlled by a corporation of the other Contracting State, or which carries on business in the other Contracting State, through a permanent establishment or otherwise shall not of itself constitute either corporation a permanent establishment of the other.

ARTICLE 6. INCOME FROM IMMOVABLE PROPERTY (REAL PROPERTY)

Paragraph (1) provides that income from immovable property including income from agriculture or forestry, may be taxed in the Contracting State where the property is situated. This rule does not confer an exclusive right of taxation to the State where the property is located, but only confirms that the situs State has the primary right to tax such income regardless of whether the income is derived through a permanent establishment in that State.

Paragraph (2) provides that the term "immovable property" is to be defined under the laws of the Contracting State where the property is located. Generally, the term "immovable property" refers to real property for purposes of United States and United Kingdom law. Moreover, paragraph (2) also defines the term "immovable property" to include usufruct of immovable property and rights to variable or fixed payments (e.g., royalties) as consideration for the working of, or the right to work, mineral deposits, sources, and other natural resources (e.g., oil or gas wells). Ships, boats and aircraft shall not be regarded as immovable property.

This Article shall apply to income derived from the use in any form of immovable property, including income from leases of immovable property, but it does not include interest on indebtedness secured by real property (e.g., mortgages).

Where income is derived from immovable property through a permanent establishment in a Contracting State, such income may be taxed in accordance with Article 7 (Business Profits).

Income from immovable property does not include gains from the sale of immovable property. Where those gains are capital gains within the meaning of Article 13 (Capital Gains), that Article shall apply.

This Article differs from the provisions of Article IX of the 1945 Convention. During the years since that Convention was ratified both the United States and the United Kingdom have enacted statutes permitting the taxpayer to elect to treat income in respect of real property, wells, mines and other natural resources, as income from a trade or business. In these cases, the taxpayer is taxed only on net income rather on the gross income derived from such operations. Thus, it was determined that this Convention need not continue the terms of the 1945 Convention.

ARTICLE 7. BUSINESS PROFITS

Paragraph (1) provides that business profits (as defined in paragraph (7) of this Article) of an enterprise of one Contracting State shall be taxable only in that State unless the enterprise carries on business in the other Contracting State through a permanent establishment situated therein, except where the enterprise is a national of that other Contracting State. (See the saving clause in paragraph (3) of Article 1 (Personal Scope)). The term "permanent establishment" is defined in Article 5 (Permanent Establishment). Where business is carried on through a permanent establishment in the other Contracting State, the business profits attributable to the permanent establishment can be taxed by that other Contracting State.

Business profits may be attributable to a permanent establishment which an enterprise of one Contracting State has in the other Contracting State, whether from sources within or without a Contracting State. Thus, items of income described in section 864 (c)(4)(B) of the Code which are attributable to a permanent establishment situated in the United States will be subject to tax by the United States.

In determining the proper attribution of business profits under the Convention to a permanent establishment, paragraph (2) provides that both Contracting States will attribute to the permanent establishment such profits as it would reasonably be expected to derive if it were an independent entity engaged in the same or similar activities under the same or similar conditions and dealing wholly independently with the enterprise of which it is a permanent establishment.

Under paragraph (3), expenses, wherever incurred, which are reasonably connected with profits attributable to the permanent establishment, including a reasonable allocation of executive and general administrative expenses, research and development expenses, interest, and other expenses incurred for the enterprise as a whole (or the part which includes the permanent establishment), will be allowed as deductions in determining the business profits of the permanent establishment. However, in determining the amount of the deduction under paragraph (3) for expenses incurred by the head office, the deduction generally will be limited to the expense incurred without including a profit element for the head office.

Under paragraph (4) profits shall not be attributed to a permanent establishment merely because of the purchase of goods or merchandise by that permanent establishment for the account of the enterprise. Paragraph (2) of the Article does not override paragraph (4). Thus, for example, where a permanent establishment purchases goods for its head office, the business profits attributed under paragraph (2) to the permanent establishment with respect to its other activities will not be increased by adding a national figure for profits from purchasing.

For purposes of this Article, paragraph (5) provides that the profits attributed to a permanent establishment shall be determined by the same method every year unless there is a good reason to change such method. The purpose of this provision is to give assurance of continuous and consistent tax treatment.

Paragraph (6) provides that, where the profits of a permanent establishment include items of income which are dealt with separately in other Articles of the Convention, the provisions of those Articles will not be affected by the provisions of this Article. Thus, for example, the taxation of interest income will be controlled by Article 11 (Interest) and not by this Article unless, as provided by paragraph (4) of Article 11, the interest is effectively connected with a permanent establishment which the recipient, being a resident of one of the Contracting States, has in the other State. This same exception applies with respect to items of income dealt with in Article 8 (Shipping and Air Transport), dividends under paragraph (4) of Article 10 (Dividends), royalties under paragraph (4) of Article 12 (Royalties) or other income under paragraph (2) of Article 22 (Other Income).

Under paragraph (7), the term "business profits" includes, but is not limited to, income derived from manufacturing, mercantile, banking, insurance (or reinsurance), agricultural, fishing or mining activities, the operation of ships or aircraft, the furnishing of services, the rental of tangible personal (movable) property, and the rental or licensing of motion picture films or films or tapes used for radio or television broadcasting or from copyrights thereof. Thus, for example, income derived by a resident of the United States from the rental of tangible personal property to a person in the United Kingdom shall not be subject to tax in the United Kingdom unless that lessor has a permanent establishment in the United Kingdom to which such income is attributable. The term "business profits" also includes any other income which is effectively connected with a permanent establishment which the recipient, being a resident of one of the Contracting States, has in the other Contracting State. The term "business profits" does not include income from the performance of personal services derived by an individual either as an employee or in an independent capacity. Income from such activities is dealt with under Articles 14 (Independent Personal Services), 15 (Dependent Personal Services) and 17 (Artistes and Athletes), as the case may be.

This Article is substantially similar to Article III of the 1945 Convention and is also based on Article 7 (Business Profits) of the OECD Model Convention.

ARTICLE 8. SHIPPING AND AIR TRANSPORT

Paragraph (1) provides that profits of an enterprise of a Contracting State from the operation of ships or aircraft in international traffic shall be taxable only in that Contracting State.

Paragraph (2) confirms that the United Kingdom grants to nationals of the United States and United States corporations the equivalent shipping and aircraft exemption required for application of Code sections 872(b) and 883. It should be noted that the exemption provided under this paragraph is available only with respect to the profits derived from operating ships documented or aircraft registered under the laws of the United States.

Under paragraph (3), this Article applies to profits derived from the rental of ships or aircraft under a bareboat charter if the lessor is engaged in the operation of ships or aircraft in international traffic and the rental income is incidental to operations of the lessor described in paragraph (1). In these cases the lessee of the property need not be a resident of a Contracting State. For example, if an airline which is a resident of one Contracting State has excess equipment in the winter months and leases several of its aircraft which are not required by it during that period to another airline, the rental profits of the lessor are not subject to tax by that other Contracting State, regardless of the state of residence of the lessee.

Paragraph (4) provides that profits derived by an enterprise of a Contracting State from the use, maintenance, or rental of containers (including trailers and related equipment for the transport of containers), used to transport goods or merchandise shall be taxable only in that State except to the extent that those goods or merchandise are transported solely between places within a Contracting State. The income covered by this provision need not be incidental to the operation of ships or aircraft. Thus, this Article applies to lessors of containers who do not own or operate the ships or aircraft upon which the containers are carried. This paragraph also applies to income derived by an enterprise from the use, maintenance, and lease of containers and other related equipment in connection with the operation of ships or aircraft described in paragraph (1).

Paragraph (5) provides that this Article shall also apply to profits derived by an enterprise of a Contracting State from participation in a pool, a joint business or an international operating agency.

Paragraph (6) provides that gains of an enterprise of a Contracting State from the alienation of ships, aircraft or containers owned and operated by the enterprise shall be taxable only in that State if the income from such ships, aircraft or containers is taxable only in that State.

Except for paragraph (2), this Article is subject to the saving clause of paragraph (3) of Article 1 (Personal Scope). Therefore, a Contracting State may tax income from shipping or air transport, or from the use or rental of containers, derived by a resident of the other Contracting State without regard to this Article if such resident is a national of the first-mentioned Contracting State.

ARTICLE 9. ASSOCIATED ENTERPRISES

Article 9 confirms the authority of the United States under section 482 of the Code. Thus, where an enterprise of a Contracting State is related to another enterprise and conditions are made or imposed between them in their commercial or financial relations which are different from those which would be made between independent enterprises, under paragraph (1) any income, deductions, receipts or outgoings which would, but for those conditions, have been attributed to one of the enterprises, but by reason of those conditions have not been so attributed, may be taken into account in computing the profits and losses of that enterprise and taxed accordingly.

Paragraph (2) sets forth an explicit formulation of the consequence of a redetermination made in accordance with paragraph (1) by a Contracting State. In such event, the other Contracting State shall make such corresponding adjustment as may be appropriate to the amount of tax charged to the related enterprise by the other Contracting State. In the case of the United States, assuming application within a reasonable time after notice of such adjustment, any refunds of tax in respect of such an adjustment shall be made notwithstanding the statute of limitations.

Under paragraph (3), if a Contracting State disagrees with a redetermination of tax by the other Contracting State, the two Contracting States will endeavor to resolve the matter in accordance with the mutual agreement procedure in Article 25 (Mutual Agreement Procedure).

Paragraph (4) deals with the methods by which a Contracting State or a political subdivision or local authority thereof may tax an enterprise which is controlled by an enterprise of the other Contracting State. Where an enterprise doing business in one Contracting State is a resident (as defined in Article 4 (Fiscal Residence)) of the other Contracting State, or is controlled, directly or indirectly, by an enterprise which is a resident of the other Contracting State, the first-mentioned Contracting State, or political subdivision or local authority thereof, in determining the tax liability of the enterprise doing business therein, may not take into account the income, deductions, receipts, or outgoings of a related enterprise which is a resident of the other Contracting State or of an enterprise of any third State which is related to the enterprise of the other Contracting State. (Because a corporation is considered a single enterprise regardless of how many branches it has, a State may take into account the income and assets of all branches of that corporation, wherever located.) The taxing jurisdiction may, however, attribute income to the enterprise under the arm's-length principles contained in the other paragraphs of this Article. In addition, where the enterprise which is a resident of the other Contracting State is a corporation, the provisions of paragraph (4) of this Article will apply only if such corporation: (1) is not a controlled foreign corporation within the meaning of Code section 957; (2) is not created or organized under the laws of the first-mentioned Contracting State or any third State; and (3) is not controlled, directly or indirectly, by a corporation which is a resident of any third State.

Finally, the prohibition contained in paragraph (4) will not apply where the enterprise doing business in a Contracting State is a resident of that State to the extent that it owns, directly or indirectly, the capital of a related enterprise. Thus, this provision does not affect the application of the United States "subpart F" rules of Code sections 951-964.

The following is an illustration of the operation of this paragraph: Corporation M, organized under the laws of the United Kingdom, is a resident of the United Kingdom, and all of its stock is owned by individuals residing in the United Kingdom who are not United States nationals. Corporation M controls subsidiaries A, B, and C, which are incorporated in, and do business in, respectively, France, Germany, and Belgium. Corporation M also controls a United States subsidiary, Z, which is incorporated in and conducts its business in X, a state of the United States. In determining the tax liability of Z, to X or to the United States, neither X nor the United States, are permitted to allocate to, apportion to, or otherwise include in Z's tax base income earned by M, A, B, or C, except to the extent the dealings between Z and those persons require the application of the arm's-length principles of the other paragraphs of this Article. Thus, in these circumstances, the United States or the states will be required to determine Z's tax liability solely on the basis of its income. The determination of Z's tax liability under any unitary or combined reporting basis is, therefore, prohibited by this Article.

The broad standard of tax jurisdiction embodied in United States tax treaties provides that one Contracting State will not tax the business profits of an enterprise of the other Contracting State unless that enterprise does business in the first-mentioned Contracting State through a permanent establishment located there. The purpose of this provision is to harmonize the tax jurisdiction under this Convention at the national, state and local levels by equating the tax base of an enterprise doing business in a state or political subdivision of the United States with the enterprise's Federal income tax base.

Paragraph (5) provides that for purposes of the Convention an enterprise is related to another enterprise if either owns or controls directly or indirectly the other, or if a third person or persons (related to each other or acting together) own or control, directly or indirectly, both. The term "control" is not limited to the ownership of the capital of an enterprise, and includes any kind of control, whether or not legally enforceable, and however exercised or exercisable.

ARTICLE 10. DIVIDENDS

Article 10 deals with the taxation of dividends derived from a corporation which is a resident of a Contracting State. Under Article VI of the 1945 Convention, the rate of tax on dividends derived by residents of one Contracting State from a corporation of the other Contracting State is limited to 15 percent of the gross amount of the dividends. In 1973 the United Kingdom introduced a system of integrating corporate and shareholder taxation. Under the system adopted by the United Kingdom, a special "Advance Corporation Tax" ("ACT" hereafter), is collected at the corporate level on a distribution of dividends by the corporation. This tax is treated both as an advance payment of a portion of the corporate income tax, and also as a payment by an individual United Kingdom resident shareholder in satisfaction of his personal tax liabilities on the dividend. The introduction of this system rendered inapplicable the current provisions of the Convention relating to United Kingdom dividends. Accordingly, the proposed Article provides a mechanism by which United States shareholders of a United Kingdom corporation will receive the benefits of the shareholder credits which have heretofore not been granted to United States residents.

This Article contains two alternatives for the taxation of dividends, depending on whether the United Kingdom continues to allow a tax credit to individual shareholders in respect of dividends derived from a corporation which is a resident of the United Kingdom. Paragraph (1) will apply only if the United Kingdom modifies its current system of shareholder credits. This paragraph limits the tax on dividends paid by a corporation which is a resident of one Contracting State to a resident (who derives and beneficially owns the dividend) of the other Contracting State to 15 percent of the gross amount of the dividends. As noted above, this is the rule contained in the 1945 Convention.

Paragraph (2) applies where, as at the present time, an individual resident in the United Kingdom is entitled to a credit in respect of dividends paid by a corporation which is a resident of the United Kingdom. So long as this system remains in force, only paragraph (2), and not paragraph (1), shall apply. With respect to dividends paid by a corporation resident in the United Kingdom to a United States corporation which either alone or together with one or more associated corporations (defined below) controls, directly or indirectly, at least 10 percent of the voting stock of the United Kingdom resident corporation which is paying the dividend, the shareholder will be entitled to payment from the United Kingdom of a tax credit (hereinafter referred to as a refund) equal to one-half of the tax credit to which an individual resident in the United Kingdom would be entitled, less 5 percent of the aggregate amount of the cash dividend and the United Kingdom refund.

For United States tax purposes, the gross amount of the refund (without reduction for the tax withheld) will be considered as a dividend (see discussion under Article 23 (Elimination of Double Taxation)) and the 5 percent tax withheld will be considered as a tax on the shareholder receiving the dividend (see paragraph (1)(b) of Article 23 (Elimination of Double Taxation)). The unrefunded portion of the ACT paid in respect of the dividend will be regarded as an income tax imposed on the distributing corporation (see paragraph (1)(c) of Article 23).

In the case of United States shareholders other than corporations which control at least 10 percent of the voting stock of the United Kingdom resident corporation, the United Kingdom refund will equal the full credit payable to an individual resident in the United Kingdom, less 15 percent of the aggregate amount of the dividend and the U.K. refund. For United States tax purposes, the U.K. refund shall be treated as additional gross income and the 15 percent withholding shall be considered as a tax on the shareholder. In the case of a $65 dividend, the result is as follows:

Dividend for U.S. Tax Purposes		
Dividend	$ 65.00	
U.K. refund	35.00	
Gross Dividend	100.00	
United Kingdom Withholding Tax		$15.00
Foreign Tax Credit		$15.00

With respect to dividends paid by a United States corporation to a corporation which is a resident of the United Kingdom, and which controls, directly or indirectly, at least 10 percent of the voting stock of the United States corporation paying the dividend, the United States tax shall not exceed 5 percent of the gross dividend.

In all other cases of dividends paid by a United States corporation to any other resident of the United Kingdom, the rate of tax imposed by the United States shall not exceed 15 percent.

For purposes of paragraph (2), two corporations are associated if one controls directly or indirectly more than 50 percent of the voting power in the other corporation, or a third corporation controls more than 50 percent of the voting power in both of them.

As noted above, a resident of a Contracting State may benefit from this Article only if he derives and beneficially owns the dividend paid by a corporation of one of the Contracting States. A nominee or agent which is a resident of a Contracting State may not claim the benefits of this Article if the dividend is received on behalf of a person who is not a resident of that Contracting State. Similarly, dividends received by a nominee for the benefit of a resident, as, for example, with respect to a depositary receipt, would qualify for the benefits of this Article. This is generally the case with respect to all income tax conventions of the United States.

Paragraph (3) defines the term "dividends" to include any item which is treated as a distribution under the laws of the United Kingdom for United Kingdom tax purposes or, as a distribution out of earnings and profits for United States tax purposes. Distributions which are not within this definition of "dividends," or covered by any other provision of this Convention, shall be treated as "other income" under Article 22 (Other Income) of this Convention.

Paragraph (4) provides that paragraphs (1) and (2) of this Article shall not apply if the person deriving the dividends, being a resident of a Contracting State, has a permanent establishment in the other Contracting State or performs personal services from a fixed base situated therein, and the holding in respect of which the dividends are paid is effectively connected with the permanent establishment or fixed base. In such a case, the diivdends will be treated as business profits subject to the provision of Article 7 (Business Profits) or taxable in accordance with Articles 14 (Independent Personal Services) or 17 (Artistes and Athletes), as the case may be.

Paragraph (5) provides that dividends paid by a corporation which is a resident of a Contracting State, regardless of where it derives its income, to a person other than a resident of the other Contracting State (and in the case of dividends paid by a corporation which is a resident of the United Kingdom, to a person other than a United States citizen), shall be exempt from tax by the other Contracting State unless the holding with respect to which such dividends are paid is effectively connected with a permanent establishment or a fixed base which the person deriving the dividends has in that other State. For example, if a corporation which is a resident of the United Kingdom and is doing business in the United States pays dividends to a resident of the United Kingdom, or to a resident of a third State, those dividends shall be exempt from United States tax unless they are paid to a citizen or resident of the United States, or unless the holding in respect of which the dividends are paid is effectively connected with a permanent establishment or fixed base which the United Kingdom resident or resident of a third State maintains in the United States. This rule is contained in Article XV of the 1945 Convention. A dual-resident corporation which derives dividends from a resident of a Contracting State may not claim the benefits of this provision, although dividends received from a dual-resident corporation will qualify for the benefits of this Article.

Paragraph (6) continues the provisions of Article XVI of the 1945 Convention, and provides that a corporation which is a resident of the United Kingdom shall be exempt from the United States tax on accumulated or undistributed earnings (as provided by Code sections 531 (the accumulated earnings tax) and 541 (the personal holding company tax)), if individuals, other than citizens of the United States, who are residents of the United Kingdom, control, directly or indirectly, more than 50 percent of the entire voting power in such corporation.

Paragraph (7) prevents the application of paragraphs (1) and (2) of this Article in two circumstances where tax avoidance may occur. First, under subparagraph (a), where a resident of a Contracting State owns 10 percent or more of the shares of a corporation with respect to which dividends are paid, paragraphs (1) or (2) of this Article shall not apply to the extent that the dividends are paid out of profits which the corporation earned or other income which it received in a period ending 12 months or more before the date on which the shareholder became the owner of 10 percent or more of the corporation's stock. This rule is designed to prevent transactions where a 10 percent stock interest is acquired in order to obtain a distribution of the past earnings of a corporation at reduced rates of tax.

A second rule contained in subparagraph (b) is designed to deny the benefits of the Convention to tax exempt organizations if the recipient of a dividend is exempt from tax in the United States and the dividends are received in circumstances where if received by an exempt organization of the United Kingdom such interest or dividends would not be so exempt. Under United Kingdom law, if a resident of the United Kingdom sells securities to an exempt organization immediately before the payment of dividends, the organization will be taxable on the dividends paid in respect of the securities if the transaction was designed to accord the initial seller a preferential rate of tax on his sale. This rule is contained in Article VII A of the 1945 Convention.

The rules of paragraph (7), stated above, shall not apply if the beneficial owner of the shares satisfies the competent authorities of the respective States that the shares were acquired for *bona fide* commercial purposes and not to secure the benefits of the Convention.

This Article is subject to the saving clause of paragraph (3) of Article 1 (Personal Scope). Thus, dividends derived by a citizen of a Contracting State may be taxed by that Contracting State without regard to this Article.

ARTICLE 11. INTEREST

Paragraphs (1) and (2) provide that interest derived and beneficially owned by a resident of one Contracting State shall be exempt from tax by the other Contracting State. In these cases, interest is taxable only in the taxpayer's State of residence. The exemption only applies where the person deriving the interest is a resident of a Contracting State (as defined in Article 4 (Fiscal Residence)) and is the beneficial owner of the interest. Thus, the exemption does not apply where an intermediary, which is a resident of a Contracting State, such as an agent or nominee, collects or receives the interest on behalf of a person who is not a resident of that Contracting State.

Paragraph (3) defines the term interest for purposes of this Article as income from Government securities, bonds or debentures, whether or not secured by mortgage or whether or not carrying a right to participate in profits, and debt claims of every kind, as well as all other income (such as original issue discount) which, under the taxation law of the Contracting State in which the income has its source, is assimilated to income from money lent. Paragraphs (1) and (2) apply to all "interest", from whatever source derived. Penalty charges and late payment penalties shall not be regarded as interest. Such payments shall be regarded as "other income" dealt with by Article 22 (Other Income).

Paragraph (4) provides that the exemption from tax provided by paragraphs (1) and (2) shall not apply if the person deriving the interest, being a resident of a Contracting State, has a permanent establishment in the other Contracting State or performs personal services from a fixed base situated therein, and the indebtedness giving rise to the interest is effectively connected with the permanent establishment or fixed base. In such a case, the interest will be treated as business profits subject to the provisions of Article 7 (Business Profits) or will be taxable in accordance with Article 14 (Independent Personal Services) or 17 (Artistes and Athletes), as the case may be.

If excessive interest is paid pursuant to a special relationship between the payer and the person deriving the interest or between both of them and a third person, under paragraph (5) the provisions of Article 11 shall not apply to the excess portion of the payment. For this purpose, those persons need not be "related" within the meaning of paragraph (5) of Article 9 (Related Enterprises). The excessive portion may be taxed by each Contracting State, in accordance with its own law, including the Convention where applicable. In the case of the United States, the excessive portion may, for example, be taxed as a dividend, in which case the provisions of Article 10 (Dividends) will apply.

Paragraph (6) provides that interest paid by a resident of a Contracting State, regardless of where it derives its income, to a person other than a resident of the other Contracting State (and in the case of interest paid by a resident of the United Kingdom, to a person other than a United States citizen), shall be exempt from tax by the other Contracting State unless the debt claim in respect of which such interest is paid is effectively connected with a permanent establishment or a fixed base which the person deriving the interest has in that other State. For example, if a corporation which is a resident of the United Kingdom and is doing business in the United States pays interest to a resident of the United Kingdom, or to a resident of a third State, that interest shall be exempt from United States tax unless it is paid to a citizen or resident of the United States, or unless the debt obligation is effectively connected with a permanent establishment or a fixed base which the United Kingdom resident or resident of a third State maintains in the United States. A dual-resident corporation may not claim the benefits of this provision. A debt obligation is effectively connected with a permanent establishment in the United States when interest on that obligation is effectively connected with a trade or business in the United States within the meaning of Code section 864(c)(2) or 864(c)(4)(B)(ii), depending on the source of the interest under United States law.

Paragraph (7) is carried over from paragraph (5) of Article VII of the 1945 Convention. Under United Kingdom domestic law, interest payments by United Kingdom corporations to non-United Kingdom corporations which have 75 percent or more control, directly or indirectly, of the United Kingdom corporation are treated as distributions (dividends) rather than as deductible interest. This paragraph provides, in reciprocal terms, that this rule shall not apply where the payment is to a resident of the other Contracting State. By virtue of paragraph (2) of Article 1 (Personal Scope), a dual-resident corporation may claim the benefits of this provision with respect to interest payments it makes. However, this paragraph also provides that where the interest is paid to a corporation which is a resident of a Contracting State of which more than 50 percent of the voting power is directly or indirectly controlled by persons who are residents of the other Contracting State, the exemption shall not apply.

Paragraph (8) provides that the exemption from United Kingdom tax under paragraph (2) of this Article will not apply if the recipient of the interest is exempt from tax on such income in the United States and the recipient sells or makes a contract to sell the holding from which such interest is derived within three months after the date the recipient acquired such holding.

The provisions of this Article are subject to the saving clause of paragraph (3) of Article 1 (Personal Scope). Thus, interest derived by a citizen of a Contracting State may be taxed by that Contracting State without regard to this Article.

ARTICLE 12. ROYALTIES

Paragraphs (1) and (2) provide that royalties derived and beneficially owned by a resident of a Contracting State shall be exempt from tax by the other Contracting State. Such income, therefore, is taxable only in the State of residence. As in Article 10 (Dividends) and 11 (Interest), this exemption applies only where the person deriving the royalties is a resident of a Contracting State and is the beneficial owner of the royalty. Thus, the exemption does not apply where an intermediary, such as an agent or nominee, who is a resident of a Contracting State collects or receives the royalties on behalf of a nonresident of that Contracting State. This Article deals with royalties from sources within a Contracting State or from sources within any third State, except as described below.

Paragraph (3) defines the term "royalties" as payment of any kind made as consideration for the use of, or the right to use, copyrights of literary, artistic, or scientific works (but not including copyrights of motion picture films or films or tapes used for radio or television broadcasting (which are treated as business profits under paragraph (7) of Article 7 (Business Profits)), patents, trade mark, design or model, plan, secret formula or process, or other like right or property, or for information concerning industrial, commercial or scientific experience. This term includes "know-how" and similar experience or skill, including the supply of assistance of an ancillary and subsidiary nature furnished as a means of enabling the application or enjoyment of any such right or property. The term also includes gains derived from the alienation (e.g.; the sale, exchange, or other disposition) of any such right or property to the extent the amounts realized on such alienation are contingent on the productivity, use, or disposition of the right or property. If the amounts realized are not so contingent, the provision of Article 13 (Capital Gains) may apply. The article does not apply to amounts which are characterized as interest pursuant to section 483 of the Code.

Paragraph (4) provides that paragraphs (1) and (2) will not apply if the royalty recipient, being a resident of one Contracting State, carries on business in the other Contracting State through a permanent establishment situated therein or performs in that other Contracting State personal services from a fixed base situated therein, and the right or property giving rise to the royalty is effectively connected with such permanent establishment or fixed base. In such a case, the royalty will be treated as business profits subject to Article 7 (Business Profits) or will be taxable in accordance with Articles 14 (Independent Personal Services) or 17 (Artistes and Athletes) as the case may be.

If excessive royalties are paid pursuant to a special relationship between the payer and the person deriving the royalty or between both of them and a third person, paragraph (5) provides that the provisions of this Article shall not apply to the excessive portion of the payment. For this purpose, the persons covered by this paragraph need not be "related" within the meaning of paragraph (5) of Article 9 (Related Enterprises). The excessive portion may be taxed in each Contracting State, in accordance with its own law, including the Convention where applicable. In the case of the United States, the execssive portion may, for example, be taxed as a dividend, in which case the provisions of Article 10 (Dividends) will apply.

This Article is subject to the saving clause of paragraph (3) of Article 1 (Personal Scope). Therefore, royalties derived by a citizen of a Contracting State may be taxed by the Contracting State without regard to this Article.

ARTICLE 13. CAPITAL GAINS

This Article provides that, except as provided in Article 8 (Shipping and Air Transport) capital gains are taxable in accordance with the domestic laws of the Contracting States. This rule applies to the existing laws of a Contracting State respecting the taxation of capital gains and revisions of those laws subsequent to the effective date of this Convention. Thus, for example, capital gains in respect of the sale of immovable property described by Article 6 (Immovable Property) or the sale of a right or property giving rise to royalties described by Article 12 (Royalties) (which are not contingent on productivity, etc.,) may be taxed in accordance with the respective domestic laws of the Contracting States. The provision of Article 7 (Business Profits) shall apply to gains attributable to a permanent establishment. Article 22 (Other Income) does not apply to capital gains.

Under current United States law, contained in Code sections 871 and 872, nonresident alien individuals are generally not taxable in the U.S. on their United States source capital gains unless they are present in the United States for 183 days or more during a taxable year, or if the gains are effectively connected with the conduct of a U.S. trade or business. Under Code sections 881 and 882 foreign corporations generally are taxable in the U.S. only on capital gains which are effectively connected with the conduct of a U.S. trade or business.

Notwithstanding the foregoing rules, under paragraph (6) of Article 8 (Shipping and Air Transport) gains which an enterprise of a Contracting State derives from the sale, exchange or other disposition of ships, aircraft or containers which the enterprise owns or operates (dealt with by Article 8 (Shipping and Air Transport)), shall be taxable only in the State in which the income from the ships, aircraft or containers was taxable.

Under paragraph (2) of Article 3 (General Definitions), whether an item of income constitutes capital gains shall be determined under the laws of the Contracting State seeking to tax those gains.

The representatives of the Contracting States will consult with each other upon the enactment or proposed enactment by either State of any laws which substantially change the manner in which capital gains derived by nonresidents are taxed by the respective States.

ARTICLE 14. INDEPENDENT PERSONAL SERVICES

In dealing with the taxation of income from personal services, the Convention distinguishes between "independent" and "dependent" personal services. The Convention also provides special treatment for individuals who are "artistes or athletes" and for amounts received in certain circumstances in respect of the services of an artiste or athlete.

Personal services performed in an independent capacity, that is, independent personal services, are services performed by an individual for his own account where he receives the income and bears the losses arising from such services. If an individual is an independent contractor he is considered as rendering independent personal services. Income from services in which capital is a material income-producing factor, however, will generally be governed by the provisions of Article 7 (Business Profits). Generally, services rendered as a director of a corporation, or rendered by physicians, lawyers, engineers, architects, dentists, consultants, and accountants, performing personal services as sole proprietors or partners, are independent personal services, whereas the income earned by the employees of such persons, or as an officer of a corporation, is considered to be income from dependent personal services.

Under this Article income derived by an individual who is a resident of one Contracting State from the performance of personal services in an independent capacity may be taxed by that Contracting State. Except as permitted by subparagraphs (a) and (b) of this Article, such income will be exempt from tax by the other Contracting State.

Subparagraph (a) provides that income derived from services performed in the other Contracting State may also be subject to tax in that other Contracting State if the individual is present therein for a period or periods exceeding 183 days in the tax year, but only to the extent such income is attributable to services performed in that State. In addition, subparagraph (b) provides that income from personal services may be taxed in the other Contracting State if the individual has a fixed base regularly available to him for the purpose of performing his activities, but only to the extent such income is attributable to services performed in that State. The term fixed base is synonymous with the term "permanent establishment" as described in Article 5 (Permanent Establishment).

ARTICLE 15. DEPENDENT PERSONAL SERVICES

This Article deals with the taxation of income in respect of dependent personal services. The Article is based on Article 15 (Dependent Personal Services) of the OECD Model Convention. Under paragraph (1), subject to Articles 18 (Pensions) and 19 (Government Service), salaries, wages and other similar remuneration derived by an individual who is a resident of one Contracting State from labor or personal services performed as an employee (of any person) shall be taxed only by that Contracting State unless that employment is exercised in the other Contracting State. Except as provided by paragraph (2), remuneration derived with respect to services performed within the other Contracting State may also be taxed by that other Contracting State. It is intended that for purposes of the Convention the term "salaries, wages and other similar remuneration" includes income from services performed as an officer of a corporation.

Under paragraph (2), remuneration derived by an individual who is a resident of one Contracting State in respect of an employment exercised in the other Contracting State will be exempt from tax by the other Contracting State if: (a) the individual is present in that other Contracting State for a period or periods aggregating less than 183 days in the taxable year; (b) the employee's remuneration is paid by or on behalf of an employer who is not a resident of that other Contracting State; and (c) the remuneration is not borne as such by a permanent establishment or fixed base which the employer has in that other Contracting State. Such income may nevertheless be taxed by that other Contracting State if the individual is a citizen or resident of that Contracting State, pursuant to the saving clause of paragraph (3) of Article 1 (Personal Scope).

In the United States, remuneration from the performance of dependent services will be viewed as not having been borne by the permanent establishment or fixed base maintained in the United States if the employee is performing stewardship or overseeing functions for the benefit of a resident of or a permanent establishment maintained in the United Kingdom. However, the remuneration will be considered to be borne by the permanent establishment or fixed base maintained in the United States if the remuneration is paid for activities other than stewardship or overseeing functions and the permanent establishment or fixed base is entitled to claim the employee's remuneration as a deduction in computing taxable income for United States purposes because the remuneration is definitely related and allocable to its gross income or a class of its gross income pursuant to Code section 861 and the regulations thereunder.

Paragraph (3) provides that, notwithstanding paragraphs (1) and (2) of this Article, remuneration derived by an individual employee in respect of an employment as a member of the regular complement of a ship or aircraft in international traffic may be taxed by the Contracting State of which the employer operating the ship or aircraft is a resident.

ARTICLE 16. INVESTMENT OR HOLDING COMPANIES

This Article provides that a corporation which is a resident of one Contracting State and which derives dividends, interest or royalties arising within the other Contracting State shall not be entitled to claim the benefits of Articles 10 (Dividends), 11 (Interest), or 12 (Royalties), if the tax imposed by the first-mentioned Contracting State with respect to such dividends, interest or royalties is substantially less than the tax generally imposed by that State on corporate profits; and 25 percent or more of the capital of such corporation is owned directly or indirectly by persons who are not individual residents of the first-mentioned Contracting State and are not nationals of the United States.

This Article also provides that a corporation which is a resident of the United States and which derives dividends, interest or royalties arising in the United Kingdom shall not be entitled to the benefits of Articles 10 (Dividends), 11 (Interest), or 12 (Royalties) where more than 80 percent of its gross income (including such dividends, interest, or royalties) is derived from sources outside of the United States as determined by and for the purposes of Code Sections 861 (a)(1)(B) and 861(a)(2)(A), and as they may be amended from time to time without changing their general principles. This limitation applies only if 25 percent or more of the capital of the corporation is owned directly or indirectly by persons who are not individual residents of the United States or nationals of the United States.

Paragraph (2) provides that nothing in this Article will prevent a claim under the provisions of Articles 10 (Dividends), 11 (Interest) or 12 (Royalties) by a United States corporation, if 75 percent or more of the capital of that corporation is directly or indirectly owned: (a) by another United States corporation which receives 20 percent or more of its gross income from sources within the United States as determined by and for the period described in sections 861(a)(1)(B) and (a)(2)(A) of the Code, as they may be amended from time to time so as not to affect their general principle; or (b) by a corporation other than a United States corporation which would not be treated as a close company under section 283 of the United Kingdom Income and Corporation Taxes Act of 1970 (as may be amended without changing the general principle thereof); or (c) by a corporation, resident in the United Kingdom, more than 50 percent of the voting power of which is controlled directly or indirectly by individuals who are residents of the United Kingdom.

The purposes of this Article are, first, to prevent the potential abuse of the Convention which would occur if residents of a third country could take advantage of the reduced rates of withholding provided by this treaty in situations where one of the Contracting States provided preferential rates of tax for investment or holding companies deriving foreign source income. In the absence of this Article, residents of a third country could organize a corporation in the Contracting State extending the preferential rates for the purpose of making investments in the other Contracting State. The combination of low tax rates in the first Contracting State and the reduced rates or exemptions in the other Contracting State would enable the third country residents to realize unintended benefits.

The Article is also intended to prevent the use of United States corporations by residents of third countries to take advantage of the reduced rates of tax or exemptions from tax granted by the United Kingdom on dividends, interest and royalties paid to residents (including corporations) of the United States). Generally, under sections 861 (a)(1)(B) and 861(a)(2)(A) of the Code, interest and dividends paid by U.S. corporations to nonresidents of the United States are not subject to tax by the United States if more than 80 percent of the corporation's gross income is from sources outside the United States. Accordingly, were it not for this provision, a resident of a third country could establish a United States corporation solely to derive interest or dividends from the United Kingdom subject to the reduced rates and refunds allowed by the Convention. While such income would be subject to normal corporate taxes in the United States, the corporation's dividends or interest to the third country residents would be exempt from U.S. withholding taxes if the conditions of Code sections 861(a)(1)(B) and (a)(2)(A) are met. The Article prevents this abuse where the above mentioned share-ownership requirements apply. Since the purpose of this provision is only to prevent the use of United States corporations in cases where their income would otherwise qualify for reduced withholding rates in the United Kingdom and their distributions to third country residents would not attract United States withholding taxes, exceptions to the rule are given where that corporation is owned by another United States corporation whose distributions would attract United States withholding taxes; where that corporation is owned by a corporation which is not a close company under United Kingdom law; and where that corporation is owned by a corporation resident in the United Kingdom 50 percent or more of the voting power of which is controlled by United Kingdom resident individuals.

ARTICLE 17. ARTISTES AND ATHLETES

This Article deals with the taxation of income derived by entertainers, musicians, and athletes (sometimes referred to hereinafter as "artistes and athletes") in respect of the performance of services in a Contracting State. The Article applies in cases where an artiste or athlete performs services on his own behalf and in cases where services are performed on behalf of another person, as an employee or pursuant to any other arrangement.

Paragraph (1) states the general rule that notwithstanding the provisions of Article 14 (Independent Personal Services) and Article 15 (Dependent Personal Services), income derived by entertainers such as theatre, motion picture, radio, or television artistes, and musicians or athletes, for their personal activities as such, may be taxed in the Contracting State where those services are exercised. Such income, however, is taxable under this Article only where the gross receipts derived by the artiste or athlete, including expenses reimbursed to him or borne on his behalf, in respect of such activities, exceed $15,000 or its equivalent in pounds sterling for the tax year concerned. In computing the $15,000 limitation, expenses borne on behalf of the entertainer include any expenditures for travel, meals and lodging, payments to persons such as band members or agents, and other amounts which are generally related to the activities of the artiste or athlete. This rule includes expenses borne by persons in the Contracting State where services are performed or borne by persons in the other or any third State if borne on behalf of the artiste or athlete. If the total of these expenses, including the amounts paid to the artiste or athlete, exceed $15,000, the entire amount is taxable in the State where the activities are performed. For example, where an entertainer's gross income, including reimbursed expenses and expenses borne on his behalf, totals $20,000, the full $20,000 is subject to tax in the State where the services are performed.

Also, in computing the $15,000 limitation, amounts paid in taxable years prior or subsequent to the year in which the services were performed shall be included in the determination of the amount of income attributable to the year in which the services were performed.

As noted above, this paragraph overrides the provisions of Articles 14 and 15, so that an artiste or athlete may be taxed in the State where his activities take place regardless of the period of time he is present in that State. Generally, however, income derived from services rendered by producers, directors, technicians and others who are not artistes and athletes is taxable in accordance with the provisions of Article 14 (Independent Personal Services), or Article 15 (Dependent Personal Services), as the case may be.

Paragraph (2) deals with cases where income in respect of the activities of an entertainer or athlete accrues to a person other than, or in addition to, the entertainer or athlete. A common method employed by foreign entertainers is to perform services in the United States as an employee of, or a contractor for, a corporation or other person. That person may act as the nominal recipient of the income in respect of the entertainer's services and the entertainer may act as its "employee" or "contractor." In such cases, the corporation may escape taxation in respect of those services under the provisions of Article 7 (Business Profits) because it does not have a permanent establishment in the United States described in Article 5 (Permanent Establishment). The entertainer may also escape taxation by being paid a small salary while in the United

States and by receiving payment in a later year when the income is subject to reduced rates of tax or no tax at all, or by liquidating the corporation after the services are performed.

Paragraph (2) is designed to deal with these situations by providing that where income in respect of the personal activities of an artiste or athlete accrues to the benefit of another person (including a corporation, trust, or partnership of either Contracting State or any third State), that income may, notwithstanding the provisions of Article 7 (Business Profits), 14 (Independent Personal Services), and 15 (Dependent Personal Services), be taxed in the Contracting State in which the activities of the entertainer or athlete take place. Thus, for example, such other person could not claim the permanent establishment protection provided by Articles 5 (Permanent Establishment) and 7 (Business Profits).

For purposes of paragraph (2), income is considered to accrue to the benefit of another person where that other person has control over or the right to gross income derived in respect of an entertainer or athlete's services as such. This rule applies regardless of whether the other person is a "sham" corporation or conduit. Income will not, however, be deemed to accrue to the benefit of another person where it is established to the satisfaction of the competent authority of the Contracting State in which the services are performed that neither the entertainer or athlete, nor persons related thereto, participate directly or indirectly in the profits of such other person, in any manner, including the receipt of deferred compensation, bonuses, fees, dividends, partnership distributions or other distributions. Persons may be considered to be related to the artiste or athlete regardless of whether the persons are considered to be related under the provisions of paragraph (5) of Article 9 (Related Enterprises). For this purpose, a person may be considered to be related to the artiste or athlete if he is an employee or agent of the artiste or athlete, or if he is regularly employed by the artiste or athlete in an advisory capacity, such as his attorney, accountant, or investment advisor.

This section is similar to provisions in other recent Conventions of the United States with Japan, Trinidad and Tobago, and Iceland, and follows Article 17 (Artistes and Athletes) of the OECD Model Convention. It differs from the 1945 Convention, which under Article XI exempts an entertainer or athlete from United States tax where he: (a) is present in the United States for a period or periods not exceeding 183 days of a taxable year and (b) services are performed for or on behalf of a person who is a resident of the United Kingdom. The application of this section and Article III, regarding the industrial or commercial profits of an enterprise furnishing the services of an entertainer, was discussed in detail in Revenue Rulings 74-330 and 74-331. Both rulings considered cases where the services of foreign entertainers were "loaned" to United Kingdom corporations in order to benefit from the provisions of the 1945 Convention and to thereby avoid any taxation of the income derived in respect of their activities in the United States.

ARTICLE 18. PENSIONS

Paragraph (1) provides that, subject to the provisions of paragraph (2) of Article 19 (Government Service), pension payments received in consideration of past employment and annuity payments paid to an individual who is a resident of a Contracting State shall be taxable only in that State. The term "pension" includes payments from qualified retirement plans as well as other forms of retirement benefits paid for services rendered, or by way of compensation for injuries or sickness incurred in connection with past employment. A pension does not include payments in respect of the cancellation or premature termination of employment contracts (e.g., "golden handshakes" or severance pay). Such payments are taxable under the provisions of Articles 14 (Independent Personal Services), 15 (Dependent Personal Services), or 17 (Artistes and Athletes), as the case may be.

Payments which are not covered by any other Article of this Convention (e.g., Article 14 (Independent Personal Services), 15 (Dependent Personal Services), 17 (Artistes and Athletes), or 19 (Government Service)), are taxable in accordance with Article 22 (Other Income) in the recipient's State of residence.

For purposes of this Article, the term "pension" does not include social security payments and other public pensions, e.g., railroad retirement benefits. Such items are taxable pursuant to Article 22 (Other Income).

Paragraph (2) provides that alimony paid to an individual who is a resident of a Contracting State is taxable only in that State. The term "alimony" is not defined, but with respect to the United States, means periodic payments made pursuant to a decree of divorce, separate maintenance agreement, or support or separation agreement which is taxable to the recipient under the internal laws of the United States. Thus, for the United States, the term "alimony" would not include a payment which would not be taxable to the recipient even though such payment is made pursuant to a decree of divorce or of separate maintenance agreement. Payments for child support within the meaning of the Code are not covered by this Article and are, accordingly, taxable in the State where the recipient resides under Article 22 (Other Income). In the case of the United States, under present law, a recipient of child support is not taxable on such payments.

Paragraph (3) defines the term "annuity" to mean a stated sum payable periodically at stated times, during life or during a specified or ascertainable period of time, under an obligation to make the payments in return for adequate and full consideration in money or money's worth.

This Article is subject to the saving clause of paragraph (3) of Article 1 (Personal Scope). Thus, individuals who are nationals of a Contracting State may be taxed by that Contracting State without regard to this Article.

ARTICLE 19. GOVERNMENT SERVICE

This Article generally follows Article 19 (Government Service) of the

OECD Model Convention and is similar to Article X of the 1945 Convention.

Paragraph (1)(a) provides that remuneration, other than a pension, paid by a Contracting State to an individual for services rendered to that State will be taxable only in that State. This paragraph only applies to individuals who are employees of a Contracting State, and not to employees of a political subdivision or local authority of a Contracting State. Under paragraph (1)(b), such remuneration will be taxable only in the State in which the services are being performed if the recipient is a resident of that State and either is a national of that State or did not become a resident of that State solely for the purpose of performing the services.

Under paragraph (2)(a), any pension paid by a Contracting State or a political subdivision or a local authority thereof to any individual in respect of services rendered to that State or subdivision or local authority thereof will be taxable only in that State. An exception similar to the one contained in paragraph (1)(b) is incorporated in paragraph (2)(b) with respect to pensions. That paragraph provides that a pension described in paragraph (2)(a) will be taxable only in the other Contracting State if the recipient is both a national of and a resident of that State.

Paragraphs (1) and (2) do not apply if the services are rendered in connection with any business carried on by or on behalf of one of the Contracting States or one of its political subdivisions, or local authorities paying the remuneration. In such cases, the provisions of Articles 14 (Independent Personal Services), 15 (Dependent Personal Services), 17 (Artistes and Athletes), and 18 (Pensions), as the case may be, shall apply.

If an individual acquires immigrant status in the State in which he performs the services or receives the pension, that Contracting State may tax the individual without regard to this Article. See paragraphs (3) and (4)(b) of Article 1 (Personal Scope).

ARTICLE 20. TEACHERS

Paragraph (1) provides that a professor or teacher who visits one of the Contracting States for a period not exceeding two years, for the purpose of teaching or engaging in research at a university, college, or other recognized educational institution in that Contracting State, and who was immediately before that visit a resident of that other Contracting State, will be exempted from tax by the first-mentioned Contracting State on any remuneration for such teaching or research for a period not exceeding two years from the date he first visits that State for the purpose of teaching or engaging in research. Since this two year period is determined from the date he first visits the Contracting State, periodic vacations outside the first-mentioned Contracting State, or a brief return to the other Contracting State will not toll the running of the two-year period. Unlike the existing Convention, if the two-year period beginning from the date of his arrival is exceeded, the exemption will be lost retroactively. Thus, if a person comes to a Contracting State for the purpose of teaching and stays for a period in excess of two years, the exemption will not apply for the first two years. A person who meets the qualifications of this provision may again claim its benefits if he first reestablishes his residence in the other Contracting State. In such case, the person claiming these benefits on a subsequent occasion must first satisfy the competent authority of the first-mentioned Contracting State that he had become a bona fide resident of the other State for a substantial period of time (normally at least one year).

Under paragraph (2), the Contracting State in which the teaching or research is performed may apply this exemption either to current payments to a professor or teacher in anticipation of fulfillment of the requirements of paragraph (1) or by way of withholding and refund. Thus, the recipient may be required to report and pay taxes on such income on a current basis and seek a refund of taxes paid upon fulfillment of the requirements of paragraph (1).

If an individual becomes a national of, or acquires immigrant status in, the State where he is visiting, that other Contracting State may tax the individual without regard to this Article. See paragraphs (3) and (4)(b) of Article 1 (Personal Scope).

Pursuant to paragraph (3), this Article only applies to income from research undertaken in the public interest which is not primarily for the benefit of a private person or persons. For example, research projects which are undertaken to discover or perfect product processes, designs, etc., which are expected to be commercially exploited by the researcher or his present (or former) employer do not qualify under this Article.

ARTICLE 21. STUDENTS AND TRAINEES

This Article corresponds generally to Article XIX of the 1945 Convention and Article 20 (Students) of the OECD Model Convention. Under this Article, payments which a student or business apprentice, who immediately before visiting a Contracting State was a resident of the other Contracting State receives for his maintenance, education or training, will not be taxed in the first-mentioned State if the recipient of the payments is engaged in a full-time education or training program and the payments are made from sources outside the State in which the education or training takes place. Payments will be considered to have been made from sources outside a State when they are borne by a person who is not a resident (as defined in Article 4 (Fiscal Residence)) of the Contracting State in which the education or training takes place. Like other articles referred to in paragraph 4(b) of Article 1, this Article will not apply to payments to students or business apprentices who are nationals of or residents with immigrant status in the first-mentioned Contracting State.

ARTICLE 22. OTHER INCOME

This Article follows Article 21 (Other Income) of the OECD Model Convention. It contains the general rule that income of a resident of a Contracting State, from any source, which is not dealt with by any specific Article in the Convention, shall be taxable only in that person's State of residence. This is the first United States tax convention to follow this rule. The scope of this Article is not confined to income having a source in the other Contracting State, but applies to a resident's income from sources in third countries. Moreover, this rule applies irrespective of whether the State of residence exercises its right to tax the income covered by this Article. Specific items of income not dealt with by other Articles of this Convention include child support payments, prizes or awards, and social security payments. These items are subject to the provisions of this Article and are taxable only in the State of residence.

This Article also makes it clear that the United Kingdom may continue to impose its tax on discretionary and accumulation trusts. United Kingdom law currently provides that discretionary and accumulation trusts are subject to the basic rate of income tax (35 percent) and to an additional tax of 15 percent. Trustees are eligible to claim double taxation relief in the respect of foreign tax paid on the income. Under United Kingdom law a distribution of income from a discretionary or accumulation trust is treated in the hands of the beneficiary as a payment from which tax has been deducted at the aggregate of the two rates (35 and 15) in force for the year of payment. That is, the distribution is grossed-up by 100 percent and the amount of the gross-up is treated as tax paid by, and creditable to, the distributee in the year of distribution.

Under paragraph (1) of Article 22 (Other Income) and paragraph (3) of Article 25 (Mutual Agreement Procedure), the United Kingdom will continue to impose its taxes on discretionary and accumulation trusts and will not be obligated to refund these taxes at the time of distributions to United States residents. However, to give double taxation relief, the United Kingdom will treat a United States person taxable on the income as if he were entitled to receive the income of the trust directly. Thus, the beneficiary will be given the benefit of relief provisions in United Kingdom domestic law (e.g., government securities held by non-residents). Additionally, any income covered by the Convention, such as dividends and interest, will receive the benefits of the Convention to the extent that the payments from the trust are made out of this income.

This Article is subject to the saving clause provisions of paragraph (3) of Article 1 (Personal Scope).

This Article does not apply if the resident deriving the income carries on business in the other Contracting State through a permanent establishment situated therein or performs independent personal services from a fixed base therein, and the right or property in respect of which the income is paid is effectively connected with such permanent establishment or fixed base. In such cases, the provisions of Articles 7 (Business Profits), 14 (Independent Personal Services), or 17 (Artistes and Athletes) as the case may be, apply. As in the case of paragraph (1), this paragraph applies to income from all sources.

It should be noted that the proposed Convention specifically covers most types of income.

ARTICLE 23. ELIMINATION OF DOUBLE TAXATION

In order to prevent the double taxation of income covered by this Convention, each Contracting State agrees in this Article to provide a credit against its taxes for taxes paid to the other Contracting State.

Under paragraph (1), the United States agrees to allow a United States citizen or resident as a credit against United States tax the appropriate amount of taxes paid or accrued to the United Kingdom in accordance with the provisions and subject to the limitations of the law of the United States (as it may be amended from time to time without changing the general principle of paragraph (1)). In addition, in the case of a United States corporation owning at least ten percent of the voting stock of a United Kingdom corporation from which it receives dividends in any taxable year, the United States will allow credit for the appropriate amount of taxes paid or accrued to the United Kingdom by the United Kingdom corporation paying such dividends with respect to the profits out of which such dividends are paid. The rules for calculating the appropriate amount of taxes creditable in such a case are set forth below. However, the amount of tax credit is not to exceed the limitations (for the purpose of limiting the credit to the United States tax on income from sources within the United Kingdom or on income from sources outside of the United States) provided by United States law for the taxable year. This provision does not require the United States to maintain a per-country or overall limitation in the future so long as the general principle of a foreign tax credit remains in effect.

For the purpose of applying the United States credit in relation to taxes paid to the United Kingdom, the taxes referred to in paragraphs (2)(b) and (3) of Article 2 (Taxes Covered) shall be considered to be income taxes. In the case of dual-resident corporations described by paragraph (2) of Article 1 (Personal Scope), the United Kingdom petroleum revenue tax and the unrefunded portion of the ACT referred to in paragraph (1)(c) of this Article shall be regarded as an income tax for purposes of this Article. (See paragraph (2) of Article 1 (Personal Scope)). Any other taxes imposed by the United Kingdom on such corporation shall be treated as income taxes for purposes of the United States tax credit only in accordance with the laws of the United States.

Under paragraphs (2)(a)(i) and (2)(a)(ii) of Article 10 (Dividends), the United Kingdom allows residents of the United States certain tax credits or refunds in respect of dividends paid by a corporation which is a resident of the United Kingdom, subject to taxes withheld of 5 or 15 percent on the aggregate amounts received as dividends and tax credits. Subparagraph (1)(b) of this Article provides that the amounts withheld (5 or 15 percent) by the United Kingdom pursuant to paragraph 2(a)(i) or (ii) of Article 10 (Dividends) from the refund paid to residents of the United States shall be regarded as an income tax imposed on the recipient of the dividend. Thus, the United States foreign tax credit with respect to those amounts shall be computed in accordance with Code section 901.

In the case of tax credits allowed to

corporate shareholders of a corporation which is a resident of the United Kingdom pursuant to subparagraph (2)(a)(i) of Article 10, only one-half of the credit otherwise paid to individual shareholders is paid to those corporate shareholders. Subparagraph (1)(c) of this Article provides that the portion of the credit not paid to these corporate shareholders, i.e., one-half of the ACT paid in respect of the distribution, shall be treated as an income tax imposed on the corporation paying the dividend.

In the United Kingdom tax system, ACT serves a dual function. To the extent that it offsets the United Kingdom corporate income tax imposed without regard to distributions (hereinafter referred to as "mainstream tax"), it is analogous to a payment of regular corporate income tax. To the extent that it does not offset mainstream tax, it is more analogous to a tax imposed on distributions which are income to the shareholders.

To reflect this hybrid nature of ACT, ACT which offsets mainstream tax will be attributed to the earnings of the year in which it offsets such tax and treated as if it were regular corporate tax. ACT which does not offset mainstream tax will generally be attributed to the accumulated profits of the year of distribution.

In order that the derivative foreign tax credit be computed as intended under the Convention, corporate shareholders receiving the benefits of subparagraph 2(a)(i) of Article 10 (Dividends) must apply the following rules:

1. ACT paid with respect to a distribution shall be treated as attributable to the accumlated profits (determined under U.S. principles) of the year of distribution, except in two circumstances:

a) to the extent the ACT reduces mainstream tax for a prior or subsequent year (see Example 4 below); and

b) if, after attribution of ACT which does not reduce mainstream tax, accumulated profits would not exceed corporate taxes for the year (see Example 5 below).

ACT which reduces mainstream tax in any year or years shall be attributable to any accumulated profits of the year or years for which the mainstream tax is reduced. Where ACT is used to offset mainstream tax, the offset will be viewed as a refund of the ACT initially allowed as a credit and as a tax paid in respect of the year for which the ACT is applied as an offset. Consequently, a reduction in the foreign tax credit for the year from which the ACT is carried must be made in accordance with section 905(c) of the Code.

Mainstream tax will be considered offset first by ACT incurred with respect to the current distribution. Additional offset will be considered to be attributable to ACT incurred in the earliest year from which the ACT can be carried.

Where attribution to a year of ACT which does not offset mainstream tax leaves no accumulated profits for that year, the more exact attribution method set forth in Example 5 should be used.

2. A distribution in respect of which the ACT paid reduces mainstream tax for the current taxable year may be treated by the Internal Revenue Service as made first out of the entire profits of that year (computed as of the close of the year). This rule, which applies regardless of whether the distribution is made in the first 60 days of the taxable year, will be applied where necessary to prevent crediting of a prior year's mainstream tax unreduced by ACT, while at the same time using such ACT to reduce the current year's mainstream tax.

3. Where a United States corporation owns less than all the stock of a corporation resident in the United Kingdom, the derivative tax credit will be calculated with reference solely to the proportionate interest in accumulated profits attributable to the United States shareholder. Thus, for example, the ratio which the distribution to the United States shareholder bears to accumulated profits in excess of income taxes, as well as the amount of mainstream tax and ACT paid with respect thereto, will be calculated as if the United States shareholder's proportionate interest in the accumulated profits were the entire accumulated profits of a corporation of which it was the sole owner. The amount of foreign tax credit will not vary according to either (1) the status of any other shareholder; or (2) the imposition or refund of ACT with respect to a distribution to any other shareholder.

In the case of dividends paid by a United Kingdom corporation wholly owned by a United States parent corporation, the determination of the appropriate amount of creditable taxes is illustrated by the following examples:

Example 1. A United Kingdom resident corporation wholly owned by a United States parent corporation has $100 of pretax earnings in year 1 and pays a dividend equal to 50 percent of the amount available for distribution in year 1.

1.	Accumulated profits	$100.00
2.	British mainstream tax at 52% rate	52.00
3.	Available for distribution	48.00
4.	Distribution	24.00
5.	ACT with respect to distribution before refund	12.92
6.	Net mainstream tax, reduced by ACT *	39.08
7.	Refund of one-half ACT pursuant to paragraph (2)(a)(i) of Article 10	6.46
8.	Unrefunded one-half of ACT treated as corporate tax pursuant to paragraph (1)(c) of Article 23	6.46
9.	Total corporate tax (39.08 mainstream plus 6.46 unrefunded ACT)	45.54
10.	Total dividend received before withholding tax (24.00 declared plus 6.46 refund treated as dividend pursuant to paragraph (1)(a)(iii) of Article 10)	30.46
11.	Accumulated profits in excess of British corporate taxes (100 − 45.54)	54.46
12.	Derivative tax credit $\left(\frac{30.46}{54.46} \times 45.54\right)$	25.47
13.	British withholding tax (5 percent of total dividend of 30.46)	1.52
14.	Total foreign tax credit	26.99
15.	Taxable income (30.46 dividend plus 25.47 "gross-up" of derivative tax credit)	55.93
16.	United States tax before credit (48% of 55.93)	26.85
17.	Amount by which foreign tax credit exceeds U.S. tax	0.14

Example 2. Assume the same facts as in the previous example, except that in year two the British corporation makes a distribution out of what, under United States tax law principles, are the remaining $24.00 of earnings from year one. Assume further

that there are no earnings in year two for United Kingdom purposes, and that the ACT with respect to the distribution is carried back and credited against mainstream tax of year one.

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* It is assumed in this example, as is generally the case, that ACT is fully credited against mainstream tax.

1.	Distribution in year two	$ 24.00
2.	ACT	12.92
3.	Reduction in mainstream tax for year one	12.92
4.	Net mainstream tax for year one, reduced by ACT	26.16
5.	Refund of one-half ACT	6.46
6.	Unrefunded ACT	6.46
7.	Total corporate tax (26.16 mainstream + 6.46 unrefunded ACT in respect of distribution in year one + 6.46 unrefunded ACT in respect of distribution in year two)	39.08
8.	Total dividend received before withholding tax	30.46
9.	Accumulated profits in excess of British corporate taxes (100 − 39.08)	60.92
10.	Derivative tax credit $\left(\frac{30.46}{60.92} \times 39.08\right)$	19.54
11.	Taxable income (30.46 dividend plus 19.54 "gross-up" of derivative tax credit)	50.00

It should be noted that the total taxable income in respect of the two distributions is $105.93 ($55.93 + $50), which is $5.93 more than the accumulated profits of $100; and the total derivative tax credit is $45.01, which is $5.93 more than the corporate tax of $39.08. The disparity occurs for two reasons: first, that the Convention treats refunded ACT as a dividend, but does not treat ACT that is potentially refundable as profits out of which future dividends can be paid [*]; and second, that $6.46 of the $45.54 mainstream tax considered paid in respect of the accumulated profits in *Example 1* is subsequently refunded.

The above result is considered appropriate in order to ensure that, with reference to a 50 percent distribution, the British refund substantially benefits the United States shareholder. An adjustment is necessary, however, when tax which has been taken into account in computing derivative foreign tax credit in respect of a prior distribution—of whatever percentage of the accumulated profits—is refunded in the form of ACT. The refunded ACT must, with respect to such distribution, both

a) increase accumulated profits in excess of income taxes, and

b) decrease taxes paid in respect of accumulated profits.

By reason of the $6.46 refund of ACT in *Example 2,* therefore, the derivative foreign tax credit in *Example 1* must be recalculated as follows:

1. Calculation before adjustment (see (12) of *Example 1*)

$$\frac{30.46 \times 45.54}{54.46}$$

2. Addition of $6.46 to accumulated profits in excess of income taxes

$$\frac{30.46}{60.92}$$

3. Subtraction of $6.46 from taxes paid

$$\$45.54 - 6.46 = \$39.08$$

4. Derivative foreign tax credit

$$\left(\frac{30.46}{60.92} \times 39.08\right) \qquad \$19.54$$

The adjusted result in *Example 1* is the same as in *Example 2*. Both the taxable income and tax credit in respect of the prior distribution will therefore be decreased by $5.93, in accordance with section 905(c) of the Internal Revenue Code.

The determination of the appropriate amount of creditable taxes in the case of dividends paid by a less-than-wholly-owned United Kingdom corporation is illustrated by the following example:

Example 3. A United Kingdom resident corporation, *W*, is owned by U.S. corporation *X* (25%), U.K. corporation *Y* (60%), corporation *Z* (10%), and individual *A* (5%). *W* has $400 of pre-tax earnings in year 1 and pays a dividend of 50 percent of the amount available for distribution in year 1. *Z* is organized in country *M* and has no right to receive a refund of ACT from the United Kingdom. *A*, a United Kingdom resident, receives a tax credit equal to the entire ACT imposed, and *Y* makes an election under U.K. law to eliminate ACT with respect to distributions to itself.

1.	Accumulated profits	$400.00
2.	Mainstream tax imposed at a 52% rate	208.00
3.	Available for distribution	192.00
4.	Total distribution	96.00
5.	Portion of accumulated profits attributable to *X*'s shareholding—25%	100.00
6.	*Determination of X's United States foreign tax credit:*	
A.	Accumulated profits	$100.00
B.	British mainstream tax at 52% rate	52.00
C.	Available for distribution	48.00
D.	Distribution to U.S. corporation *X*	24.00
E.	For remainder of computation see *Example 1*	

In the above examples it has been assumed that the earnings and profits used in calculating the indirect tax credit for United States tax purposes approximate the earnings and profits of the United Kingdom corporation as computed in the United Kingdom for United Kingdom tax purposes. This assumption, of course, is not always valid and there will be situations where the earnings and profits differ for United Kingdom and United States tax purposes. Accordingly, it will be necessary for United States shareholders to maintain separate records to reflect these differences. Such records must currently be maintained by United States shareholders of foreign corporations where the amount of earnings and profits of that corporation differ under the rules of the respective countries. Separate records will be especially important where United States shareholders do not own all of the shares of a United Kingdom corporation. Quite often the shares of a United Kingdom corporation are owned by both United States and foreign shareholders. In these cases, the payment of an ACT credit to the United States shareholders will require a separate computation of earnings and profits for United States tax purposes which reflects that shareholder's proportionate interest in the corporation.

Example 4. A United Kingdom resident corporation is wholly owned by a U.S. corporation. The accumulated profits (according to United States standards), taxable profits (according to United Kingdom standards), and distributions of the subsidiary are as follows:

		Year 1	*Year 2*	*Year 3*
1.	Accumulated profits	$120	$100	$100
2.	Taxable profits	0	50	50
3.	Distribution	0	26	130

With respect to year 1, the U.S. parent corporation has no taxable income for U.S. purposes, no U.S. tax, and no foreign tax credit.

As of the end of year 2, the year 2 taxes of the parent are calculated as follows:

1.	Accumulated profits	$100.00
2.	U.K. taxable profits	50.00
3.	British mainstream tax at 52% rate	26.00
4.	Distribution	26.00
5.	ACT with respect to distribution before refund	14.00
6.	Net mainstream tax, reduced by ACT	12.00
7.	Refund of one-half of ACT	7.00
8.	Unrefunded one-half of ACT	7.00
9.	Total corporate tax ($12.00 plus $7.00)	19.00
10.	Total dividend received before withholding tax ($26.00 plus $7.00)	33.00
11.	Accumulated profits in excess of British corporate taxes ($100 minus $19)	81.00
12.	Derivative tax credit $\left(\frac{33}{81} \times 19\right)$	7.74
13.	British withholding tax (5% of $33.00)	1.65
14.	Total foreign tax credit ($7.74 + $1.65)	9.39
15.	Taxable income ($33.00 + $7.74)	40.74
16.	United States tax before credit (48% of $40.74)	19.56
17.	United States tax after credit ($19.56 minus $9.39)	10.17

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[*] If that were done, the fraction for computing the derivative tax credit in respect of the distribution in *Example 1* would be

$$\frac{30.46}{54.46 + 6.46 \text{ potentially refundable ACT}}$$

or $\frac{30.46}{60.92} \times$ taxes paid.

As of the end of year 3, the year 3 taxes are calculated as follows:

	Year 1	*Year 2*	*Year 3*
1. Accumulated profits	$120.00	$100.00	$100.00
2. U.K. taxable profits	—0—	50.00	50.00
3. Year 2 U.K. corporate tax before year 3 ACT (line 9 above)	—	19.00	—
4. Year 3 British mainstream tax at 52% rate	—	—	26.00
5. Year 3 ACT before adjustments	—	—	70.00
6. Year 3 ACT offset to mainstream tax	—0—	(3.50)*	(17.50)*
7. Year 3 ACT carried back and deemed mainstream tax	—0—	3.50	(3.50)
8. Year 3 ACT refund before adjustment	—	—	(35.00)
9. Year 3 ACT refund carried back	—0—	(1.75)	1.75
10. U.K. corporate tax after year 3 ACT (sum of lines 3 through 9)	—0—	17.25	41.75
11. Accumulated profits in excess of British corporate taxes (line 1 minus line 10)	120.00	82.75	58.25
12. Year 2 dividend	—	33.00	—
13. Accumulated profits available for distribution in year 3 (line 11 minus line 12)	120.00	49.75	58.25
14. Year 3 dividend before § 78 gross-up (130 + 35 ACT refund)	—	—	165.00
a. From year 3 accumulated profits (line 13)	—	—	58.25
b. From year 2 accumulated profits (line 13)	—	—	49.75
c. From year 1 accumulated profits (balance)	—	—	57.00
15. Year 3 foreign tax credit			
a. British withholding tax (5% of 165)	—	—	8.25
b. Year 3 derivative tax credit (from line 10)	—	—	41.75
c. Year 2 derivative tax credit $\left(\frac{49.75}{82.75} \times 17.25\right)$	—	—	10.37
16. Taxable income (165 + 41.75 + 10.37)	—	—	217.12
17. United States tax before credit (48% of 217.12)	—	—	104.22
18. Total foreign tax credit (8.25 + 41.75 + 10.37)	—	—	60.37
19. United States tax after credit (104.22 less 60.37)	—	—	43.85

As of the end of year 3, the year 2 taxes are recalculated as follows:

1. Total dividend received before withholding tax	$33.00
2. British withholding tax (5% of 33)	1.65
3. Derivative tax credit $\frac{33}{81 + 1.75} \times (19—1.75)$	6.88
4. Taxable income (33 + 6.88)	39.88
5. United States tax before credit (48% of 39.88)	19.14
6. Total foreign tax credit (1.65 + 6..88)	8.53
7. United states tax after credit (19.14 minus 8.53)	10.61
8. United States tax previously paid	10.17
9. Additional United States tax due (10.61 minus 10.17)	.44

Example 5. This example, showing a more exact attribution of non-offset ACT, is to be used *only* if, after attribution of non-offset ACT, there are no accumulated profits in excess of British corporate tax.

The facts are the same as in *Example 4,* except that the accumulated profits for year 3 are $30 rather than $100.

The calculation of the year 2 taxes as of the end of year 2 is the same as in *Example 4.* As of the end of year 3, the year 3 taxes are calculated as follows:

	Year 1	*Year 2*	*Year 3*
1. Accumulated profits	$120.00	$100.00	$ 30.00
2. U.K. taxable profits	—0—	50.00	50.00
3. Year 2 U.K. corporate tax before year 3 ACT (line 9 of *Example 4* calculation of year 2 taxes as of the end of year 2)	—	19.00	—
4 Year 3 British mainstream tax at 52% rate	—	—	26.00
5. Year 3 ACT before adjustments	—	—	70.00
6. Year 3 ACT offset to mainstream tax	—0—	(3.50)	(17.50)
7. Year 3 ACT carried back and deemed mainstream	—0—	3.50	(3.50)
8. Year 3 ACT refund before adjustment	—	—	(35.00)
9. Year 3 ACT refund carried back	—0—	(1.75)	1.75
10. U.K. corporate tax after year 3 ACT (sum of lines 3 through 9)	—0—	17.25	41.75
11. Accumulated profits in excess of British corporate taxes (line 1 minus line 10)	120.00	82.75	(11.75)

Since attribution of the non-offset ACT to year 3 eliminates any excess of accumulated profits over British corporate tax, the calculation must be redone, taking into account only offset ACT, and then attributing non-offset unrefunded ACT only to the extent of $17.50* for every $82.50 of accumulated profits considered distributed (determined under U.S. rules before taking into account non-offset ACT).

In year 3, only $17.50 of ACT offsets mainstream tax. One-half of this is refunded. In year 3, therefore, U.K. corporate tax after the offset ACT is:

$$\begin{array}{r} 26.00 \\ (17.50) \\ 8.75 \\ \hline 17.25 \end{array}$$

Accumulated profits in excess of British corporate tax other than non-offset ACT is $30.00 minus $17.25, or $12.75. Non-offset unrefunded ACT is $24.50

$$\frac{(70 - 17.50 - 3.50)}{2}.$$

In determining the maximum amount of $24.50 non-offset unrefunded ACT to be attributed to year 3, no ACT should be attributed to deemed distributions, since they do not incur ACT. Thus, of the $12.75, the $8.75 of refunded ACT attributable to the $17.50 offset is excluded from the amount to which unrefunded non-offset ACT is attributable. The maximum amount of non-offset unrefunded ACT attributed to the remaining $4.00 of accumulated profits in year 3 is $0.85. The $0.85 is calculated as

$$\frac{17.5}{82.5} \times 4.00.$$

Thus, of the $12.75, $8.75 is deemed distributed as offset refunded ACT; $0.85 is non-offset unrefunded ACT; $0.85 is non-offset refunded ACT deemed distributed; and $2.30 is the remaining actual distribution considered to have been made from year 3.

In year 2, the accumulated profits available for distribution before adjustment for year three non-offset ACT are $49.75 (from line thirteen of *Example 4* calculation of year 3 taxes). Of that amount, $1.75 is deemed distributed as offset refunded ACT. The non-offset unrefunded ACT attributable to the remaining $48.00 is $10.18 ($\$48.00 \times \frac{17.5}{82.5}$). Thus, the accumulated profits available for actual distribution in year 2 are $27.64 ($49.75 less $1.75 (deemed distribution) less $10.18 (non-offset refunded ACT deemed distributed) less $10.18 (non-offset unrefunded ACT); and the U.K. corporate tax is $27.43 ($17.25 + $10.18).

A similar attribution procedure is followed in attributing ACT to distributions from year 1.

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* Under U.K. rules, the maximum amount of ACT that can be credited against mainstream tax is 35/52 of mainstream tax, and excess ACT is carried back two years, and then carried forward indefinitely. Thus, since $26 of mainstream tax was payable for each of years 2 and 3, the offset for ACT for each of years 2 and 3 cannot exceed $17.50 (26 × 35/52). For year 2, this means an increased offset of $3.50 (17.50 minus 14 previously offset).

* $17.50 represents the amount of unrefunded ACT which would result from an actual distribution of $65 (one-half of $65 $\times \frac{35}{65}$). With an actual distribution of $65, the $17.50 of refunded ACT would be deemed distributed, thus increasing the total distribution to $82.50.

The carryback of non-offset unrefunded ACT is limited to two years, and there is no carryforward.

Paragraph (2) of this Article parallels paragraph (1) with respect to the treatment of United States taxes paid by a resident of the United Kingdom. Under this paragraph, the United Kingdom will allow a resident of the United Kingdom as a credit against United Kingdom taxes paid to the United States in accordance with the provisions of the law of the United Kingdom for the allowance of credits for taxes to territories outside the United Kingdom (as it may be amended from time to time without changing the general principle of paragraph (2)). Such credit shall be allowed with respect to taxes payable in accordance with this Convention on profits or income from sources within the United States, as determined by subparagraph (3) of this Article (excluding, in the case of a dividend, tax payable in respect of the profits out of which the dividend is paid).

In the case of a dividend paid by a United States corporation to a corporation which is a resident of the United Kingdom which controls directly or indirectly 10 percent or more of the voting power of that paying corporation, the United Kingdom shall also allow a credit for the appropriate amount of taxes paid or accrued to the United States by the United States corporation paying such dividends with respect to the profits out of which such dividends are paid.

Paragraph (3) sets forth the source of income rules applicable for purposes of determining the allowance of tax credits under this Article. For purposes of the preceding paragraphs, income or profits derived by a resident of a Contracting State which are taxed in the other Contracting State in accordance with the Convention (other than by reason of the saving clause referred to below) shall be deemed to arise from sources within that other Contracting State. However, where a United States citizen is subject to tax in the United States by reason of his citizenship under the saving clause of paragraph (3) of Article 1 (Personal Scope), the United Kingdom will allow that person a tax credit for any United States tax paid with respect to income which under the internal laws of the United Kingdom has its source in the United States; and the United States will allow that person, subject to limitations of the Internal Revenue Code to claim a credit for taxes paid to the United Kingdom with respect to income which under the internal laws of the United States has its source in the United Kingdom. This paragraph has particular relevance with respect to a United States citizen who is a resident of the United Kingdom for purposes of this Convention (see Article 4 (Fiscal Residence)).

In the case of third country income earned by a United States citizen who is a resident of the United Kingdom, (e.g., dividends from Germany), the United Kingdom is not required to allow a credit for United States taxes on that income. Double taxation of income may be avoided, however, under the overall method for computing foreign tax credits. In such case, the United States will allow under its internal law a credit for both the United Kingdom and third country taxes.

Finally, paragraph (4) makes it clear that the credit allowed for taxes paid to the United Kingdom, especially the petroleum revenue tax, shall be subject to the tax credit limitations of the Tax Reduction Act of 1975 which apply to foreign oil and gas extraction income.

ARTICLE 24. NON-DISCRIMINATION

Paragraph (1) provides that individuals who are nationals of a Contracting State and who are residents of the other Contracting State will not be subjected in that other Contracting State to taxation or any other requirement connected therewith which is other or more burdensome than the taxation or requirements connected therewith to which nationals of that other Contracting State in the same circumstances are or may be subjected. Thus, for example, a national of the United Kingdom who is a resident of the United States and who meets the requirements specified in Code section 911 would, under this Article, be entitled to the benefits of that section even though he is not also a national of the United States. On the other hand, just as a United States citizen who becomes a non-resident alien at any time during a taxable year or whose spouse is a non-resident alien cannot in the absence of an election file a joint return for that year, a United Kingdom national would not be entitled to file a joint return with his spouse in the absence of such election if either is a non-resident alien at any time during the taxable year.

Paragraph (2) provides that a permanent establishment which an enterprise of one Contracting State has in the other Contracting State will not be subject in that other Contracting State to less favorable taxation than an enterprise of that other Contracting State carrying on the same activities.

Subject to the provisions of paragraph (4), discussed below, paragraph (3) provides that interest, royalties, and other disbursements paid by an enterprise of a Contracting State to an enterprise of the other Contracting State shall, if reasonable in amount, be deductible for purposes of determining the taxable profits of the enterprise in that Contracting State under the same conditions as if they had been paid to a resident of that Contracting State. This rule is not limited to payments to related parties.

For purposes of this paragraph, the term "other disbursements" includes charges for amounts expended by a resident of the other Contracting State for the benefit of the enterprise. The term "other disbursements" is to be broadly defined, to includes charges or allocations by such resident for the benefit of such enterprise, including reasonable allocations of executive and general administrative overhead (except to the extent such expenses are not for the benefit of the enterprise, but are for "stewardship" or "overseeing" functions for the resident's own benefit as an investor in the enterprise). The term also includes charges and allocations of research and development expenses where the enterprise has the benefits of such activities under a cost or risk sharing agreement and other expenditures by the resident of a group of enterprises which includes such enterprise.

Paragraph (4) states that paragraph (3), above, does not apply to interest, royalties, or other disbursements to which the provisions of Article 9 (Associated Enterprise), paragraphs (5) and (7) of Article 11 (Interest), or paragraph (5) of article 12 (Royalties) apply with respect to transactions between related parties.

Paragraph (5) prohibits one Contracting State from subjecting an enterprise of such Contracting State, the capital of which is wholly or partly owned or controlled, directly or indirectly, by one or more residents of the other Contracting State, to any taxation or any requirement connected with taxation which is other or more burdensome than is applicable to enterprises of the first-mentioned Contracting State carrying on the same activities, the capital of which is wholly or partly owned or controlled by one or more residents of the first-mentioned Contracting State.

Paragraph (6) provides that nothing in this Article obliges a Contracting State to grant to individual residents of the other Contracting State any personal allowances, reliefs, or deductions for taxation purposes on account of civil status or family responsibilities which it grants to its own residents.

This Article is similar to Article XXI of the 1945 Convention and Article 24 (Non-Discrimination) of the OECD Model Convention.

ARTICLE 25. MUTUAL AGREEMENT PROCEDURE

This Article generally extends the mutual agreement procedures found in Article XXA of the 1945 Convention and is similar to Article 25 (Mutual Agreement Procedure) of the OECD Model Convention.

Under paragraph (1), when a resident or national of a Contracting State considers that the actions of one or both Contracting States results or will result in taxation which is not in accordance with the Convention, he may, notwithstanding the remedies provided by the national laws of those States, present his case to the competent authority of the Contracting State of which he is a resident or national. A resident or national of a Contracting State need not, although it is anticipated that in the normal situation he will, exhaust his other administrative or judicial remedies prior to resorting to the use of the mutual agreement procedure.

Under paragraph (2), if the claim is considered to be justified by the competent authority and if it cannot alone arrive at an appropriate solution to the issue involved, that competent authority shall endeavor to resolve the case by agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is contrary to the Convention. In cases in which the competent authorities reach an agreement, taxes will be imposed, and refunds or credits of taxes will be allowed, as appropriate, by the Contracting States in accordance with such agreement. In the case of the United States, where an agreement is reached between the competent authorities which requires the United States to make a refund of tax or to extend any other similar credit, such refund or credit will be made, assuming presentation of his case to the competent authority within a reasonable period, notwithstanding any procedural barriers otherwise existing under United States law, including any statute of limitations. In cases where an agreement cannot be reached between the competent authorities, the United States will not be required to provide any relief for double taxation on a unilateral basis.

Paragraph (3) permits the competent authorities of the two Contracting States to endeavor to resolve by mutual agreement any difficulties or doubts arising as to the application of the Convention. In particular, the competent authorities may reach agreement on the attribution of income, deductions, credits, or allowances of an enterprise of a Contracting State to its permanent establishment situated in the other Contracting State; the allocation of income, deductions, credits, or allowances between persons; the nature of particular items of income; the meaning of terms not otherwise defined in this Convention; the place where a particular item of income has its source; and the elimination of double taxation in respect of income paid out of trusts. In the case of trust distributions, the competent authorities may conclude that elimination of double taxation requires that the character of the income giving rise to such distributions must be determined. In such a case, taxpayers will be expected to have the records necessary to demonstrate the character of income underlying a trust distribution.

Under paragraph (4), the competent authorities may communicate with each other directly and, when advisable, meet together for an oral exchange of opinions, for the purpose of reaching an agreement.

ARTICLE 26. EXCHANGE OF INFORMATION AND ADMINISTRATIVE ASSISTANCE

This Article extends without change the exchange of information Article (Article XX) and the assistance in collection Article (Article XIXA) of the 1945 Convention.

Paragraph (1) provides for a system of administrative cooperation between the competent authorities of the two Contracting States by requiring an exchange of information necessary for the carrying out of the Convention and of the domestic laws of the Contracting States concerning taxes covered by the Convention insofar as the taxation thereunder is in accordance with the Convention. The competent authorities may exchange information in connection with tax compliance generally, not merely illegal acts or crimes. Information need be exchanged, however, only if it is of a class that can be obtained under the laws and administrative practices of each Contracting State with respect to its own taxes.

The information exchanged must be treated as secret. However, such information may be disclosed to any persons or authorities (including a court or administrative body) concerned with the assessment, collection, or enforcement of, or prosecution with respect to, the taxes which are the subject of the Convention. No information may be exchanged which would disclose any trade, business, industrial or professional secret or any trade process.

Paragraph (2) provides that one Contracting State will give the other Contracting State limited assistance in collecting its taxes. Thus, each Contracting State is required to collect on behalf of the other Contracting State only those taxes imposed by such other Contracting State as will ensure that any exemption or reduced rate of tax granted under this Convention by such other Contracting State is not enjoyed by persons not entitled to such benefits.

Paragraph (3) makes clear that a Contracting State is not obligated to carry out measures which are at variance with its laws or the administrative practice with respect to the collection of its own taxes; or which would be contrary to its sovereignty, security or public policy. A Contracting State may also consider, in determining the administrative measures it will use, the administrative measures utilized by the other Contracting State in a comparable situation.

Paragraph (4) provides that the competent authorities will consult to cooperate and advise each other on the implementation of these provisions.

ARTICLE 27. EFFECT ON DIPLOMATIC AND CONSULAR OFFICIALS AND DOMESTIC LAWS

Paragraph (1) of this Article provides that nothing in the Convention will affect the fiscal privileges of diplomatic and consular officials under the general rules of international law or under the provisions of special agreements.

Paragraph (2) provides that the Convention will not restrict in any manner any exclusion, exemption, deduction, credit, or other allowance now or hereafter accorded by the laws of a Contracting State. This rule reflects the principle that a Convention should not increase the tax burden on residents of the Contracting States.

ARTICLE 28. ENTRY INTO FORCE

Paragraph (1) provides that the proposed Convention shall be ratified and that the instruments of ratification shall be exchanged at Washington, D.C. as soon as possible after both States have ratified the Convention.

Paragraph (2) provides that the Convention will enter into force on the thirty-first day following the date of exchange of the instruments of ratification. With respect to the United Kingdom, the proposed Convention will take effect in the following manner. In relation to any dividend to which subparagraph (2)(a)(ii) of Article 10 (Dividends) applies, the provisions of that Article shall apply to any year of assessment beginning on or after April 6, 1973. For this purpose, a dividend paid on or after April 1, 1973, and before April 6, 1973, shall be treated for tax credit purposes (i.e., for purposes of any refund of the ACT) as paid on April 6, 1973. United States shareholders who derived dividends from corporations which were residents of the United Kingdom during this period will be entitled to claim refunds from the United Kingdom in respect of those dividends and in accordance with the provisions of paragraph 2(a)(ii) of Article 10. It is anticipated that the United Kingdom will prescribe the procedures for claiming those refunds upon ratification of this Convention.

In the case of dividends to which subparagraph (2)(a)(i) of Article 10 (Dividends) applies (i.e., dividends received from a corporation which is a resident of the United Kingdom by a United States corporation owning 10 percent or more of the voting stock thereof), and any other provision of the Convention in respect of income tax and payments of tax credits (i.e., refunds of ACT), and in respect of the United Kingdom capital gains tax, those provisions shall be effective for any year of assessment beginning on or after April 6, 1975. Refunds of tax may be claimed in the manner to be prescribed by the United Kingdom.

The Convention will be effective in respect of the United Kingdom corporation tax, for any financial year beginning on or after April 1, 1975, in respect of the United Kingdom petroleum revenue tax, for any chargeable period beginning on or after January 1, 1975, and (in accord with Article V of the Protocol of [March 31], 1977) in respect of the special domicile rule of paragraph (4) of Article 4 (Fiscal Residence) for any year of assessment beginning on or after April 6, 1976.

For the United States, tax credits for taxes paid to the United Kingdom on or after April 1, 1973, shall be allowed for the period subsequent to that date in accordance with paragraph (1) of Article 23 (Elimination of Double Taxation). In the case of dividends received for any year of assessment beginning on or after April 6, 1973, and before any year of assessment beginning on or after April 6, 1975, by a United States corporation described by paragraph (2)(a)(i) of Article 10 (Dividends), the full amount of ACT paid in respect of such dividends shall be regarded as a tax imposed on the distributing corporation.

With respect to taxes withheld at source, this Convention shall become effective in the United States on January 1, 1975, for taxes withheld on or after that date and with respect to all other taxes, this Convention will be effective in the United States for taxable years beginning on or after January 1, 1975.

Subject to the provisions of paragraph (4) of this Article, the 1945 Convention, as amended by the Supplementary Protocol of June 6, 1946, by the Supplementary Protocol of May 25, 1954, by the Supplementary Protocol of August 19, 1957, and by the Supplementary Protocol of March 17, 1966, will cease to have effect in respect of taxes to which this Convention in accordance with the provisions of paragraph (2) of this Article applies.

Where any provision of the 1945 Convention would have afforded any greater relief from tax, any such provision will continue to have effect for any year of assessment or financial year in the United Kingdom and for any taxable year in the United States beginning, in either case, before January 1, 1976.

The 1945 Convention will terminate on the last date on which it has effect in accordance with the foregoing provisions of this Article. In addition, this Convention will not affect any Agreement in force extending the 1945 Convention in accordance with Article XXII thereof. In those cases, the 1945 Convention will continue to apply to those territories. The United States has requested the United Kingdom to advise territories to which the 1945 Convention has been extended that the United States desires to renegotiate the Convention as it affects those territories so as to reflect the principles of this Convention.

The amendments to this Convention effected by the Notes exchanged at London on April 13, 1976 shall enter into force on the same date as determined under paragraph (2) of this Article and, in accord with the provisions of Article V of the Protocol of August 26, 1976 and of Article VI of the Protocol of [March 31], 1977, the amendments to this Convention effected by those protocols shall, upon ratification, enter into force on the thirty-first day following the date of the exchange of the instruments of ratification of those Protocols. Once in force, the provisions of the Notes and the two protocols shall have effect in accordance with this Article.

ARTICLE 29. TERMINATION

This Article is drafted in substantially the same manner as the termination Article of the 1945 Convention.

Paragraph (1) provides that the Convention will remain in force indefinitely, but that either Contracting State may, on or before June 30 in any year after the year 1980, give to the other Contracting State through diplomatic channels notice of termination. When notice is properly given, the Convention ceases to be effective for taxable years beginning on or after January 1 of the following year for United States tax; for a year of assessment beginning on or after April 6 of the following year for United Kingdom income tax and capital gains tax; for a financial year beginning on or after April 1 of the following year for United Kingdom corporation tax; and for a chargeable period beginning on or after January 1 of the following year for United Kingdom petroleum revenue tax.

Under paragraph (2), the termination of the proposed Convention will not have the effect of reviving any treaty or arangement abrogated by the present Convention or by treaties previously concluded between the Contracting States.

Part III. Administrative, Procedural, and Miscellaneous

ERISA Non-Compliance Enforcement Program

Notice 80-7 [1]

The Service has established a new relief procedure for certain employee plans that were not timely amended to comply with Title II of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 1974-3 C.B. 1, 67. The procedure will apply both with respect to plans that had favorable pre-ERISA determination letters but that failed to comply with ERISA by the end of their remedial amendment periods and to plans that received favorable post-ERISA determination letters (including those which were not timely amended to comply with final regulations in accordance with Announcement 78-175, 1978-47 I.R.B. 19).

Under the procedure, authority to grant the relief is delegated to the Director, Employee Plans Division and the Director, Actuarial Division of the Internal Revenue Service National Office, and to all Directors of EP/EO Key Districts. However, after December 31, 1982, relief with respect to plans described in this release may be granted only through the National Office.

Requirements for Relief

Except for a plan that satisfies Section 601.201(l) of the Statement of Procedural Rules, in order to be eligible for relief, plan sponsors must execute necessary plan amendments to conform to ERISA retroactively and take necessary action to restore employees' rights and/or benefits (which may require additional plan contributions). The sponsors must make amendments to bring the plan into complete compliance with ERISA no later than 91 days after the issuance of either a final determination letter or notice of amendments needed to effect compliance (which notice shall be issued at least 91 days prior to the issuance of a final Employee Plans examination report). In addition, the employers must take appropriate action to restore all former and present employee benefits to levels they would have attained had ERISA amendments been made timely. If the plan sponsors take these actions, relief generally will be granted to certain of the parties who otherwise would be adversely affected by the plan's earlier non-compliance.

Limitations on Relief

Relief will not be granted under this procedure if, (1) the plan was found to violate the exclusive benefit rule, or (2) after September 30, 1982, amendments required for complete compliance have not been executed or a request for a determination letter with proposed ERISA amendments has not been filed.

Where relief is available, however, the nature of the relief will differ depending on whether in the case of a plan with a favorable pre-ERISA determination letter, the plan was in substantial compliance with ERISA on June 4, 1980 and, in the case of a plan with a favorable post-ERISA determination letter, the extent to which the plan complied with certain operational requirements.

Plans With Pre-ERISA Determination Letters

If the employee plan with only a favorable pre-ERISA determination letter was in substantial compliance with ERISA on June 4, 1980 the relief will be granted to the trust, the employer and all participants. Proposed plan amendments that have been received by the Service on June 4, 1980 will be taken into consideration in determining whether a plan is in substantial compliance.

Employee plans will be considered in substantial compliance if, on June 4, 1980 they meet certain form and operational requirements.

As to form, the plan (i) must meet the eligibility and vesting requirements of sections 410(a) and 411(a) of the Internal Revenue Code, respectively (except to the extent that the rules for computing service for purposes of eligibility and vesting are not satisfied), and (ii) must, where applicable, provide for a joint and survivor annuity. In addition, the plan, (iii) must not have discriminated in operation in favor of officers, shareholders or highly compensated employees, and (iv) must not in operation have violated either the requirements of section 414(l) dealing with mergers and consolidations or the requirements of section 415(c) by providing excess allocations to officers, shareholders or highly compensated individuals.

For those plans which are not in substantial compliance on June 4, 1980, only limited relief may be granted under this procedure. As to the employer, the disqualification will be retroactive so that plan contributions will not be deductible under the rules for qualified plans. Further, if the plan discriminates in operation, no relief will be provided to individuals who are officers, shareholders or highly compensated. If the plan violates section 415(c) of the Code by providing excess allocations to officers, shareholders or highly compensated individuals, no relief will be granted to any of the above individuals who receive such excess allocations. The accounts of these individuals would then be subject to tax in accordance with the rules applicable to participants in nonqualified plans.

Plans With Post-ERISA Determination Letters

Plans with post-ERISA determination letters will, absent certain operational defects, be granted complete relief with respect to the trust, the employer and all participants.

However, if the plan, in operation (i) discriminated in favor of officers, shareholders, or highly compensated employees, (ii) violated the requirements of section 414(l) of the Code dealing with mergers or consolidations, or (iii) violated the requirements of section 415(c) by providing excess allocations to officers, shareholders, or highly compensated employees, then the relief, as described above, may be limited.

Period of Relief

The period for which the appropriate Service official grants the relief will commence with the ERISA effective date for the minimum participation standards determined with regard to each plan and will end with the applicable compliance deadline. The compliance deadline is 91 days after the issuance of a (i) final determination letter or (ii) notice of amendments needed to effect compliance.

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[1] Also released as New Release IR-80-66, dated June 4, 1980.

Plans Without Determination Letters

Generally, this relief procedure does not apply to any individual retirement plan or any plan without a determination letter. However, for purposes of this procedure, a favorable opinion letter issued with respect to an HR-10 master or prototype plan will be considered as a determination letter for each employer who had adopted the plan or amendments with respect to which the favorable opinion letter was issued if the plan has been deemed qualified under Rev. Proc. 75-51, 1975-2 C.B. 590.

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26 CFR 601.105: Examinations of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, Sections 4071, 7805; 48.4071-2, 301.7805-1.)

Rev. Proc. 80-19

SECTION 1. PURPOSE

The purpose of this Revenue Procedure is to modify and supersede Rev. Proc. 79-9, 1979-1 C.B. 488, which specifies the method under which tire manufacturers, producers, and importers may determine tire and tube weights on an average weight basis for the purpose of computing the manufacturers excise tax imposed by section 4071(a) of the Internal Revenue Code of 1954.

In attempting to comply with Rev. Proc. 79-9, manufacturers and importers encountered difficulties not previously anticipated. Therefore, the procedure is being restated with modifications.

SEC. 2. BACKGROUND

.01 Section 4071(a) of the Code imposes an excise tax on tires, tubes, and tread rubber sold by the manufacturer, producer, or importer. The tax is based on the weight of the article at a rate computed on each pound including any fraction thereof.

.02 Section 4071(c) of the Code provides that the weight shall be based on total weight except that the metal rims or rim bases are excluded in the case of tires. Total weight shall be determined under regulations prescribed by the Secretary.

.03 Section 48.4071-2(b) of the Manufacturers and Retailers Excise Tax Regulations provides that a manufacturer who has received permission from the Commissioner, subject to conditions prescribed by the Commissioner, may determine total weight of tires and inner tubes manufactured and sold by the manufacturer on the basis of the average weight of each type, size, grade, and classification shown in schedules published by the tire industry. The average weights shall be established in accordance with the method approved by the Commissioner and shall apply for such periods as the Commissioner may prescribe. The Commissioner may terminate the approval granted any manufacturer. In the case of the termination of the approval granted any manufacturer, the termination shall become effective 10 days from the date of the receipt by the manufacturer of the notice of termination. A manufacturer may terminate its use of the average weight schedule by giving no less than 10 days written notice to the Commissioner. The termination shall not affect the manufacturer's liability for tires and tubes sold prior to the effective date of termination. The authority of the Commissioner under section 48.4071-2(b) and 301.7701-9 in these matters has been delegated to the Director, Examination Division.

.04 In accordance with the above, the Rubber Manufacturers Association has published schedules of average weights that have been used for some time.

.05 The regulations under section 48.4071-2(b) do not specify how the average weight is to be computed. Therefore, in order to specify the method of computing average weights, this revenue procedure prescribes the use of an industry-wide weighted average, the size of the sample to be used by manufacturers, producers, and importers, and the conditions under which a manufacturer, producer, or importer may use the industry schedule of average weights for each type, size, grade, and classification of tire and inner tube.

.06 For the purpose of this revenue procedure, the term "manufacturer" includes a producer and "tire" includes an inner tube. The term "fiscal year" means the period July 1 to June 30. The term "category" means a particular type, size, grade, and classification of tire or inner tube. The term "specification weight" means the weight of the tire determined by composition formula. A category will often include tires of differing specification weights but alike as to type, size, grade, and classification. The term "ordinary production" means the regular production of the tire as against, for example, a small test run. The term "industry group" means the Rubber Manufacturers Association or any other organization that establishes to the satisfaction of the Commissioner schedules of average tire weights for determining the tax under section 4071.

SEC. 3. APPLICATION

.01 A manufacturer or importer wishing to determine total weight of tires and inner tubes manufactured or imported and sold by it on the basis of the average weight for each category must request permission to do so by submitting an application with three copies to the Director, Examination Division, CP:E, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, in substantially the form shown in section 8 of this procedure. At the same time the applicant must send a copy to the industry group responsible for compiling the average weight schedules. The application must be signed by the applicant.

.02 Upon approval, the Service will furnish copies to the industry group, the appropriate district director, and the applicant.

.03 *Manufacturers, Annual information to be supplied.*

The manufacturer must furnish the industry group annually by August 10th the following information from each plant's ordinary production for the prior fiscal year for use in compiling the industry group's table of average weights to be used for the next calendar year for each category.

1 The specification weight of the tires in each category of tires produced in the plant, rounded off to two decimal places,

2 The quantity of tires produced for domestic consumption in each such category,

3 If in one of its plants a manufacturer produces two or more tires differing in specification weight in a single category, the single specification weight figure submitted to the industry group for that category by the manufacturer shall be weighted by volume of production for domestic consumption. For example, manufacturer *N* produces two tires differing in specification weight but falling within the same category, *X*. In the prior fiscal year *N* produced for domestic consumption 50,000 category *X* tires with a specification weight of 30 pounds and 100,000 category *X* tires with a specification weight of 30.50 pounds. The specification weight figure that *N* furnishes the industry group for category *X* is computed as follows.

(1) Specification Weights	(2) Total Production for Domestic Consumption	(3) Col. (1) × Col. (2)
30.00	50,000	1,500,000
30.50	100,000	3,050,000
	150,000	4,550,000

$$\frac{\text{Total Col. 3}}{\textit{Total Col. 2}} = \frac{4{,}550{,}000}{\textit{150{,}000}} = 30.33 = \text{Specification weight}$$

N submits a specification weight of 30.33 pounds for category *X*.

.04 *Manufacturers, Weighing tires.*

1 If a manufacturer reported (or is to report) the specification weight for a category of tire produced in a plant in the prior fiscal year, and within that category only one tire by specification weight was produced in the plant, then in the first month of ordinary production of the same tire (by specification weight) during the period beginning with the last month of the prior fiscal year and ending with the last month of the current fiscal year, the manufacturer must select and weigh a random sample of at least 10 of those tires from that month's production or, if less, the entire ordinary production for the month. The manufacturer will divide the sum of the actual weights of the tires by the number of tires in the sample to compute an average actual weight of the sampled tires. This average actual weight shall be rounded off to two decimal places. The average weight so obtained for that month will be submitted to the industry group by the 10th of the second succeeding month. The manufacturer must correlate the average actual weight to the specification weight reported to the industry group.

2 Where a plant produced in the prior fiscal year tires falling within the same category but differing in specification weight, the manufacturer must also select and weigh a random sample of tires in the category. However, in computing an average actual weight for a category in which a manufacturer had multiple specification weights in the prior fiscal year, it necessarily follows that the manufacturer would only select and weigh samples of those tires (by each specification weight) considered in arriving at the prior year's specification weight figure. New tires being produced in the current fiscal year in the category by the manufacturer would be disregarded. By way of example, if a plant in the prior fiscal year produced within category *X* tires *A*, *B*, and *C*, differing only in specification weight, the manufacturer would provide the industry group a specification weight figure computed in accordance with 3.033. When during the current fiscal year the manufacturer computes an average actual weight figure for that category, it would only consider tires *A*, *B*, and *C*, and not new tire *D*, which although falling within category

X, was not produced in the prior fiscal year.

The average actual weight for a multiple specification weight category shall, as in 3.033, be weighted by the prior year's volume for domestic production, and be determined in the same manner as the specification weight reported (or to be reported) to the industry group. Using the example in 3.033, assume that in the current fiscal year *N* begins production in one of its plants of category *X* tires in August. Although the specification weight figure for the category that was furnished to the industry group was 30.33 pounds, a production-weighted figure, in reality *N* is manufacturing in category *X* tires with specification weights of either 30 or 30.5 pounds. *N* must select and weigh a random sample of at least ten tires of each specification weight to be sampled or, if less, the entire ordinary production for the month of tires of a specification weight to be sampled. *N* will then compute the average actual weight for the sampled tires of each specification weight and multiply each resultant figure by the prior year's volume of production of tires of that specification weight for domestic consumption. *N* must then add the two totals and divide by the total of the prior year's production of that category of tires in that plant to arrive at an average actual weight figure, production-weighted, to be submitted to the industry group by October 10.

The following is illustrative of the procedure to be followed:

(1) Specification Weights for Prior Fiscal Year	(2) Total Weight of 10-tire Sample	(3) Average Actual Weight	×	(4) Prior Fiscal Year's Production	(5) Col. 3 × Col. 4
30.00	301	30.10		50,000	1,505,000
30.50	304	30.40		100,000	3,040,000
					4,545,000

$$\frac{\text{Total Col. 5}}{\text{Total Col. 4}} = \frac{4{,}545{,}000}{150{,}000} = 30.30 =$$ Average actual weight for category submitted to industry group

The manufacturer must correlate the average actual weight to the category for which the specification weight figure, 30.33, was originally submitted.

3 Where a manufacturer in one of its plants begins production in a particular month of tires of one or more specification weights in a category but not of tires of all of the specification weights in the category which were reported (or are to be reported) in the category for the prior fiscal year, the manufacturer shall proceed as follows. By the 10th day of the second succeeding month after the manufacturer begins production of the tires in the plant it must submit to the industry group a partial report. The manufacturer shall indicate that it is not a final report and will furnish to the industry group the average actual sample weight of each tire (by specification weight) in the category put into production in the plant, and must correlate the actual weights to the category for which a specification weight was originally submitted. The manufacturer will submit revised reports as tires of other specification weights in the category that were reported the prior fiscal year are placed into production at the plant. By the 10th day of the second succeeding month after all tires (by specification weight) to be sampled in the category have been placed in production, the manufacturer must furnish the industry group the average actual weight for the category, determined following the procedure in 3.042 above.

4 In those instances where a manufacturer will not, during the period beginning with the last month of the prior fiscal year and ending with the last month of the current fiscal year, produce in a plant tires of all of the specification weights in a category which it reported (or is to report) in that category for the prior fiscal year, it should so inform the industry group within a reasonable period of time after it has determined that this will be the case and, in no event, later than August 10th of the following fiscal year. The manufacturer will indicate that as a result it cannot provide for that category an average actual weight.

.05 *Manufacturers, Exceptions.*

Where there was no ordinary production in that plant by that manufacturer of tires in a category in the prior fiscal year, or, that manufacturer had no specification weight for tires in the category in the prior fiscal year, the manufacturer may use the industry group's average weight schedule for such category during the current fiscal year notwithstanding section 3.13. During the first month of production in the plant of tires in that category in the current fiscal year, the manufacturer will submit to the industry group the specification weight of tires in such category if available. By the 10th of the next month a random sample average actual weight of each of the tires (by specification weight) in that category will be submitted to the industry group.

Where there is no category in the industry group's average weight schedule for a tire, the manufacturer will submit to the industry group a complete description of the tire with its uses and specification weight.

.06 *Importers of tires.*

Importers must furnish the industry group annually, by August 10th, the following information obtained from tires imported for domestic consumption in the prior fiscal year for use in compiling the industry group's table of average weights to be used for the next calendar year for each category.

1. (a) If in the prior fiscal year the importer imported within a category tires of a single specification weight, the importer may furnish the industry group with the average actual weight of a random sample of tires in the category. The sample shall have consisted of at least 10 tires or, if less, the entire ordinary importation for the prior fiscal year. The importer may, at its option, furnish the information described in 3.061(b) below. If the importer is importing tires falling within the same category but differing in specification weight, the

importer must provide the information described in 3.061(b) below.

(b) An importer importing within a category tires of a single specification weight may, in the alternative, furnish the industry group with the specification weight for that category. An importer importing tires within a category differing in specification weight must provide the specification weights for that category. The specification weights may be obtained from sources within or outside the United States, and there shall be maintained within the United States at least one copy of the composition formula for each specification weight at one stated location in the United States. Thus, if there are, for example, 10 importers of the identical tire, only one need maintain the specification formula. As in the case of manufacturers, where an importer imports into the United States tires that differ in specification weight but that fall in the same category, the importer shall furnish to the industry group an average specification weight figure which is weighted by volume of importation into the United States and computed as described in 3.033.

2 The importer must also furnish the industry the quantity of tires imported for domestic consumption by category.

3 In the case of an importer who in the prior fiscal year imported within a category tires of a single specification weight, in the first month of the importation of the same tires in such category during the period beginning with the last month of the prior fiscal year and ending with the last month of the current fiscal year, the importer must select and weigh a random sample of at least 10 tires from that month's importation, or, if less, the entire importation for the month of those tires in that category. The importer shall determine the average actual weight and furnish this figure to the industry group by the 10th of the second succeeding month. The importer must correlate the average weight to the category for which an average actual weight or specification weight figure is submitted in accordance with 3.061. In the case of an importer who imported tires of differing specification weights within a category in the prior fiscal year, such importer shall follow the procedures set forth for manufacturers in 3.04 in reporting average actual weight. As in the case of manufacturers, the importer, in determining average actual weight for a particular category, shall disregard tires in that category being imported by it in the current fiscal year but not imported by it in the prior fiscal year.

.07 *Importers of tires. Exceptions.*

Where any of the following circumstances are present:

1 Tires in a category are first being imported by that importer in the current fiscal year, or

2 There is not a copy of the specification formula available in the United States,

the importer may use the industry group's average weight schedule for such category during the current fiscal year, notwithstanding section 3.13. During the first month's importation of tires in such category during the current fiscal year the importer will weigh or have weighed a random sample of at least 10 tires in the category or, if less, the entire ordinary importation for the month. The importer will compute the average actual weight for the tires in the category and provide such figure to the industry group by the 10th of the second succeeding month.

Where there is no category in the industry group's average weight schedule for a tire, the importer will in addition submit to the industry group a complete description of the tire and its uses.

.08 *Importers of articles equipped with imported tires subject to tax who do not import tires separately.*

Importers must furnish the industry group annually, by August 10th, the following information with respect to articles imported for domestic consumption in the prior fiscal year for use in compiling the industry group's table of average weights to be used for the next calendar year for each category.

1. The quantity of tires imported for domestic use by category.

2 If notified by the industry group that weight data is needed for a particular category of tires the importer of such tires will supply the specification weight or, where it is importing within a category tires of a single specification weight, the average weight of a random sample.

.09 *Importers of articles equipped with tires who do not import tires separately. Exceptions.*

Where the importer had no importation of articles equipped with tires in a category for domestic consumption in the prior fiscal year, and the importer is now importing articles with tires in that category, the importer may use the industry group's average weight schedule for such category during the current fiscal year, notwithstanding section 3.13.

If notified by the industry group that weight data is needed for a particular tire, the importer of such tires will furnish the industry group the specification weight or, where it is importing within a category tires of a single specification weight, the average weight of a random sample.

Where there is no category in the average weight schedule for a tire, the importer will in addition submit to the industry group a complete description of the tire and its uses.

.10 If a participant receives a request from the industry group for weight data on a particular tire, or verification of other data submitted, the information will be submitted to the industry group within 15 days of the post office marked date of the request.

.11 Where the Service finds that the data submitted by a participant to the industry group is inaccurate, the participant's tax liability may be redetermined by the Service on the basis of actual weights, and consideration will be given to terminating the approval for that participant to determine total weight on the basis of average weight, as provided in section 48.4071-2(b) of the regulations.

.12 Failure to comply with any of the provisions of this procedure applicable to the participant will result in assessment of the tax as determined by the Service for the particular period in question.

.13 This revenue procedure and the average weights published by the industry group may not be used by a manufacturer or importer to determine tax liability unless such taxpayer has complied with the requirements in this procedure.

.14 This procedure and the average weight schedule may not be used to determine the tax liability for imported used tires.

.15 The information required by this revenue procedure is for use in determining excise tax and the preparation and filing of excise tax returns. Therefore, as provided for in section 7206 of the Code, any person who willfully makes and subscribes, aids or assists in, procures, counsels, or advises in fraudulent or false statements, returns, affidavits, claims, or other documents in connection with the application of this revenue procedure, will be guilty of a felony and, upon conviction, will be fined not more than $5,000, or imprisoned not more than 3 years, or both, together with the costs of prosecution.

SEC. 4. INDUSTRY GROUP

.01 The industry group will publish by November 1 of each year, effective for the next calendar year, a schedule of weighted average weights as to each category. The schedule will be based on the data submitted by manufacturers or importers who have obtained approval to determine total weight of their tires on the basis of the average weights. The industry group will furnish copies of the schedule, and any additions and corrections, to each participant and to the Commissioner of Internal Revenue.

.02 The industry group will add the number of tires imported on other articles, by category, to the number received from importers of tires. Where the weight for a category of tires imported on other articles is not available from other importers, as provided in section 3.061, the industry group will notify the importer to provide the specification weight, or the average weight of a random sample, at the importer's option, in accordance with section 3.061. The information on imported tires will be added, by category, to domestic production for the purpose of determining weighted averages.

.03 Any corrections will be made by supplement in the published schedule of weighted averages if the net tax liability of a tire category in the schedule is changed by one cent or more. The change will be effective beginning the month following issuance of notice of the change.

.04 Where the industry group has reason to believe that any part of the data submitted may be in error, the industry group will request written verification of that part of the data from the participant. See section 3.10.

.05 The Director, Examination Division, will be notified by the industry group of any noncompliance with the requirements of this revenue procedure.

.06 The industry group will not include in any category a tire whose weight is not reasonable for that category.

.07 The industry group will submit to the Service a list of the categories with the average weight and the weight spread found in each category one month prior to publication of the schedule. Copies of all schedule changes issued will be submitted to the Service.

SEC. 5. RECORDS

.01 The industry group will maintain a file, by participant, of all correspondence and average weight data. Each item in the file will be kept for four years, except agreements. Agreements will be kept for at least four years after they are terminated. Each item in section 5.04 and 5.06 will be kept for at least four years.

.02 The industry group will maintain all summary, subsidiary, and detailed records involving its computations used to arrive at the average weights in the schedule for four years after the effective year of that schedule.

.03 The above records will be made available to the Service for verification.

.04 Each participant will maintain all summary, subsidiary, and detailed records involving its computations used to arrive at the data submitted to the industry group. This includes tire component formulae where tire specification weight is submitted to the industry group.

.05 Upon request, the records in section 5.04 will be made available to the Internal Revenue Service.

.06 Each taxpayer participant will maintain a file of the data submitted, copies of agreements, correspondence, copies of weight data, and other material concerning this procedure.

.07 Where coded record systems are used, machine sensible records of the pertinent information will be maintained.

SEC. 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 79-9 is modified and superseded. Taxpayers with agreements under prior rules who wish to continue to use average weights are required to apply for permission to use average weights under this revenue procedure. All prior agreements were revoked by Rev. Proc. 79-9 as of January 1, 1980.

SEC. 7. EFFECTIVE DATE

This revenue procedure is effective June 23, 1980.

SEC. 8. AGREEMENT AND APPLICATION FORM

APPLICATION AND AGREEMENT ON TIRES AND INNER TUBES

The undersigned has read Revenue Procedure 80-19 and applies for permission to use the average weight schedules prepared under that Revenue Procedure.

(a) In consideration of the permission granted by acceptance of this application by the Internal Revenue Service, the undersigned understands it is subject to and will comply with the provisions of Revenue Procedure 80-19, which is part of this agreement.

(b) That revenue procedure may subsequently be corrected, amended, revised, and superseded and this agreement includes all such changes unless the undersigned, by written notice, ends this agreement within sixty days of publication of such change in the Internal Revenue Bulletin.

(c) Ten days after the post office marked date of the undersigned's written notice to the Director, Examination Division, ending this agreement under (b), the permission to use average weights is revoked.

(d) In consideration of the permission to use the average weights the undersigned waives any rights to claim refund, credit, or abatement of any part of the tax it has paid under this agreement on the basis (1) that the actual weight of its particular tire or tube is less than that established in the schedule of average weights, (2) that the use of the schedules is not legal, or (3) that the Commissioner or his delegate has exceeded discretionary power in adopting such weights or in accepting this agreement.

____
Name of Taxpayer

By __________________ ________
President Date

__________________ ________
Secretary Date

__________________ ________
Treasurer Date

Approved:

__________________ ________
Director, Examination Division Date

CONSENT TO HAVE IRS DISCLOSE INFORMATION

I hereby authorize the Internal Revenue Service to disclose the information contained in the attached Application and Agreement on Tires and Inner Tubes, or a copy of such Application and Agreement, to the industry group responsible for compiling the average weight schedules used.

____
Taxpayer's Name and Address

____
Taxpayer Identification Number

By: ________________________
Signature

____
Date

____
Title (Must be an officer with the power to bind the Corporation.)

Part IV. Items of General Interest

Age Limit for Jobs Credit Raised to Age 20 for Youths Participating in a Qualified Cooperative Education Program

Announcement 80-83

Under present law, a jobs credit is provided for hiring individuals who are members of certain targeted groups. The credit, which is elective, equals 50 percent of qualified first-year wages and 25 percent of qualified second-year wages. Recently enacted Pub. L. 96-222, 1980-20 I.R.B. 5, amended the law for one of the targeted groups. This group consists of youths who actively participate in qualified cooperative education programs.

The new law provides that individuals in this group must be 16, 17, 18, or 19 years old. Before enactment of Pub. L. 96-222, these individuals had to be 16, 17, or 18 years old. The law is retroactive so that an individual reaching age 19 will qualify as a member of this targeted group for wages paid or incurred after November 26, 1979.

The change can affect users of two Internal Revenue Service forms: Form 6199, Certification of Youth Participating in a Qualified Cooperative Education Program, and Form 5884, Jobs Credit.

Instruction B(1)(i) for Form 6199 should be revised to read as follows:

"(i) having reached age 16 and not having attained age 20. (Note: An individual reaching 19 will be treated as a youth participating in a qualified cooperative education program only for wages paid or incurred after November 26, 1979.)"

Users of Form 5884 may find that the change increases their allowable jobs credit for 1979. For example, an employer hired a certified youth on July 1, 1979, and paid that person $5,000 in wages by the time the youth turned 19 on December 1, 1979. The employer paid this person $1,000 more in wages during December 1979, and filed Form 5884 to figure the jobs credit for the calendar year. Under the old law, the employer figured the jobs credit based only on the $5,000 paid before the youth turned 19. Under the new law the employer figures the jobs credit based on the full $6,000 paid in 1979 if the employee continues to meet all the other requirements for certification.

Employers should file amended returns if they have already filed their 1979 income tax returns without claiming the full jobs credit to which they are now entitled. They should attach a completed 1979 Form 5884 to show the computation.

Special Rule for the Deduction of Certain Charitable Contributions of Inventory and Other Property—Public Hearing

Announcement 80-84 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to a special rule for the deduction of certain charitable contributions of inventory and other property as added by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1].

DATES: The public hearing will be held on July 15, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by July 1, 1980.

ADDRESS: The public hearing will be held in the Chief Counsel's Conference Room, Room 4132, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-272-76), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under section 170(e)(3) of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Thursday, March 20, 1980, at page 18030 (45 FR 18030).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of the comments to be presented at the hearing and the time they wish to devote to each subject by July 1, 1980. Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive on improving government regulations appearing in the Federal Register for Wednesday, November 8, 1978.

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[1] Filed by the Office of the Federal Register on May 29, 1980, and published in the issue of the Federal Register for May 30, 1980, 45 F.R. 36431.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing, the following individuals have been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Robert B. Clarkson	Anderson, SC	Attorney	April 25, 1980
John E. DeSantis	Belmont, CA	Certified Public Accountant	May 12, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 150.4995-1 through 150.4995-3, 150.6050C-1, added; published as temporary regulations in T.D. 7694, 1980-23 I.R.B. 19.	Withholding and depositing windfall profit tax when producer is integrated oil company.	April 25, 1980	June 24, 1980
26 CFR 1.50A-1, 1.50A-2, 1.50B-1 through 1.50B-5, amended; 1.50A-3 through 1.50A-7, deleted; 1.280C-1 redesignated as 1.280C-2; 1.50B-6, 1.280C-1, added.	Work incentive program (WIN) credit.	April 30, 1980	June 30, 1980
26 CFR 1.120-1 deleted; 1.120-1, 1.120-2, 1.501(c)(20)-1, added.	Qualified group legal services plans.	April 29, 1980	June 30, 1980
26 CFR 1.6073-1 through 1.6073-3, amended.	Time for filing declarations of estimated tax by farmers, fishermen, and certain nonresident aliens.	May 21, 1980	July 21, 1980
27 CFR 1.217-2 revised.	Special rules for foreign moving expenses and the allowance of moving expense deductions in the case of retirees or dependents of decedents who were working abroad.	May 22, 1980	July 21, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1, dated January 7, 1980.

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* Denotes entry since last publication

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80-17, 1980-3 I.R.B. **5**

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[1] See footnote at end of list.

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75-461
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80-59, 1980-9 I.R.B. **18**

76-439
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80-85, 1980-13 I.R.B. **6**

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80-134, 1980-19 I.R.B. **10**

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80-22, 1980-3 I.R.B. **15**

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1 I.R.B., dated January 7, 1980.

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1928–2	9.50	*1942–2*	*5.55*	1958–2	13.00	1971–1	10.55
1929–1	12.00	*1943*(*)	*9.55*	1958–3	15.00	1971–2	8.50
1929–2	*3.15*	*1944*(*)	*7.85*	1959–1	15.00	1972–1	13.50
1930–1	7.30	1945(*)	9.40	1959–2	9.60	1972–2	13.70
1930–2	9.50	*1946–1*	*2.55*	1960–1	9.00	1973–1	16.00
1931–1	*3.60*	1946–2	5.20	1960–2	11.50	1973–2	8.30
1931–2	13.00	*1947–1*	*1.80*	1961–1	14.00	1974–1	11.00
1932–1	*2.80*	1947–2	3.40	1961–2	10.00	1974–2	9.95
1932–2	8.65	*1948–1*	*3.15*	1962–1	14.00	*1974–3*	*8.20*
1933–1	*3.35*	1948–2	7.50	1962–2	13.00	1974–3 Supp.	10.00
1933–2	*3.45*	*1949–1*	*6.90*	1962–3	20.00	1975–1	16.00
1934–1	*3.70*	*1949–2*	*2.80*	1963–1	9.00	1975–2	13.00
1934–2	14.00	1950–1	6.35	1963–2	10.75	1976–1	11.00
1935–1	6.90	*1950–2*	*4.70*	1964–1–1	10.00	1976–2	10.25
1935–2	*4.00*	*1951–1*	*2.65*	1964–1–2	11.00	1976–3–1	9.50
1936–1	*3.55*	*1951–2*	*5.05*	1964–2	9.80	1976–3–2	16.00
1936–2	*3.90*	*1952–1*	*2.55*	1965–1	10.70	1976–3–3	10.00
1937–1	*3.75*	1952–2	7.05	1965–2	12.25	1977–1	10.75
1937–2	7.70	*1953–1*	*4.25*	1966–1	14.00	1977–2	11.75
1938–1	*4.05*	1953–2	12.00	1966–2	14.05	1978–1	11.75
1938–2	*3.50*	1954–1	12.00	1967–1	10.00	1978–2	13.00
1939–1–1	8.25	1954–2	12.00	1967–2	15.00	1978–3–1	12.25
1939–1–2	10.90	1955–1	10.25	1968–1	14.00	1978–3–2	9.00
1939–2	9.40	1955–2	13.00	1968–2	11.75	1979–1	14.00
1940–1	5.55	1956–1	15.00	1969–1	7.50	1979–2	15.00
1940–2	14.00	1956–2	18.00	1969–2	6.50		

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INTERNAL REVENUE BULLETIN

The Introduction on page 3 describes the purpose and content of this publication. The weekly Internal Revenue Bulletin is sold on a yearly subscription basis by the Superintendent of Documents. Current subscribers are notified by the Superintendent of Documents when their subscriptions must be renewed.

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The contents of the weekly Bulletin are consolidated semiannually into a permanent, indexed, Cumulative Bulletin. These are sold on a single copy basis and *are not* included as part of the subscription to the Internal Revenue Bulletin. Subscribers to the weekly Bulletin are notified when copies of the Cumulative Bulletin are available. Certain issues of Cumulative Bulletins are out of print and are not available. Persons desiring available Cumulative Bulletins, which are listed on the reverse, may purchase them from the Superintendent of Documents.

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June 30, 1980
Bulletin No. 1980-26

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Proc. 80-22, page 26.
Areas in which advance rulings will not be issued. A revised list of those areas of the Code under the jurisdiction of the Assistant Commissioner (Technical) in which the Service will not issue advance rulings or determination letters is provided; Rev. Procs. 79-14, 79-52, and 79-68 superseded.

EXEMPT ORGANIZATIONS

Rev. Proc. 80-24, page 30.
Rulings; determination letters; closing agreements. Procedures are provided for issuing rulings and determination, opinion, notification, and advisory letters and for entering into closing agreements on specific issues in employee plan and exempt organization matters.

Rev. Proc. 80-25, page 39.
Rulings; applications, revocations, and modifications. Procedures are provided for applying for recognition of exemption and for revoking or modifying exemption rulings and determination letters; Rev. Proc. 72-4, 76-33, 77-21 superseded; Rev. Proc. 76-34 modified; Rev. Proc. 77-31 revoked.

Rev. Proc. 80-26, page 43.
Technical advice to key District Directors and Appeals Offices. Procedures are provided for furnishing technical advice to key District Directors or Appeals Offices on employee plan and exempt organization matters.

Rev. Proc. 80-27, page 49.
Rulings; procedures; group exemption letters. Procedures are set forth under which recognition of exemption under section 501(c) of the Code may be obtained on a group basis for subordinate organizations affiliated with and under the general supervision or control of a central organization; Rev. Proc. 77-38 superseded.

Rev. Proc. 80-28, page 51.
Rulings; determination letters; court determined exemption. The procedures are provided under which an organization that has been determined by a court to qualify as an exempt organization may obtain a ruling or determintion letter recognizing such qualification for the tax years subsequent to that involved in the litigation; Rev. Proc. 80-25 amplified.

Announcement 80-86, page 69.
A listing is given of organizations now classified as private foundations.

EMPLOYEE PLANS

Rev. Proc. 80-24, page 30.
Rulings; determination letters; closing agreements. Procedures are provided for issuing rulings and determination, opinion, notification, and advisory letters and for entering into closing agreements on specific issues in employee plan and exempt organization matters.

Rev. Proc. 80-26, page 43.
Technical advice to key District Directors and Appeals Offices. Procedures are provided for fur-

(Continued on page 4)

Finding List begins on page 73.
Announcement of Disbarments on page 70.
Announcement of Proposed Rulemaking on page 71.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

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Highlights of this Issue—Continued

(Continued from page 1)

EMPLOYEE PLANS—Cont'd

nishing technical advice to key District Directors or Appeals Offices on employee plan and exempt organization matters.

Rev. Proc. 80-29, page 52.

Rulings and opinion letters; master or prototype plans; issuance. Procedures are set forth pertaining to the issuance of rulings and opinion letters relating to master or prototype pension, annuity, and profit-sharing plans under sections 401 and 403(a) of the Code and the status of related trusts or custodial accounts under section 501(a); Rev. Procs. 72-7, 72-8, 75-51, and 75-52 superseded.

Rev. Proc. 80-30, page 56.

Determination letters; issuance. Procedures are set forth pertaining to the issuance of determination letters on the qualification of pension, profit-sharing, stock bonus, and bond purchase plans involving sections 401, 403(a), 405(a), 409A, and 4975(e)(7) of the Code; Rev. Procs. 75-48, 76-15, 77-23, and 78-14 modified; Rev. Procs. 56-22, 56-42, and 67-26 obsoleted; Rev. Procs. 72-6, 75-31, 75-47, 76-38, and 77-22 superseded.

ESTATE AND GIFT TAXES

Rev. Proc. 80-22, page 26.

Areas in which advance rulings will not be issued. A revised list of those areas of the Code under the jurisdiction of the Assistant Commissioner (Technical) in which the Service will not issue advance rulings or determination letters is provided; Rev. Procs. 79-14, 79-52, and 79-68 superseded.

EMPLOYMENT TAXES

Page 5.

Railroad retirement; rate determination; quarterly. The Railroad Retirement Board has determined that the rate of tax imposed by section 3221(c) of the Code shall be twelve and one-half cents for the quarter beginning July 1, 1980.

EXCISE TAXES

Rev. Proc. 80-23, page 30.

Windfall profit tax; Form 720; reporting with other taxes. Procedures are set forth to be followed when Form 720, Quarterly Federal Excise Tax Return, reports liability for several excise taxes, including the windfall profit tax, that are subject to different reporting times.

Announcement 80-90, page 70.

Due to the repeal of the special tax on coin-operated gaming devices it is not necessary to file Form 11-B, Special Tax Return—Gaming Devices, or pay the tax after June 30, 1980.

ADMINISTRATIVE

Rev. Proc. 80-20, page 7.

Rulings; determination letters; closing agreements. Revised procedures are provided for issuing rulings and determination letters and for entering into closing agreements on specific issues; Rev. Proc. 79-45 superseded.

Rev. Proc. 80-21, page 19.

Technical advice to District Directors and Chiefs, Appeals Offices. Revised procedures are provided for furnishing technical advice to District Directors and Chiefs, Appeals Offices. Taxpayers' rights when such advice is requested are also set forth. Rev. Proc. 79-46 superseded and Rev. Proc. 79-63 modified.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 170.—Charitable, Etc., Contributions and Gifts

26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance of deduction.

Procedures of the Service with regard to applications for recognition of exemption from federal income tax under sections 501 and 521 of the Code and with respect to revocation or modification of exemption rulings and determination letters. See Rev. Proc. 80-25, page 39.

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401.1: Qualified pension, profit-sharing, and stock bonus plans.

Procedures for requests relating to qualification as to form of master and prototype pension, profit-sharing and annuity plans. See Rev. Proc. 80-29, page 52.

26 CFR 1.401-1: Qualified pension, profit-sharing, and stock bonus plans.

Procedures pertaining to the issuance of determination letters on the qualification of pension, annuity, profit-sharing, or stock bonus plans involving sections 401, 403(a), and 405(a) of the Code. See Rev. Proc. 80-30, page 56.

Section 403.—Taxation of Employee Annuities

26 CFR 1.403(a)-1: Taxability of beneficiary under qualified annuity plans.

Procedures for requests relating to qualification as to form of master and prototype pension, profit-sharing and annuity plans. See Rev. Proc. 80-29, page 52.

26 CFR 1.403(a)-1: Taxability of beneficiary under qualified annuity plans.

Procedures pertaining to the issuance of determination letters on the qualification of pension, annuity, profit-sharing, or stock bonus plans involving sections 401, 403(a), and 405(a) of the Code. See Rev. Proc. 80-30, page 56.

Section 405.—Qualified Pension, Profit-Sharing and Stock Bonus Plans

26 CFR 1.405-1: Qualified pension, profit-sharing, and stock bonus plans.

Procedures pertaining to the issuance of determination letters on the qualification of pension, annuity, profit-sharing, or stock bonus plans involving sections 401, 403(a), and 405(a) of the Code. See Rev. Proc. 80-30, page 56.

Section 501.—Exemption from Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(a)-1: Exemption from taxation.

Procedures of the Service with regard to applications for recognition of exemption from federal income tax under sections 501 and 521 of the Code and with respect to revocation or modification of exemption rulings and determination letters. See Rev. Proc. 80-25, page 39.

26 CFR 1.501(a)-1: Exemption from taxation.

Procedures under which recognition of exemption from federal income tax under section 501(c) of the Code may be obtained on a group basis for subordinate organizations affiliated with and under the general supervision or control of a central organization. See Rev. Proc. 80-27, page 49.

26 CFR 1.501(a)-1: Exemption from taxation.

Procedure for the issuance of ruling or determination letters by the Internal Revenue Service to organizations that have established their qualification for exemption from federal income tax in the courts. See Rev. Proc. 80-28, page 51.

26 CFR 1.501(a)-1: Exemption from taxation.

Procedures for requests relating to exemption of trusts forming part of master and prototype pension and profit-sharing plans. See Rev. Proc. 80-29, page 52.

26 CFR 1.501(a)-1: Exemption from taxation.

Procedures pertaining to the issuance of determination letters on the qualification of pension, annuity, profit-sharing, or stock bonus plans involving sections 401, 403(a), and 405(a) of the Code. See Rev. Proc. 80-30, page 56.

Section 508.—Special Rules with Respect to Section 501(c)(3) Organizations

26 CFR 1.508-1: Notices.

Procedure for the issuance of ruling or determination letters by the Internal Revenue Service to organizations that have established their qualification for exemption from federal income tax in the courts. See Rev. Proc. 80-28, page 51.

Section 509.—Private Foundation Defined

26 CFR 1.509(a)-1: Definition of private foundation.

Procedures of the Service with regard to applications for recognition of exemption from federal income tax under sections 501 and 521 of the Code and with respect to revocation or modification of exemption rulings and determination letters. See Rev. Proc. 80-25, page 39.

Section 521.—Exemption of Farmers' Cooperatives from Tax

26 CFR 1.521-1: Farmers' cooperative marketing and purchasing associations; requirements for exemption under section 521.

Procedures of the Service with regard to applications for recognition of exemption from federal income tax under sections 501 and 521 of the Code and with respect to revocation or modification of exemption rulings and determination letters. See Rev. Proc. 80-25, page 39.

26 CFR 1.521-1: Farmers' cooperative marketing and purchasing associations; requirements for exemption under section 521.

Procedures for the issuance of ruling or determination letters by the Internal Revenue Service to organizations that have established their qualification for exemption from federal income tax in the courts. See Rev. Proc. 80-28, page 51.

Section 3221.—Rate of Tax [Railroad Retirement Tax Act]

RAILROAD RETIREMENT BOARD

Determination of Quarterly Rate of Excise Tax for Railroad Retirement Supplemental Annuity Program

In accordance with directions in section 3221(c) of the Railroad Retirement Tax Act (26 U.S.C. 3221 (c)), the Railroad Retirement Board has determined that the excise tax imposed by such section 3221(c) on every employer, with respect to having individuals in his employ, for each work-hour for which compensation is paid by such employer for services rendered to him during the quarter beginning July 1, 1980, shall be at the rate of twelve and one-half cents.

In accordance with directions in section 15(a) of the Railroad Retirement Act of 1974, the Railroad Retirement Board has determined that for the quarter beginning July 1, 1980, 20.3 percent of the taxes collected under sections 3211(b) and 3221(c) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Account and 79.7 percent of the taxes collected under such sections 3211(b) and 3221(c) plus one hundred percent of the taxes collected under section 3221(d) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Supplemental Account.

Dated May 15, 1980.

By Authority of the Board.

R. F. BUTLER,
Secretary of the Board.

(Filed by the Office of the Federal Register on May 23, 1980, 8:45 a.m., and published in the issue of the Federal Register for May 27, 1980, 45 F.R. 35457)

Section 4942.—Taxes on Failure to Distribute Income

26 CFR 53.4942(b)-1: Operating foundations.

Procedures of the Service with regard to applications for recognition of exemption from federal income tax under sections 501 and 521 of the Code and with respect to revocation or modification of exemption rulings and determination letters. See Rev. Proc. 80-25, page 39.

Section 6071.—Time for Filing Returns and Other Documents

26 CFR 46.6071(a)-1: Time for filing returns.

Filing procedures where Form 720, Quarterly Federal Excise Tax Return, reports liability for several excise taxes that are subject to different reporting times. See Rev. Proc. 80-23, page 30.

Section 6076.—Time for Filing Return of Windfall Profit Tax

26 CFR 150.6076-1: Time for filing return of windfall profit tax.

Filing procedures where Form 720, Quarterly Federal Excise Tax Return, reports liability for several excise taxes that are subject to different reporting times. See Rev. Proc. 80-23, page 30.

Section 6651.—Failure to File Tax Return or to Pay Tax

26 CFR 301.6651-1: Failure to file tax return or to pay tax.

Filing procedures where Form 720, Quarterly Federal Excise Tax Return, reports liability for several excise taxes that are subject to different reporting times. See Rev. Proc. 80-23, page 30.

Section 7428.—Declaratory Judgments Relating to Status and Classification of Organizations Under Section 501(c)(3), Etc.

Procedures of the Service with regard to applications for recognition of exemption from federal income tax under sections 501 and 521 of the Code and with respect to revocation or modification of exemption rulings and determination letters. See Rev. Proc. 80-25, page 39.

Section 7476.—Declaratory Judgments

26 CFR 1.7476-1: Interested parties.

Procedures pertaining to the issuance of determination letters on the qualification of pension, annuity, profit-sharing, or stock bonus plans involving sections 401, 403(a), and 405(a) of the Code. See Rev. Proc. 80-30, page 56.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 80-20

SECTION 1. PURPOSE

The purpose of this revenue procedure is to supersede Rev. Proc. 79-45, 1979-2 C.B. 508, by providing revised procedures for issuing rulings and determination and information letters, and for entering into closing agreements on specific issues involving the interpretation or application of the federal tax laws. It also tells taxpayers and their representatives where to send requests for rulings and determination and information letters. It gives the steps to follow so that requests may be handled more efficiently.

SEC. 2. SCOPE

This revenue procedure applies only to ruling requests, information letters, and closing agreements under the jurisdiction of the Assistant Commissioner (Technical), and to requests for determination letters under the jurisdiction of field offices that relate to Code sections under the jurisdiction of the Assistant Commissioner (Technical). The Assistant Commissioner (Technical) acts as the principal assistant to the Commissioner in providing basic principles and rules for the uniform interpretation and application of the federal tax laws under the jurisdiction of the Assistant Commissioner (Technical). The procedures for obtaining rulings, etc., that apply specifically to federal firearms taxes under subtitle E of the Internal Revenue Code are under the jurisdiction of the Bureau of Alcohol, Tobacco and Firearms. The procedures for obtaining rulings, determination letters, etc., on employee plans and exempt organizations are under the jurisdiction of the Assistant Commissioner (Employee Plans and Exempt Organizations). However, the jurisdiction of the Assistant Commissioner (Technical) includes section 521 of the Code, on exemption of farmers' cooperatives from tax; section 526, on shipowners' protection and indemnity associations; section 527(a), (b), (c), (d), (e), and (g), on political organizations, and section 528, on certain homeowners' associations.

SEC. 3. CHANGES

.01 Section 5.01 has been expanded to (1) incorporate the present practice that the National Office does not rule on the classification of an organization for which a return has been filed, and (2) to cross reference Rev. Proc. 79-63, 1979-2 C.B. 578, which concerns applications for extension of the time for making an election or application for relief pursuant to section 1.9100-1 of the regulations. In this connection section 5.01 now provides that if a request for an extension of time under section 1.9100-1 is submitted after the return is filed but before the return is examined, the procedures under Rev. Proc. 80-20 are applicable. However, if an examination of the return in such situation has begun, or is being considered by an Appeals office, the procedures of Rev. Proc. 80-21, page 19, this Bulletin, are applicable.

.02 Section 5.02 has been modified to permit issuance of rulings in estate tax matters after the estate tax return has been filed if the request for ruling is submitted before the return is filed.

.03 Section 5.02(c) has been clarified to state that the National Office will issue rulings regarding the application of the generation-skipping transfer tax effective date rules to wills, trusts, and trust equivalents in existence on June 11, 1976.

.04 Section 9.02 has been revised to cover specifically signatures on ruling requests from partnerships and trusts.

.05 Section 9.05 has been expanded to (1) explain additional procedures for extending the 21-day period for confirming additional material submitted, and (2) cite additional revenue procedures relating to specific Code or regulatory provisions.

.06 Section 9.06 has been expanded to (1) clarify by limiting the reference to issue pending in litigation to litigation involving an issue in a return of the taxpayer or a related taxpayer that is the same issue in the request for ruling, and (2) state the purpose of requiring the ruling request to be attached to a return filed before the ruling is received.

.07 Section 9.08 has been revised to encourage, rather than require, material on contrary authorities to be submitted.

.08 Section 9.09 has been expanded to make it clear that the disclosure procedures in section 9.09 are applicable to information submitted after the initial request.

.09 Section 11.1 has been clarified to point out that a conference must be held within 21 calendar days after the initial notification as to the time and place of the conference.

.10 Section 20 now provides the procedures for requesting application of 7805(b) of the Code to ruling letters and determination letters.

SEC. 4. GENERAL PRACTICE AND DEFINITIONS

.01 The Service answers inquiries of individuals and organizations, when appropriate in the interest of sound tax administration, about their status for tax purposes and the tax effects of their acts or transactions. The National Office issues rulings in such matters.

.02 District Directors of Internal Revenue apply the statutes and tax treaties, regulations, revenue rulings, and other precedents published in the Internal Revenue Bulletin in determining tax liability, collecting taxes, and issuing information letters and determination letters in answer to taxpayers' inquiries or requests. For purposes of this revenue procedure, any reference to District Director or district office includes, when appropriate, the director of an Internal Revenue Service Center and the Director of International Operations, or their respective offices.

.03 The word "taxpayer" includes all persons subject to any provision of the Internal Revenue Code and, when appropriate, their representatives. Any reference to National Office means only the Office of the Assistant Commissioner (Technical).

.04 A "ruling" is a written statement issued to a taxpayer by the National Office that interprets and applies the tax laws to the taxpayer's specific set of facts. Rulings are issued only by the National Office, under the general supervision of the Assistant Commissioner (Technical). Issuing rulings has been largely delegated to the Directors of the Corporation Tax Division and the Individual Tax Division.

.05 A "determination letter" is a written statement issued by a District Director in response to a written inquiry by a taxpayer which applies the principles and precedents previously announced by the National Office to a specific set of facts. A determination letter is issued only when a determination can be made on the basis of clearly established rules in the statute or regulations, or by a position in a ruling, opinion, or court decision published in the Internal Revenue Bulletin that specifically answers the question presented. A determination letter will not be issued if a determination cannot be made, for example, when the question presents a novel issue, or if the matter is excluded from the jurisdiction of a District Director under section 7 of this revenue procedure.

.06 An "information letter" is a statement issued either by the National Office or by a District Director that calls attention to a well-established interpretation or principle of tax law, without applying it to a specific set of facts. It may be issued if the request indicates that the taxpayer is seeking general information. If the request does not meet the requirements of section 9 of this revenue procedure, but the Service thinks that the general information may help the individual or organization, it may issue an information letter.

.07 A "revenue ruling" is an interpretation by the Service that has been published in the Internal Revenue Bulletin. It is the conclusion of the Service on how the law is applied to an entire set of facts. Revenue rulings are issued only by the National Office and are published for the information and guidance of taxpayers, Internal Revenue Service officials, and other interested parties.

.08 A "closing agreement" is an agreement between the Commissioner of Internal Revenue or the Commissioner's delegate and a taxpayer on a specific issue or issues or liability that is entered into under the authority in section 7121 of the Code. A closing agreement prepared in an office under the responsibility of the Assistant Commissioner (Technical) is based on a ruling that has been signed by the Commissioner, or the Commissioner's delegate, which says that a closing agreement will be entered into on the basis of the holding of the ruling letter. Closing agreements are final, unless fraud, malfeasance, or misrepresentation of a material fact can be shown. Closing agreements may be entered into when it is advantageous to have the matter permanently and conclusively closed, or when a taxpayer can show good and sufficient reasons for an agreement and the government will sustain no disadvantage by its consummation. In appropriate cases, taxpayers may be asked to enter into a closing agreement as a condition to the issuing of a ruling. If, in a single case, closing agreements are requested for each of a number of taxpayers, such agreements are entered into only if the number of taxpayers is 25 or less. However, if the issue and holding are identical for all the taxpayers and they number more than 25, a "mass closing agreement" will be entered into with the taxpayer who is authorized by the others to represent the entire group.

SEC. 5. RULINGS ISSUED BY THE NATIONAL OFFICE

.01 *In income and gift tax matters,* the National Office issues rulings on prospective transactions and on completed transactions before the return is filed for them. However, the National Office will issue rulings after the return is filed if a ruling is required by section 367 of the Code and the ruling request is filed on time under that section. Further, see Rev. Proc. 79-63, 1979-2 C.B. 578, which concerns applications for extension of the time for making an election or application for relief pursuant to section 1.9100-1 of the regulations. If a request for an extension of time under section 1.9100-1 is submitted after the return is filed but before the return is examined the procedures under Rev. Proc. 80-20 are applicable. If an examination of the return has begun, or is being considered by an Appeals office, the procedures of Rev. Proc. 80-21 are applicable. The National Office issues rulings on the exempt status of organizations under section 521. See Rev. Proc. 80-25, page 39, this Bulletin. The National Office ordinarily does not issue rulings if at the time the ruling is requested, the identical issue is involved in the taxpayer's return for an earlier period, and (1) that issue is being examined by a District Director or is being considered by an Appeals office, or (2) that issue has been examined by a District Director or considered by an Appeals office and the statutory period of limitation on assessment or refund of tax has not expired, or (3) a closing agreement covering the issue or liability has not been entered into by a District Director or by an Appeals office. If a return dealing with an issue for a particular year is filed while a request for ruling on that issue is pending, the National Office will issue the ruling unless it is notified by the taxpayer that an examination of that issue or the identical issue on an earlier year's return has been started by a District Director. See section 9.06. However, even if an examination has begun, the National Office ordinarily will issue the ruling if the District Director agrees, by memorandum, to permit the ruling to be issued. The National Office does not issue rulings for the replacement of involuntarily converted property, even though replacement has not been made, if the taxpayer has filed a return for the tax year in which the property was converted. See section 7.05 on the District Directors' authority to issue determination letters in this connection. In addition, the National Office does not issue rulings on the classification of an organization if a return has been filed for the organization for an earlier period. The National Office also does not issue rulings on only part of an integrated transaction.

.02 *In estate tax matters,* the National Office issues rulings with respect to transactions affecting the estate tax of a decedent before the estate tax return is filed. If the estate tax return is due to be filed before the ruling is issued, the taxpayer should secure an extension of time for filing the return for the maximum period of six months, and notify the National Office Branch considering the request for ruling that an extension has been secured. If the return is filed before the ruling is issued, the taxpayer must disclose on the return that a ruling has been requested, attach a copy of the pending ruling request to the return, and notify the National Office that the return has been filed. The National Office will make every effort to issue the ruling within three months of the day on which the return was filed. If the ruling cannot be issued within that three-month period, the National Office will notify the District Director having jurisdiction of the return who may, by memorandum to the National Office, grant an additional period for the issuance of the ruling. The National Office will not rule on matters relating to the application of the estate tax to property or the estate of a living person.

1 *In generation-skipping transfer tax matters,* the National Office issues rulings on transactions that affect the generation-skipping transfer tax before the return is filed. Rulings are not issued until after the generation-skipping trust, or trust equivalent, has been established. Rulings are not issued on a generation-skipping transfer tax matter before the distribution or termination takes place. Notwithstanding the foregoing, the National Office will issue rulings regarding the application of the generation-skipping transfer tax effective date rules (section 2006(c) of the Tax Reform Act of 1976, Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 365, as amended by section 702(n)(1) of the Revenue Act of 1978, Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, 169) to wills, trusts, and trust equivalents in existence on June 11, 1976.

2 *In matters involving additional tax under section 2032A(c),* the National Office issues rulings on prospective transactions and on completed transactions before the return is filed for those transactions.

.03 *In employment and excise tax matters,* the National Office issues rulings on prospective transactions and on completed transactions either before or after the return is filed for those transactions. In employment tax matters, generally the taxpayer is the person who employs the worker. However, if the worker asks for the ruling, both the worker and the person who employs the worker are considered to be the taxpayer and both are entitled to the ruling. The National Office usually will not issue rulings if at the time the ruling is requested, the identical issue is involved in the taxpayer's return for an earlier period and (1) that issue is under examination by a District Director or under consideration by an Appeals office, or (2) that issue has been examined by a District Director or considered by an Appeals office and the statutory period of limitation on assessment or refund of tax has not expired, or (3) a closing agreement covering the issue or liability has not been entered into by a District Director or by an Appeals office. However, if a District Director began an examination of the issue involved in the ruling request, the National Office usually will issue the ruling if the District Director agrees, by memorandum, to permit the ruling to be issued.

.04 *In administrative provisions matters,* the National Office issues rulings on issues arising under the Internal Revenue Code and related statutes, and the regulations thereunder, that relate primarily to the time, place, manner, and procedures, for reporting and paying taxes; assessing and collecting taxes (including interest and penalties); abating, crediting, or refunding overassessments or overpayments of tax; and filing information returns. Rulings ordinarily are not issued, if at the time the ruling is requested, the identical issue is involved in the taxpayer's return for an earlier period and (1) that issue is being considered by a District Director or the Director of a Service Center, or (2) that issue has been considered and the statutory period of limitation on assessment or refund of tax has not expired, or (3) a closing agreement covering the issue or liability has not been entered into. If a return involving an issue for a particular year is filed while a request for a ruling on that issue is pending, the National Office will issue the ruling unless an examination of that issue or an examination of the identical issue on an earlier year's return has been started by a District Director or a Director of a Service Center. But, even if consideration has begun, the National Office ordinarily will issue the ruling if the District Director or the Director of a Service Center agrees, by memorandum, to permit the ruling to be issued. Rulings ordinarily are not issued if at the time the ruling is requested, the identical issue is involved in the taxpayer's return for an earlier period and (1) that issue is being considered by an Appeals office, or (2) that issue has been considered by an Appeals office and the statutory period of limitation on assessment or refund of tax has not expired, or (3) a closing agreement covering the issue or liability has not been entered into.

.05 The National Office does not issue rulings to business, trade, or industrial associations, or to similar groups concerning the application of the tax laws to members of the group. It may, however, issue rulings to these groups or associations on their own tax status or liability, if the tax status or liability is not an issue that is being examined by any field office (including consideration by any Appeals office) for the same taxpayer for the same or an earlier period under the conditions stated in section 5.

.06 Pending the adoption of regulations (either temporary or final) that interpret the provisions of any act, the issuing of rulings will be considered under the following conditions:

1 If the ruling request presents an issue on which the answer seems clear by applying the statute to the facts, a ruling will be issued under the usual procedures.

2 If the ruling request presents an issue on which the answers seems reasonably certain but not entirely free from doubt, a ruling will be issued only if it is established that a business emergency requires a ruling or that unusual hardship will result from failure to obtain a ruling. If the taxpayer believes that a business emergency

exists or that an unusual hardship will result from failure to obtain a ruling, the taxpayer should submit with the request a separate letter stating the facts necessary for the Service to make a determination. In this connection, the Service will not consider a "business emergency" to result from circumstances under the taxpayer's control, such as, scheduling within an inordinately short time the closing date for a transaction or a meeting of the board of directors or the shareholders of a corporation. However, if the ruling request presents an issue that cannot be reasonably resolved before regulations are issued, a ruling will not be issued.

SEC. 6. DETERMINATIONS UNDER SECTION 999(d) OF THE CODE

Under Rev. Proc. 77-9, 1977-1 C.B. 542, procedures, the National Office issues determinations under section 999(d) of the Code that may deny certain benefits of the foreign tax credit, deferral of earnings of foreign subsidiaries, and domestic international sales corporation (DISC) to a person, if that person, or a member of a controlled group (within the meaning of section 993(a)(3)) that includes that person, or a foreign corporation of which a member of the controlled group is a United States shareholder, agrees to participate in or cooperate with an international boycott.

SEC. 7. DETERMINATION LETTERS ISSUED BY DISTRICT DIRECTORS

.01 *In income and gift tax matters,* District Directors issue determination letters in response to taxpayers' written requests on completed transactions that affect returns over which they have examination jurisdiction. This applies only if the question presented is specifically answered by statute or regulation, or by the position stated in a ruling, opinion, or court decision published in the Internal Revenue Bulletin. A determination letter usually is not issued for a question concerning a return to be filed by the taxpayer if the same question is involved in a return already filed. District Directors do not issue determination letters on the tax consequences of prospective or proposed transactions, except as provided in section 7.05.

.02 *In estate tax matters,* District Directors issue determination letters in response to written requests affecting the estate tax returns of decedents that they will examine, but only if the question presented is specifically answered by statute or regulation, or by the position stated in a ruling, opinion, or court decision published in the Internal Revenue Bulletin. District Directors do not issue determination letters on matters concerning the application of the estate tax to property or the estate of a living person.

1 *In generation-skipping transfer tax matters,* District Directors issue determination letters in response to written requests affecting the generation-skipping transfer tax returns that they will examine, but only if the questions presented are specifically answered by statute or regulation, or by a position stated in a ruling, opinion, or court decision published in the Internal Revenue Bulletin. District Directors do not issue determination letters or matters concerning the application of the generation-skipping transfer tax before the distribution or termination takes place.

.03 *In employment and excise tax matters,* District Directors issue determination letters on completed transactions in response to written requests from taxpayers over which they have examination jurisdiction, but only if the question presented is specifically answered by statute or regulation, or by the position stated in a ruling, opinion, or court decision published in the Internal Revenue Bulletin.

.04 Notwithstanding the provisions of sections 7.01, 7.02, and 7.03, a District Director will not issue a determination letter in response to a request that presents a question specifically answered by statute or regulation, or by the position stated in rulings, etc., published in the Internal Revenue Bulletin, if (1) it appears that the taxpayer has directed a similar inquiry to the National Office, (2) the same issue involving the same taxpayer is pending in a case before an Appeals office, (3) the determination letter is requested by an industry, trade association, or similar group, or (4) the request involves an industry-wide problem. Under no circumstances will a District Director issue a determination letter unless it is clearly shown that the request concerns a return that has been filed or is required to be filed over which the District Director has or will have examination jurisdiction. Notwithstanding the provisions of section 7.03, a District Director will not issue a determination letter on an employment tax question if the specific question for the same taxpayer has been or is being considered by the Central Office of the Social Security Administration or the Railroad Retirement Board. Nor will District Directors issue determination letters for determination of a constructive sales price under section 4216(b) or 4218(e) of the Code. The National Office, however, will issue rulings in this area. See section 8.03.

.05 District Directors issue determination letters on the replacement of involuntarily converted property under section 1033 even though the replacement has not been made, if the taxpayer has filed an income tax return for the year in which the property was involuntarily converted.

.06 A request received by a District Director on a question concerning an income, estate, or gift tax return already filed will, in general, be considered in connection with the examination of the return. If a response is made to such a request before the return is examined, it will be considered a tentative finding in any later examination of that return.

SEC. 8. DISCRETIONARY AUTHORITY TO ISSUE RULINGS AND DETERMINATION LETTERS

.01 The Service ordinarily will not issue rulings or determination letters in certain areas because of the factual nature of the problem involved, or for other reasons. Rev. Proc. 80-22, page 26, this Bulletin, provides a list of these areas. This list is not all inclusive, since the Service may decline to issue a ruling or a determination letter on other questions, whenever warranted by the facts or circumstances of a particular case. The National Office and District Directors may, when it is considered appropriate and in the best interest of the Service, issue information letters calling attention to well-established principles of tax law.

.02 A ruling or a determination letter is not issued on alternative plans of proposed transactions or on hypothetical situations.

.03 The National Office will issue rulings in all cases on prospective or future transactions if the law or regulations require a determination of the effect of a proposed transaction for tax purposes, as in a transfer under sections 1491 and 1492 of the Code. The National Office will issue rulings on all transfers described in section 367(a)(1) if the request is filed within 183 days after the beginning of the transfer. The National Office also will issue rulings in all cases on the determination of a constructive sales price under section 4216(b) or 4218(e).

SEC. 9. INSTRUCTIONS TO TAXPAYER

.01 The taxpayer should submit a request for a ruling or a determination letter in duplicate if (1) more than one issue is presented in the request, or if (2) a closing agreement is requested on the issue presented. It is not necessary to submit requests in duplicate under other circumstances.

.02 A request for a ruling or determination letter and any factual information submitted at a later time must be accompanied by a declaration in the following form. "Under penalties of perjury, I declare that I have examined this request, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of the requested ruling or determination letter are true, correct, and complete." The declaration may not be made by the taxpayer's representative. It must be signed by the person or persons on whose behalf the request is made. The person who must sign for a corporate taxpayer must be an officer of the corporate taxpayer who has personal knowledge of the facts. The officer must be one whose duties are not limited to obtaining a ruling or determination letter from the Service. The person signing for a trust or partnership must be a trustee or partner who has personal knowledge of the facts.

.03 If more than one issue is presented in a request for a ruling, the Service generally will issue a single ruling letter. However, the taxpayer may request a separate ruling letter on any of the issues. Unless the Service determines that it is not feasible or not in the best interest of the Service to comply with such a request, it will issue separate ruling letters.

.04 When multiple issues are involved in a single factual situation and separate letters requesting rulings are submitted, a statement to this effect must be included in each ruling letter request. The Service in issuing each ruling will state that separate rulings have been issued or requests for rulings are pending.

.05 Each request for a ruling or a determination letter must contain a complete statement of all of the facts relating to the transaction. Such facts include: names, addresses, and taxpayer identification numbers of all interested parties; the location of the District Office that has or will have jurisdiction over the return; a full and precise statement of the business reasons for the transaction; and a carefully detailed description of the transaction. (The term "all interested parties" does not mean that a list is required of all shareholders of a widely-held corporation requesting a ruling relating to a reorganization, or a list of employees where a large number may be involved.) In addition, true copies of all contracts, wills, deeds, agreements, instruments, and other documents in the transaction must be submitted with the request. Original documents, such as contracts, wills, etc., should not be submitted because they become part of the Service's file and will not be returned. All material facts in documents must be included in the taxpayer's letter requesting a ruling or in supplemental letters, and not merely incorporated by reference, and must be accompanied by an analysis of their bearing on the issue or issues, specifying the provisions that apply. Material facts furnished to the Service by telephone or orally at a conference must be promptly confirmed by letter to the Service with a declaration in the form described in section 9.02. This confirmation must be furnished within 21 calendar days to be considered part of the request. An extension of the 21-day period will be granted only if justified in writing by the taxpayer and approved by the Chief or Assistant Chief of the Technical Branch to which the case is assigned. A request for extension should be submitted before the end of the 21-day period. If unusual circumstances close to the end of the 21-day period make a written request impractical, within the 21-day period the National Office should be told of the problem and that the written request for extension will be coming soon. Such a request must be sent promptly. The taxpayer or taxpayer's representative will be told promptly and later in writing of the approval or denial of the requested extension. There is no right of appeal to a denial of an extension request. Because the purpose of these procedures is to speed up the ruling process, the taxpayer is encouraged to submit the required relevant material promptly. Therefore, requests for extensions should be justified by compelling facts and circumstances. If the Service is not made aware, as provided above, of problems in meeting the 21-day period, or if the request is not sent promptly after the National Office is notified of problems in meeting the 21-day period, the Service will process the case on the assumption that no further submission will be received.

Specific guidelines for requesting rulings under certain code sections follow: Rev. Proc. 79-4, 1979-1 C.B. 483 (guidelines for submitting requests for rulings under sections 103 and 7478 on whether interest on certain governmental obligations can be excluded from the gross income of those who own them); Rev. Proc. 68-11, 1968-1 C.B. 761 (guidelines for a ruling request under section 117); Rev. Proc. 73-35, 1973-2 C.B. 490 (guidelines concerning a request for a ruling under section 302 or 311); Rev. Proc. 73-17, 1973-2 C.B. 465 (guidelines concerning a request for a ruling under section 332, 334(b)(1) or 334(b)(2)); Rev. Proc. 75-32, 1975-2 C.B. 555 (guidelines concerning a request for a ruling under section 337); Rev. Proc. 73-36, 1973-2 C.B. 496 (guidelines concerning a request for a ruling under section 331 or 346); Rev. Proc. 73-10, 1973-1 C.B. 760 (guidelines concerning a request for a ruling under section 351); Rev. Proc. 75-35, 1975-2 C.B. 561 (guidelines concerning a request for a ruling under section 355); Rev. Proc. 68-23, 1968-1 C.B. 821, Rev. Proc. 69-19, 1969-2 C.B. 301, Rev. Proc. 74-36, 1974-2 C.B. 491, Rev. Proc. 76-20, 1976-1 C.B. 560, Rev. Proc. 77-5, 1977-1 C.B. 536, and Rev. Proc. 77-17, 1977-1 C.B. 577 (guidelines concerning a request for a ruling under section 367). However, see section 7.367 of the Temporary Income Tax Regulations under the Tax Reform Act of 1976, which superseded the previously mentioned revenue procedures relating to section 367, to the extent of overlapping rules. Rev. Proc. 75-29, 1975-1 C.B. 754, Rev. Proc. 76-4, 1976-1 C.B. 543, Rev. Proc. 76-24, 1976-1 C.B. 563, Rev. Proc. 76-44, 1976-2 C.B. 668, and Rev. Proc. 77-4, 1977-1 C.B. 536 (guidelines for changes to closing agreements as a condition to issuing rulings under section 367); Rev. Proc. 78-33, 1978-2 C.B. 532 (guidelines concerning a request for a ruling under section 368(a)(1)(E)); Rev. Proc. 77-30, 1977-2 C.B. 539, and Rev. Proc. 77-37, 1977-2 C.B. 568 as amplified by Rev. Proc. 77-41, 1977-2 C.B. 574 (guidelines concerning requests for rulings handled by the Reorganization Branch of the Corporation Tax Division); Rev. Proc. 72-13, 1972-1 C.B. 735, Rev. Proc. 74-17, 1974-1 C.B. 438, and Rev. Proc. 75-16, 1975-1 C.B. 676 (guidelines on classification of limited partnerships); Rev. Proc. 79-1, 1979-1 C.B. 481 (guidelines on classification of organizations as liquidating trusts); Rev. Proc. 79-63, 1979-2 C.B. 578 (factors considered and information needed for granting extensions under section 1.9100-1 of the Income Tax Regulations). If the request concerns a corporate distribution, reorganization, or similar transaction, the corporate balance sheet and profit and loss statement closest to the date of the transaction should be submitted. (If the request relates to a prospective transaction, the most recent balance sheet and profit and loss statement should be submitted.)

.06 The request must contain a statement of whether, to the best of the knowledge of the taxpayer and the taxpayer's representative(s), if any, the identical issue is in a return of the taxpayer (or of a related taxpayer within the meaning of section 267 of the Code, or a member of an affiliated group of which the taxpayer is also a member within the meaning of section 1504) and, if so, whether the issue (1) is being examined by a District Director, (2) has been examined and the statutory period of limitation on assessment or refund of tax has not expired or a closing agreement covering the issue or liability has not been entered into by a District Director, (3) is being considered by an Appeals office in connection with the taxpayer's return for an earlier period, or that issue has been considered by an Appeals office and the statutory period of limitation on assessment or refund of tax has not expired or a closing agreement covering the issue or liability has not been entered into by an Appeals office, or (4) is pending in litigation in a case involving the taxpayer or a related taxpayer. The request must contain a statement whether, to the best of the knowledge of the taxpayer and the taxpayer's representative(s), the identical or similar issue has been ruled on by the Service to the taxpayer or to the taxpayer's predecessor and, if so, when and with what results. If after the request is filed but before a ruling is issued, the taxpayer knows that an examination of the issue by a District Director has been started, the taxpayer must notify the National Office of such action. If a return is filed before a ruling is received from the National Office concerning the return, a copy of the request must be attached to the return. This alerts the District Office and avoids premature District action on the issue.

If the request deals with only one step of a larger integrated transaction, the facts, circumstances, etc., relating to the entire transaction must be submitted.

.07 As an alternative procedure for the issuing of rulings on prospective transactions, the taxpayer may submit a summary of the facts considered to be controlling the issue, in addition to the complete statement required for ruling requests by section 9.05. If the National Office agrees with the summary, the National Office will use it as the basis for the ruling. To use this procedure, the taxpayer should submit the following with the request for a ruling:

1 A complete statement of facts about the transaction, together with related documents, as required by section 9.05; and

2 A summary statement of the facts believed to be controlling in reaching the requested conclusion. When the taxpayer's statement of controlling facts is accepted, the Service will base its ruling on these facts and only this statement will ordinarily be incorporated in the ruling letter. It is emphasized, however, that:

(a) The taxpayer may elect this procedure for a "two-part" ruling request. It is not to be considered a required substitute for the regular procedures provided by this revenue procedure;

(b) The taxpayer's rights and responsibilities are the same under the "two-part" ruling request procedure as those provided in this revenue procedure;

(c) The Service reserves the right to rule on the basis of a more complete statement of facts it considers controlling and to seek more information in developing facts and restating them; and

(d) The "two-part" ruling request procedure will not apply if it is inconsistent with other procedures, such as those dealing with: requests for permission to change accounting methods or periods; applications for recognition of exempt status under section 521 of the Code; or rulings on employment tax status.

.08 If the taxpayer asserts a particular determination, an explanation of the grounds for the assertion must be furnished, together with a statement of relevant authorities in support of the taxpayer's views. Even though the taxpayer is urging no particular determination of a proposed or prospective transaction, the taxpayer's views on the tax results of the proposed action and a statement of relevant authorities to support those views must be furnished. In addition, the taxpayer is encouraged to inform the Service of, and discuss the implications of, any legislation, or tax treaties, court decisions, regulations, revenue rulings or revenue procedures that the taxpayer determines to be contrary to the position advanced. If the taxpayer determines that there are no contrary authorities, a statement to this effect would be helpful in the ruling request. Identification and discussion of contrary authorities will generally enable Service personnel to arrive more quickly at a full understanding of the issue and the relevant authorities. There is a further advantage to the taxpayer. When Service personnel receive the request, they will have before them the taxpayer's thinking on the effect and applicability of contrary authorities. Such information should, therefore, make research easier and lead to earlier action by the Service. Conversely, failure to disclose and distinguish significant contrary authorities may result in requests for additional information memoranda which will delay action on the ruling request.

.09 To assist the National Office in making the deletions, required by section 6110(c) of the Code, from the text of rulings and determination letters, to be made open to public inspection under section 6110(a), a deletions statement must accompany requests. The statement must either state that no information other than names, addresses, and identifying numbers need be deleted, or if more information is proposed to be deleted, the statement must indicate the deletions proposed by the person requesting the ruling or determination letter. If the latter alternative is chosen, the statement must be made in a separate document, and it must be accompanied by a copy of the request for a ruling or determination letter and supporting documents, on which must be shown by the use of brackets, the material that the person making the request believes should be deleted pursuant to section 6110(c). The statement of proposed deletions must indicate the statutory basis, under section 6110(c), for each proposed deletion. The statement of proposed deletions must not appear or be referred to anywhere in the request for a ruling or determination letter. If the person making the request decides to ask for additional deletions before the ruling or determination letter is issued, additional statements may be submitted. The procedures in this paragraph also apply to additional information that is submitted after the initial request.

.10 A request by or for a taxpayer must be signed by the taxpayer or the taxpayer's authorized representative. If the request is signed by a representative, or if the representative is to appear before the Service in connection with the request, the representative must be:

1 an attorney who is a member in good standing of the bar of the highest court of any state, possession, territory, commonwealth, or the District of Columbia, and who files with the Service a written declaration that he or she is currently qualified as an attorney and is authorized to represent the taxpayer;

2 a certified public accountant who is qualified to practice in any state, possession, territory, commonwealth, or the District of Columbia, and who files with the Service a written declaration that he or she is currently qualified as a certified public accountant and is authorized to represent the taxpayer; or

3 a person, other than an attorney or certified public accountant who is currently enrolled to practice before the Service, and who files with the Service a written declaration that he or she is currently enrolled (including in the declaration either the enrollment number or the expiration date of the enrollment card) and is authorized to represent the taxpayer. (See Treasury Department Circular No. 230 (31 CFR Part 10), revised, 1966-2 C.B. 1171, amended 1967-1 C.B. 433, and 1970-2 C.B. 644, for the rules on who may practice before the Service.) These requirements do not apply to an individual representing his or her full-time employer, or to a bona fide officer, administrator, administratrix, trustee, etc., representing a corporation, trust, estate, association, or organized group. An unenrolled preparer of a return (other than an attorney or certified public accountant referred to in (1) and (2) above) who is not a full-time employee or a bona fide officer, administrator, administratrix, trustee, etc., may not represent a taxpayer in connection with a ruling or a determination letter. Any authorized representative, whether or not enrolled to practice, must also comply with the conference and practice requirements of the Statement of Procedural Rules (26 CFR 601). Form 2848, Power of Attorney, and Form 2848-D, Authorization and Declaration, may be used with regard to rulings, closing agreements, and determination letters requested under this revenue procedure.

.11 If a taxpayer has more than one representative, it is sufficient to send a copy of the ruling to any one of them. Copies of rulings will be sent to no more than two representatives, provided that they are located at different mailing addresses. If a taxpayer does not designate which representative is to receive a copy of the ruling, a copy of the ruling will be sent to the first representative named on the latest power of attorney. If the original of the ruling is to be sent to a representative, the power of attorney should contain a statement to that effect and designate the mailing address of the representative.

.12 A request for a ruling letter by the National Office should be sent to the Internal Revenue Service, Assistant Commissioner (Technical), Attention T:FP:T, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. A request for a determination letter should be sent to the District Director of Internal Revenue whose office has or will have examination jurisdiction over the taxpayer's return.

.13 If a request for a ruling or determination letter does not comply with all the provisions of this revenue procedure, the request will be acknowledged, and the requirements that have not been met will be pointed out. If a request for a ruling lacks essential information, the taxpayer will be told that if the information is not received within 30 days, the request will be closed. If the information is received after the request is closed, it will be reopened and treated as a new request as of the date the essential information is received. A request for a ruling letter sent to the District Director that does not comply with the provisions of this revenue procedure will be returned by the District Director for corrections before it is sent directly to the National Office.

.14 A taxpayer who wants to have a conference on the issue or issues involved should indicate this in writing when, or soon after, filing the request.

.15 The Service processes requests for ruling and determination letters in regular order and as expeditiously as possible. Consideration of a request for processing ahead of its regular order, or by a specified time, delays the processing of other matters. Requests for processing ahead of the regular order must be made in writing, preferably in a separate letter sent with, or soon after, the request. If the request is not made in a separate letter, then the letter in which the request is made should say, at the top of the first page: "Expeditious Handling Is Requested. See page   of this letter." The request should give a compelling need for such treatment. The Service cannot give assurance that any letter will be processed by the time requested. For example, the scheduling of a closing date for a transaction or a meeting of the board of directors or shareholders of a corporation, without regard for the time it may take to obtain a ruling or determination letter, will not be considered sufficient reason for handling a request ahead of its regular order. Nor will the possible effect of fluctuation in the market price of stocks on a transaction be considered sufficient reason for handling a request out of order. Requests by telegram will be treated in the same manner as requests by letter. Ruling and determination letters ordinarily are not issued by telegram. A request for expeditious handling will not cause the Communications Branch to route the case to the Ruling Branch ahead of normal processing; and a request for expeditious handling will not be considered until the underlying ruling request has been found to satisfy the section 6110 requirements.

.16 The Director, Individual Tax Division, has primary responsibility for providing basic principles for uniform interpretation and application of the federal tax laws in those areas involving: income taxes of noncorporate taxpayers (including individuals, partnerships, estates, and trusts); political organizations under section 527 (except subsection (f)); employment taxes and taxes on self-employment income; estate, gift, generation-skipping transfer, and certain excise taxes; and procedure and administration provisions of the Internal Revenue Code, except those that apply specifically to employee plans, exempt organizations, and actuarial determinations.

.17 The Director, Corporation Tax Division, has primary responsibility for providing basic principles of and rules for uniform interpretation and application of the federal tax laws in those areas involving: income taxes and earnings and profits of corporate taxpayers; changes in methods and periods of accounting, depreciation, depletion, valuation and other engineering issues; the taxable status of exchanges and distributions in connection with corporate organizations, reorganizations, and liquidations; and the exemption of farmers' cooperatives (under section 521), shipowners' protection and indemnity associations (under section 526), and certain homeowners associations (under section 528).

.18 A taxpayer may obtain information regarding the status of a request by calling the person whose name and telephone number is shown on the acknowledgement of receipt of the request.

.19 If after receiving the notice under section 6110(f)(1) of the Code of intention to disclose the ruling or determination letter (including a copy of the version proposed to be open to public inspection and notations of third-party communications under section 6110(d)), the person requesting the ruling or determination letter wants to protest the disclosure of certain information in the ruling or determination letter, that person must within 20 days send a written statement to the Internal Revenue Service, Chief, Rulings Disclosure Section, Attention T:FP:T:D, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, identifying those deletions that the Service has not made and that the person requesting the ruling or determination letter believes should have been made. That person must also submit a copy of the version of the ruling or determination letter proposed to be open to public inspection on which the person indicates, by use of brackets, the deletions proposed by the taxpayer that have not been made by the National Office. Generally, the Service will not consider the deletion under this subparagraph of any material that the taxpayer did not propose to be deleted before the ruling or determination letter was issued. Within 20 days after it receives the response to the notice under section 6110(f)(1), the National Office will mail to that person its final administrative conclusion regarding the deletions to be made. The taxpayer does not have the right to a conference to resolve any disagreements concerning material to be deleted from the text of the ruling. However, these matters may be taken up at any conference that is otherwise scheduled regarding the request.

.20 After receiving the notice under section 6110(f)(1) of the Code of intention to disclose (but no later than 60 days after the notice is mailed), the person requesting a ruling or determination letter may send a request for delay of public inspection under either section 6110(g)(3) or section 6110(g)(3) and (4). The request for delay must be sent to the Internal Revenue Service, Chief, Rulings Disclosure Section, Attention T:FP:T:D, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. A request for delay must contain the date on which it is expected that the underlying transaction will be completed. The request for delay under section 6110(g)(4) must contain a statement from which the Commissioner may determine that there are good reasons for the delay.

.21 A taxpayer who receives a ruling or determination letter before filing a return about any transaction that has been consummated and that is relevant to the return being filed should attach a copy of the ruling or determination letter to the return when it is filed.

.22 Protests to adverse rulings under section 367 will be processed as follows:

Under Rev. Proc. 77-5, 1977-1 C.B. 536, a taxpayer may protest an adverse, or terms and conditions, ruling letter issued on or after January 31, 1977, under section 367(a)(1) of the Code. This includes a ruling on an exchange described in section 367(b) that began before January 1, 1978, or section 1042 (e) of the Tax Reform Act of 1976 (Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 115). The protest may not be made later than the close of the 45th day after the date of the ruling letter. A protest is considered made on the date of the postmark of a letter of protest sent to the Assistant Commissioner (Technical), or the date that the letter is hand delivered to the Service. The letter must include: (1) a copy of the ruling letter; (2) the reasons for the protest including, if applicable, (a) the grounds for asserting that none of the principal purposes for the exchange is the avoidance of federal income tax, (b) the grounds for asserting that the terms and conditions in the ruling letter pursuant to which an exchange to which section 367 applies will be considered not to be in pursuance of tax avoidance are not reasonable, and (c) the arguments supporting a protest of the validity of a ruling position published by the Service, such as a position in the guidelines announced in Rev. Proc. 68-23, 1968-1 C.B. 821 (factual material not previously submitted and considered by the Service should not be included in the protest); (3) a statement of whether a conference is desired; and (4) names of persons (including authorized representatives) expected to attend the conference, if a conference is granted. The Assistant Commissioner (Technical) will establish an ad hoc advisory board to consider each protest, whether or not a conference is requested. The taxpayer will be granted one conference upon request. Whether or not such a request is made the board may ask for one or more conferences or for written submissions. The taxpayer will be notified of the time, date, and place of the conference, and of the names of the members of the board. The board will consider all materials submitted in writing by the taxpayer and oral arguments presented at the conference. The board will make its recommendation to the Assistant Commissioner (Technical) who will make a decision in the matter. Any oral arguments made at a conference by the taxpayer, which have not previously been submitted to the Service in writing, may, if desired, be submitted to the Service in writing if postmarked no later than the end of the 7th day after the day of the conference. The taxpayer will be informed of the decision of the Assistant Commissioner by certified or registered mail.

.23 For appeal procedures with regard to adverse determination letters under section 521 of of the Code and revocation or modification of exemption rulings and determination letters under section 521, see Rev. Proc. 80-25.

Sec. 10. Handling of Ruling Requests

.01 Within 15 work days after a ruling request is received in the branch, Service personnel will contact the taxpayer to discuss informally the procedural and substantive issues in the ruling request.

.02 The following subject matters are included in the 15-day procedure:

1 Individual Income Tax Branch

(a) Partnerships and trusts

(b) Code section 103 (issues under its jurisdiction)

(c) Real estate investment trusts

(d) Stock options

(e) Charitable remainder trusts

(f) Pooled income funds

2 All matters within the jurisdiction of the Corporation Tax Branch, except cases

(a) involving a request for change in accounting methods or periods,

(b) relating to the last-in, first-out method of computing inventory,

(c) concerning insurance issues on contracts with reserves based on segregated asset accounts,

(d) concerning insurance issues requiring actuarial computations.

3 All matters within the jurisdiction of the Wage, Excise and Administrative Provisions Branch, except ruling requests from individuals for employment status submitted on Forms SS-8.

4 All matters within the jurisdiction of the Engineering and Valuation Branch (except cases involving a request for a change in accounting methods), Reorganization Branch, and Estate and Gift Tax Branch.

.03 Procedures to be followed regarding ruling requests are:

1 Within 15 work days after a ruling request has been received in the branch having jurisdiction, a representative of the branch will contact the taxpayer to discuss the procedural and substantive issues in the ruling requests covered by this procedure. As to each issue coming within the jurisdiction of the branch, the branch representative will tell the taxpayer:

(a) whether the branch representative will recommend the Service rule as the taxpayer requested, rule adversely on the matter, or not rule;

(b) whether the taxpayer should submit additional information or representations to enable the Service to rule on the matter; or

(c) whether because of the nature of the transaction, or the issue presented, a tentative conclusion on the issue cannot be reached.

2 When the rulings requested involve matters within the jurisdiction of more than one branch or more than one office in the same branch, a representative of the branch that received the original ruling request will tell the taxpayer within the initial 15 work day contract period: (1) that the rulings requested involving matters within the jurisdiction of another branch or another office in the same branch have been referred to the other branch or office for consideration; and (2) that a representative of the other branch or office will contact the taxpayer within 15 work days after receiving the referral to informally discuss the procedural and substantive issues if covered by this procedure.

3 If something less than a fully favorable ruling is indicated, the branch representative will tell the taxpayer if minor modifications of the transaction or adherence to certain published positions will warrant the issuing of a favorable ruling. In addition, the branch representative may tell the taxpayer what representations must be fur-

nished in a document to comply with the requirements of the Service. See Rev. Proc. 75-21, 1975-1 C.B. 715, and Rev. Proc. 75-28, 1975-1 C.B. 752. However, the branch representative will not suggest precise changes that would materially alter the form of the proposed transaction. If, at the conclusion of the discussion, the branch representative determines that a meeting in the National Office would better serve the purpose of developing or exchanging information, a meeting will be offered and an early meeting date arranged. This meeting will not be the taxpayer's conference of right, as described in this revenue procedure.

4 The Service will not be bound by the informal opinion expressed by the branch representative or any other authorized Service representative under this procedure, and such an opinion cannot be relied upon as a basis for granting retroactive relief under the provisions of section 7805(b) of the Code.

5 The ruling request will then be processed under present procedures.

SEC. 11. CONFERENCES IN THE NATIONAL OFFICE

.01 A taxpayer may request a conference only in connection with a ruling request. Normally, a conference is scheduled only when the National Office considers it to be helpful in deciding the case or when an adverse decision is indicated. If conferences are being arranged for more than one request for a ruling involving the same taxpayer, they will be scheduled so as to cause the least inconvenience to the taxpayer. If a conference has been requested, the taxpayer will be notified by telephone, if possible, of the time and place of the conference. The conference must be held within 21 calendar days after such contact has been made. Procedures for requesting an extension of the 21-day period and notifying the taxpayer or the taxpayer's representative of the Service's decision are the same as those stated in section 9.05.

.02 A taxpayer is entitled, as a matter of right, to only one conference in the National Office unless one of the circumstances discussed in section 11.06 develops. This conference normally will be held at the branch level of the appropriate division in the office of the Assistant Commissioner (Technical) and will be attended by a person who, at the time of the conference, has authority to sign the ruling letter for the branch chief in the case being discussed. If more than one subject is to be discussed at the conference, the discussion will constitute a conference on each subject. In order to promote a free and open discussion of the issues, the conference usually will be held after the branch has had an opportunity to study the case. However, at the request of the taxpayer or representative, the conference of right may be held at an earlier stage in the consideration of the case than the Service ordinarily would designate. No taxpayer has a "right" to appeal the action of a branch to a division director or to any other official of the Service, nor is a taxpayer entitled, as a matter of right, to a separate conference in the Chief Counsel's office on a request for a ruling.

.03 In employment tax matters, only the party entitled to the ruling is entitled to a conference.

.04 Since conference procedures are informal, no tape, stenographic, or other verbatim recording of a conference will be made.

.05 The senior Service representative present at the conference insures that the taxpayer has full opportunity to present views on all of the issues that are in question. The Service representative explains the Service's tentative decision on the substantive issues and the reasons for that decision. If the taxpayer advances prospective application under section 7805(b) of the Code, the Service representative will discuss the tentative recommendation concerning the request for relief and the reasons for the tentative recommendation. No commitment will be made as to the conclusion that the Service will finally adopt.

.06 An invitation to an additional conference will be extended if after the conference of right an adverse holding is proposed but on a new issue or on the same issue but on different grounds from those discussed at the first conference. There is no right to another conference when a proposed holding is reversed at a higher level with a result less favorable to the taxpayer if the grounds or arguments on which the reversal is based were discussed at the conference of right. The provisions of this revenue procedure limiting the number of conferences a taxpayer is entitled to will not prevent a taxpayer from attending further conferences when, in the opinion of National Office personnel, such conferences are necessary. All additional conferences of the type discussed in this paragraph are held only at the invitation of the Service.

.07 It is the responsibility of the taxpayer to furnish in writing to the National Office any additional data, lines of reasoning, precedents, etc., that are proposed by the taxpayer and discussed at the conference but that were not previously or adequately presented in writing. The taxpayer must furnish the additional information within 21 calendar days. If the additional information is not received within that time, a ruling will be issued on the basis of the information on hand or, if appropriate, no ruling will be issued. Procedures for requesting an extension of the 21-day period and notifying the taxpayer or the taxpayer's representative of the Service's decision are the same as those stated in section 9.05.

SEC. 12. REFERRAL OF MATTERS TO THE NATIONAL OFFICE

.01 Requests for determination letters received by District Directors that, under the provisions of this revenue procedure, may not be acted upon by a district office, will be forwarded to the National Office for reply. The district office will let the taxpayer know that this action has been taken. District Directors also refer to the National Office any request for a determination letter that in their judgment should have the attention of the National Office.

.02 If the request involves an issue on which the Service will not issue a ruling or a determination letter, the request will not be forwarded to the National Office. The district office will let the taxpayer know that the Service will not issue a ruling or a determination letter on the issue. See section 8.01 of this revenue procedure.

SEC. 13. REFERRAL OF MATTERS TO DISTRICT OFFICES

Requests for rulings received by the National Office that, under section 5 of this revenue procedure, may not be acted upon by the National Office will be forwarded to the district office that has examination jurisdiction over the taxpayer's return. The taxpayer will be notified of this action. If the request is on an issue or in an area of the type discussed in section 8.01 and it is decided not to issue a ruling, the National Office will let the taxpayer know and the request will then be forwarded to the appropriate district office for association with the related return.

SEC. 14. REVIEW OF DETERMINATION LETTERS

Determination letters issued under sections 7.01, 7.02, and 7.03 are not reviewed by the National Office before they are issued. If a taxpayer believes that a determination letter of this type is in error, the taxpayer may ask the District Director to reconsider the matter. The taxpayer may also ask the District Director to request technical advice from the National Office. In such an event the procedure in Rev. Proc. 80-21 must be followed.

SEC. 15. WITHDRAWAL OF REQUESTS

A request for a ruling or determination letter may be withdrawn at any time before the signing of the letter of reply. If a request for a ruling is withdrawn, the National Office may give its views on the subject matter of the request to the District Director whose office will have examination jurisdiction over the taxpayer's return for consideration in connection with any later examination of the taxpayer's return. Even though a request is withdrawn, all correspondence and exhibits will be kept by the Service and will not be returned to the taxpayer. In appropriate cases, the Service may publish its findings in a revenue ruling or revenue procedure.

SEC. 16. ORAL ADVICE TO TAXPAYERS

.01 The Service does not issue rulings or determination letters on oral requests. National Office officials and employees ordinarily do not discuss a substantive tax issue with a taxpayer before a written request for a ruling is received, since oral opinions or advice are not binding on the Service. This does not prevent a taxpayer from asking whether the Service will rule on a particular issue. In such cases, however, the name of the taxpayer and identifying number must be disclosed. The Service also will discuss questions relating to procedural matters about submitting a request for a ruling, including the application of the provisions of section 9 to a particular case.

.02 A taxpayer may seek oral technical assistance from a Taxpayer Service Representative in a district office or service center when preparing a return or report, under other established procedures. Oral advice is advisory only and the Service is not bound to recognize it in the examination of the taxpayer's return.

SEC. 17. EFFECT OF RULINGS

.01 A taxpayer may not rely on a ruling issued to another taxpayer. A ruling, except to the extent incorporated in a closing agreement, may be revoked or modified at any time under appropriate circumstances. See section 4.08 for the effect of a closing agreement. If a ruling is revoked or modified, the revocation or modification applies to all years open under the statutes, unless the Commissioner or the Commissioner's delegate exercises the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of the revocation or modification. The manner in which this authority generally is exercised is given later in this section. For information on rulings relating to the sale or lease of articles subject to the manufacturer's excise tax and the retailer's excise tax, see section 17.08.

.02 When determining a taxpayer's liability, the District Director must ascertain whether (1) any ruling previously issued to the taxpayer has been properly applied, (2) the representations upon which the ruling was based reflected an accurate statement of the material facts, and (3) the transaction actually was carried out substantially as proposed. If, in the course of determining the tax liability, the District Director finds that a ruling should be modified or revoked, the findings and recommendations of the District Director will be forwarded to the National Office for consideration before further action. Such a referral to the National Office will be treated as a request for technical advice and the procedures of Rev. Proc. 80-21 will be followed. Otherwise the ruling is to be applied by the district office in its determination of the taxpayer's liability.

.03 Appropriate coordination with the National Office will be undertaken if any field official having jurisdiction over a return or other matter proposes to reach a conclusion contrary to a ruling previously issued to the taxpayer.

.04 A ruling found to be in error or not in accord with the current views of the Service may be modified or revoked. Modification or revocation of a ruling may be made by (1) a notice to the taxpayer to whom the ruling was issued, (2) an enactment of legislation or ratification of a tax treaty, (3) a decision of the United States Supreme Court, (4) the issuing of temporary or final regulations, or (5) the issuing of a revenue ruling, a revenue procedure, or other statement published in the Internal Revenue Bulletin. Consistent with these provisions, if a ruling relates to a continuing action or a series of actions, the ruling will ordinarily be applied until any one of the actions described above has taken place, or until specifically withdrawn.

.05 Except in rare or unusual circumstances, the revocation or modification of a ruling will not be applied retroactively to the taxpayer for whom the ruling was issued or to a taxpayer whose tax liability was directly involved in the ruling if (1) there has been no misstatement or omission of material facts, (2) the facts developed later are not materially different from the facts on which the ruling was based, (3) there has been no change in the applicable law, (4) the ruling was originally issued with respect to a prospective or proposed transaction, and (5) the taxpayer directly involved in the ruling acted in good faith in reliance upon the ruling and the retroactive revocation would be to the taxpayer's detriment. For example, the tax liability of each shareholder is directly involved in a ruling on the reorganization of a corporation. However, the tax liability of members of an industry is not directly involved in a ruling issued to one of the members, and the holding in a revocation or modification of a ruling to one member of an industry may be retroactively applied to other members of that industry. By the same reasoning, a tax practitioner may not obtain the nonretroactive application to one client of a modification or revocation of a ruling previously issued to another client. If a ruling is revoked by letter with retroactive effect, the letter will, except in fraud cases, state the grounds upon which the revocation is being made and the reasons why the revocation is being applied retroactively.

.06 A ruling issued on a particular transaction represents a holding of the Service on that transaction only. However, the application of that ruling to the transaction will not be affected by the later issuing of regulations (either temporary or final), if the conditions specified in section 17.05 are met. If the ruling is later found to be in error or no longer in accord with the position of the Service, it will not give the taxpayer protection for a like transaction in the same or later year.

.07 However, if a ruling is issued covering a continuing action or a series of actions and it is determined that the ruling was in error, or no longer in accord with the position of the Service, the Assistant Commissioner (Technical) ordinarily will limit the retroactivity of the revocation or modification to a date that is not earlier than that on which the ruling is modified or revoked. To illustrate, if a taxpayer receives a ruling that certain payments are excludable from gross income for federal income tax purposes and it is later determined that the ruling is in error or no longer in accord with the position of the Service, the Assistant Commissioner (Technical) ordinarily will restrict the retroactive application of the revocation or modification of the ruling. If a taxpayer rendered service or provided a facility that is subject to the excise tax on services or facilities, and in reliance on a ruling issued to the same taxpayer did not pass the tax on to the user of the service or the facility, the Assistant Commissioner (Technical) ordinarily will restrict the retroactive application of the revocation or modification of the ruling. If an employer incurred liability under the Federal Insurance Contributions Act, but in reliance on a ruling made to the same employer, neither collected the employee tax nor paid the employee and employer taxes under the Act, the Assistant Commissioner (Technical) ordinarily will restrict the retroactive application of the revocation or modification of the ruling for both the employer tax and the employee tax. In the last situation, however, the restriction of retroactive application ordinarily will be conditioned on the furnishing by the employer of wage data, as may be required by section 31.6011(a)-1 of the Employment Tax Regulations. Publication of a notice of proposed rulemaking will not affect the application of any ruling issued under the procedures stated in this revenue procedure.

.08 A ruling holding that the sale or lease of a particular article is subject to the manufacturer's excise tax or the retailer's excise tax may not retroactively revoke or modify an earlier ruling holding that the sale or lease of such an article was not taxable, if the taxpayer to whom the ruling was issued, in reliance upon the earlier ruling, parted with possession or ownership of the article without passing the tax on to the customer. Section 1108 (b), Revenue Act of 1926.

.09 For rulings involving completed transactions, other than those described in sections 17.07 and 17.08, taxpayers will not be given the protection against retroactive revocation provided in section 17.05, since they will not have entered into the transactions in reliance on the ruling.

SEC. 18. EFFECT OF DETERMINATION LETTERS

A determination letter issued by a District Director has the same effect as a ruling issued to a taxpayer under section 17 of this revenue procedure. However, if the District Director is of the opinion that a conclusion contrary to that expressed in the determination letter is indicated, the matter need not be referred to the National Office. A District Director may not limit the modification or revocation of a determination letter but may refer the matter to the National Office for the possible exercise by the Commissioner or the Commissioner's delegate of the authority to limit the modification or revocation.

SEC. 19. EFFECT OF INFORMATION LETTERS

An information letter issued by the National Office or by a District Director is advisory only and the provisions of section 17 do not apply.

SEC. 20. PROCEDURE FOR REQUESTING APPLICATION OF SECTION 7805(b) IN THE CASE OF RULINGS AND DETERMINATION LETTERS

.01 Pursuant to section 7805(b) of the Code, it is within the discretion of the Commissioner or the Commissioner's delegate to prescribe the extent, if any, to which any ruling (including determination letters) will be applied without retroactive effect.

A taxpayer to whom a ruling or determination letter has been issued may request that the Assistant Commissioner (Technical), the Commissioner's delegate, exercise the discretionary authority under section 7805 (b) of the Code to limit the retroactive effect of any subsequent revocation or modification of the ruling or determination letter.

.02 In the case of a ruling, a request to limit the retroactive effect of the revocation or modification of a ruling must be in the form of, and meet the requirements for, a ruling request generally. These requirements are set forth in section 9 of this revenue procedure. Specifically, the request must state that it is being made pursuant to section 7805(b), contain a statement of the relief sought and an explanation of the reasons and arguments in support of the relief requested, and also be accompanied by any documents bearing on the request. The explanation in support of the application of section 7805(b) should include a discussion of the five items enumerated in section 17.05 of this revenue procedure as they relate to the taxpayer's particular situation.

A request for the application of section 7805(b) of the Code may take the form of a separate request for ruling when, for example, a revenue ruling has the effect of modifying or revoking a ruling previously issued to the taxpayer or when the Service notifies the taxpayer of a change in position that will have the effect of revoking or modifying such a ruling. However, when such notice is given by the District Director during the course of an examination of the taxpayer's return, or during consideration by the Chief, Appeals Office, a request to limit the retroactive effect of the modification or revocation of a ruling must be made in the form of a request for technical advice. See section 12.03 of Rev. Proc. 80-21. When germane to a pending ruling request, a request for the application of section 7805(b) may be made as part of the request, either initially or at any time before the ruling is issued. When a ruling that concerns a continuing transaction is modified or revoked by, for example, a subsequent revenue ruling, a request to limit the retroactive effect of the modification or revocation of the ruling must be made before a return is examined that contains the transaction that is the subject of the request for ruling.

.03 When a request for the application of section 7805(b) of the Code is made in a separate ruling request, the taxpayer has the right to a conference in the National Office in accordance with the provisions of section 11 of this revenue procedure. If the request is made initially as part of a pending ruling request or is made before the conference of right is held on the substantive issues, the section 7805(b) issue will be discussed at the taxpayer's one conference of right. (See section 11.05 of this revenue procedure.) If the request for the application of 7805(b) is made as part of a pending ruling request after a conference has been held on the substantive issue, and the Service determines that there is justification for having delayed the request, then the taxpayer will have the right to one conference of right concerning the application of section 7805(b) with the conference limited to discussion of this issue.

.04 In the case of a determination letter that the District Director proposes to modify or revoke, a request to limit the modification or revocation of the determination letter must be made by requesting the District Director who issued the determination letter to seek technical advice from the National Office, since a District Director has not been delegated authority under section 7805(b) of the Code to limit the modification or revocation of a determination letter. See section 12.03 of Rev. Proc. 80-21. The taxpayer's request must state that it is being made pursuant to section 7805(b), contain a statement of the relief sought and an explanation of the reasons and arguments in support of the relief requested, and also be accompanied by any documents bearing on the request. The explanation in support of the application of section 7805(b) should include a discussion of the five items enumerated in section 17.05 of this revenue procedure as they relate to the taxpayer's particular situation.

.05 When technical advice is requested with respect to the application of section 7805(b) of the Code under the circumstances set forth in .04 above, the taxpayer has a right to a conference in the National Office to the same extent as does any taxpayer who is the subject of a technical advice request. See section 8 of Rev. Proc. 80-21.

Sec. 21. Effect on Other Documents

Rev. Proc. 79-45 is superseded.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.

Rev. Proc. 80-21

Section 1. Purpose

The purpose of this revenue procedure is to supersede Rev. Proc. 79-46, 1979-2 C.B. 521, by providing revised procedures for furnishing technical advice to District Directors and Chiefs, Appeals Offices, by the Assistant Commissioner (Technical). It also tells taxpayers about their rights when a District Director or a Chief, Appeals Office, requests such advice.

Sec. 2. Scope

.01 The Assistant Commissioner (Technical) acts as the primary assistant to the Commissioner in providing principles and rules for uniformly interpreting and applying the federal tax laws under the jurisdiction of the Assistant Commissioner (Technical). The procedures for obtaining technical advice specifically applicable to federal firearms taxes under subtitle E of the Internal Revenue Code are under the jurisdiction of the Bureau of Alcohol, Tobacco and Firearms. The procedures for obtaining technical advice specifically on employee plans and exempt organizations are under the jurisdiction of the Assistant Commissioner (Employee Plans and Exempt Organizations). The procedures that apply to technical advice for employee plans and exempt organizations are followed in obtaining technical advice on exemption of farmers' cooperatives from tax under section 521 of the Code, even though the Assistant Commissioner (Technical) has jurisdiction for issuing technical advice under this section. The Assistant Commissioner (Technical) also has jurisdiction for issuing technical advice under section 526, on shipowners' protection and indemnity associations; section 527(a), (b), (c), (d), (e), and (g), on political organizations; and section 528, on certain homeowners' associations, under this revenue procedure.

.02 In the Office of the Assistant Commissioner (Technical), the authority to issue technical advice has been largely redelegated to the Branch Chiefs in the Individual Tax Division and the Corporation Tax Division.

Sec. 3. Changes

.01 Section 5.05 has been clarified to encourage taxpayers to comment on contrary authority.

.02 Section 5.09 has been expanded to make it clear that the disclosure procedures in section 5.09 are applicable to information submitted by taxpayers after submission of the technical advice request to the National Office.

.03 A new section 5.11 has been added to cross reference Rev. Proc. 79-63, 1979-2 C.B. 578, to state that the procedures under Rev. Proc. 80-21 are applicable when an extension of time is requested under section 1.9100-1 of the regulations after the return is under examination or is being considered by an Appeals office. In addition, section 5.03 of Rev. Proc. 79-63 has been modified to exclude such requests from the instruction that requests for extension of time under section 1.9100-1 of the regulations must be addressed to the National Office.

.04 Section 6.03 has been expanded to tell taxpayers that National Office officials who are considering denials of technical advice requests from taxpayers may consult with National Office Technical officials.

.05 Section 8.01 has been clarified to point out that a conference must be held within 21 calendar days after the initial notification as to the time and place of conference and expanded to explain additional procedures for extending the 21-day period for holding a National Office conference.

.06 Section 8.06 has been modified to point out that procedures for extending the 21-day period for furnishing additional material are the same as those in section 8.01.

.07 Section 12 now provides the procedure for requesting application of 7805(b) of the Code to technical advice memoranda.

SEC. 4. DEFINITION AND NATURE OF TECHNICAL ADVICE

.01 For purposes of this revenue procedure, the word "taxpayer" includes all persons subject to any provision of the Internal Revenue Code and their representatives and issuers of section 103 obligations.

.02 Unless otherwise indicated, any reference to the National Office means only the Office of the Assistant Commissioner (Technical).

.03 Any reference to District Director or district office includes the office of the Director of International Operations, where appropriate. Any reference to Chief, Appeals Office, includes Associate Chief, Appeals Office.

.04 "Technical advice" means advice or guidance furnished by the National Office upon request of a district or an Appeals office in response to any technical or procedural question that develops during any stage of any proceeding on the interpretation and proper application of tax law, tax treaties, regulations, revenue rulings, or other precedents published by the National Office to a specific set of facts. Such proceedings include (1) the examination of a taxpayer's return, (2) consideration of a taxpayer's claim for refund or credit, or (3) any other matter involving a specific taxpayer under the jurisdiction of the Chief, Examination Division, such as the consideration of a taxpayer's application to enter into an agreement about the useful life, method, and rate of depreciation of business property provided by section 167(d) of the Code. These proceedings include an examination to determine whether obligations issued are described in section 103(a). They also include processing and considering nondocketed cases in an Appeals office. Technical advice is furnished as a way of helping Service personnel close cases and establish and maintain consistent holdings throughout the Internal Revenue Service. A District Director or an Appeals office may raise an issue in any tax period, even though technical advice may have been asked for and furnished for the same or a similar issue for another tax period. Technical advice does not include memoranda on matters of general technical application furnished to district or Appeals offices when the issues are not raised in connection with a proceeding involving a specific taxpayer.

.05 If a District Director, Chief, Appeals Office, or a taxpayer requests technical advice on a determination letter under section 521 of the Code, the procedures under section 601.201 (n) of the Statement of Procedural Rules must be followed.

.06 Only the National Office can revoke a ruling letter. Therefore, if a District Director or a Chief, Appeals Office, thinks that a ruling letter previously issued to a taxpayer should be modified or revoked, the procedures in section 5 of this revenue procedure must be followed.

.07 The provisions of this revenue procedure apply only to a case under the jurisdiction of a District Director or Chief, Appeals Office. Technical advice may be requested on issues considered in a prior Appeals disposition, not based on mutual concessions for the same tax period of the same taxpayer, if the Appeals office that had the case concurs in the request. A District Director may not request technical advice on an issue if an Appeals office is currently considering an identical issue of the same taxpayer (or of a related taxpayer within the meaning of section 267 of the Code or a member of an affiliated group of which the taxpayer is also a member within the meaning of section 1504). A case remains under the jurisdiction of the District Director even though an Appeals office has the identical issue under consideration in the case of another taxpayer (not related within the meaning of sections 267 and 1504, respectively) in an entirely different transaction. With respect to the same taxpayer or the same transaction, when the issue is under the jurisdiction of an Appeals office, and the applicability of more than one kind of tax is dependent upon the resolution of that issue, a District Director may not request technical advice on the applicability of any of the taxes involved.

SEC. 5. REQUESTING TECHNICAL ADVICE

.01 The district or Appeals office is responsible for determining whether to request technical advice on any issue being considered. However, while the case is under the jurisdiction of the District Director or the Chief, Appeals Office, a taxpayer may request that an issue be referred to the National Office for technical advice. The grounds for a request are that a lack of uniformity exists on the disposition of the issue or that the issue is unusual or complex enough to warrant consideration by the National Office. Although taxpayers are encouraged to make written requests setting forth the facts, law, and argument on the issue, and reasons for requesting National Office technical advice, they may make the request orally. If, after considering the taxpayer's request, the examining officer or Appeals Officer thinks that the circumstances do not warrant referral of the case to the National Office, the examining officer or Appeals Officer will tell the taxpayer. (See section 6 for taxpayer's appeal rights when an examining officer or an Appeals Officer declines to request technical advice.)

.02 When technical advice is going to be requested, whether or not on the request of the taxpayer, the taxpayer will be told about it, except as noted in section 5.10. If the examining officer or the Appeals Officer initiates the action, the Service will give the taxpayer a copy of the statement of the pertinent facts and the questions proposed for submission to the National Office. The request for advice should be worded to avoid possible misunderstanding in the National Office of the facts or the specific points at issue.

.03 If the Service initiates the request for technical advice, the taxpayer has 10 calendar days after receiving the statement of facts and specific questions to indicate in writing any disagreement about them. The taxpayer must justify in writing an extension of time beyond the 10 calendar days. The justification must be approved by the Chief, Examination Division, or the Chief, Appeals Office. Every effort should be made to reach agreement on the facts and the specific points at issue. If agreement cannot be reached, the taxpayer may send, within 10 calendar days after receipt of notice, a statement of the taxpayer's understanding of the specific points at issue. This statement will be forwarded to the National Office with the request for technical advice. The taxpayer must justify in writing an extension of time beyond the 10 calendar days. The justification must be approved by the Chief, Examination Division, or the Chief, Appeals Office.

.04 If the taxpayer initiates the action to request technical advice and the taxpayer's statement of the facts and points at issue is not wholly acceptable to the district or Appeals office, the Service will tell the taxpayer in writing what the areas of disagreement are. The taxpayer has 10 calendar days after receiving the written notice to reply to it. The taxpayer must justify in writing an extension of time beyond the 10 calendar days. The justification must be approved by the Chief, Examination Division or the Chief, Appeals Office. If agreement cannot be reached, both the statements of the taxpayer and the district or Appeals office will be forwarded to the National Office with the request for technical advice.

.05 If it has not already been done, the taxpayer may submit a statement explaining the taxpayer's position on the issues and citing precedents that the taxpayer believes will bear on the case. This statement will be forwarded to the National Office with the request for technical advice. If the taxpayer's statement is received after the request for technical advice has been forwarded to the National Office, it will be forwarded there to be associated with the request for technical advice. The taxpayer is encouraged to comment on any legislation, tax treaties, regulations, revenue rulings, revenue procedures, or court decisions contrary to the taxpayer's position.

.06 At the time the taxpayer is told that the matter is being referred to the National Office, the taxpayer will also be told about the right to a conference in the National Office if an adverse decision is indicated and will be asked to say whether such a conference is desired.

.07 In connection with requests for technical advice, the taxpayer also has the same 10 days as in sections 5.03 and 5.04 to submit the statement described in section 5.09 of proposed deletions under section 6110(c) of the Code. If the taxpayer does not submit it, the District Director or the Chief, Appeals Office, will tell the taxpayer that such a statement is required. If the District Director or the Chief, Appeals Office, does not receive the statement within 10 days after such notification, the District Director or the Chief, Appeals Office, may decline to submit the request for technical advice. If the District Director or the Chief, Appeals Office, decides to request technical advice in a case in which the taxpayer has not submitted the statement of proposed deletions, the National Office will make those deletions that the Commissioner determines are required by section 6110(c).

.08 The requirements for submitting statements and other material for proposed deletions in technical advice memoranda before public inspection is allowed do not apply to requests made by a District Director before November 1, 1976, or to requests for any document to which section 6104 of the Code applies.

.09 To help the National Office make the deletions required by section 6110(c) of the Code in technical advice memoranda to be made open to public inspection under section 6110(a), a deletions statement must accompany requests. The statement must either state that no information other than names, addresses, and identifying numbers need be deleted, or if more information is proposed to be deleted, the statement must indicate the deletions proposed by the taxpayer. If the latter alternative is chosen, the statement must be made in a separate document, and it must be accompanied by a copy of all statements of facts and supporting documents that are submitted to the National Office under sections 5.03 and 5.04. The material that the taxpayer wants deleted must be shown in brackets. The statement of proposed deletions must show the statutory basis, under section 6110(c), for each proposed deletion. The statement of proposed deletions must not appear or be referred to anywhere in the request for technical advice. If the taxpayer decides to request additional deletions under section 6110(c) before the National Office replies to the request for technical advice, the taxpayer may submit additional statements. The procedures in this paragraph also apply to additional information submitted during consideration of the technical advice request.

.10 The provisions of this section (about referring issues upon the taxpayer's request, telling the taxpayer about the referral of issues, submitting proposed deletions, and granting conferences in the National Office) do not apply to technical advice memoranda, described in section 6110(g)(5)(A) of the Code, on cases involving criminal or civil fraud investigations and jeopardy or termination assessments. However, in these cases the taxpayer may provide the statement of proposed deletions to the National Office after all proceedings in the investigations or assessments are complete but before the Commissioner mails the notice, under section 6110(f)(1), of intention to disclose the technical advice memorandum.

.11 See Rev. Proc. 79-63, 1979-2 C.B. 578, which concerns applications for extension of the time for making an election or application for relief pursuant to section 1.9100-1 of the regulations. If a taxpayer requests an extension of time under section 1.9100-1 during an examination or when being considered by an Appeals office, the procedures of Rev. Proc. 80-21 are applicable.

.12 Form 4463, Request for Technical Advice, should be used for transmitting requests for technical advice to the National Office.

SEC. 6. APPEAL BY TAXPAYERS OF DISTRICT OR APPEALS OFFICE DETERMINATION NOT TO SEEK TECHNICAL ADVICE

.01 If the examining officer or Appeals Officer thinks that a taxpayer's request for referral of an issue to the National Office for technical advice does not warrant referral, the examining officer or Appeals Officer will tell the taxpayer.

.02 The taxpayer may appeal the decision of the examining officer or the Appeals Officer not to request technical advice by submitting to that official, within 10 calendar days after being told of the decision, a statement of the facts, law, and arguments on the issue, and the reasons why the taxpayer believes the matter should be referred to the National Office for technical advice. The taxpayer must justify in writing a request for an extension of time beyond the 10 calendar days. The justification must be approved by the Chief, Examination Division, or the Chief, Appeals Office.

.03 The examining officer or the Appeals Officer submits the taxpayer's statement through channels to the Chief, Examination Division, or the Chief, Appeals Office, along with the examining officer's or the Appeals Officer's statement of why the issue should not be referred to the National Office. The Chief determines, on the basis of the statement, whether technical advice will be requested. If the Chief determines that technical advice is not warranted and proposes to deny the request, the taxpayer is told in writing about the determination. In the letter to the taxpayer, the Chief states the reasons for the proposed denial (except in unusual situations when doing so would be prejudicial to the best interest of the Government). The taxpayer has 10 calendar days after receiving the letter to notify the Chief of agreement or disagreement with the proposed denial. The taxpayer may not appeal the decision of the Chief, Examination Division, or the Chief, Appeals Office, not to request technical advice from the National Office. However, if the taxpayer does not agree with the proposed denial, all data on the issue for which technical advice has been sought, including the taxpayer's written request and statements, will be submitted to the Director, Examination Division, or the Director, Appeals Division (Office of the Assistant Commissioner (Compliance)), for review. If the appropriate director thinks the circumstances warrant it, he or she may consult the Assistant Commissioner (Technical) or his or her representatives. After this review the district office or the Appeals office is notified whether the proposed denial is approved or disapproved.

.04 While the matter is being reviewed, the district office or the Appeals office suspends action on the issue (except when the delay would prejudice the Government's interests) until it is notified that the proposed denial is approved or disapproved. This notification is made within 30 calendar days after receipt of the data. The review is solely on the basis of the written record and no conference is held on the matter.

SEC. 7. WITHDRAWAL OF REQUESTS

.01 The District Director or Chief, Appeals Office, may withdraw a request for technical advice at any time before the responding transmittal memorandum is signed. The District Director or Chief, Appeals Office, must notify the taxpayer in writing of intent to withdraw the request for technical advice except (1) when the period of limitation on assessment is about to expire and the taxpayer has declined to sign a consent to extend the period, or (2) when such notification would be prejudicial to the best interests of the government. If the taxpayer does not agree that the request for technical advice should be withdrawn, the procedures in section 6 of this revenue procedure must be followed.

.02 When a request for technical advice is withdrawn, the National Office may send its views to the District Director or the Chief, Appeals Office, when acknowledging the withdrawal request. In appropriate cases, the subject matter may be published as a revenue ruling or revenue procedure.

SEC. 8. CONFERENCE IN THE NATIONAL OFFICE

.01 If after an analysis of the technical advice request it appears that advice adverse to the taxpayer will be given, and if a conference has been requested, the taxpayer will be told, by telephone if possible, the time and place of the conference. The conference must be held within 21 calendar days after such contact has been made. If conferences are being arranged for more than one request for technical advice for the same taxpayer, they will be scheduled to cause the least inconvenience to the taxpayer. An extension of the 21-day period will be granted only if the taxpayer justifies it in writing and the Chief or Assistant Chief of the technical branch to which the case is assigned approves it. Because the purpose of these procedures is to facilitate the technical advice process by encouraging prompt submission of the required relevant material, requests for extensions should be justified by compelling facts and circumstances. The request for extension should be submitted before the end of the 21-day period. If unusual circumstances near the end of the 21-day period make a written request impractical, within the 21-day period the National Office should be told orally about the problem and of the forthcoming written request for extension. These requests must be promptly submitted. The taxpayer or taxpayer's representative will be told promptly and later in writing of the approval or denial of the requested extension. There is no right of appeal to the denial of an extension request. If it is not advised of problems with meeting the 21-day period, or if the request is not sent promptly after the National Office is notified of problems with meeting the 21-day period, the Service will process the case on the assumption that no further submission will be received.

.02 A taxpayer is entitled by right to only one conference in the National Office unless one of the circumstances discussed in this section exists. This conference is normally held at the branch level in the appropriate division (Individual Tax Division or Corporation Tax Division) of the office of the Assistant Commissioner (Technical). It is attended by a person who has authority to sign the transmittal memorandum discussed in section 9.07 on behalf of the branch chief. In appropriate cases, the examining officer or the Appeals Officer may also attend the conference to clarify the facts in the case. If more than one subject is discussed at the conference, the discussion constitutes a conference for each subject. To promote a free and open discussion of the issues, the conference usually is held after the branch has had an opportunity to study the case. However, the taxpayer may request that the conference of right be held at a stage earlier in the consideration of the case than the Service would ordinarily designate. The taxpayer has no right to appeal the action of a branch to a division director or to any other official of the Service. The taxpayer is not entitled, as a matter of right, to a separate conference in the Chief Counsel's office on a technical advice request.

.03 Because conference procedures are informal, no tape, stenographic, or other verbatim recording of a conference is made.

.04 The senior Service representative at the conference ensures that the taxpayer has full opportunity to present views on all of the issues in question. The Service representatives explain the Service's tentative decision on the substantive issues and the reasons for it. If prospective application under section 7805(b) of the Code is advanced by the taxpayer, the Service representative will discuss the tentative recommendation concerning the request for relief and the reason for the tentative recommendation. No commitment will be made as to the conclusion that the Service will finally adopt.

.05 An invitation to an additional conference is made if, after the conference of right, an adverse holding is proposed either (1) on a new issue or (2) on the same issue but on grounds different from those discussed at the first conference. When a proposed holding is reversed at a higher level with a result less favorable to the taxpayer, the taxpayer has no right to another conference if the grounds or arguments on which the reversal is based were discussed at the conference of right. The limitation on the number of conferences to which a taxpayer is entitled does not prevent inviting a taxpayer to attend further conferences when National Office personnel think they are necessary. These additional conferences are held only at the invitation of the National Office.

.06 The taxpayer is responsible for furnishing in writing to the National Office within 21 calendar days after the conference any additional data, line of reasoning, precedents, etc., that the taxpayer proposed and that were discussed at the conference but not previously or adequately presented in writing. An extension of the 21-day period may be granted only if the taxpayer justifies it in writing and the Chief or the Assistant Chief of the Technical branch to which the case is assigned approves it. Procedures for requesting an extension of the 21-day period and notifying the taxpayer or the taxpayer's representative of the Service's decision are the same as those in section 8.01. Any additional material should be submitted in duplicate to the National Office. If the additional information would have a significant impact on the facts in the request for technical advice, the National Office sends a copy to the District Director or the Chief, Appeals Office, for comment on the facts contained in the additional information submitted. The District Director or the Chief, Appeals Office, gives the matter prompt attention.

.07 A taxpayer may get information on the status of the request for technical advice by contacting the district or Appeals office that requested the technical advice.

.08 A District Director or a Chief, Appeals Office, may get current information on the status of the request for technical advice by calling the person whose name and telephone number are shown on the acknowledgement of receipt of the request for technical advice.

SEC. 9. PREPARATION OF TECHNICAL ADVICE MEMORANDUM BY THE NATIONAL OFFICE

.01 As soon as the request for technical advice is assigned, the technical employee analyzes the file to see whether it meets all requirements of section 5. If it does not comply with the requirements of section 5.09 relating to the statement of proposed deletions, the National Office makes the deletions from the technical advice memorandum that the Commissioner determines are required by section 6110(c) of the Code.

.02 Usually, within 15 work days after the Branch Office receives the request for technical advice, a representative of the Branch telephones the district or Appeals office to discuss the procedural and substantive issues in the request that come within the Branch's jurisdiction. The Branch representative informs the district or Appeals office:

(a) that the case is being returned because substantial additional information is required to resolve an issue, because significant unresolved factual variances exist between the statements of facts submitted by the district or Appeals office and the taxpayer, or because major procedural problems cannot be resolved by phone; or

(b) that the case is not being returned but more information is needed or minor procedural deficiencies exist; or

(c) what the Branch representative's tentative conclusion is and the estimated date that the technical advice memorandum will be mailed; or

(d) that a tentative conclusion has not been reached because of the complexity of the issue and the estimated date the tentative conclusion will be made.

.03 Within 15 work days after the Branch receives the additional information requested in section 9.02(b), the Branch representative telephones the district or Appeals office to discuss the procedural and substantive issues in the request that come within the jurisdiction of the Branch. The representative indicates either (1) the tentative conclusion and the estimated date the technical advice memorandum will be mailed, or (2) the fact that a tentative conclusion has not been reached because of the complexity of the issue and the estimated date the tentative conclusion will be made.

.04 Because the Branch representative's tentative conclusion may change during the preparation and review of the technical advice memorandum, it is not, under any circumstances, considered final. The district or Appeals office may not tell the taxpayer what the tentative conclusion is.

.05 When the technical advice request concerns matters within the jurisdiction of more than one Branch or more than one office in the same Branch, a representative of the Branch that received the original technical advice request informs the district or Appeals office within the initial 15-work-day period: (1) that the matters within the jurisdiction of another Branch or another office in the same Branch have been referred to the other Branch or office for consideration, and (2) that a representative of the other Branch or office will contact the district or Appeals office about the referral of the technical advice request within 15 work days after receiving it in accordance with section 9.02.

.06 Generally, before replying to the request for technical advice, the National Office informs the taxpayer orally or in writing of the material likely to appear in the technical advice memorandum which the taxpayer proposed be deleted but which the Service determined should not be deleted. If so informed, the taxpayer may submit within 10 days any further information, arguments, or other material to support the position that the material should be deleted. The Service attempts, if possible, to resolve all disagreements about proposed deletions before the National Office replies to the request for technical advice. However, the taxpayer does not have the right to a conference to resolve any disagreements about material to be deleted from the text of the technical advice memorandum. These matters, however, may be considered at any conference otherwise scheduled for the request.

.07 Replies to requests for technical advice are addressed to the District Director or the Chief, Appeals Office, and are in two parts. Each part identifies the taxpayer by name, address, identification number, and year or years involved. The first part of the reply is a transmittal memorandum. In unusual cases it is a way of giving the district or Appeals office administrative information or other information that under the nondisclosure statutes or for other reasons, may not be discussed with the taxpayer. The second part (the "technical advice memorandum") contains (1) a statement of the issues; (2) a statement of the pertinent facts in the issues; (3) a statement of the pertinent law, tax treaties regulations, revenue rulings and other precedents published in the Bulletin, and court decisions; (4) a discussion of the rationale developed by the National Office; and (5) the conclusions of the National Office. The conclusions give direct answers, whenever possible, to the specific questions of the district or Appeals office. The discussion of the issues is in enough detail so the district or Appeals officials know the reasoning underlying the conclusion. Accompanying the technical advice memorandum is a notice, under section 6110(f)(1) of the Code, of intention to disclose a technical advice memorandum (including a copy of the version proposed to be open to public inspection and notations of third party communications under section 6110(d)). The District Director or the Chief, Appeals Office, forwards this notice to the taxpayer when the District Director or the Chief, Appeals Office, gives a copy of the technical advice memorandum to the taxpayer according to section 9.08.

.08 The general practice of the Service is to give a copy of the technical advice memorandum to the taxpayer after it has been adopted by the District Director or the Chief, Appeals Office. However, in the case of technical advice memoranda described in section 6110(g)(5)(A) of the Code, relating to cases involving criminal or civil fraud investigations and jeopardy or termination assessments, a copy of the technical advice memorandum is not given to the taxpayer until all proceedings in the investigations or assessments are completed.

.09 If after receiving the notice under section 6110(f)(1) of the Code of intention to disclose the technical advice memorandum the taxpayer wants to protest the disclosure of certain information in it, the taxpayer must submit a written statement within 20 days identifying those deletions not made by the Service that the taxpayer believes should have been made. The taxpayer must also submit a copy of the version of the technical advice memorandum proposed to be open to public inspection with brackets around deletions that are proposed by the taxpayer but that have not been made by the National Office. Generally, the National Office does not consider the deletion of any material that the taxpayer has not proposed be deleted before the National Office sent its reply to the request for technical advice to the District Director or the Chief, Appeals Office. Within 20 days after it receives the taxpayer's response to the notice under section 6110(f)(1), the National Office must mail the taxpayers its final administrative conclusion about the deletions to be made.

SEC. 10. ACTION ON TECHNICAL ADVICE IN DISTRICT AND APPEALS OFFICES

.01 The District Director or the Chief, Appeals Office, processes the taxpayer's case on the basis of the conclusions in the technical advice memorandum unless (1) the District Director or the Chief, Appeals Office, thinks that the conclusions reached by the National Office in a technical advice memorandum should be reconsidered, or (2) the Chief, Appeals Office, in the case of technical advice unfavorable to the taxpayer, decides to settle the issue in the usual manner under existing authority.

.02 The District Director or the Chief, Appeals Office, gives the taxpayer (1) a copy of the technical advice memorandum described in section 9.07, and (2) the notice under section 6110(f)(1) of the Code of intention to disclose the technical advice memorandum (including a copy of the version proposed to be open to public inspection and notations of third party communications under section 6110(d)). This requirement does not apply to technical advice memoranda involving civil fraud or criminal investigations; jeopardy or termination assessments, as described in section 5.10; or documents to which section 6104 applies.

.03 In those cases in which the National Office tells the District Director or the Chief, Appeals Office, that a copy of the technical advice memorandum should not be given to the taxpayer, the District Director or the Chief, Appeals Office, tells this to the taxpayer if the taxpayer requests a copy.

SEC. 11. EFFECT OF TECHNICAL ADVICE

.01 Except in rare or unusual circumstances, a holding in a technical advice memorandum that is favorable to the taxpayer is applied retroactively. Moreover, since technical advice, as described in section 4.04 of this revenue procedure, is issued only on closed transactions, a holding that is adverse to the taxpayer is also applied retroactively unless the Assistant Commissioner (Technical) exercises the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of the holding.

.02 A holding that modifies or revokes a holding in a prior technical advice memorandum is applied retroactively, with one exception. If the new holding is less favorable to the taxpayer than the earlier one, it generally is not applied to the period in which the taxpayer relied on the prior holding in situations involving continuing transactions.

.03 If a technical advice memorandum relates to a continuing action or a series of actions, it is ordinarily applied until specifically withdrawn or until the conclusion is modified or revoked by enactment of legislation, ratification of a tax treaty, or issuance of a United States Supreme Court decision, regulations (temporary or final), a revenue ruling, or other statement published in the Internal Revenue Bulletin. Publication of a notice of proposed rulemaking does not affect the application of a technical advice memorandum.

.04 Generally, a technical advice memorandum that revokes or modifies a letter ruling or another technical advice memorandum is not applied retroactively for either the taxpayer to whom or for whom the ruling or memorandum was originally issued or for a taxpayer whose tax liability was directly involved in such ruling or memorandum if: (1) there has been no misstatement or omission of material facts; (2) the facts later developed are not materially different from the facts on which the ruling or memorandum was based; (3) there has been no change in the applicable law; (4) the ruling was originally issued for a prospective or proposed transaction; and (5) the taxpayer directly involved in the ruling or memorandum acted in good faith in relying on the ruling or memorandum and the retroactive revocation would be to the taxpayer's detriment. The tax liabilities of members of an industry are not directly involved in a ruling or in a memorandum issued to or for one of the members. The holding in a revocation or modification of a ruling or a memorandum to or for one member of an industry may be retroactively applied to other members of that industry. A tax practitioner may not obtain the nonretroactive application for one client of a modification or revocation of a ruling or a memorandum that was previously issued to or for another client. When a ruling to a taxpayer or a memorandum involving a taxpayer is revoked with retroactive effect, the notice to the taxpayer, except in fraud cases, sets forth the grounds on which the revocation is being made and the reasons why the revocation is being applied retroactively.

SEC. 12. PROCEDURE FOR REQUESTING APPLICATION OF SECTION 7805(b) IN THE CASE OF TECHNICAL ADVICE

.01 Pursuant to section 7805(b) of the Code, it is within the discretion of the Commissioner or the Commissioner's delegate to prescribe the extent, if any, to which any ruling (including technical advice) will be applied without retroactive effect.

A taxpayer to whom a technical advice memorandum has been addressed or with respect to whom a technical advice request is pending may request that the Assistant Commissioner (Technical), the Commissioner's delegate, exercise the discretionary authority under section 7805 (b) of the Code to limit the retroactive effect of any holding stated in the technical advice memorandum or to limit the retroactive effect of any subsequent modification or revocation of the technical advice memorandum.

.02 When a technical advice memorandum that concerns a continuing transaction is modified or revoked by, for example, a subsequent revenue ruling or final regulations, a request to limit the retroactive effect of the modification or revocation of the technical advice memorandum must be made in the form of a request for a ruling when the request is submitted before a return is examined that contains the transaction that is the subject of the request for ruling. See section 20.02 of Rev. Proc. 80-20, page 7, this Bulletin.

.03 When a taxpayer is informed of the modification or revocation of a technical advice memorandum, ruling letter, or determination letter during the course of an examination of the taxpayer's return by the District Director or during consideration by the Chief, Appeals Office, a request to limit the retroactive application of the modification or revocation of the technical advice memorandum, ruling letter, or determination letter must itself be made in the form of a request for technical advice. See section 5 of this revenue procedure. However, the taxpayer must also submit a statement, which will be forwarded to the National Office with the request for technical advice, that the request is being made pursuant to section 7805(b) of the Code. This statement must also set forth the relief sought and an explanation of the reasons and arguments in support of the relief requested, and it must be accompanied by any documents bearing on the request. The explanation in support of the application of section 7805(b) should include a discussion of the five items enumerated in section 11.04 of this revenue procedure as they relate to the taxpayer's particular situation.

.04 A request to limit the retroactive effect of a holding in a technical advice memorandum that does not modify or revoke a technical advice memorandum may be made as part of that technical advice request either initially or at any time before the technical advice memorandum is issued by the National Office. In such a case, the taxpayer must also submit a statement in support of the application of section 7805(b) of the Code, as described in .03 above.

.05 When a request for technical advice concerns only the application of section 7805(b) of the Code, the taxpayer has the right to a conference in the National Office in accordance with the provisions of section 8 of this revenue procedure. If the request for application of 7805(b) is included in the request for technical advice on the substantive issues or is made before the conference of right on the substantive issues, the section 7805(b) issue will be discussed at the taxpayer's one conference of right. If the request for the application of 7805(b) is made as part of a pending technical advice request after a conference has been held on the substantive issue, and the Service determines that there is justification for having delayed the request, then the taxpayer will have the right to one conference of right concerning the application of section 7805(b) with the conference limited to discussion of this issue.

SEC. 13. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 79-46 is superseded and Rev. Proc. 79-63 is modified.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 80-22

SECTION 1. PURPOSE AND NATURE OF CHANGES

.01 The purpose of this revenue procedure is to supersede Rev. Proc. 79-14, 1979-1 C.B. 496, Rev. Proc. 79-52, 1979-2 C.B. 538, and Rev. Proc. 79-68, 1979-2 C.B. 600, by providing a revised list of those areas of the Internal Revenue Code under the jurisdiction of the Assistant Commissioner (Technical) in which the Internal Revenue Service will not issue advance rulings or determination letters.

.02 Changes.

1 New section 3.011 refers to section 79 of the Code.

2 New section 3.012 refers to section 83 of the Code.

3 New section 3.013 refers to section 105(h) of the Code.

4 New section 3.014 refers to sections 121 and 1034 of the Code.

5 New section 3.0113 refers to section 302 of the Code.

6 New Section 3.0119 refers to section 451 of the Code.

7 New section 3.0120 refers to sections 451 and 457 of the Code.

8 New section 3.027 refers to section 2031 of the Code.

9 New section 3.028 refers to section 2512 of the Code.

10 New sections 3.0129 through 3.0131 refer to section 7701 of the Code.

11 New section 3.026 refers to the tax consequences of proposed legislation.

12 New section 3.027 refers to determination of reasonable cause under Subtitle F (Procedure and Administration) of the Code.

13 New section 3.028 refers to the applicability of criminal penalties to proposed transactions.

14 New sections 4.10 and 4.11 refer to section 7701 of the Code.

15 Section 4.011 now refers to sections 61 and 163 of the Code.

16 New section 4.013 refers to section 170(c) of the Code.

17 New section 5 lists temporary "no ruling" areas.

18 New section 5.01 refers to sections 61, 72, 79, 83, 101, 162, 264, and 641 of the Code.

19 New section 5.02 refers to section 117 of the Code.

20 New section 5.04 refers to section 1001 of the Code.

21 New section 5.05 refers to section 1372 of the Code.

22 New section 6 lists areas for which the Service cannot rule because of statutory prohibition against doing so.

23 New section 6.01 refers to section 61 of the Code.

24 New section 6.02 refers to section 162 of the Code.

25 New section 6.03 refers to section 170 of the Code.

SEC. 2. BACKGROUND AND SCOPE OF APPLICATION

.01 Background.

Whenever appropriate in the interest of sound tax administration, it is the policy of the Service to answer inquiries of individuals and organizations regarding their status for tax purposes and the tax effects of their acts or transactions, prior to the filing of returns or reports that are required by the revenue laws.

There are, however, certain areas in which, because of the inherently factual nature of the problems involved, or for other reasons, the Service will not issue advance rulings or determination letters. These areas are set forth in four sections of this revenue procedure. Section 3 reflects those areas in which advance rulings and determinations will not be issued. Section 4 sets forth those areas in which they will not ordinarily be issued. "Not ordinarily" connotes that unique and compelling reasons must be demonstrated to justify a ruling or determination letter. Those sections reflect a number of specific questions and problems as well as general areas. Section 5 lists specific areas for which the Service is temporarily not issuing advance rulings and determinations because those matters are under extensive study. Section 6 lists areas for which the Service is prohibited by statute from issuing rulings or determination letters.

With respect to the items listed, revenue rulings or revenue procedures may be published in the Internal Revenue Bulletin from time to time to provide general guidelines regarding the position of the Service.

Additions or deletions to this revenue procedure as well as restatement of items listed will be made by modification of this revenue procedure. A new revenue procedure will be published annually in the first quarter of the calendar year and changes made thereafter will be published quarterly. These lists should not be considered all inclusive. Decisions not to rule on individual cases, as contrasted with those that present significant pattern issues, are not reported in this revenue procedure and will not be added to subsequent revisions.

The authority and general procedures of the Technical Function of the National Office of the Internal Revenue Service of the Offices of the District Directors of the Internal Revenue with respect to the issuance of advance rulings and determination letters with respect to Code sections under the jurisdiction of the Assistant Commissioner (Technical) are outlined in Rev. Proc. 80-20, page 7, this Bulletin.

.02 Scope of Application.

This revenue procedure is not to be considered as precluding the submission of requests for technical advice to the National Office from the Office of a District Director of Internal Revenue or a Chief, Appeals Office.

Sec. 3. Areas in Which Rulings or Determination Letters Will Not Be Issued

.01 Specific questions and problems.

1 Section 79.—Group Term Life Insurance Purchased for Employees.—Whether a group insurance plan for 10 or more employees qualifies as group term insurance if the amount of insurance is not computed under a formula that would meet the requirements of section 1.79-1(c)(2)(ii) if the group consisted of fewer than 10 employees.

2 Section 83.—Property Transferred in Connection with Performance of Services.—Whether a restriction constitutes a substantial risk of forfeiture if the employee is a controlling shareholder.

3 Section 105(h).—Amount Paid to Highly Compensated Individuals under a Discriminatory Self-Insured Medical Expense Reimbursement Plan.—Whether, following a determination that a self-insured medical expense reimbursement plan is discriminatory, that plan had previously made reasonable efforts to comply with tax discrimination rules.

4 Sections 121 and 1034.—One-Time Exclusion of Gain from Sale of Principal Residence by Individual Who Has Attained Age 55; Rollover of Gain on Sale of Principal Residence.—Whether at the time of its sale property qualifies as the taxpayer's principal residence.

5 Section 162.—Trade or Business Expenses.—Whether compensation is reasonable in amount.

6 Section 170.—Charitable Contributions and Gifts.—Whether a taxpayer who advances funds to a charitable organization and receives therefor a promissory note may deduct as contributions, in one taxable year or in each of several years, amounts forgiven by the taxpayer in each of several years by endorsements on the note.

7 Section 264(b). — Certain Amounts Paid in Connection with Insurance Contracts.—Whether "substantially all" the premiums of a contract of insurance are paid within a period of four years from the date on which the contract is purchased. Also, whether an amount deposited is in payment of a "substantial number" of future premiums on such a contract.

8 Section 264(c)(1).—Certain Indebtedness Incurred or Continued as Part of a Plan in Connection with Insurance Contracts.—Whether section 264(c)(1) of the Code applies.

9 Section 269.—Acquisition Made to Evade or Avoid Income Tax.—Whether an acquisition is within the meaning of section 269 of the Code.

10 Section 302.—Redemption of Stock.—Whether section 302(b) of the Code applies when the consideration given in redemption by a corporation consists entirely or partly of its notes payable, and the shareholder's stock is held in escrow or as security for payment of the notes with the possibility that the stock may or will be returned to the shareholder in the future, upon the happening of specified defaults by the corporation.

11 Section 302.—Redemption of Stock.—Whether section 302(b) of the Code applies when the consideration given in redemption by a corporation in exchange for a shareholder's stock consists entirely or partly of the corporation's promise to pay an amount that is based on, or contingent on, future earnings of the corporation, or when the promise to pay is contingent on working capital being maintained at a certain level, or any other similar contingency.

12 Section 302.—Redemption of Stock.—Whether section 302(b) of the Code applies to a redemption of stock if after the redemption the distributing corporation used property that is owned by the shareholder from whom the stock is redeemed and the payments by the corporation for the use of the property are dependent upon the corporation's future earnings

or are subordinate to the claims of the corporation's general creditors. Payments for the use of property will not be considered to be dependent upon future earnings merely because they are based on a fixed percentage of receipts or sales.

13 Section 302.—Distributions in Redemption of Stock.—Whether the acquisition or disposition of stock described in section 302(c)(2)(B) of the Code has, or did not have, as one of its principal purposes the avoidance of federal income taxes within the meaning of that section, unless the facts and circumstances are materially identical to those set forth in Rev. Rul. 56-556, 1956-2 C.B. 177, Rev. Rul. 56-584, 1956-2 C.B. 179, Rev. Rul. 57-387, 1957-2 C.B. 225, Rev. Rul. 77-293, 1977-2 C.B. 91, or Rev. Rul. 79-67, 1979-1 C.B. 128.

14 Sections 311 and 336.—Taxability of Corporation on Distribution; General Rule.—Upon distribution of property in kind by a corporation to its shareholders, in complete liquidation under section 331 of the Code (when under the facts a sale of the property by the corporation would not qualify under section 337), in partial liquidation under section 346, or in redemption of stock under section 302(a), followed by a sale of the property, whether the sale can be deemed to have been made by the corporation under the doctrine of *Commissioner v. Court Holding Company,* 324 U.S. 331 (1945), Ct. D. 1636, 1945 C.B. 58.

15 Section 312.—Earnings and Profits.—The determination of the amount of earnings and profits of a corporation.

16 Sections 331, 332, and 333.—Effects on Recipients of Distributions in Corporate Liquidations.—The tax effect of the liquidation of a corporation preceded or followed by the reincorporation of all or a part of the business and assets when more than a nominal amount of the stock (that is, more than 20 percent in value) of both the liquidating corporation and the transferee corporation is owned by the same shareholders; or when a liquidation is followed by the sale of the corporate assets by the shareholders to another corporation in which such shareholders own more than a nominal amount of the stock (that is, more than 20 percent in value).

17 Section 337.—Gain or Loss; Certain Liquidations.—The application of this section to a corporation upon the sale of property, in connection with its liquidation, to another corporation, when more than a nominal amount of the stock (that is, more than 20 percent in value) of both the selling corporation and the purchasing corporation is owned by the same persons.

18 Section 346.—Partial Liquidation.—The amount of working capital attributable to a business or portion of a business terminated that may be distributed in partial liquidation.

19 Section 451.—General Rule for Taxable Year of Inclusion.—The tax consequences of a nonqualified unfunded deferred compensation arrangement with respect to a controlling shareholder employee eligible to participate in the arrangement.

20 Sections 451 and 457.—General Rule for Taxable Year of Inclusion; Deferred Compensation Plans With Respect to Service for State and Local Governments.—The tax consequences to unidentified independent contractors in nonqualified unfunded deferred compensation plans. This applies to plans established under section 451 of the Code by employers in the private sector and to eligible state plans under section 457. However, a ruling with respect to a specific independent contractor's participation in such a plan may be issued.

21 Section 453.—Revolving Credit Sales as Installment Sales.—Whether a proposed sampling procedure will be acceptable by the Service for the purpose of determining the portion of revolving credit balances to be treated as installment account balances. See Rev. Proc. 64-4, 1964-1 (Part 1) C.B. 644, and Rev. Proc. 65-5, 1965-1 C.B. 720.

22 Section 642(c).—Deduction for Amounts Paid or Permanently Set Aside for a Charitable Purpose.—Allowance of an unlimited deduction for amounts set aside by a trust or estate for charitable purposes when there is a possibility that the corpus of the trust or estate may be invaded.

23 Section 704(b)(2).—Partner's Distributive Share Determined.—Whether the allocation to a partner under the parnership agreement of income, gain, loss, deduction, or credit (or an item thereof) has substantial economic effect.

24 Section 704(e).—Family Partnerships.—Matters relating to the validity of a family partnership when capital is not a material income producing factor.

25 Section 1221.—Capital Asset Defined.—Whether specialty stock allocated to an investment account by a registered specialist on a national securities exchange is a capital asset.

26 Section 1551.—Disallowance of Surtax Exemption and Accumulated Earnings Credit.—Whether a transfer is within section 1551 of the Code.

27 Section 2031.—Definition of Gross Estate.—Actuarial factors for valuing interests in the prospective gross estate of a living person.

28 Section 2512.—Valuation of Gifts.—Actuarial factors for valuing prospective or hypothetical gifts of a donor.

29 Section 7701.—Definitions.—Whether a foreign arrangement that is a participant in a domestic arrangement classified as a partnership for U.S. tax purposes will itself be classified as a partnership.

30 Section 7701.—Definitions.—Whether a foreign limited liability company will be classified as a partnership if the taxpayer requests classification as a partnership and (1) the taxpayer is a corporation and less than 20 percent of the interests in the limited liability company are held by independent parties or (2) the taxpayer is not a corporation and independent parties hold only a nominal interest in the company.

31 Section 7701.—Definitions.—The classification of arrangements formed as partnerships under local law where the members of such partnerships are professional corporations.

.02 General Areas.

1 The results of transactions that lack bona fide business purpose or have

as their principal purpose the reduction of federal taxes.

2 A matter upon which a court decision adverse to the government has been handed down and the question of following the decision or litigating further has not yet been resolved.

3 A matter involving the prospective application of the estate tax to the property or the estate of a living person.

4 A matter involving alternate plans of proposed transactions or involving hypothetical situations.

5 A matter involving the federal tax consequences of any proposed federal, state, local, or municipal legislation. The Service may provide general information in response to an inquiry.

6 Whether reasonable cause exists under Subtitle F (Procedure and Administration) of the Code.

7 Whether a proposed transaction would subject the taxpayer to a criminal penalty.

8 A request that does not comply with the provisions of Rev. Proc. 80-20.

SEC. 4. AREAS IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT ORDINARILY BE ISSUED

.01 Specific questions and problems.

1 Sections 61 and 163.—Gross Income Defined; Interest.—Determinations as to who is the true owner of property or the true borrower of money in cases in which the formal ownership of the property or liability for the indebtedness is in another party.

2 Section 167.—Depreciation.

(a) Useful lives of assets.

(b) Depreciation rates.

(c) Salvage value of assets.

3 Section 170(c).—Charitable, etc., Contributions and Gifts.—Whether a taxpayer who transfers property to a charitable organization and thereafter leases back all or a portion of the transferred property, may deduct the fair market value of the property transferred and leased back as a charitable contribution.

4 Section 302. — Redemption of Stock.—The tax effect of the redemption of stock for notes, when the payments on the notes are to be made over a period in excess of 15 years from the date of issuance of such notes.

5 Section 306.—Disposition of Certain Stock.—Whether the distribution or disposition or redemption of "section 306 stock" in a closely held corporation is in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes within the meaning of section 306(b)(4) of the Code.

6 Section 331.—Gain or Loss to Shareholders in Corporate Liquidations.—The tax effect of the liquidation of a corporation by a series of distributions, when the distributions in liquidation are to be made over a period in excess of three years from the adoption of the plan of liquidation.

7 Section 341.—Collapsible Corporations.—Whether a corporation will be considered to be a "collapsible corporation," that is, whether it was "formed or availed of" with the view of certain tax consequences. However, ruling requests will be considered on this matter when the enterprise (1) has been in existence for at least 20 years, (2) has had substantially the same owners during that period, and (3) has conducted substantially the same trade or business during that period.

8 Section 351.—Transfers to Controlled Corporation.—The tax effect of the transfer when part of the consideration received by the transferors consist of bonds, debentures, or any other evidences of indebtedness of the transferee.

9 Section 992.—Requirements of a Domestic International Sales Corporation.—The tax effects of a Domestic International Sales Corporation's stock being held by individuals who are also shareholders in a related supplier corporation.

10 Section 7701. — Definitions. — Whether what is generally known as a foreign corporation will be classified as a partnership for U.S. tax purposes if the taxpayer requests classification as a partnership.

11 Section 7701. — Definitions. — Whether a foreign partnership will be classified as an association for U.S. tax purposes if the taxpayer requests classification as an association.

.02 General areas.

1 Any matter in which the determination requested is primarily one of fact, e.g., market value of property, or whether an interest in a corporation is to be treated as stock or indebtedness.

2 The tax effect of any transaction to be consummated at some indefinite future time.

3 Any matter dealing with the question of whether property is held primarily for sale to customers in the ordinary course of trade or business.

SEC. 5. AREAS UNDER EXTENSIVE STUDY IN WHICH RULINGS OR DETERMINATION LETTERS WILL NOT BE ISSUED UNTIL THE SERVICE RESOLVES THE ISSUE THROUGH PUBLICATION OF A REVENUE RULING, REVENUE PROCEDURE, REGULATIONS OR OTHERWISE

.01 Section 79.—Group Term Life Insurance Purchased for Employees.—Whether life insurance provided for employees under a "retired lives reserve" plan will be considered group term insurance (also sections 61, 72, 83, 101, 162, 264, and 641).

.02 Section 117.—Scholarships and Fellowships Grants.—Whether an employer-related scholarship or fellowship grant is excludable from the employee's gross income if there is no intermediary private foundation distributing the grants, as there was in Rev. Proc. 76-47, 1976-2 C.B. 670.

.03 Section 368.—Definitions Relating to Corporate Reorganizations. Whether the continuity of business enterprise requirement of section 1.368-1(b) of the regulations is satisfied if the transferee corporation does not continue the historic business (the business conducted most recently) of the transferor corporation or, when such business is not continued, the transferee does not use a significant portion of the assets of the transferor's historic business in the transferee's business.

.04 Section 1001.—Determination of Amount of and Recognition of Gain or Loss.—Determination of amount of, and recognition of, gain or loss in divorce property settlements.

.05 Section 1372.—Election by Small Business Corporation.—Whether trailer or mobile home parks or aircraft rental businesses qualify as electing small business corporations.

Sec. 6. Areas for Which the Service Is Prohibited by Statute from Issuing Rulings or Determination Letters

.01 Section 61.—Gross Income Defined.—Employee fringe benefits. Pub. L. 96-167, 1980-5 I.R.B. 12.

.02 Section 162.—Trade or Business Expenses.—Expenses of commuting. Pub. L. 96-167.

.03 Section 170.—Charitable, etc., Contributions and Gifts.—Application of revenue ruling (Rev. Rul. 79-99, 1979-1 C.B. 108) to deny a charitable contribution deduction. Pub. L. 96-74, 1979-2 C.B. 473.

Sec. 7. Effect on Other Documents

Rev. Procs. 79-14, 79-52, and 79-68 are superseded.

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26 CFR 601.402: Sales taxes collected by return.
(Also Part I, Sections 6071, 6076, 6651; 46.6071(a)-1, 48.6071(a)-1, 150.6076-1, 301.6651-1.)

Rev. Proc. 80-23 [1]

Section 1. Purpose

The purpose of this revenue procedure is to clarify the return filing procedures that are to be followed where Form 720, Quarterly Federal Excise Tax Return, reports liability for several excise taxes that are subject to different reporting times.

Sec. 2. Background

Under section 6076 of the Internal Revenue Code and section 150.6076-1 of the Temporary Excise Tax Regulations under the Crude Oil Windfall Profit Tax Act of 1980 windfall profits tax liability must be reported on Form 720 on or before the last day of the second month following the close of the calendar quarter. Section 48.6071(a)-1(a) of the Manufacturers and Retailers Excise Tax Regulations provides that liability for the manufacturers excise tax on gasoline, etc. must be reported on Form 720 on or before the last day of the first month following the calendar quarter. Other excise taxes reportable on Form 720 must also be reported by the last day of the first month following the quarter.

Sec. 3. Procedure

Where a Form 720 reports liability for federal excise taxes reportable on or before the last day of the first month following the calendar quarter (or 10 days after if timely deposits in full payment have been made) as well as taxes reportable on or before the last day of the second month following the calendar quarter, the return may be filed without penalty on or before the latter date, provided that the taxpayer has made timely deposits of the taxes reportable on the earlier date.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 80-24

Section 1. Purpose

The purpose of this revenue procedure is to update and restate the general procedures of the Internal Revenue Service in issuing rulings, determination, opinion, notification, and information letters to taxpayers and in entering into closing agreements on specific issues as to the interpretation or application of the federal tax laws in the employee plan and exempt organization areas. This revenue procedure also informs taxpayers and their representatives where they may direct requests for rulings, determination, notification, and opinion letters, and closing agreements; and outlines procedures to be followed in order to promote efficient handling of their inquiries.

Sec. 2. General Practice and Definitions

.01 It is the practice of the Service to answer inquiries of individuals and organizations, whenever appropriate in the interest of sound tax administration, as to their status for tax purposes, and as to the tax effects of their acts or transactions, or in the interest of proper design and administration of employee benefit plans. One of the functions of the National Office of the Service is to issue rulings in such matters. Key District Directors of Internal Revenue apply the statutes, regulations, revenue rulings, and other precedents published in the Internal Revenue Bulletin in the determination of tax liability, the collection of taxes, and the issuance of determination letters in answer to taxpayers' inquiries or requests. For a list of key District Directors, see Rev. Proc. 80-25, page 39, this Bulletin, or Rev. Proc. 80-30, page 56, this Bulletin.

.02 For purposes of this revenue procedure, the term "taxpayer" includes all persons subject to any provision of the Internal Revenue Code and, whenever appropriate, their authorized representative(s).

.03 A "ruling" is a written statement issued to a taxpayer by the National Office that interprets and applies the tax laws, or any non-tax laws applicable to employee benefit plans for which the Service has jurisdiction, to a specific set of facts. Rulings are issued only by the National Office. The issuance of rulings in employee plan and exempt organization matters is under the general supervision of the Assistant Commissioner (Employee Plans and Exempt Organizations) and has been largely redelegated to the directors of the Actuarial, Employee Plans, and Exempt Organizations Divisions.

.04 A "determination letter" is a written statement issued by a key District Director in response to a written inquiry by an individual or an organization that applies to the particular facts involved, and to the principles and precedents previously announced by the National Office. A determination letter is issued only where a determination can be made on the basis of clearly established rules as set forth in the statute or regulations, or in a ruling, opinion, or court decision published in the Internal Revenue Bulletin. Where such a determination cannot be made, such as where the question presented involves a novel issue or the matter is excluded from the jurisdiction of a key District Director by the provisions of section 4 of this revenue procedure, a determination letter will not be issued.

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[1] Also released as News Release IR-80-70, dated June 12, 1980.

.05 A "notification letter" is a written statement furnished by a key district office, upon request, as to the acceptability (for purposes of sections 401 and 501(a) of the Internal Revenue Code) of the form of a pattern plan or a field prototype plan and any related trust or custodial account.

.06 An "opinion letter" is a written statement furnished by the National Office, upon request, as to the acceptability (for purposes of sections 401 and 501(a) of the Code) of the form of any master or prototype plan and any related trust or custodial account, or as to the conformance of a prototype trust, custodial account, individual annuity, or endowment contract with the requirements of section 408(a), (b), or (k), as applicable. See Rev. Proc. 75-6, 1975-1 C.B. 646, and Rev. Proc. 80-29, page 52, this Bulletin.

.07 An "information letter" is a statement issued either by the National Office or by a key District Director that does no more than call attention to a well-established interpretation or principle of tax law, without applying it to a specific set of facts. An information letter may be issued when the nature of the request from the individual or the organization suggests that it is seeking general information, or where the request does not meet all the requirements of section 6 of this revenue procedure, and it is believed that such general information will assist the individual or organization.

.08 A "revenue ruling" is an official interpretation of the Internal Revenue laws, related statutes, tax treaties, and regulations, by the Internal Revenue Service that has been published in the Internal Revenue Bulletin. Revenue rulings are issued only by the National Office and are published for the information and guidance of taxpayers, Service officials, and others concerned.

.09 A "closing agreement," as the term is used herein, is an agreement between the Commissioner of Internal Revenue or the Commissioner's delegate and a taxpayer with respect to a specific issue or issues entered into pursuant to the authority contained in section 7121 of the Code. Such a closing agreement is based on a ruling that has been signed by the Commissioner or the Commissioner's delegate and in which it is indicated that a closing agreement will be entered into on the basis of the holding of the ruling letter. Closing agreements are final and conclusive except upon a showing of fraud, malfeasance, or misrepresentation of material fact. They may be entered into where it is advantageous to have the matter permanently and conclusively closed, or where a taxpayer can show good and sufficient reasons for an agreement and the government will sustain no disadvantage by its consummation. In appropriate cases, taxpayers may be requested to enter into a closing agreement as a condition to the issuance of a ruling. Where in a single case, closing agreements are requested on behalf of each of a number of taxpayers, such agreements are not entered into if the number of such taxpayers exceeds twenty-five. However, in a case where the issue and holding are identical as to all of the taxpayers and the number of taxpayers is in excess of twenty-five, a "mass closing agreement" will be entered into with the taxpayer who is authorized by the others to represent the entire group.

SEC. 3. RULINGS AND OPINION LETTERS ISSUED BY THE NATIONAL OFFICE

.01 In employee plan and exempt organization matters, the National Office issues rulings on prospective transactions and on completed transactions before the appropriate return is filed. However, rulings will not ordinarily be issued if the identical issue is present in a return of the taxpayer for a prior year which is under active examination or audit by a key district office, is being considered on appeal within the Service, or is pending in litigation. If a return involving an issue for a particular year is filed while a request for a ruling on that issue is pending, the National Office will issue the ruling unless the taxpayer notifies the National Office as discussed in section 6.06 that an examination of the issue for which a ruling is requested or an examination of the identical issue on a prior year's return has been initiated by a key District Director. However, even in the event that an examination is initiated, the National Office ordinarily will issue the ruling if the key District Director agrees, by memorandum, to permit the issuance of the ruling. The National Office issues rulings involving the exempt status of organizations under section 501 or 521 of the Code, only to the extent provided in Rev. Proc. 72-5, 1972-1 C.B. 709, Rev. Proc. 80-25, and Rev. Proc. 80-27, page 49, this Bulletin. The National Office may issue rulings involving employee plans matters under sections 401 through 415, except as provided in section 3 of Rev. Proc. 80-30. The National Office issues rulings involving waiver of the minimum funding standard, changes in the funding method, and changes in the plan year under section 412. The National Office issues rulings involving section 219 except for issues relating to the deductibility of contributions that depend on whether a particular program meets the requirements of section 408. The National Office also issues rulings involving prohibited transactions under sections 503 and 4975. The National Office issues opinion letters as to the acceptability of the form of master or prototype plans and any related trusts or custodial accounts involving sections 401, 403(a), and 501(a), and of prototype trusts, custodial accounts, annuities, or endowment contracts under section 408(a), (b), or (k), only to the extent provided in Rev. Procs. 75-6 and 80-29. The National Office issues rulings as to whether individual retirement accounts established by employers or associations of employees meet the requirements of section 408(c). See Rev. Proc. 76-32, 1976-2 C.B. 654.

.02 With regard to applications for extension of the time for making an election or application for relief pursuant to section 1.9100 of the Income Tax Regulations, see Rev. Proc. 79-63, 1979-2 C.B. 578. If a request for an extension of time under section 1.9100-1 is submitted before or after the return is filed but before the return is examined, the procedures of this revenue procedure are applicable. If an examination of the return has begun, or is being considered by an Appeals office, the procedures of Rev. Proc. 80-26, page 43, this Bulletin, are applicable.

.03 The Service will not issue rulings to business, trade, or industrial associations, or to other similar groups relating to the application of the tax laws to individual taxpayers within the group. However, rulings may be issued to such groups or associations relating to their own tax status or liability or that of member organizations included under a group exemption letter, provided such tax status or liability is not an issue before any key district office, or on appeal within the Service, in connection with an examination or audit of the liability of the same taxpayer for the same or a prior period.

.04 Pending the adoption of regulations (either temporary or final) that reflect the provisions of any Act, consideration will be given to the issuance of rulings under the conditions set forth below.

1 If an inquiry presents an issue on which the answer seems to be clear from an application of the provisions of the statute to the facts described, a ruling will be issued in accordance with usual procedures.

2 If an inquiry presents an issue on which the answer seems reasonably certain but not entirely free from doubt, a ruling will be issued only if it is established that a business emergency requires a ruling or that unusual hardship will result from failure to obtain a ruling.

3 If an inquiry presents an issue that cannot be reasonably resolved prior to the issuance of regulations, a ruling will not be issued.

4 If any case in which the taxpayer believes that a business emergency exists or that an unusual hardship will result from failure to obtain a ruling, the taxpayer should submit with the request a separate letter setting forth the facts necessary for the Service to make a determination in this regard. In this connection, the Service will not deem a "business emergency" to result from circumstances within the control of the taxpayer such as, for example, scheduling within an inordinately short time the closing date for a transaction or a meeting of the board of directors or the shareholders of a corporation.

SEC. 4. DETERMINATION AND NOTIFICATION LETTERS ISSUED BY KEY DISTRICT DIRECTORS

.01 In employee plan and exempt organization matters, key District Directors issue determination letters in response to taxpayers' written requests submitted to their offices involving *completed* transactions affecting taxpayers that are under their audit jurisdiction, but only if the answers to the question presented is covered specifically by statute or regulations, or specifically by a ruling, opinion, or court decision published in the Internal Revenue Bulletin. A determination letter usually will not be issued with respect to a question that involves a return to be filed by the taxpayer if the identical question is involved in a return or returns already filed by the taxpayer. Key District Directors will not issue determination letters as to the tax consequences of prospective or proposed transactions, except as provided in sections 4.03, 4.04, and 4.05.

.02 Notwithstanding the provisions of section 4.01, a key District Director generally will not issue a determination letter in response to an inquiry, although presenting a question specifically covered by statute, regulations, or rulings, etc., published in the Internal Revenue Bulletin, where (1) it appears that the taxpayer has directed the same inquiry to the National Office, (2) the identical issue involving the same taxpayer is pending in litigation or on appeal within the Service, or (3) the determination letter is requested by an industry, trade association, or similar group on behalf of individual taxpayers within the group (other than subordinate organizations covered by a group exemption letter). Under no circumstances will a key District Director issue a determination letter unless the inquiry is made by a taxpayer or taxpayers that are or will be under the Director's audit jurisdiction.

.03 Key District Directors issue determination letters as to the qualification of plans involving sections 401, 403(a), and 405(a) of the Code, the exempt status of related trusts, if any, under section 501, and as to whether an individually designed defined contribution plan constitutes an employee stock ownership plan under section 301(d) and (e) of the Tax Reduction Act of 1975, Pub. L. 94-12, 1975-1 C.B. 545 (see Rev. Proc. 75-48, 1975-2 C.B. 581 and 80-30) or, for taxable years beginning after December 31, 1978, under sections 409A or 4975(e)(7) of the Code, as added or amended respectively, by the Revenue Act of 1978, Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1. Key District Directors also issue determination letters as to the qualification of certain organizations for exemption from federal income tax under sections 501 and 521 to the extent provided in Rev. Proc. 80-25, and as to private foundation status under Rev. Proc. 76-34, 1976-2 C.B. 656.

.04 Key district offices issue notification letters as to the acceptability of the form of pattern plans and any related trusts or custodial accounts involving sections 401 and 501(a) of the Code only to the extent provided in Rev. Proc. 76-15, 1976-1 C.B. 553. Key district offices also issue notification letters as to the acceptability of the form of field prototype plans and any related trusts or custodial accounts involving sections 401 and 501(a) only to the extent provided in Rev. Proc. 77-23, 1977-2 C.B. 530.

.05 A request received by a key District Director with respect to a question involved in a return already filed will, in general, be considered in connection with the examination or audit of the return. If response is made to such inquiry prior to an examination or audit, it will be considered a tentative finding subject to the conclusions of any subsequent examination or audit of the return.

SEC. 5. DISCRETIONARY AUTHORITY TO ISSUE RULINGS AND DETERMINATION LETTERS

.01 There are certain areas where, because of the inherently factual nature of the problem involved, or for other reasons, the Service will not issue, or ordinarily will not issue, rulings or determination letters. A ruling or a determination letter is not issued, for example, on alternative plans of proposed transactions or on hypothetical situations. A list of these areas for employee plans is set forth in Rev. Proc. 80-30. This list is not all inclusive since the Service may decline to issue rulings or determination letters on other questions whenever warranted by the facts or circumstances of a particular case. The National Office and key District Directors may, when it is deemed appropriate and in the best interest of the Service, issue information letters calling attention to well-established principles of tax law or to the proper interpretation of the laws pertaining to employee benefit plans.

.02 The National Office will issue rulings in all cases on prospective or future transactions when the law or regulations require a determination of the effect of a proposed transaction for tax purposes.

.03 In the case of employee plans, a ruling or determination letter relating to an issue that is being considered by the Pension Benefit Guaranty Corporation or the Department of Labor, and involves the same taxpayer, shall be issued at the discretion of the Service.

SEC. 6. INSTRUCTIONS TO TAXPAYER

.01 A request for a ruling or a determination letter is to be submitted in duplicate if (1) more than one issue is presented in the request or (2) a closing agreement is requested with respect to the issue presented. It is not necessary to present requests in duplicate under other circumstances.

.02 In cases in which more than one issue is presented in a request for a ruling, the Service generally will issue a single ruling letter. However, the taxpayer may request a separate ruling letter on any of the issues. Unless the Service determines that it is not feasible or not in the best interest of the Service to comply with the taxpayer's request, separate ruling letters will be issued.

.03 When multiple issues are involved in a single factual situation and separate letters requesting rulings are submitted, a statement to this effect must be included in each ruling letter request. The Service, in issuing each ruling, shall state that separate rulings have been issued or requests for rulings are pending.

.04 Each request for a ruling or a determination letter must contain a complete statement of all relevant facts relating to the transaction. Such facts include names, addresses, and taxpayer identifying numbers of all interested parties; the location of the key district office that has or will have audit jurisdiction over each party; a full and precise statement of the reasons for the transaction; and a carefully detailed description of the transaction. In addition, true copies of all contracts, wills, deeds, agreements, instruments, plan documents, trust agreements, and other documents involved in the transaction must be submitted with the request. However, relevant facts reflected in documents submitted must be included in the taxpayer's statement and not merely incorporated by reference, and must be accompanied by an analysis of their bearing on the issue or issues, specifying the pertinent provisions. (The term "all interested parties" is not to be construed as requiring a list of employees where a large number may be involved in a plan.) The request must contain a statement whether, to the best of the knowledge of the taxpayer, the identical issue is in a return of the taxpayer (or of a related taxpayer within the meaning of section 267 of the Code or a member of an affiliated group of which the taxpayer is also a member within the meaning of section 1504) and, if so, whether it is being considered by any key district office in connection with an active examination or audit, is being considered on appeal within the Service, or is pending in litigation, or, in the case of employee plans, is being considered by the Pension Benefit Guaranty Corporation or the Department of Labor. Where the request pertains to only one step of a larger integrated transaction, the facts, circumstances, etc., must be submitted with respect to the entire transaction. Original documents should not be submitted because documents and exhibits become a part of the Internal Revenue Service file which cannot be returned. If a return is filed prior to the receipt of a ruling from the National Office concerning the return, a copy of the request must be attached to such return.

.05 As an alternative procedure for the issuance of rulings on prospective transactions, the taxpayer may submit a summary statement of the facts the taxpayer considers controlling the issue, in addition to the complete statement required for ruling requests by section 6.04 above. Assuming agreement with the taxpayer's summary statement, the Service will use it as the basis for the ruling. Any taxpayer wishing to adopt this procedure should submit with the request for ruling:

1 A complete statement of facts relating to the transaction, together with related documents, as required by section 6.04 above; and

2 A summary statement of the facts which the taxpayer believes should be controlling in reaching the requested conclusion. Where the taxpayer's statement of controlling facts is accepted, the ruling will be based on these facts and only this statement will ordinarily be incorporated in the ruling letter. It is emphasized, however, that:

(a) This procedure for a "two-part" ruling request is elective with the taxpayer and is not to be considered a required substitute for the regular procedures contained in this revenue procedure;

(b) Taxpayers' rights and responsibilities are the same under the "two part" ruling request procedure as those provided in this revenue procedure;

(c) The Service reserves the right to rule on the basis of a more complete statement of facts it considers controlling and to seek further information in developing facts and restating them for ruling purposes; and

(d) The "two-part" ruling request procedure will not apply where it is inconsistent with other procedures applicable to specific situations.

.06 If the taxpayer asserts a particular determination, an explanation of the grounds for the assertion must be furnished, together with a statement of relevant authorities in support of the taxpayer's views. Even though the taxpayer is urging no particular determination of a proposed or prospective transaction, the taxpayer's views on the tax results of the proposed action and a statement of relevant authorities to support those views must be furnished. In addition, the taxpayer is encouraged to inform the Service of, and discuss the implications of, any legislation, or tax treaties, court decisions, regulations, revenue rulings, or revenue procedures that the taxpayer determines to be contrary to the position advanced. If the taxpayer determines that there are no contrary authorities, a statement to this effect would be helpful in the ruling request. Identification and discussion of contrary authorities will generally enable Service personnel to arrive more quickly at a full understanding of the issue and the relevant authorities. There is a further advantage to the taxpayer. When Service personnel receive the request, they will have before them the taxpayer's thinking on the effect and applicability of contrary authorities. Such information should, therefore, make research easier and lead to earlier action by the Service. Conversely, failure to disclose and distinguish significant contrary authorities may result in requests for additional information, which will delay action on the ruling request.

.07 If the request is with respect to the qualification of a plan involving section 401, 403(a), 405(a), or 408 of the Code, or conformance of an employee stock ownership plan to sections 301(d) and (e) of the Tax Reduction Act of 1975 (for taxable years beginning before December 31, 1978) or to section 409A or 4975(e)(7) of the Code (for taxable years beginning after December 31, 1978), see Rev. Procs. 75-6, 75-48, 76-15, 76-32, 77-23, 80-29, and 80-30. If the request is with respect to the qualification of an organization for exemption from Federal income tax under section 501 or 521, see Rev. Procs. 72-5, 80-25, and 80-27.

.08 Before making the text of a ruling or determination letter open or available to public inspection pursuant to section 6110(a) of the Code, certain information identifying the taxpayer is deleted pursuant to section 6110(c). In order to assist the Internal Revenue Service in making the required deletions, the taxpayer requesting the ruling or determination letter must accompany the request with either a statement of deletions and the statutory basis for each proposed deletion, or a statement that no information other than names, addresses, and taxpayer identifying numbers need be deleted. Such statements shall be made in a separate document. The statement of proposed deletions shall be accompanied by a copy of the request for a ruling or determination letter and supporting documents, on which shall be indicated, by the use of brackets, the material that the taxpayer indicates should be deleted pursuant to section 6110(c). The statement of proposed deletions shall indicate the statutory basis, under section 6110(c), for each proposed deletion. The statement of proposed deletions shall not appear or be referred to anywhere in the request for a ruling or determination letter. If the taxpayer decides to request additional deletions pursuant to section 6110(c) prior to the time the ruling or determination letter is issued, additional statements may be submitted.

.09 A request for a ruling or determination letter to which section 6110 of the Code applies should contain a declaration in the following form: "Under the penalties of perjury, I declare that I have examined this request, including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of the request are true, correct, and complete." This declaration must be signed by the taxpayer (i.e., an authorized corporate officer of a corporation, a trustee of a trust, or an individual taxpayer seeking a ruling on the taxpayer's own behalf). The signature of an individual with a power of attorney will not suffice for the declaration.

.10 A request by or for a taxpayer must be signed by the taxpayer or the taxpayer's authorized representative. If the request is signed by a representative of the taxpayer, or if the representative is to appear before the Internal Revenue Service in connection with the request, he or she must be:

1 an attorney who is a member in good standing of the bar of the highest court of any state, possession, territory, Commonwealth, or the District of Columbia, and who files with the Service a written declaration that he or she is currently qualified as an attorney and he or she is authorized to represent the principal;

2 a certified public accountant who is duly qualified to practice in any state, possession, territory, Commonwealth, or the District of Columbia, and who files with the Service a written declaration that he or she is currently qualified as a certified public accountant and he or she is authorized to represent the principal; or

3 a person, other than an attorney or certified public accountant, enrolled to practice before the Service, and who files with the Service a written declaration that he or she is currently enrolled (including in the declaration either his or her enrollment number or the expiration date of his or her enrollment card) and that he or she is authorized to represent the principal. (See Treasury Department Circular No. 230. Revised, 1966-2 C.B. 1171, as amended, 1967-1 C.B. 433, and 1970-2 C.B. 644, for the rules on who may practice before the Service.) The above requirements do not apply to an individual representing his or her full-time employer, or to a bona fide officer, administrator, trustee, etc., representing a corporation, trust, estate, association, or organized group. An unenrolled preparer of a return (other than an attorney or certified public accountant referred to in clauses 1 and 2 above) who is not a full-time employee or a bona fide officer, administrator, trustee, etc., may not represent a taxpayer with respect to a ruling or a determination letter. Any authorized representative, whether or not he or she is enrolled to practice, must also comply with the conference and practice requirements of the Statement of Procedural Rules (26 CFR 601). Forms 2848, Power of Attorney, and 2848-D, Authorization and Declaration, may be used with regard to rulings, determination letters, notification letters, and opinion letters requested under this revenue procedure and Rev. Procs. 72-5, 75-6, 75-48, 76-15, 76-32, 76-34, 77-23, 80-25, 80-27, 80-29, and 80-30.

.11 If a taxpayer has more than one representative, sending a copy of the ruling to any one representative shall be sufficient. Copies of rulings will be sent to not more than two representatives provided that they are located at different mailing addresses. If a taxpayer does not designate which representative is to receive a copy of the ruling, a copy of the ruling will be sent to the first representative named on the latest power of attorney. If the original of the ruling is to be sent to a representative, the power of attorney should contain a statement to that effect and designate the mailing address of such representative.

.12 A request for a ruling or opinion letter by the National Office should be addressed to the Assistant Commissioner (Employee Plans and Exempt Organizations), 1111 Constitution Avenue, N.W., Washington, D.C. 20224. A request for a determination or notification letter should be addressed to the key District Director, Internal Revenue Service, whose office has or will have audit jurisdiction over the organization. See also Rev. Procs. 72-5, 75-6, 75-48, 76-15, 76-32, 77-23, 80-25, 80-27, 80-29, and 80-30.

.13 A request for a notification letter by the key district office should be addressed in accordance with the procedures of Rev. Proc. 76-15 in the case of a pattern plan, and Rev. Proc. 77-23 in the case of a field prototype plan.

.14 Any request for a ruling or an opinion, notification, or determination letter that does not comply with all the provisions of this revenue procedure will be acknowledged, and the requirements that have not been met will be pointed out. When applicable, Employee Plans will return the request to the applicant. A request for a ruling or opinion letter addressed to the key District Director that does not comply with the provisions of this revenue procedure will be returned by the key District Director for completion prior to sending it to the National Office.

.15 A taxpayer who desires an oral discussion of the issue or issues involved should indicate such desire in writing when filing the request or soon thereafter in order that the conference may be arranged at that stage of the consideration when it will be most helpful.

.16 It is the practice of the Service to process requests for ruling, opinion, notification and determination letters in regular order and as expeditiously as possible. Compliance with a request for consideration of a particular matter ahead of its regular order, or by a specified time, tends to delay the disposition of other cases. However, requests for processing ahead of the regular order, made in writing in a separate letter submitted with the request or subseqent thereto and showing clear need for such treatment, will be given consideration as the particular circumstances warrant. No assurance can be given that any letter will be processed by the time requested. For example, the scheduling of a closing date for a transaction or a meeting of the Board of Directors or shareholders of a corporation without due regard to the time it may take to obtain a ruling, opinion, notification, or determination letter will not be deemed sufficient reason for handling a request ahead of its regular order. Neither will the possible effect of fluctuation in the market price of stocks on a transaction be deemed sufficient reason for handling a request out of order. Requests by telegram will be treated as though made by letter. Ruling, opinion, notification, and determination letters ordinarily will not be issued by telegram.

.17 The Director, Exempt Organizations Division, has primary responsibility for issuing rulings with respect to organizations exempt from income tax. The Director, Employee Plans Division, has primary responsibility for matters involving the qualification of pension, annuity, profit-sharing, stock bonus, and bond purchase plans; the tax treatment of employees and their beneficiaries and deduction for employer contributions under such plans; and the applicability of the prohibited transactions provisions of section 4975 of the Code. The Director, Actuarial Division, has primary responsibility for matters requiring actuarial determinations.

.18 A taxpayer desiring to obtain information as to the status of the taxpayer's case may do so by contacting the person indicated on the letter acknowledging receipt of the case.

.19 When a taxpayer receives a ruling or determination letter prior to the filing of a return with respect to any transaction that has been consummated and that is relevant to the return being filed, a copy of the ruling or determination letter should be attached to the return.

.20 If after receiving the notice pursant to section 6110(f)(1) of the Code of intention to disclose the ruling or determination letter (including a copy of the version proposed to be open to public inspection and notations of third party communications pursant to section 6110(d)), the taxpayer requesting the ruling or determination letter desires to protest the disclosure of certain information in the ruling or determination letter, the taxpayer must submit to the office indicated in the notice a written statement within 20 calendar days after the notice is mailed. The statement must identify those deletions not made by the Service that the taxpayer believes should have been made. The taxpayer must also submit a copy of the version of the ruling or determination letter proposed to be open to public inspection on which the taxpayer indicates, by the use of brackets, the deletions proposed by the taxpayer that have not been made by the Service. Generally, the Service will not consider the deletion of any material that the taxpayer did not propose be deleted prior to the issuance of the ruling or determination letter. The Service shall, within 20 days after receipt of the response by the taxpayer to the notice, mail to the taxpayer its final administrative conclusion regarding the deletions to be made.

.21 After receiving the notice pursant to section 6110(f)(1) of the Code of intention to disclose (but no later than 60 days after such notice is mailed), the taxpayer may submit a request for delay of public inspection pursant to either section 6110(g)(3) or sections 6110(g)(3) and (4). The request for delay shall be submitted to the office indicated in the notice and shall contain the date on which it is expected that the underlying transaction will be completed. The request for delay pursuant to section 6110(g)(4) must contain a statement from which the Commissioner may determine that good cause exists to warrant such delay.

SEC. 7. CONFERENCES IN THE NATIONAL OFFICE

.01 If a conference has been requested, the taxpayer will be notified of the time and place of the conference. A conference is normally scheduled only when the Service deems it will be helpful in deciding the case or an adverse decision is indicated. If conferences are being arranged with respect to more than one request for a ruling involving the same taxpayer, they will be so scheduled as to cause the least inconvenience to the taxpayer.

.02 A taxpayer is entitled, as a matter of right, to only one conference in the National Office unless one of the circumstances discussed in section 7.04 develops. This conference will usually be held at the branch level of the appropriate division in the office of the Assistant Commissioner (Employee Plans and Exempt Organizations) within 21 days of the date the taxpayer was notified that the National Office was ready to schedule a conference, and will usually be attended by a person who has authority to represent the branch chief. If more than one subject is to be discussed at the conference, the discussion will constitute a conference with respect to each subject. In order to promote a free and open discussion of the issues, the conference will usually be held after the branch has had an opportunity to study the case. However, at the request of the taxpayer, the conference may be held at an earlier stage in the consideration of the case than the Service would ordinarily designate. No taxpayer has a "right" to appeal the action of a branch to a division director or to any other official of the Service, nor is a taxpayer entitled, as a matter of right, to a separate conference in the Chief Counsel's office on a request for a ruling.

.03 Since conference procedures are informal, no tape, stenographic, or other verbatim recording of a conference will be made.

.04 In the process of consideration in the National Office of a position proposed by a branch, it may appear that the final answer will involve a reversal of the branch proposal with a result that will be less favorable to the taxpayer. Or it may appear that an adverse position proposed by a branch will be sustained, but on a new or different issue or on substantially different grounds than those on which the branch decided the case. Under either of these circumstances, the taxpayer will be invited to another conference. The provisions of this revenue procedure limiting the number of conferences a taxpayer is entitled to will not foreclose the invitation of a taxpayer to attend further conferences when, in the opinion of National Office personnel, such need arises. All additional conferences of the type discussed in this paragraph are held only at the invitation of the Service.

.05 It is the responsibility of the taxpayer to add to the case file within 21 days after the date of the conference a written record of any additional data, lines of reasoning, precedents, etc., which are proposed by the taxpayer and discussed at the conference but which were not previously or adequately presented in writing.

SEC. 8. REFERENCE OF MATTERS TO THE NATIONAL OFFICE

.01 Requests for determination letters, received by the key District Directors that, in accordance with the provisions of section 4 of this revenue procedure, may not be acted upon by a key district office, will be forwarded to the National Office for reply and the taxpayer advised accordingly. Key District Directors also refer to the National Office any request for a determination letter that in their judgment warrants the attention of the National Office. See also the provisions of Rev. Procs. 80-29 and 80-30 with respect to requests relating to qualification of a plan involving sections 401, 403(a), and 405(a) of the Code, and Rev. Procs. 72-5, 80-25, and 80-27 with respect to applications for recognition of exempt status under sections 501 and 521.

.02 If the request is with regard to an issue or an area with respect to which the Service will not issue a ruling or a determination letter, such request will not be forwarded to the National Office, but the key district office will advise the taxpayer that the Service will not issue a ruling or a determination letter on the issue. See section 5.01 of this revenue procedure.

SEC. 9. REFERENCE OF MATTERS TO KEY DISTRICT OFFICES

Requests for rulings received by the National Office that, in accordance with the provisions of section 3 of this revenue procedure, may not be acted upon by the National Office will be forwarded for appropriate action to the key district office that has or will have audit jurisdiction. The taxpayer will be advised accordingly. If the request is with respect to an issue or an area of the type discussed in section 5.01, the taxpayer will be so advised and the request may be forwarded to the appropriate key district office for association with the related return or report of the taxpayer.

SEC. 10. REVIEW OF DETERMINATION LETTERS

.01 Determination letters issued with respect to the types of inquiries authorized by section 4.01 are not generally reviewed by the National Office as they merely inform a taxpayer of a position of the Service which has been previously established either in the regulations or in a ruling, opinion, or court decision published in the Internal Revenue Bulletin. If a taxpayer believes that a determination letter of this type is in error, the taxpayer may ask the key District Director to reconsider the matter. The taxpayer may also ask the key District Director to request advice from the National Office. In such event the procedure in Rev. Proc. 80-26 will be followed.

.02 The procedures for review of determination letters relating to the qualification of employers' plans involving sections 401, 403(a), and 405 (a) of the Code are provided in Rev. Proc. 80-30.

.03 The procedures for review of determination letters relating to the exemption from federal income tax of certain organizations under sections 501 and 521 of the Code are provided in Rev. Proc. 80-25.

SEC. 11. WITHDRAWAL OF REQUESTS

The taxpayer's request for a ruling or a determination letter may be withdrawn at any time prior to the signing of the letter of reply. However, in such a case, the National Office may furnish its views to the key District Director whose office has or will have audit jurisdiction of the taxpayer's return. The key District Director will consider the information submitted in any subsequent audit or examination of the taxpayer's return. Even though a request is withdrawn, all correspondence and exhibits will be retained in the Service and will not be returned to the taxpayer.

SEC. 12. ORAL ADVICE TO TAXPAYERS

.01 The Service does not issue rulings or determination letters upon oral requests. Furthermore, National Office officials and employees ordinarily will not discuss a substantive tax issue with a taxpayer prior to the receipt of a written request for a ruling, since oral opinions or advice are not binding on the Service. Persons who phone the National Office for oral advice are provided with the telephone number (toll-free if long distance) of the nearest office with Taxpayer Service personnel.

.02 A taxpayer may, of course, seek oral technical assistance from a key district office in the preparation of his or her return or report, pursuant to other established procedures. Such oral advice is advisory only and the Service is not bound to recognize it in any examination or audit.

.03 Taxpayer Service personnel will provide the answers to questions on procedural matters such as the application of the provisions of section 6 above, and questions relating to filing requirements, to obtaining plan determinations or recognition of exempt status. Taxpayer Service will also answer substantive questions on individual retirement savings arrangements, self-employed retirement plans, rollovers, and the taxability of pension distributions.

SEC. 13. EFFECT OF RULINGS

.01 A taxpayer may not rely on an advance ruling issued to another taxpayer. A ruling, except to the extent incorporated in a closing agreement, may be revoked or modified at any time in the wise administration of the taxing statutes. See section 2.09 for the effect of a closing agreement. If a ruling is revoked or modified, the revocation or modification applies to all open years under the statutes, unless the Commissioner or the Assistant Commissioner or Deputy Assistant Commissioner (Employee Plans and Exempt Organizations) exercises the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of the revocation or modification. The manner in which the Commissioner or the Assistant Commissioner or Deputy Assistant Commissioner (Employee Plans and Exempt Organizations) generally will exercise this authority is set forth in this section.

.02 As part of the determination of a taxpayer's liability, it is the responsibility of the key District Director to ascertain whether any ruling previously issued to the taxpayer has been properly applied. It should be determined whether the representations upon which the ruling was based reflected an accurate statement of the material facts and whether the transaction actually was carried out substantially as proposed. If, in the course of the determination of the tax liability, it is the view of the key District Director that a ruling previously issued to the taxpayer should be modified or revoked, the findings and recommendations of that office will be forwarded to the National Office for consideration prior to further action. Such reference to the National Office will be treated as a request for technical advice and the procedures of Rev. Proc. 80-26 will be followed. Otherwise, the ruling is to be applied by the key district office in its determination of the taxpayer's liability.

.03 Appropriate coordination with the National Office will be undertaken in the event that any other field official having jurisdiction of a return or other matter proposes to reach a conclusion contrary to a ruling previously issued to the taxpayer.

.04 A ruling found to be in error or not in accord with the current views of the Service may be modified or revoked. Modification or revocation may be effected by (1) a notice to the taxpayer to whom the ruling originally was issued, (2) enactment of legislation or ratification of a tax treaty, (3) a decision of the United States Supreme Court, (4) issuance of temporary or final regulations, or (5) issuance of a revenue ruling, a revenue procedure, or other statement published in the Internal Revenue Bulletin.

.05 Except in rare or unusual circumstances, the revocation or modification of a ruling will not be applied retroactively with respect to the taxpayer to whom the ruling was originally issued or to a taxpayer whose tax liability was directly involved in such ruling if (1) there has been no misstatement or omission of material facts, (2) the facts subsequently developed are not materially different from the facts on which the ruling was based, (3) there has been no change in the applicable law, (4) the ruling was originally issued with respect to a prospective or proposed transaction, and (5) the taxpayer directly involved in the ruling acted in good faith in reliance upon the ruling and the retroactive revocation would be to the taxpayer's detriment. To illustrate, the tax liability of each employee covered by a ruling relating to a pension plan of an employer is directly involved in such ruling. However, the tax liability of members of an industry is not directly involved in a ruling issued to one of the members, and the holding in a revocation or modification of a ruling to one member of an industry may be retroactively applied to other members of that industry. By the same reasoning, a tax practitioner may not obtain the nonretroactive application to one client of a modification or revocation of a ruling previously issued to another client. Where a ruling to a taxpayer is revoked with retroactive effect, the notice to such taxpayer will, except in fraud cases, set forth the grounds upon which the revocation is being made and the reasons why the revocation is being applied retroactively.

.06 A ruling issued to a taxpayer with respect to a particular transaction represents a holding of the Service on that transaction only. However, the application of that ruling to the transaction will not be affected by the subsequent issuance of regulations (either temporary or final), if the conditions specified in section 13.05 above are met. If the ruling is later found to be in error or no longer in accord with the holding of the Service, it will afford the taxpayer no protection with respect to a like transaction in the same or subsequent year, except to the extent provided in section 13.07.

.07 If a ruling is issued covering a continuing action or a series of actions and it is determined that the ruling was in error or no longer in accord with the holding of the Service, the Assistant Commissioner (Employee Plans and Exempt Organizations) ordinarily will limit the retroactivity of the revocation or modification to a date not earlier than that on which the original ruling is modified or revoked. Consistent with these provisions, if a ruling relates to a continuing aciton or a series of actions, the ruling will be applied until the date of issuance of applicable regulations or the publication of a revenue ruling holding otherwise, or until specifically withdrawn. Publication of a notice of proposed rulemaking will not affect the application of any ruling issued under the procedures set forth herein. (As to the effective date in cases involving revocation or modification of rulings or determination letters recognizing exemption, see section 13.01 of Rev. Proc. 80-25.)

.08 In the case of rulings involving completed transactions, other than those described in .07, above, taxpayers will not be afforded the protection against retroactive revocation provided in .05 above in the case of proposed transactions since they will not have entered into the transactions in reliance on the ruling.

SEC. 14. EFFECT OF DETERMINATION LETTERS

.01 A determination letter issued by a key District Director in accordance with this revenue procedure will be given the same effect upon examination or audit as is described in section 13 except that reference to the National Office is not necessary where, upon examination or audit, it is the opinion of the key District Director that a conclusion contrary to that expressed in the determination letter is indicated. Except as provided in Delegation Order No. 96 (Rev. 4) with respect to certain employee plans determination letters, the key District Director may not limit the modification or revocation of a determination letter but must refer the matter to the National Office for exercise by the Commissioner or the Assistant Commissioner (Employee Plans and Exempt Organizations) of the authority to limit the modification or revocation.

.02 In this connection see also Rev. Procs. 80-25 and 80-30.

SEC. 15. EFFECT OF INFORMATION LETTERS

An information letter issued by the National Office or by a key District Director is advisory only and the provisions of section 13 of this revenue procedure do not apply.

SEC. 16. PROCEDURE FOR REQUESTING APPLICATION OF SECTION 7805(b) IN THE CASE OF RULINGS AND DETERMINATION LETTERS

.01 Pursuant to section 7805(b) of the Code, it is within the discretion of the Commissioner or the Commissioner's delegate to prescribe the extent, if any, to which any ruling (including determination letters) will be applied without retroactive effect. A taxpayer to whom a ruling or determination letter has been issued may request that the Assistant Commissioner (Employee Plans and Exempt Organizations), the Commissioner's delegate, exercise the discretionary authority under section 7805(b) to limit the retroactive effect of any subsequent revocation or modification of the ruling or determination letter.

.02 In the case of a ruling seeking section 7805(b) relief, a request to limit the retroactive effect of the revocation or modification must be in the form of, and meet the requirements for, a ruling request generally. These requirements are set forth in section 6. Specifically, the request must state that it is being made pursuant to section 7805(b) of the Code, contain a statement of the relief sought and an explanation of the reasons and arguments in support of the relief requested, and also be accompanied by any documents bearing on the request. The explanation in support of the application of section 7805(b) should include a discussion of the five items enumerated in section 13.05 as they relate to the taxpayer's particular situation. A request for the application of section 7805(b) may take the form of a separate request for a ruling when, for example, a revenue ruling has the effect of modifying or revoking a ruling previously issued to the taxpayer or when the Service notifies the taxpayer of a change in position that will have the effect of revoking or modifying such a ruling. When germane to a pending ruling request, a request for the application of section 7805(b) may be made as part of the request, either initially or at any time before the ruling is issued. When a ruling that concerns a continuing transaction is modified or revoked by, for example, a subsequent revenue ruling, a request to limit the retroactive effect of the modification or revocation of the ruling must be made before a return is examined that contains the transaction that is the subject of the request for a ruling.

.03 When a request for the application of section 7805(b) of the Code is made in a separate ruling request, the taxpayer has the right to a conference in the National Office in accordance with the provisions of section 7. If the request is made initially as part of a pending ruling request or is made before the conference of right is held on the substantive issues, the section 7805(b) issue will be discussed at the taxpayer's one conference of right (see section 7.02). If the request is made as part of a pending ruling request after a conference has been held on the substantive issue, and the Service determines that there is justification for having delayed the request, then the taxpayer will have the right to one conference of right concerning the application of section 7805(b) with the conference limited to discussion of this issue.

.04 In the case of a determination letter that the key District Director proposes to modify or revoke, a request to limit the modification or revocation of the determination letter must be made by requesting the key District Director who issued the determination letter to seek technical advice from the National Office, since a key District Director has not been delegated authority under section 7805(b) of the Code to limit the modification or revocation of a determination letter (except as provided in Delegation Order No. 96 (Rev. 4), regarding certain employee plans letters). The taxpayer's request must state that it is being made pursuant to section 7805 (b), contain a statement of the relief sought and an explanation of the reasons and arguments in support of the relief requested, and also be accompanied by any documents bearing on the request. The explanation in support of the application of section 7805(b) should include a discussion of the five items enumerated in section 13.05 as they relate to the taxpayer's particular situation.

.05 When technical advice is requested with respect to the application of section 7805(b) of the Code under the circumstances set forth in .04 above, the taxpayer has a right to a conference in the National Office to the same extent as does a taxpayer who is the subject of a technical advice request involving another section of the Code. See section 6 of Rev. Proc. 80-26.

Sec. 17. Effective Date

This revenue procedure is effective June 30, 1980, the date of its publication in the Internal Revenue Bulletin.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 170, 501, 509, 521, 4942, 7428; 1.170A-1, 1.501(a)-1, 1.509 (a)-1, 1.521-1, 53.4942(b)-1.)

Rev. Proc. 80-25

Section 1. Purpose

This revenue procedure sets forth revised procedures with regard to applications for recognition of exemption from federal income tax under sections 501 and 521 of the Internal Revenue Code and with respect to revocation or modification of exemption rulings and determination letters, other than those subject to Rev. Proc. 80-30, page 56, this Bulletin (relating to pension, annuity, profit-sharing, and stock bonus plans). This revenue procedure also supplements Rev. Proc. 76-34, 1976-2 C.B. 656, with respect to the effects of section 7428 on the classification of organizations under sections 509(a) and 4942(j)(3). See Rev. Proc. 80-27, page 49, this Bulletin, for procedures under which exemption may be recognized on a group basis for subordinate organizations affiliated with and under the general supervision or control of a central organization. Also, see Rev. Proc. 72-5, 1972-1 C.B. 709, for information on applications for recognition of exemption filed by certain religious and apostolic organizations. Requests for rulings or determination letters generally are governed by the procedures outlined in Rev. Proc. 80-24, page 30, this Bulletin.

Sec. 2. Nature of Changes

This revenue procedure combines and updates the procedures previously set forth in Rev Proc. 72-4, 1972-1 C.B. 706, relating to processing requests for exemption, Rev. Proc. 76-33, 1976-2 C.B. 655, relating to the appeal procedures with regard to adverse determination letters and revocation or modification of exemption rulings and determination letters, and Rev. Proc. 77-21, 1977-1 C.B. 586, relating to the issuance of determinations and related matters to which section 7428 of the Code applies. This is due to the establishment of a single appeals function in each region, headed by a Regional Director of Appeals. The new Appeals office now has responsibility for the appeals function formerly performed by the office of the Assistant Regional Commissioner (Employee Plans and Exempt Organizations). In line with the new appeals procedures, the certiorari appeal to the National Office previously provided has been eliminated. The right to seek technical advice from the National Office, however, has been expanded to include requests from both district and Appeals offices and, in certain cases, has been made mandatory (see Rev. Proc. 80-26, page 43, this Bulletin). Rev. Proc. 77-31, 1977-2 C.B. 540, relating to the appeals procedures regarding the imposition of certain taxes on organizations exempt under section 501 or 521, is being revoked since the Regional Director of Appeals now handles all appeals of additional tax determinations. Since appeals from exempt organizations on such matters will be handled in the same manner as other taxes, a separate revenue procedure is unnecessary. Regarding the effective date of revocation or modification of exemption letters, the general rule previously set forth in Rev. Proc. 72-4 has been revised to conform to the general rules concerning effective date as currently set forth in Rev. Proc. 80-24. Austin and Jacksonville are eliminated from the list of key districts since their functions have been taken over by Dallas and Atlanta, respectively. A reference to discussion of contrary authorities has been added.

Sec. 3. General

.01 When used in this revenue procedure, the term "key District Director" means the District Director of one of the 17 key district offices for exempt organization matters.

.02 The term "determination letter" refers to a letter issued by a key District Director, or an Appeals office in the case of an exemption application, in response to a written inquiry by an individual or an organization that applies to the particular facts involved, and to the principles and precedents previously announced by the National Office. This includes a letter issued on the basis of advice secured from the National Office pursuant to the procedures prescribed herein and in Rev. Proc. 80-26. The term "ruling" refers to a letter issued by the National Office.

.03 The declaratory judgment provisions of section 7428 of the Code, with regard to this revenue procedure, apply to an actual controversy involving a determination by the Service or a failure by the Service to make a determination with respect to the initial or continuing qualification or classification of an organization under section 501(c)(3) (charitable, educational, etc.); 170(c)(2) (deductibility of contributions); 509(a) (private foundation status); or 4942(j)(3) (operating foundation status).

SEC. 4. FILING AND PROCESSING APPLICATIONS FOR RECOGNITION OF EXEMPTIONS

An organization seeking recognition of exempt status under section 501 or 521 of the Code is required to file an application with the key District Director for the Internal Revenue District in which is located the principal place of business or principal office of the organization. Following are the 17 key district offices that process the applications, the Internal Revenue districts covered by each, and the regional office designations:

Key District(s)	IRS Districts Covered
	Central Region
Cincinnati	Cincinnati, Indianapolis, Louisville.
Cleveland	Cleveland, Parkersburg.
Detroit	Detroit.
	Mit-Atlantic Region
Baltimore	Baltimore (which includes the District of Columbia and Office of International Operations), Pittsburgh, Richmond.
Philadelphia	Philadelphia, Wilmington.
Newark	Newark.
	Midwest Region
Chicago	Chicago.
St. Paul	Aberdeen, Fargo, Milwaukee, St. Paul.
St. Louis	Des Moines, Omaha, St. Louis, Springfield.
	North-Atlantic Region
Boston	Augusta, Boston, Burlington, Hartford, Portsmouth, Providence.
Manhattan	Manhattan.
Brooklyn	Albany, Brooklyn, Buffalo.
	Southeast Region
Atlanta	Atlanta, Birmingham, Columbia, Greensboro, Jackson, Jacksonville, Nashville.
	Southwest Region
Dallas	Albuquerque, Austin, Cheyenne, Dallas, Denver, Little Rock, New Orleans, Oklahoma City, Wichita.
	Western Region
Los Angeles	Honolulu, Los Angeles, Phoenix.
San Francisco	Reno, Salt Lake City, San Francisco.
Seattle	Anchorage, Boise, Helena, Portland, Seattle.

SEC. 5. STANDARDS FOR ISSUING RULINGS OR DETERMINATION LETTERS WITH RESPECT TO EXEMPT STATUS

.01 A ruling or determination letter will be issued to an organization, provided its application and supporting documents establish that it meets the particular requirements of the section under which exemption is claimed. Any oral representation of additional facts or modification of facts as represented or alleged in the application for a ruling or determination letter must be reduced to writing over the signature of the taxpayer or authorized representative.

.02 Exempt status will be recognized in advance of operations if proposed operations can be described in sufficient detail to permit a conclusion that the organization will clearly meet the particular requirements of the section under which exemption is claimed. A mere restatement of purposes or a statement that proposed activities will be in furtherance of such purposes will not satisfy this requirement. The organization must fully describe the activities in which it expects to engage, including the standards, criteria, procedures, or other means adopted or planned for carrying out the activities; the anticipated sources of receipts; and the nature of contemplated expenditures. Where the organization cannot demonstrate to the satisfaction of the Service that its proposed activities will be exempt, a record of actual operations may be required before a ruling or determination letter will be issued. In those cases where an organization is unable to describe fully its purposes and activities, a refusal to issue a ruling or determination letter will be considered an adverse determination from which administrative appeal rights will be afforded.

.03 Where an application for recognition of exemption does not contain the required information, the application may be returned to the applicant without being considered on its merits with an appropriate letter of explanation. In the case of an application under section 501(c)(3) of the Code that is returned, the applicant will also be informed of the time within which the completed application must be resubmitted in order for the application to be considered as a timely notice within the meaning of section 508(a).

.04 A ruling or determination letter recognizing exemption will not ordinarily be issued if an issue involving the organization's exempt status under section 501 or 521 of the Code is pending in litigation or is under consideration within the Service.

.05 In the case of an application under section 501(c)(3) of the Code, the 270-day period referred to in section 7428(b)(2) will be considered by the Service to begin on the date a substantially completed Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code, is filed with or mailed to the appropriate key District Director. A substantially completed Form 1023 is one that:

1 is signed by an authorized individual;

2 includes an Employer Identification Number (EIN) or a completed Form SS-4, Application for Employer Identification Number;

3 includes a statement of receipts and expenditures and a balance sheet for the current year and the three preceding years (or the years the organization was in existence, if less than four years). If the organization has

not yet commenced operations, or has not completed one accounting period, a proposed budget for two full accounting periods and a current statement of assets and liabilities will be acceptable;

4 includes a statement of proposed activities and a description of anticipated receipts and contemplated expenditures;

5 includes a copy of the organizing or enabling document that is signed by a principal officer or is accompanied by a written declaration signed by an officer authorized to sign for the organization certifying that the document is a complete and accurate copy of the original; and

6 if the organization is a corporation or unincorporated association and it has adopted by-laws, includes a copy that is signed or otherwise verified as current by an authorized officer.

.06 If a Form 1023 does not contain all of the items set out in section 5.05, it will not be further processed and may be returned to the applicant for completion. The 270-day period will not be considered as starting until the date the Form 1023 is refiled with or remailed to the Service with the requested information, or, if remailed and a postmark is not evident, on the date the Service receives a substantially completed Form 1023.

.07 If the application for recognition of exemption involves an issue where contrary authorities exist, failure to disclose and distinguish significant contrary authorities may result in requests for additional information, which will delay action on the application (see section 6.06 of Rev. Proc. 80-24).

SEC. 6. ISSUING RULINGS OR KEY DISTRICT DETERMINATION LETTERS WITH RESPECT TO EXEMPT STATUS

.01 Under the general procedures outlined in Rev. Proc. 80-24, key District Directors are authorized to issue determination letters involving applications for recognition of exemption under sections 501 and 521 of the Code.

.02 A key District Director will refer to the National Office those applications that present questions the answers to which are not specifically covered by statute or regulations, or by a ruling, opinion, or court decision published in the Internal Revenue Bulletin. In addition, key District Directors will refer those applications that have been specifically reserved by revenue procedure and/or Internal Revenue Manual instructions for National Office handling for purposes of establishing uniformity or centralized control of designated categories of cases. The National Office will consider each such application, issue a ruling directly to the organization, and send a copy of the ruling to the key District Director. In the event of a conclusion unfavorable to the applicant, it will be informed of the basis for the conclusion and of its right to file a protest with and for a conference in the National Office. If a conference is requested, the conference procedures outlined in sections 7.02, 7.03, and 7.04 of Rev. Proc. 80-24 will be followed.

.03 If the key District Director proposes to recognize exemption of an organization to which the National Office had issued a previous contrary ruling or technical advice, the key District Director must seek technical advice from the National Office before issuing a determination letter. See Rev. Proc. 80-26.

.04 If at any time during the course of consideration of an exemption application the organization believes that its case involves an issue on which there is no published precedent or there is nonuniformity between districts, the organization should ask the key District Director to request technical advice from the National Office. See Rev. Proc. 80-26.

SEC. 7. WITHDRAWAL OF APPLICATIONS

.01 Applications for recognition of exemption under section 501 or 521 of the Code may be withdrawn, upon the written request of a principal officer or authorized representative of the organization, at any time prior to the issuance of the ruling or determination letter. Even though the application is withdrawn, however, the application and all supporting documents will be retained by the Service and will not be returned to the organization.

.02 In the case of an application under section 501(c)(3) of the Code, a withdrawal will not be considered by the Service as either a failure to make a determination within the meaning of section 7428(a)(2) or as an exhaustion of administrative remedies within the meaning of section 7428(b)(2).

SEC. 8. NATIONAL OFFICE POST REVIEW OF DETERMINATION LETTERS

.01 The Exempt Organizations Division, or the Corporate Tax Division for cases under section 521 of the Code, in the National Office will review key district determination letters after issuance to assure uniformity in application of the statutes or regulations, or rulings, opinions, or court decisions published in the Internal Revenue Bulletin.

.02 Where the National Office takes exception to a key district determination letter, the key District Director will be advised. If the organization protests the exception taken, the file and protest will be returned to the National Office. The referral will be treated as a request for technical advice and sections 6, 7, and 8 of Rev. Proc. 80-26 will be followed.

SEC. 9. PROTEST OF ADVERSE DETERMINATION LETTERS

.01 Upon the issuance of an adverse determination letter or a letter proposing revocation or modification of exempt status, the key District Director will advise the organization of its right to protest the determination by requesting Appeals office consideration. To do this, the organization must submit to the key District Director within 30 days from the date of the letter, a statement of the facts, law, and arguments in support of its position. The organization must also state whether it wishes an Appeals office conference.

.02 Any determination letter that is issued on the basis of National Office technical advice may not be appealed to the Appeals office regarding those issues that were the subject of the technical advice.

.03 Upon receipt of an organization's request for Appeals office consideration, the key district will, if it maintains its position, forward the request and the case file to the Chief of the appropriate Appeals office.

Sec. 10. Consideration at the Appeals Office

.01 The Appeals office, after considering the organization's protest and any additional information developed in conference, will advise the organization of its decision and issue the appropriate determination letter to the organization.

.02 Organizations should make full presentation of the facts, circumstances, and arguments at the initial level of consideration by the Appeals office, since submission of additional facts, circumstances, and arguments may result in suspension of appeal procedures and referral of the case back to the key district for additional consideration. Any oral representation of additional facts or modification of facts originally represented or alleged must be reduced to writing.

.03 If the Appeals office believes that an exemption or private foundation status issue is not covered by published precedent or that there is nonuniformity, the Appeals office must request technical advice from the National Office. Unless the Appeals office feels that the conclusions reached by the National Office should be reconsidered and promptly requests such consideration, the case will be disposed of by the Appeals office on the basis of the decision in the technical advice memorandum. See Rev. Proc. 80-26.

.04 If at any time during the course of Appeals office consideration the organization believes that its case involves an issue on which there is no published precedent or there is nonuniformity between districts, the organization should ask the Appeals office to request technical advice from the National Office. See Rev. Proc. 80-26.

.05 If the proposed disposition by the Appeals office is contrary to a prior National Office technical advice or ruling concerning tax exemption on the case, the proposed disposition will be submitted through the Office of the Regional Director of Appeals to the Assistant Commissioner (Employee Plans and Exempt Organizations), or, in a case under section 521 of the Code, to the Assistant Commissioner (Technical). Unless the Appeals office feels that the conclusions reached by the National Office should be reconsidered and promptly requests such consideration, the decision of the National Office will be followed by the Appeals office. In any event, the Assistant Commissioner will make the final decision.

Sec. 11. Exhaustion of Administrative Remedies for Declaratory Judgment Purposes

.01 Section 7428 of the Code, in part, requires that an organization seeking initial or continuing recognition of exemption under section 501 (c)(3) must exhaust its administrative remedies by taking timely, reasonable steps to secure a determination prior to filing for declaratory judgment. Those steps and administrative remedies required to be exhausted within the Service are:

1 the filing of a substantially completed application Form 1023 pursuant to section 5.05 or the filing of a request for a determination of foundation status pursuant to Rev. Proc. 76-34;

2 the timely submission of all additional information requested by the Service to perfect an exemption application or request for determination of private foundation status; and

3 exhaustion of all administrative appeals available within the Service pursuant to sections 9 and 10, or appeal of a proposed adverse ruling pursuant to section 6.02 in National Office original jurisdiction exemption application cases.

.02 An organization will in no event be deemed to have exhausted its administrative remedies prior to the earlier of:

1 the completion of the steps in section 11.01, and the sending by certified or registered mail of a notice of final determination; or

2 the expiration of the 270-day period described in section 7428(b)(2) of the Code in a case where the Service has not issued a notice of final determination and the organization has taken, in a timely manner, all reasonable steps to secure a ruling or determination.

.03 The steps described in section 11.01 will not be considered completed until the Service has had a reasonable time to act upon the appeal or request for consideration, as the case may be.

.04 A notice of final determination to which section 7428 of the Code applies is a ruling or determination letter, sent by certified or registered mail, which holds that the organization is not described in section 501(c)(3) or 170(c)(2), is a private foundation as defined in section 509(a), or is not a private operating foundation as defined in section 4942(j)(3).

Sec. 12. Effect of Rulings or Determination Letters Recognizing Exemption

.01 A ruling or determination letter recognizing exemption is usually effective as of the date of formation of an organization if its purposes and activities during the period prior to the date of the ruling or determination letter were consistent with the requirements for exemption. However, for special rules regarding organizations formed after October 9, 1969, applying for recognition of exemption under section 501(c)(3) of the Code, see section 508(a) and Rev. Rul 77-208, 1977-1 C.B. 153. If the organization is required to alter its activities or to make substantive amendments to its enabling instrument, the ruling or determination letter recognizing its exempt status will be effective as of the date specified therein.

.02 A ruling or determination letter recognizing exemption may not be relied upon if there is a material change, inconsistent with exemption, in the character, the purpose, or the method of operation of the organization.

Sec. 13. Revocation or Modification of Rulings or Determination Letters Recognizing Exemption

.01 A ruling or determination letter recognizing exemption may be revoked or modified by a subsequent ruling or determination letter addressed to the organization, or by a revenue ruling or other statement published in the Internal Revenue Bulletin. The revocation or modification may be retroactive if the organization omitted or misstated a material fact, operated in a manner materially different from that originally represented, or, in the case of organizations to which section 503 of the Code applies, engaged in a prohibited transaction with the purpose of diverting corpus or income of the organization from its exempt purpose and such transaction involved a substantial part of the corpus or income of such organization. Where there is a material change, inconsistent with exemption, in the character, the purpose, or the method of operation of an organization, revocation or modification will ordinarily take effect as of the date of such material change. In cases where a ruling or determination letter was issued in error or is no longer in accord with the holding of the Service, retroactivity of the revocation or modification ordinarily will be limited to a date not earlier than that on which the original ruling or determination letter is modified or revoked.

.02 In the case of a revocation or modification, the protest and conference procedures are the same as set out in sections 9 and 10, including the right of the organization to request that the key District Director or the Chief, Appeals Office, seek technical advice from the National Office. If the case involves a status issue on which the National Office had issued a previous contrary ruling or technical advice, the key District Director must seek technical advice from the National Office.

.03 The provisions of sections 9 and 10 relating to protest and conference rights before a final revocation notice is issued are not applicable to matters where delay would be prejudicial to the interests of the Internal Revenue Service (such as in cases involving fraud, jeopardy, the imminence of the expiration of the statute of limitations, or where imediate action is necessary to protect the interests of the Government).

SEC. 14. EFFECT ON OTHER DOCUMENTS

Rev. Procs. 72-4, 76-33, and 77-21, 1977-1 C.B. 586, are superseded. Sections 3.01, 3.04, 4.02, 6.02, 6.04, and 8.02 of Rev. Proc. 76-34 are modified to the extent that this revenue procedure supersedes Rev. Procs. 72-4 and 76-33. Rev. Proc. 77-31, is revoked.

SEC. 15. EFFECTIVE DATE

This revenue procedure is effective June 30, 1980, the date of its publication in the Internal Revenue Bulletin.

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26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 80-26

SECTION 1. PURPOSE

.01 This revenue procedure sets forth revised procedures for furnishing technical advice from the National Office regarding employee plans (including actuarial matters) and exempt organizations. It is also intended to inform taxpayers of their rights when such advice is requested. Technical advice will be furnished only upon the request of key District Directors or Appeals offices, on their own behalf or on the behalf of the taxpayers, in connection with issues raised at either the district level (including the Office of International Operations) or at the Appeals level. Technical advice may be requested at any stage in the district or Appeals office proceedings, but should be made at the earliest possible stage.

.02 Technical advice procedures regarding excise taxes (other than the excise taxes imposed under Chapters 41, 42, and 43 of the Internal Revenue Code), and employment taxes that employee plans and exempt organizations may be subject to, are set forth in Rev. Proc. 80-21, page 19, this Bulletin.

.03 Requests for technical advice regarding farmers cooperative issues under section 521 of the Code should be submitted to the National Office, Attention: Assistant Commissioner (Technical), under the procedures in this revenue procedure.

.04 For purposes of this revenue procedure, any reference to EP/EO will mean Employee Plans and Exempt Organizations. When used in this revenue procedure, the term "key District Director" means the District Director of one of the key district offices as set out in Rev. Proc. 80-25, page 39, this Bulletin. The term "Appeals office" means the appeals organization established in each region headed by a Regional Director of Appeals. The term "taxpayer" includes all persons subject to any provision of the Internal Revenue Code and their authorized representative(s).

.05 With regard to requests for technical advice that are subject to the disclosure provisions of section 6110 of the Code, the taxpayer must follow the procedures in section 601.201(n)(9)(iii)(e) of the Statement of Procedural Rules (26 CFR Part 601). For guidance as to which technical advice requests are subject to section 6110, see section 301.6110-1(a) of the Regulations on Procedure and Administration (26 CFR Part 301).

SEC. 2. DEFINITION AND NATURE OF TECHNICAL ADVICE

.01 "Technical advice" as used in this revenue procedure means advice or guidance as to the interpretation and proper application of internal revenue laws, related statutes, tax treaties, regulations, revenue rulings, or other precedents published on employee plan and exempt organization matters by the National Office to a specific set of facts. Technical advice is furnished by the National Office upon request by a key district or Appeals office in connection with the examination of a taxpayer's return or consideration of a taxpayer's claim for refund or credit, or request for a determination letter. It is furnished as a means of assisting Service personnel in closing cases and establishing and maintaining consistent holdings in the several key districts. It does not include memoranda on matters of general technical application furnished to key district or Appeals offices where the issues are not raised in connection with the examination of a taxpayer's return or a request for a determination letter.

.02 The Assistant Commissioner (EP/EO), acting under a delegation of authority from the Commissioner of Internal Revenue, is exclusively responsible for providing technical advice in any issue involving interpretation and application of certain tax laws that apply to employee plans (including actuarial matters) and exempt organizations (other than technical advice issues arising out of section 521 of the Code). This authority has been largely redelegated to subordinate officials.

.03 The provisions of this revenue procedure apply to EP/EO cases under the jurisdiction of either a key district office or an Appeals office. A case remains under the jurisdiction of a key district office even though the Appeals office has the identical issue under consideration in the case of another taxpayer (not related within the meaning of section 267 of the Code) in an entirely different transaction.

.04 Any determination letter on exempt status or private foundation status issued by a key district office on the basis of National Office technical advice may not, thereafter, be appealed to the Appeals office with regard to those status issues that were the subject of technical advice.

.05 If technical advice has been issued by the National Office to a key district office, that issue with regard to that taxpayer may not be the subject of a request for technical advice from the Appeals office that may receive the case on other grounds.

SEC. 3. AREAS IN WHICH TECHNICAL ADVICE MAY OR MUST BE REQUESTED

.01 Technical advice may be requested on any technical or procedural question that develops during the examination of a taxpayer's return, consideration of a taxpayer's claim for refund or credit, or request for a determination letter that does not come within the requirements of section 6.02 of Rev. Proc. 80-25 regarding exemption applications. These procedures are applicable as provided in section 2.

.02 Requests for technical advice are encouraged on any technical or procedural questions arising in connection with any case of the type described in section 2.02 at any stage of the proceedings in the key district or Appeals office that cannot be resolved on the basis of law, regulations, or a clearly applicable revenue ruling or other published precedent.

.03 Aside from the exemption application cases covered by the requirements of Rev. Proc. 80-25, key district and Appeals offices are required to request technical advice on their exempt organization cases concerning qualification for exemption or foundation status for which there is no published precedent or for which there is reason to believe that nonuniformity exists. Regarding employee plans matters, a request for technical advice is required on cases concerning (1) proposed revocation of letters on collectively-bargained plans, (2) plans for which the Service is proposing to issue a revocation letter because of certain fiduciary actions that violate the exclusive benefit rule of section 401(a) of the Code and are subject to Part 4, subtitle B of Title I of ERISA, Pub. L. 93-406, 1974-3 C.B. 1, 43, or (3) amendments to defined contribution plans pursuant to Rev. Proc. 78-14, 1978-2 C.B. 486, in connection with a waiver of the minimum funding standards and a request for a determination letter.

SEC. 4. REQUESTING TECHNICAL ADVICE

.01 It is the responsibility of the key district or Appeals office to determine whether technical advice is to be requested on any issue before that office. However, while the case is under the jurisdiction of the key district office or the Appeals office, a taxpayer may request that an issue be referred to the National Office for technical advice on the grounds that a lack of uniformity exists as to the disposition of the issue, or that the issue is so unusual or complex as to warrant consideration by the National Office. Taxpayers should make written requests to the key district office or the Appeals office setting forth the facts, law, and argument with respect to the issue, and reasons for requesting technical advice. If, after considering the taxpayer's request, the key district examiner or Appeals Officer is of the opinion that the circumstances do not warrant referral of the case to the National Office, that person will so advise the taxpayer. (See section 5 for a taxpayer's appeal rights where the key district examiner or Appeals Officer declines to request advice.)

.02 When technical advice is to be requested, whether or not upon the request of the taxpayer, the taxpayer will be so advised, except as noted in section 4.09. If the Service initiates the action, the taxpayer will be furnished a copy of the statement of the pertinent facts and the question or questions proposed for submission to the National Office. The facts and issues presented should be clear and complete. When the request for advice is made by a key district office, it shall be submitted directly to the National Office.

.03 Where the technical advice request is initiated by the key district or the Appeals office, the taxpayer will be given 10 calendar days after the issuance of the statement of facts and specific questions by the key district or Appeals office in which to indicate in writing the extent, if any, to which the taxpayer may not be in complete agreement with the statement. Every effort should be made to reach agreement as to the facts and the specific point at issue. If agreement cannot be reached, the taxpayer may submit a statement of the taxpayer's understanding as to the specific point or points at issue within 10 calendar days after the date the key district or Appeals office notifies the taxpayer in writing of disagreement as to the facts and issues. This statement will be forwarded to the National Office with the request for advice. Extensions of time beyond 10 days will be granted only if justified by the taxpayer in writing, and approved by the Chief, EP/EO Division, or the Chief (or Associate Chief), Appeals Office.

.04 Where the technical advice request is initiated by the taxpayer and the statement of the facts and point or points at issue submitted by the taxpayer is not wholly acceptable to the key district or Appeals officials, the taxpayer will be advised in writing as to the areas of disagreement. The taxpayer will be given 10 calendar days after the date of issuance of the written notice to reply to the key district or

Appeals official's letter. Extensions of time beyond 10 days will be granted only if justified by the taxpayer in writing and approved by the Chief, EP/EO Division, or the Chief (or Associate Chief), Appeals Office. Every effort should be made to reach agreement on the facts. However, if agreement cannot be reached, both the statements of the taxpayer and the key district or Appeals official will be forwarded to the National Office.

.05 In the case of a request for technical advice subject to the disclosure provisions of section 6110 of the Code, the taxpayer must also submit, within the 10 day period referred to in section 4.03 or 4.04, whichever is applicable, a statement of proposed deletions as described below. The Service is required by section 6110(c) to make certain deletions from the text of technical advice memoranda. The taxpayer's statement of proposed deletions must be made in a separate document and may be either a statement of the taxpayer's proposed deletions or a statement that no information other than names, addresses, and identifying numbers need be deleted. The statement of proposed deletions shall be accompanied by a copy of all statements of facts and supporting documents that are submitted to the National Office on which shall be indicated, by the use of brackets, the material that the taxpayer indicates should be deleted pursuant to section 6110(c). The statement shall indicate the statutory basis for each proposed deletion and must not appear or be referred to anywhere in the request for technical advice. If the taxpayer decides to request additional deletions prior to the time the National Office replies to the request for technical advice, additional statements may be submitted. If the statement is not submitted, the taxpayer will be informed by the key district office or the Appeals office that the statement is required. If the key district office or the Appeals office does not receive the statement within 10 calendar days after the taxpayer has been informed of the need for the statement, the key district office or the Appeals office may decline to submit the request for technical advice. If the key district office or the Appeals office decides to request technical advice in a case where the taxpayer has not submitted the statement of proposed deletions, the National Office will make those deletions that, in the judgment of the Commissioner, are required by section 6110(c).

.06 Taxpayers may submit statements explaining their positions on the issue(s) in the requests for technical advice, citing precedents that they believe will bear on the cases. In addition, taxpayers are encouraged to comment on any legislation, tax treaties, regulations, revenue rulings, revenue procedures, or court decisions contrary to their position. These statements will be forwarded to the National Office with the request for advice. If they are received by the key district or Appeals office after the case has been transferred to the National Office, they will be forwarded for association with the case files.

.07 At the time the taxpayers are informed that the matter is being referred to the National Office, they will also be informed of their right to a conference in the National Office in the event an adverse decision is indicated, and will be asked to state whether they desire such a conference.

.08 Generally, prior to replying to the request for technical advice, the National Office shall inform the taxpayer orally or in writing of the material likely to appear in the technical advice memorandum that the taxpayer proposed be deleted but which the Service determined should not be deleted. If so informed, the taxpayer may submit, within 10 calendar days, any further information, arguments, or other material in support of the position that such material be deleted. The Service will attempt, if feasible, to resolve all disagreement with respect to proposed deletions prior to the time the National Office replies to the request for technical advice. However, in no event shall the taxpayer have the right to a conference solely with respect to resolution of any disagreements concerning material to be deleted from the text of the technical advice memorandum, but such matters may be considered at any conference otherwise scheduled with respect to the request.

.09 The provisions of this section, relating to the referral of issues upon the request of a taxpayer, advising a taxpayer of the referral of issues, the submission of proposed deletions, and the granting of a conference in the National Office, are not applicable to matters primarily of internal administration or procedural concern or in instances that would be prejudicial to the interests of the government (as in cases involving fraud or jeopardy assessments). However, in cases involving criminal or civil fraud investigations and jeopardy or termination assessments, the taxpayer shall be allowed to provide the statement of proposed deletions to the National Office upon the completion of all proceedings with respect to the investigations or assessments, but prior to the date on which the Commissioner mails the notice pursuant to section 6110(f)(1) of the Code of intention to disclose the technical advice memorandum. See section 7.03.

.10 Form 5565, Request for Technical Advice—EP/EO, should be used for transmitting requests for technical advice to the National Office.

.11 See Rev. Proc. 79-63, 1979-2 C.B. 578, which concerns applications for extension of the time for making an election or application for relief pursuant to section 1.9100-1 of the regulations. If a taxpayer requests an extension of time under section 1.9100-1 during an examination or when an issue is being considered by an Appeals office, the procedures of Rev. Proc. 80-26 are applicable.

SEC. 5. APPEALS BY TAXPAYERS OF REFUSALS TO REQUEST TECHNICAL ADVICE

.01 If the taxpayer has requested referral of an issue before a key district or Appeals office to the National Office for technical advice, and after consideration of the request the key district examiner or the Appeals Officer is of the opinion that the circumstances do not warrant such referral, that person will so advise the taxpayer in writing.

.02 The taxpayer may appeal the decision of the key district examiner or the Appeals Officer not to request technical advice by submitting to that person, within 10 calendar days from the date of issuance of the notice of decision, a statement of the facts, law, and arguments that were not previously submitted with respect to the issue and the reasons why the taxpayer believes the matter should be referred to the National Office for advice. An extension of time will be granted only if it is justified by the taxpayer in writing and approved by the Chief, EP/EO Division, or the Chief (or Associate Chief), Appeals Office.

.03 The key district examiner or the Appeals Officer will submit the statement of the taxpayer, through channels, to the Chief, EP/EO Division, or to the Chief (or Associate Chief), Appeals Office, as appropriate, accompanied by a statement of the reason(s) why the issue should not be referred to the National Office. The Chief, EP/EO Division, or the Chief (or Associate Chief), Appeals Office, will determine, on the basis of the statements submitted, whether technical advice will be requested. If it is determined that technical advice is not warranted, the taxpayer will be informed of the proposal to deny the request in a letter that (except in unusual situations where such action would be prejudicial to the best interests of the government) will state specifically the reasons for the proposed denial to request technical advice. The taxpayer will be given 10 calendar days after receipt of the letter in which to notify the Chief, EP/EO Division, or the Chief (or Associate Chief), Appeals Office, of agreement or disagreement with the proposed denial. If there is disagreement, all data relating to the issue for which technical advice has been sought, including the taxpayer's written request and statements, will be submitted to the National Office, Attention: Director, Employee Plans, Exempt Organizations, or Actuarial Division, as appropriate, for review. After the National Office reviews the material, it will notify the key district or Appeals office whether technical advice should or should not be requested. The key district or Appeals office will then notify the taxpayer of the National Office decision.

.04 While the matter is being reviewed in the National Office, action on the issue will be suspended (except where the delay would prejudice the government's interests) until the appropriate office is notified of the National Office decision. This notification will be made within 30 calendar days after receipt of the data in the National Office. The review will be solely on the basis of the written record and no conference will be held in the National Office with respect to the question of whether technical advice should be requested.

Sec. 6. CONFERENCE IN THE NATIONAL OFFICE

.01 If, after the National Office considers the case file on a request for technical advice, it appears that advice adverse to the taxpayer should be given and a conference has been requested, the taxpayer will be notified of the time and place of the conference. (If a conference has not been requested, the case will be decided on the basis of the existing written record.) If conferences are being arranged with respect to more than one request for advice involving the same taxpayer, they will be scheduled so as to cause the least inconvenience to the taxpayer. The conference will be arranged by telephone, if possible, and normally will be held within 21 calendar days after contact has been made. Extensions of time will be granted only if justified in writing by the taxpayer and approved by the appropriate branch chief or delegate in the National Office.

.02 A taxpayer is entitled, as a matter of right, to only one conference in the National Office unless one of the circumstances discussed in this section exists. This conference will usually be held at the branch level in the appropriate division (Actuarial Division, Employee Plans, or Exempt Organizations) and will usually be attended by a person who has authority to represent the branch chief in that conference. In appropriate cases, the key district examiner or the Appeals Officer may also attend the conference to clarify the facts in the case. If more than one subject is discussed at the conference, the discussion constitutes a conference with respect to each subject. At the request of the taxpayer, the conference may be held at an earlier stage in the consideration of the case than the Service would ordinarily designate. A taxpayer has no "right" of appeal from an action of a branch to the director of a division or to any other National Office official.

.03 Since conference procedures are informal, no tape, stenographic, or other verbatim recording of a conference will be made.

.04 If prospective application under section 7805(b) of the Code is advanced by the taxpayer, the Service representative will discuss the tentative recommendation with respect to such relief and the reason for such tentative recommendation. No commitment will be made as to the holding that the Service will finally adopt.

.05 In the process of review in EP/EO of a holding proposed by a branch, it may appear that the final answer will involve a reversal of the branch proposal with a result less favorable to the taxpayer. Or it may appear that an adverse proposal by a branch will be approved, but on new or different grounds than those on which the branch decided the case. Under either of these circumstances, the taxpayer or the taxpayer's authorized representative will be invited to another conference. The provisions of this revenue procedure limiting the number of conferences to which a taxpayer is entitled will not foreclose inviting a taxpayer to attend further conferences when, in the opinion of National Office personnel, such need arises. All additional conferences of the type discussed in this paragraph are held only at the invitation of the Service.

.06 It is the responsibility of the taxpayer to furnish to the National Office, within 21 calendar days after the conference, a written record of any additional data, line of reasoning, precedents, etc., that were proposed by the taxpayer and discussed at the conference but were not previously or adequately presented in writing. Extensions of time will be granted only if justified in writing by the taxpayer and approved by the appropriate EP/EO Branch Chief. Any additional material and a copy thereof should be addressed to and sent to the National Office. If the National Office determines that the additional information would have a significant impact on the facts and data involved in a case, it will forward a copy to the appropriate key district office or Appeals office for comment. The National Office will request that office give the matter its prompt attention. That office may verify the additional facts and data and comment upon them to the extent it deems appropriate.

.07 A taxpayer desiring to obtain information as to the status of taxpayer's case may do so by contacting the following offices with respect to matters in the areas of their responsibility:

Official	Telephone Numbers (not toll free) (Area Code 202)
Director, Actuarial Division	566-4311
Chief, Employee Plans Technical Branch	566-3871
Chief, Exempt Organizations Technical Branch	566-3856 or 566-3593

Sec. 7. Preparation of Technical Advice Memorandum by the National Office

.01 Upon receipt of the case in the National Office, the technical employee to whom the case is assigned will analyze the file to ascertain whether it meets all the requirements of section 4. If the case is not complete, appropriate steps will be taken to complete the file. If the issues are not clearly presented or the facts are not sufficiently developed in the request to allow a determination of the issues presented, the case will be returned to the key District Director or the Chief, Appeals Office, for necessary clarification or development, as appropriate. If there is no statement of proposed deletions, the National Office will make those deletions from a technical advice memorandum subject to section 6110 of the Code that, in the judgment of the Service, are required by that section.

.02 If the taxpayer has requested a conference in the National Office, the procedures in section 6 will be followed.

.03 Replies to requests for technical advice will be addressed to the key District Director or to the Chief, Appeals Office, and will be drafted in two parts. Each part will identify the taxpayer by name, address, identification number, and year or years involved. The first part, called the technical advice memorandum, will contain (1) a recitation of the pertinent facts having a bearing on the issue, (2) a discussion of the facts, precedents, and reasoning of the National Office, and (3) the conclusions of the National Office. The conclusions will give direct answers, whenever possible, to the specific questions of the key district or Appeals office. The discussion of the issues will be in such detail that the receiving officials are apprised of the reasoning underlying the conclusion. There shall accompany the technical advice memorandum, where applicable, a notice of intention to disclose the technical advice memorandum pursuant to section 6110(f)(1) of the Code (including a copy of the version proposed to be open to public inspection and notations of third party communications pursuant to section 6110(d)) that the key district office or the Appeals office will forward to the taxpayer at such time that it furnishes a copy of the technical advice memorandum to the taxpayer pursuant to sections 7.05 and 8.04.

.04 The second part of the reply will consist of a transmittal memorandum. In unusual cases it will serve as a vehicle for providing administrative information or other information that, under the confidentiality statutes, or for other reasons, may not be discussed with the taxpayer.

.05 It is the general practice of the Service to furnish a copy of the technical advice memorandum to the taxpayer after it has been adopted by the receiving office. However, where no definitive answer is given to the specific question presented or where the factual submission is such as to indicate that the issue should be decided by the key district or Appeals office, a copy of the technical advice memorandum will not be furnished to the taxpayer. The National Office will specifically advise the key District Director or the Chief, Appeals Office in those cases where it is determined that a copy of the technical advice memorandum is not to be made available to the taxpayer.

.06 After receiving the notice of intention to disclose the technical advice memorandum, if applicable, the taxpayer, if desiring to protest the disclosure of certain information in the memorandum, must submit to the office indicated in the notice a written statement within 20 calendar days after the notice is mailed. The statement must identify those deletions not made by the Service that the taxpayer believes should have been made. The taxpayer must also submit a copy of the version of the technical advice memorandum proposed to be open to public inspection on which the taxpayer indicates, by the use of brackets, the deletions proposed by the taxpayer that have not been made by the Service. Generally, the Service will not consider the deletion of any material which the taxpayer did not propose be deleted prior to the time when the National Office sent its reply to the request for technical advice to the appropriate office. The Service shall, within 20 days after receipt of the response by the taxpayer to the notice, mail to the taxpayer its final administrative conclusion regarding the deletions to be made.

Sec. 8. Receipt of Technical Advice in Key District or Appeals Office

.01 Unless the key District Director, or the Chief (or Associate Chief), Appeals Office, feels that the conclusions reached by the National Office in a technical advice memorandum should be reconsidered and promptly requests such consideration, he or she will proceed to process the taxpayer's case on the basis of the conclusions expressed in the technical advice memorandum. In any event, with or without requesting reconsideration, the key District Director must follow the conclusions in a technical advice memorandum as to all issues, and the Chief (or Associate Chief), Appeals Office, must follow the conclusions in a technical advice memorandum on issues of an organization's/plan's status or qualification. Thus, if the technical advice memorandum received by a key District Director concerns an organization's/plan's status or qualification, the organization/plan has no appeal to the Appeals office on those specific issues. In the case of technical advice unfavorable to the organization/plan that does not concern status or qualification, the Chief (or Associate Chief), Appeals Office, may decide to settle the issue in the usual manner under existing authority.

.02 Unless otherwise stated, a holding in a technical advice memorandum will be applied retroactively. Moreover, where the taxpayer had previously been issued a favorable ruling or determination (whether or not it was based on a previous technical advice memorandum) concerning that transaction, purpose, or method of operation, the holding in a technical advice memorandum that is adverse to the taxpayer is also applied retroactively unless the Assistant Commissioner (EP/EO) exercises the discretionary authority under section 7805(b) of the Code to limit the retroactive effect of the holding. As to the effective date in cases involving rulings or determination letters regarding exempt organizations and employee plans (including actuarial matters) see section 13.05 of Rev. Proc. 80-24, page 30, this Bulletin, section 12.01 of Rev. Proc. 80-25, and sections 5.04 and .05 of Rev. Proc. 80-30, page 56, this Bulletin.

.03 Key district offices and Appeals offices may raise an issue in any taxable period, even though they may have asked for and been furnished technical advice with regard to the same or a similar issue in any other taxable period.

.04 Unless advised otherwise by the National Office as provided in section 7.05, the key district or Appeals office will furnish to the taxpayer a copy of the technical advice memorandum and, if applicable, the notice of intention to disclose described in section 7.03. However, this does not apply to technical advice memoranda involving civil fraud or criminal investigation, or jeopardy or termination assessments or to documents to which section 6104 of the Code applies.

.05 In those cases where the National Office advises the key District Director or the Chief, Appeals Office, not to furnish a copy of the technical advice memorandum to the taxpayer, he or she will so inform the taxpayer if the taxpayer requests a copy.

Sec. 9. Procedure for Requesting Application of Section 7805(b) in the Case of Technical Advice

.01 Pursuant to section 7805(b) of the Code, it is within the discretion of the Commissioner or the Commissioner's delegate to prescribe the extent, if any, to which any ruling (including technical advice) will be applied without retroactive effect. A taxpayer to whom a technical advice memorandum has been addressed or with respect to whom a technical advice request is pending may request that the Assistant Commissioner or Deputy Assistant Commissioner (Employee Plans and Exempt Organizations), the Commissioner's delegate, exercise the discretionary authority under section 7805 (b) to limit the retroactive effect of any holding stated in the technical advice memorandum or to limit the retroactive effect of any subsequent modification or revocation of the technical advice memorandum.

.02 When a technical advice memorandum that concerns a continuing transaction is modified or revoked by, for example, a subsequent revenue ruling, a request to limit the retroactive effect of the modification or revocation of the technical advice memorandum must be made in the form of a request for a ruling when the request is submitted before a return is examined that contains the transaction that is the subject of the request for ruling. See section 16.02 of Rev. Proc. 80-24.

.03 When a taxpayer is informed of the modification or revocation of a technical advice memorandum during the course of an examination of the taxpayer's return by a key District Director or during consideration by the Chief, Appeals office, a request to limit the retroactive application of the modification or revocation of the technical advice memorandum must itself be made in the form of a request for technical advice. See section 4 of this revenue procedure. However, the taxpayer must also submit a statement, which will be forwarded to the National Office with the request for technical advice, that the request is being made pursuant to section 7805(b) of the Code. This statement must also set forth the relief sought and an explanation of the reasons and arguments in support of the relief requested, and it must be accompanied by any documents bearing on the request. The explanation in support of the application of section 7805(b) should include a discussion of the five items enumerated in section 13.05 of Rev. Proc. 80-24 as they relate to the taxpayer's particular situation.

.04 A request to limit the retroactive effect of a holding in a technical advice memorandum that does not modify or revoke a technical advice memorandum may be made as part of that technical advice request either initially or at any time before the technical advice memorandum is issued by the National Office. In such a case, the taxpayer must also submit a statement in support of the application of section 7805(b) of the Code, as described in .03 above.

.05 When a request for technical advice concerns only the application of section 7805(b) of the Code, the taxpayer has the right to a conference in the National Office in accordance with the provisions of section 6 of this revenue procedure. If the request for application of section 7805(b) is included in the request for technical advice on the substantive issues or is made before the conference of right on the substantive issues, the section 7805 (b) issue will be discussed at the taxpayer's one conference of right. If the request for the application of section 7805(b) is made as part of a pending request for technical advice after a conference has been held on the substantive issue, and the Service determines that there is justification for having delayed the request, then the taxpayer will have the right to one conference of right concerning the application of section 7805(b) with the conference limited to a discussion of this issue.

Sec. 10. Effect on Other Documents

Except as provided in section 1.02, Rev. Proc. 80-21 will not apply to employee plans, including actuarial matters, and exempt organizations.

Sec. 11. Effective Date

This revenue procedure is effective June 30, 1980, the date of its publication in the Internal Revenue Bulletin.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Section 501; 1.501(a)-1.)

Rev. Proc. 80-27

Section 1. Purpose

The purpose of this revenue procedure is to supersede Rev. Proc. 77-38, 1977-2 C.B. 571, by setting forth updated procedures under which recognition of exemption from federal income tax under section 501(c) of the Internal Revenue Code may be obtained on a group basis for subordinate organizations affiliated with and under the general supervision or control of a central organization. This procedure relieves each of the subordinates covered by a group exemption letter from filing its own application for recognition of exemption. This revenue procedure changes the time for filing the annual submission of information required to maintain a group exemption letter to 90 days before the close of the organization's accounting period. This revenue procedure also clarifies the requirements concerning subordinates' accounting periods and the 15-month rule of section 508 for section 501(c)(3) subordinates, and provides the addresses of three new Service Centers for filing purposes.

Sec. 2. Issuance of Group Exemption Letters

.01 Under this revenue procedure and Rev. Proc. 80-25, page 39, this Bulletin, the Internal Revenue Service will consider requests of central organizations for group exemption letters.

.02 A subordinate included in a group exemption letter should not apply separately for recognition of exempt status unless it no longer wants to be included in the group exemption letter.

.03 A subordinate that is organized and operated in a foreign country may not be included in a group exemption letter.

.04 A subordinate described in section 501(c)(3) of the Code may not be included in a group exemption letter if it is a private foundation defined in section 509(a). Such an organization should apply separately for recognition of exempt status under the procedures outlined in Rev. Proc. 76-34, 1976-2 C.B. 656, as supplemented by Rev. Proc. 80-25.

Sec. 3. Definitions

.01 A group exemption letter is a ruling or determination letter issued to a central organization recognizing on a group basis the exemption under section 501(c) of the Code of subordinate organizations on whose behalf the central organization has applied for recognition of exemption in accordance with this revenue procedure.

.02 A central organization is an organization that has one or more subordinates under its general supervision or control.

.03 A subordinate is a chapter, local, post, or unit of a central organization. It may or may not be incorporated, but it must have an organizing document. A central organization may be a subordinate itself, such as a state organization which has subordinate units and is itself affiliated with a national organization.

Sec. 4. Requirements for Inclusion in a Group Exemption Letter

.01 A central organization applying for a group exemption letter must obtain recognition of its own exempt status.

.02 It must also establish that the subordinates to be included in the group exemption letter are:

1 Affiliated with it;

2 Subject to its general supervision or control;

3 All exempt under the same paragraph of section 501(c) of the Code, though not necessarily the paragraph under which the central organization is exempt;

4 Not private foundations, if the application for a group exemption letter involves section 501(c)(3);

5 All on the same accounting period as the central organization if they are to be included in group returns; and

6 Organizations that have been formed within the 15-month period prior to the date of submission of the group exemption application, if they are claiming section 501(c)(3) status and are subject to the requirements of section 508(a), and wish to be recognized as exempt from their dates of creation. A group exemption letter may be issued covering subordinates, one or more of which have not been organized within the 15-month period prior to the date of submission, if all subordinates are willing to be recognized as exempt only from the date of application.

.03 Each subordinate must authorize the central organization to include it in the application for the group exemption letter. The authorization must be signed by a duly authorized officer of the subordinate and retained by the central organization while the group exemption letter is in effect. In the case of a new organization described in section 501(c)3 of the Code that wants to be included in a group exemption, it must submit its authorization before the end of the fifteenth month after it was formed in order to satisfy the requirement of section 508(a). The central organization must also include this subordinate in its next annual submission. See section 6.

Sec. 5. Filing Application for a Group Exemption Letter

.01 A central organization seeking a group exemption letter for its subordinates must obtain recognition of its own exemption by filing an application with the key District Director of Internal Revenue for the area in which is located the principal place of business or principal office of the organization. Any application received by the National Office or by a District Director other than as provided above will be forwarded, without action, to the appropriate key District Director.

.02 If the central organization is recognized as exempt, it must indicate its employer identification number (EIN), the date of the letter recognizing its exemption, and the Internal Revenue Office that issued it. It need not resubmit documents already submitted. However, if it has not already done so, it must submit a copy of any amendment to its governing instruments or internal regulations as well as any information regarding any change in its character, purposes, or method of operations.

.03 In addition to the information required to obtain recognition of its own exemption, the central organization must submit to the key District Director the following information on behalf of those subordinates to be included in the group exemption letter:

1 A letter signed by a principal officer of the central organization setting forth or including as attachments:

(a) information verifying the existence of the relationships required by section 4.02;

(b) a sample copy of a uniform governing instrument (charter, trust indenture, articles of association, etc.) adopted by the subordinates; or, in the absence of a uniform governing instrument, copies of representative instruments;

(c) a detailed description of the purposes and activities of the subordinates including the sources of receipts and the nature of expenditures;

(d) an affirmation that, to the best of the officer's knowledge, the purposes and activities of the subordinates are as set forth in (b) and (c) above;

(e) a statement that each subordinate to be included in the group exemption letter has furnished written authorization to the central organization as described in section 4.03;

(f) a list of subordinates to be included in the group exemption letter to which the Service has issued an outstanding ruling or determination letter relating to exemption;

(g) if the application for a group exemption letter involves section 501(c)(3) of the Code, and is subject to the provisions of section 508(b), an affirmation to the effect that, to the best of the officer's knowledge and belief, no subordinate to be included in the group exemption letter is a private foundation as defined in section 509(a); and

(h) for each subordinate that is a school claiming exemption under section 501(c)(3), the information required by Rev. Proc. 75-50, 1975-2 C.B. 834. Also, there must be included such other information necessary to establish that the school is complying with the requirements of Rev. Rul. 71-447, 1971-2 C.B. 230. This is the same information required by Schedule A, Form 1023, Application for Recognition of Exemption Under Section 501(c)(3) of the Internal Revenue Code.

2 A list of the names, mailing addresses (including Postal Zip Code), actual addresses if different, and employer identification numbers of subordinates to be included in the group exemption letter. A current directory of subordinates may be furnished in lieu of the list if it includes the required information and if the subordinates not to be included in the group exemption letter are identified.

.04 If the central organization does not have an employer identification number, it must submit a completed Form SS-4, Application for Employer Identification Number, with its exemption application. See Rev. Rul. 63-247, 1963-2 C.B. 612.

.05 Each subordinate must have its own employer identification number even if it has no employees. The central organization must submit with the exemption application a completed Form SS-4 on behalf of each subordinate not having a number.

SEC. 6. INFORMATION REQUIRED ANNUALLY TO MAINTAIN A GROUP EXEMPTION LETTER

.01 In order to maintain a group exemption letter, the central organization must submit annually, at least 90 days before the close of its annual accounting period, to the Internal Revenue Service Center indicated in .02 of this section, the following information:

1 Information regarding all changes in the purposes, character, or method of operation of subordinates included in the group exemption letter.

2 Lists of (a) subordinates that have changed their names or addresses during the year, (b) subordinates no longer to be included in the group exemption letter because they have ceased to exist, disaffiliated, or withdrawn their authorization to the central organization, and (c) subordinates to be added to the group exemption letter because they are newly organized or affiliated or they have newly authorized the central organization to include them. A separate list must be submitted for each of the three categories set out above. Each list must show the names, mailing address (including Postal ZIP Codes), actual address if different, and employer identification numbers of the affected subordinates. An annotated directory of subordinates will not be accepted for this purpose. If there were none of the above changes, the central organization must submit a statement to that effect.

3 The information required by section 5.031 a through h, with respect to subordinates to be added to the group exemption letter. However, if the information upon which the group exemption letter was based is applicable in all material respects to such subordinates, a statement to this effect may be submitted in lieu of the information required by items (a) through (d) of section 5.031.

.02 1 If the central organization is located in Indiana, Kentucky, Michigan, Ohio, or West Virginia, send the report to the Internal Revenue Service Center, Cincinnati, Ohio 45999.

2 If the central organization is located in Maine, New Hampshire, Vermont, Connecticut, Massachusetts, or Rhode Island, send the report to the Internal Revenue Service Center, Andover, Massachusetts 05501.

3 If the central organization is located in California, Hawaii, Arizona, Utah, or Nevada, send the report to the Internal Revenue Service Center, Fresno, California 93888.

4 If the central organization is located in North Carolina, South Carolina, Georgia, Florida, Tennessee, Alabama, or Mississippi, send the report to the Internal Revenue Service Center, Atlanta, Georgia 31101.

5 If the central organization is located in Arkansas, Colorado, Kansas, Louisiana, New Mexico, Oklahoma, Texas, or Wyoming, send the report to the Internal Revenue Service Center, Austin, Texas 73301.

6 If the central organization is located in Alaska, Idaho, Minnesota, Montana, North Dakota, Oregon, South Dakota, Washington, or Wisconsin, send the report to the Internal

Revenue Service Center, Ogden, Utah 84201.

7 If the central organization is located in New Jersey or New York, send the report to the Internal Revenue Service Center, Holtsville, New York 00501.

8 If the central organization is located in Illinois, Iowa, Missouri, or Nebraska, send the report to the Internal Revenue Service Center, Kansas City, Missouri 64999.

9 If the central organization is located in Delaware, Maryland, Pennsylvania, Virginia, District of Columbia, any U.S. possession, or a foreign country, send the report to the Internal Revenue Service Center, Philadelphia, Pennsylvania 19255.

.03 Submission of the information required by this section does not relieve the central organization or any of its subordinates of the duty to submit such additional information as a District Director may require to determine whether the conditions for continued exemption are being met. See sections 6001 and 6033 of the Code, and regulations thereunder.

SEC. 7. CIRCUMSTANCES UNDER WHICH A GROUP EXEMPTION LETTER WILL CEASE TO HAVE EFFECT

.01 Continued effectiveness of a group exemption letter is based on the following conditions:

1 continued existence of the central organization;

2 continued qualification of the central organization for exemption under section 501(c) of the Code;

3 annual submission by the central organization of the information required by section 6; and

4 annual filing by the central organization of an information return if one is required of it under section 6033.

.02 Continued effectiveness of a group exemption letter as to a particular subordinate is based on the conditions set out in .01 of this section and the following conditions:

1 continued conformity by the subordinate to the requirements for group exemption set out in SEC. 4.02 and 4.03; and

2 annual filing of an information return for the subordinate if one is required of it under section 6033 of the Code.

.03 A group exemption letter shall cease to have effect either as to a particular subordinate or to the group as a whole when:

1 The central organization notifies the Service that it is going out of existence.

2 The central organization notifies the Service, by its annual submission described in section 6 or otherwise, that any of its subordinates will no longer fulfill the conditions set out in .02 of this section.

3 The Service notifies the central organization or the affected subordinate that the group exemption letter shall cease to have effect as to some or all of the group because the conditions set out in .01 or .02 of this section have not been fulfilled.

.04 When notice is given under .03 of this section, the Service will not thereafter recognize the exempt status of the affected subordinates unless and until they file separate applications on their own behalf, or the central organization files complete supporting information for their reinclusion in the group exemption at the time of its annual submission.

.05 When notice is given by the Service as described in .03 of this section, and withdrawal of recognition is based on a failure to come within the description of the particular subparagraph of section 501(c) of the Code, the effective date will be governed by section 12.01 of Rev. Proc. 80-25. Such notice will be given after completion of the appeal procedures set out in that revenue procedure.

SEC. 8. INSTRUMENTALITIES OR AGENCIES OF POLITICAL SUBDIVISIONS

An instrumentality or agency of a political subdivision that exercises control or supervision over a number of organizations similar in purposes and operations, each of which may qualify for exemption under the same paragraph of section 501(c) of the Code, may obtain a group exemption letter covering those organizations in the same manner as a central organization. However, the instrumentality or agency must evidence that it is a qualified governmental agency. Examples of organizations over which governmental agencies exercise control or supervision are federal credit unions, state chartered credit unions, and federal land bank associations.

SEC. 9. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 77-38 is superseded.

SEC. 10. EFFECTIVE DATE

This revenue procedure is effective June 30, 1980, the date of its publication in the Internal Revenue Bulletin.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 501, 508, 521; 1.501(a)-1, 1.508-1, 1.521-1.)

Rev. Proc. 80-28

SECTION 1. PURPOSE

This revenue procedure sets forth procedures for the issuance of ruling or determination letters by the Internal Revenue Service to organizations that have established in court their qualification for exemption from federal income tax.

SEC. 2. GENERAL

.01 Under Rev. Proc. 80-25, page 39, this Bulletin, an organization seeking recognition of exempt status under section 501 or 521 of the Internal Revenue Code is required to file an application with the key District Director of Internal Revenue for the area in which the principal place of business or principal office of the organization is located.

.02 When an application for recognition of exempt status is denied, or when a ruling or determination letter recognizing exempt status is revoked or modified, an organization may avail itself of the administrative remedies prescribed by Rev. Proc. 80-25. In addition, if the statutory prerequisites are met, an organization may avail itself of certain judicial remedies. These remedies include a suit in a United States District Court or the United States Court of Claims for refund of taxes paid for one or more taxable periods; a suit in the United States Tax Court for redetermination of deficiencies for one or more taxable periods; and, with respect to the initial qualification or continuing qualificaton of an organization as one described in section 501(c)(3) of the Code which is exempt from tax under section 501(a), a suit for declaratory judgment in the United States Tax Court, the United States Court of Claims, or the United States District Court for the District of Columbia. Litigation in any of these forums may result in a decision that an organization was exempt for the period considered by the court.

.03 If an organization has secured a final judicial determination that it is exempt from tax under either section 501 or 521 of the Code, and if the underlying facts and applicable law have not changed since the period considered by the court, the Internal Revenue Service will issue a ruling or determination letter, pursuant to the procedures set forth in section 3, recognizing the organization as exempt. This ruling or determination letter will have the same force and effect, and be subject to the same limitations, as a ruling or determination letter issued pursuant to the procedures set forth in Rev. Proc. 80-25.

SEC. 3. PROCEDURES

.01 When an organization secures a final judicial determination that it is exempt after either having its application for recognition of exemption denied or having an outstanding ruling or determination letter revoked or modified, it need not submit a new application for recognition of exemption, but should submit a brief statement over the signature of a principal officer that its activities remain the same as during the period considered by the court if such is the fact. If there has not been a change in the controlling law, the Service will issue a favorable ruling upon receipt of this statement.

.02 When an organization secures a final judicial determination that it is exempt but has not previously filed an application for recognition of exempt status, it will be issued a ruling or determination letter only upon application in the manner described in Rev. Proc. 80-25. The application should contain a statement that the organization's activities remain the same as during the period considered by the court if such is the fact.

SEC. 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 80-25 is amplified.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 401, 403, 501; 1.401-1, 1.403(a)-1, 1.501(a)-1)

Rev. Proc. 80-29

SECTION 1. PURPOSE

This revenue procedure sets forth the procedures of the Internal Revenue Service pertaining to the issuance of rulings and opinion letters relating to master or prototype pension, annuity, and profit-sharing plans involving sections 401 and 403(a) of the Internal Revenue Code and the status for exemption of related trusts or custodial accounts under section 501(a).

SEC. 2. BACKGROUND AND GENERAL INFORMATION

.01 The general procedures of the Service relating to the issuance of rulings, determination letters, and opinion letters on employee plans and exempt organization matters are set forth in Rev. Proc. 80-24, page 30, this Bulletin. Rev. Proc. 80-30, page 56, this Bulletin, provides procedures relating to the issuance of determination letters as to the qualification of employee plans or trusts under sections 401(a), 403(a), and 405(a) of the Code and to the exempt status of trusts under section 501(a).

.02 Rev. Proc. 72-7, 1972-1 C.B. 715, as modified by Rev. Proc. 75-51, 1975-2 C.B. 590, contains procedures for the issuance of opinion letters as to the acceptability of the form of master and prototype plans designed to include self-employed individuals. Rev. Proc. 72-8, 1972-1 C.B. 716, as modified by Rev. Proc. 75-52, 1975-2 C.B. 592, contains procedures for the issuance of opinion letters as to the acceptability of the form of master and prototype plans that do not include self-employed individuals.

.03 This revenue procedure contains procedures relating to both those master or prototype plans designed to include owner-employees and those designed to include only individuals who are not owner-employees, thereby consolidating procedures that were previously set forth independently. This revenue procedure also provides for the issuance of an opinion letter relating to a master or prototype plan designed for a partnership that does not include an owner-employee. See section 3.04, below.

SEC. 3. DEFINITIONS

.01 A "master plan" is a plan that is made available by a "sponsoring organization" (see section 3.06) for adoption by employers and for which a single funding medium (for example, a trust or custodial account) is established, as part of the plan, for the joint use of all adopting employers.

.02 A "prototype plan" is a plan which is made available by a sponsoring organization for adoption by employers and under which a separate funding medium is established for each adopting employer.

.03 An "H.R. 10 plan" is a master or prototype plan designed to include self-employed individuals, owner-employees and their employees.

.04 A "corporate-type plan" is a master or prototype plan designed to include only individuals who are not owner-employees. The term includes both a master or prototype plan designed to include only common-law employees and a plan designed for a partnership none of whose partners is an owner-employee.

.05 An "opinion letter" is a written statement issued by the National Office to a sponsoring organization pursuant to this revenue procedure as to the acceptability of the form of a master or prototype plan and any related trust or custodial account under sections 401, 403(a), and 501(a) of the Code.

.06 A "sponsoring organization" is a trade or professional organization having characteristics similar to those described in section 1.501(c)(6)-1 of the Income Tax Regulations, a bank (as defined in section 401(d)(1) of the Code), an insurance company, a regulated investment company (as defined in section 851), an investment advisor that has an advisory contract with one or more regulated investment companies, a principal underwriter that has a principal underwriting contract with one or more regulated investment companies, or, in the case of an H.R. 10 plan, a person who, under regulations, may act as a trustee or custodian.

.07 A "variable form" plan is a corporate-type plan that permits an employer to select various options relating to basic provisions such as employee coverage, contributions, benefits, and vesting.

.08 A "standardized form" plan is a corporate-type defined contribution plan (except for a target benefit plan) which meets the following requirements:

1 The provisions governing eligibility and participation are such that an adopting employer will always meet the percentage coverage requirements of section 410(b)(1)(A) of the Code. There are no requirements for participation in the plan other than a period of service not extending past the later of the date an employee reaches age 25 or completes three years of service.

2 Each employee's rights to or derived from all contributions under the plan are fully vested and nonforfeitable at the time the contributions are paid to or under the plan.

3 Contributions under the plan, if any, are allocated on the basis of total compensation.

4 Each participant who completes a year of service shares in any allocation of employer contributions for the year, regardless of the participant's employment status on the last day of the year or any other allocation date specified in the plan.

5 The eligibility requirements and contributions are not more favorable under the plan for officers, shareholders or highly compensated employees than for other employees.

6 The plan is not integrated with old-age, survivors, and disability insurance benefits provided under the Social Security Act.

SEC. 4. OPINION LETTERS—SCOPE

.01 Opinion letters will be issued only to sponsoring organizations as defined in section 3.06 and do not constitute rulings or determinations as to either the qualification of the plans as adopted by particular employers or, in the case of prototype plans, the exempt status of related trusts or custodial accounts.

.02 Opinion letters will not be issued under this revenue procedure for prototype plans intended to meet the requirements for individual savings programs under section 408(a) or 408(b) of the Code (see Rev. Proc. 75-6, 1975-1 C.B. 646).

.03 Opinion letters will not be issued for:

1 Collectively-bargained plans (section 413(b) of the Code);

2 Stock bonus plans;

3 Bond purchase plans;

4 Employee stock ownership plans (see Rev. Proc. 75-48, 1975-2 C.B. 583);

5 Pooled fund arrangements contemplated by Rev. Rul. 56-267, 1956-1 C.B. 206 or Rev. Rul. 75-530, 1975-2 C.B. 146;

6 Annuity contracts under section 403(b) of the Code;

7 Individual retirement accounts established by employers and associations of employees intended to meet the requirements of section 408(c) of the Code (see Rev. Proc. 76-32, 1976-2 C.B. 654);

8 Pattern plans (see Rev. Proc. 76-15, 1976-1 C.B. 553);

9 Field prototype plans (see Rev. Proc. 77-23, 1977-2 C.B. 530);

10 Defined contribution plans (except for target benefit plans) under which the test for prohibited discrimination under section 401(a)(4) of the Code is to be made by reference to benefits rather than contributions;

11 H.R. 10 plans that do not contain the requirements of section 401(d) of the Code applicable to owner-employees (as defined in section 401(c)(3));

12 Corporate-type plans that involve integration with Social Security benefits except for plans that define annual compensation to be all of each employee's compensation that would be subject to taxation under section 3101(a) of the Code without the dollar limitation of section 3121(a)(1).

13 Plans described in section 414(k) of the Code (relating to a defined benefit plan which provides a benefit derived from employer contributions which is based partly on the balance of the separate account of a participant).

.04 Master or prototype plans submitted pursuant to this procedure must provide a procedure for amendments so that changes in the Code, regulations, revenue rulings, or other rules or statements published in the Internal Revenue Bulletin may be complied with on a group basis. An employer that amends any provision of an approved master or prototype plan or its adoption agreement (other than to change his choice of options, if the plan permits or contemplates such a change) or an employer that chooses to discontinue participation in a plan as amended by its sponsoring organization and does not substitute another approved master or prototype plan is considered to have adopted an individually designed plan. The procedures stated in Rev. Proc. 80-30 relating to the issuance of determination letters for individually designed plans will then apply to the plan as adopted by the employer.

SEC. 5. OPINION LETTERS AND RULING LETTERS—INSTRUCTIONS TO SPONSORING ORGANIZATIONS

.01 The National Office will, upon the request of a sponsoring organization, issue an opinion letter as to the acceptability under section 401 of the Code of the form of a master or prototype plan and any related trust or custodial account. The National Office will also issue a ruling letter to the trustee or custodian as to the exempt status under section 501 of a trust or custodial account where such trust or custodial account forms part of a master plan.

.02 A request for an opinion letter relating to an H.R. 10 plan shall be submitted on Form 3672, Application for Approval of Master or Prototype Defined Contribution Plan for Self-Employed Individuals, on Form 3672-A, Application for Approval of Master or Prototype Defined Benefit Plan for Self-Employed Individuals, as applicable, to the Commissioner of Internal Revenue, Washington, D.C. 20224, Attention: E:EP:T. A sponsoring organization requesting an opinion letter shall also submit a copy of the plan document and trust instrument. If a request relates to a plan which combines a profit-sharing plan and a money purchase plan in a single plan document, a separate Form 3672 should be submitted for each type of plan. A defined contribution plan and a defined benefit H.R. 10 plan may not be combined in a single plan document. A separate plan document should be submitted with either Form 3672 or Form 3672-A, as applicable, for each type of plan. Where a plan provides for more than one funding medium (for example, a trust and a custodial account), a separate document should be submitted for each funding medium. Options (for example, elections specifying the level of contributions) offered to adopting employers may be either included in the plan document or incorporated in a separate document (the "adoption agreement"). Plan documents and trust instruments need not be submitted in duplicate.

.03 A request for an opinion letter relating to a corporate-type plan shall be submitted on Form 4461, Application for Approval of Master or Prototype Defined Contributions Plan, or on Form 4461-A, Application for Approval of Master or Prototype Defined Benefit Plan, as appropriate. The request is to be filed with the Commissioner of Internal Revenue, Washington, D.C. 20224, Attention: E:EP:T. A sponsoring organization requesting an opinion letter shall submit a separate application and plan document for each type of plan submitted (for example, a defined benefit plan, a profit-sharing plan, a target benefit plan, or a money purchase plan). In addition, a sponsoring organization that offers both trusteed and nontrusteed versions of a particular type of plan must incorporate the nontrusteed plan in a separate plan document. Plan documents incorporating more than one type of plan are not acceptable under this procedure. Options (for example, elections to be made by the adopting employer concerning eligibility conditions, vesting rates, and contribution or benefit levels) must be set forth in a separate document (the "adoption agreement"). Options may not be interspersed throughout the plan document. Plan documents need not be submitted in duplicate.

.04 The National Office may, at its discretion, require any additional information that it deems necessary.

.05 A sponsoring organization must furnish each adopting employer with a copy of the approved plan, copies of any subsequent amendments, and the most recently issued Internal Revenue Service opinion letter.

.06 If the plan document submitted as part of an opinion letter request contains a provision that gives rise to an issue for which contrary authorities exist, failure to disclose and distinguish significant contrary authorities may result in requests for additional information, which will delay action on the request (see section 6.06 of Rev. Proc. 80-24).

SEC. 6. OPINION LETTERS—SPECIAL INSTRUCTIONS TO SPONSORING ORGANIZATION OF VARIABLE FORM CORPORATE-TYPE PLANS

.01 Where a corporate-type defined benefit plan contains one or more nonintegrated benefit formulas, the sponsoring organization must submit a separate adoption agreement containing all of the nonintegrated benefit formulas. Where such a plan contains one or more integrated benefit formulas, the sponsoring organization must submit a separate adoption agreement for each type of integrated formula (for example, excess benefit or offset benefit); each separate adoption agreement should contain all of the plan integrated benefit formulas of a particular type. For example, a corporate-type defined benefit plan with nonintegrated unit benefit and flat-benefit formulas, unit benefit excess formulas, flat-benefit excess formulas, unit benefit offset formulas, and flat-benefit offset formulas must submit at least three separate adoption agreements:

1 An adoption agreement containing all of the nonintegrated benefit formulas (unit benefit and flat-benefit);

2 An adoption agreement containing all of the excess benefit formulas (unit benefit and flat-benefit);

3 An adoption agreement containing all of the offset benefit formulas (unit benefit and flat-benefit).

.02 A copy of the approved master or prototype plan and the Internal Revenue Service opinion letter must be furnished by the the sponsoring organization to each Internal Revenue Service key district office in whose jurisdiction there are employers who adopt the plan. The sponsoring organization must also furnish key district offices with a copy of all amendments subsequently approved as to form by the National Office. Key district offices are listed in Rev. Proc. 80-30.

SEC. 7. AMENDMENTS

.01 A sponsoring organization may amend its previously approved plan (including any related trust or custodial account) and the National Office will entertain a request for a written opinion as to the acceptability, for purposes of sections 401, 403, and 501(a) of the Code, of the form of the plan as amended. Where a plan has been so amended, the sponsoring organization must submit to the National Office (1) Form 3672 or Form 3672-A, as applicable, for an H.R. 10 plan or (2) Form 4461 or Form 4461-A, as applicable, for a corporate-type plan. The sponsoring organization should also submit a copy of the amendment(s) and a cover letter summarizing the changes to the plan effected by such amendment(s).

.02 No opinion letter will be issued regarding the effect of the following amendments:

1 An amendment solely to conform a plan to the requirements of section 402(a) of Title I of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 1974-3 C.B. 1, relating to named fiduciaries.

2 An amendment solely to conform a plan to the requirements of section 503 of ERISA, relating to claims procedures.

3 An amendment, described in section 8 of this revenue procedure, solely to conform a defined contribution H.R. 10 plan to sections of the Internal Revenue Code added on revised by the Tax Reform Act of 1976, Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1.

4 An amendment that merely adjusts the maximum limitations under section 415 of the Code to reflect annual cost-of-living increases, other than an amendment that adds an automatic cost-of-living adjustment provision to the plan.

Any amendment noted above will

not affect the status of a favorable opinion letter previously issued with respect to a plan. The Service will not accept any requests for opinion letters regarding such amendments.

.03 A completely restated plan must be submitted when a plan is amended for the first time to meet the requirements of ERISA. After that time, no more than four consecutive amendments may be submitted without restating the plan. However, the Service may, at its discretion, require plan restatement at any time that it deems necessary.

Sec. 8. Amendments to Conform Certain Defined Contribution Plans to Sections of the Internal Revenue Code as Added or Revised by the Tax Reform Act of 1976

.01 The Tax Reform Act of 1976 added or revised the following provisions of the Code related to the limitation for contributions to defined contribution plans that include self-employed individuals:

1 Section 404(e)(4) of the Code was revised to limit the availability of the special deduction allowance for contributions of the lesser of $750 or 100% of earned income to those made on behalf of self-employed individuals whose adjusted gross incomes do not exceed $15,000 for the taxable year.

2 Section 415(c)(5) of the Code was added to remove the 25% limitation on contributions for certain participants and permit instead not less than $750 or 100% of earned income, whichever is the smaller amount.

3 Section 415(c)(7) of the Code was added to remove the 25% limitation for certain level premium payments for annuity contracts under plans benefitting owner-employees.

.02 For plans that already contain a minimum contribution formula, the present language should be revised to incorporate the new Code section 415(c)(5) limit by—

1 deleting the present formula and inserting the following:

"Minimum Contribution Provision—A minimum contribution shall be made on behalf of each eligible self-employed individual whose adjusted gross income (determined without regard to any deduction allowable under section 404(a) of the Code) is not in excess of $15,000 for the taxable year ending with or within the limitation year for which such contribution is made. The amount to be so contributed shall be the lesser of any stated percentage (not to exceed 100%) of the individual's earned income or a stated amount (not to exceed $750). In any taxable year in which an amount is contributed under this provision on behalf of at least one self-employed individual, each eligible common-law employee shall receive at least an equivalent amount determinable under these same limitations in the plan."

2 adding the following sentence to the definition now in the plan for the maximum permissible amount that may be contributed:

"If in any limitation year there is at least one self-employed individual whose adjusted gross income (determined without regard to any deduction allowable under section 404(a) of the Code) does not exceed $15,000 for the taxable year ending with or within such limitation year and a contribution is made on behalf of such self-employed individual under section _____ of the plan, the maximum permissible amount with respect to any other participant shall not be less than the contribution made with respect to such self-employed participant under section _____ of the Plan." (The section number to be inserted is the one assigned for the plan provision in (1) above.)

.03 For plans which do not contain a minimum contribution formula, insertion of the language of section .02-1 and .02-2 above is one method of incorporating the new Code section 415(c)(5) limit.

.04 In the case of defined contribution plans funded solely by level premium annuity, endowment, or life insurance contracts, the new limit of section 415(c)(7) of the Code may be incorporated by adding the following sentence to the plan provision which sets forth the limitation contained in section 415(c)(1):

"The 25% limitation shall not apply, however, to contributions for the benefit of an owner-employee for any limitation year in which:

(a) the owner-employee is not an active participant at any time during such year in a defined benefit plan maintained by the employer, and

(b) the annual addition with respect to such owner-employee for such year consists solely of contributions to pay level annual premiums on contracts as provided in this plan."

Sec. 9.—Approved Plans—Maintenance of Approved Status

.01 An opinion letter found to be in error or not in accord with the current views of the Service may be revoked. Revocation may be effected by a notice to the sponsoring organization to whom the letter was originally issued, or by a revenue ruling or other rule or statement published in the Internal Revenue Bulletin.

.02 An approved master or prototype plan must be amended to retain its approved status if any provisions therein fail to meet the requirements of law, regulations, or other rules and guidelines affecting qualification that become effective subsequent to the issuance of an opinion letter.

.03 An opinion letter will not be adversely affected by the publication of a revenue ruling if an amendment conforming the plan to the requirement of the revenue ruling is made by the sponsoring organization within one year after publication of the revenue ruling in the Internal Revenue Bulletin, to be effective for all adopting employers for their plan years beginning within such one year period.

Sec. 10. Withdrawal of Requests

.01 A sponsoring organization may withdraw its request for an opinion or ruling letter at any time prior to the issuance of such letter by notifying the National Office in writing of such withdrawal. The sponsoring organization must also notify any employer who adopted the plan that the request has been withdrawn. Such an employer will be deemed to have an individually designed plan to which Rev. Proc. 80-30 applies.

.02 Even though a request is withdrawn, the National Office will retain all correspondence and documents associated with that request and will not return them to the sponsoring organization. The National Office may furnish its views concerning the qualified status of the plan to District Directors who have or will have audit jurisdiction of the returns of any employers who have adopted the plan.

Sec. 11. Abandoned Plans

.01 A sponsoring organization should notify the National Office in writing of an approved master or prototype plan that is no longer used by any employer and that the sponsoring organization no longer intends to offer for adoption. Such written notification should be filed with the Commissioner of Internal Revenue, Washington, D.C. 20224, Attention: E:EP:T, and should refer to the file folder number and letter serial number appearing on the latest opinion letter issued.

.02 A sponsoring organization that intends to abandon an approved master or prototype plan that is in use by any adopting employer must inform each adopting employer that the form of the plan has been terminated and that the employer may not continue to rely on the plan's opinion letter. After so informing all adopting employers, the sponsoring organization should notify the National Office in accordance with subsection .01 above.

SEC. 12. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 72-7, Rev. Proc. 72-8, Rev. Proc. 75-51, and Rev. Proc. 75-52, as modified by Rev. Proc. 76-38, 1976-2 C.B. 661, are hereby superseded.

SEC. 13. EFFECTIVE DATE

This revenue procedure is effective June 30, 1980. Requests for opinion letters submitted prior to the effective date will be processed in accordance with Rev. Proc. 72-7 and Rev. Proc. 75-51 or Rev. Proc. 72-8 and Rev. Proc. 75-52, as applicable.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 401, 403, 405, 501, and 7476; 1.401.1, 1.403(a)-1, 1.405-1, 1.501(a)-1, 1.7476-1.)

Rev. Proc. 80-30

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SECTION 1. PURPOSE AND SCOPE

.01 The purpose of this revenue procedure is to set forth the general procedures of the various offices of the Internal Revenue Service pertaining to the issuance of determination letters on the qualification of pension, profit-sharing, stock bonus, and bond purchase plans involving sections 401, 403(a), 405(a) 409A, and 4975(e)(7) of the Internal Revenue Code, as amended by the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 1974-3 C.B. 1, and the status for exemption of any related trusts or custodial accounts under section 501(a). Specifically, this revenue procedure consolidates the determination letter procedures contained in Rev. Proc. 72-6, 1972-1 C.B. 710, Rev. Proc. 72-7, 1972-1 C.B. 715, Rev. Proc. 72-8, 1972-1 C.B. 716, Rev. Proc. 76-38, 1976-2 C.B. 661, and Rev. Proc. 77-22, 1977-2 C.B. 529, and the procedures for notification of interested parties contained in Rev. Proc. 75-31, 1975-2 C.B. 551.

.02 This revenue procedure applies only to determination letters issued in accordance with section 3.01 below and to plans approved in accordance with section 15 below. See section 3 below for the areas in which the Service will issue determination letters with respect to employee plans matters.

.03 This revenue procedure does not extend to the issuance of determination letters where the determination is only with respect to whether an individually designed defined contribution plan constitutes an employee stock ownership plan under sections 301(d) and (e) of the Tax Reduction Act of 1975, Pub. L. 94-12, 1975-1 C.B. 545, as amended by the Tax Reform Act of 1976, Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1 (see Rev. Proc. 75-48, 1975-2 C.B. 583) and the Revenue Act of 1978 (Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1). The reference in Rev. Proc. 75-48 to Rev. Proc. 75-47 should be read as a reference to this revenue procedure.

SEC. 2. BACKGROUND AND GENERAL INFORMATION

.01 The general procedures of the Service relating to the issuance of rulings, determination letters, and opinion letters are set forth in Rev. Proc. 80-24, page 30, this Bulletin.

.02 Prior to the issuance of the amendments to the Statement of Procedural Rules (26 CFR 601), 1975-2 C.B. 597, Rev. Proc. 72-6 provided detailed procedures relating to the issuance of determination letters as to the qualification of employee plans involving sections 401, 403(a), and 405(a) of the Code, and the exempt status of related trusts under section 501(a). The amendments to the Statement of Procedural Rules cited above set forth changes with respect to the issuance of determination letters which were necessary to reflect changes made by ERISA. Rev. Proc. 75-47, 1975-2

C.B. 581, modified Rev. Proc. 72-6 by providing supplemental and revised procedures for issuing determination letters relating to the qualification of individually designed plans.

.03 Rev. Proc. 80-29, page 52, this Bulletin, sets forth the procedures relating to the issuance of opinion letters by the National Office as to the acceptability of the form of master and prototype plans.

.04 Section 601.201(n)(9) of the Statement of Procedural Rules sets forth the technical advice procedures applicable to employee plans matters.

.05 Rev. Proc. 75-31 sets forth requirements with respect to notifying interested parties of requests for determination letters relating to the qualification of employee plans involving sections 401, 403(a) and 405(a) of the Code. These requirements are now set forth in section 7 of this revenue procedure.

.06 Rev. Proc. 76-15, 1976-1 C.B. 553, sets forth the procedures whereby law firms may submit pattern plans with requests for notification letters that will enable those pattern plans to be used on behalf of numerous employers represented by such practitioners. Rev. Proc. 76-15 also sets forth procedures for the issuance of determination letters to employers adopting pattern plans. The reference in section 4.04 of Rev. Proc. 76-15 to the provisions of Rev. Proc. 75-47 should be read as a reference to the provisions of this revenue procedure.

.07 Rev. Proc. 76-38, modified Rev. Proc. 75-47, Rev. Proc. 75-51, 1975-2 C.B. 590, and Rev. Proc. 75-52, 1975-2 C.B. 592, to permit the Service to issue determination and opinion letters with respect to target benefit plans.

.08 Rev. Proc. 77-15, 1977-1 C.B. 572, sets forth the procedures for the adoption of the Model Profit-Sharing Plan and the Model Money Purchase Pension Plan, designed for initial qualification under section 401 of the Code, and the Restated Model Profit-Sharing Plan and the Restated Model Money Purchase Pension Plan, designed to change existing plans to qualify under section 401. In this regard, see section 15.01 below.

.09 Rev. Proc. 77-22 sets forth guidelines under which determination letters with respect to certain types of defined contribution and defined benefit plans will be issued to employers adopting corporate-type master or prototype plans or certain other types of plans. These guidelines are now set forth in section 4 below.

.10 Rev. Proc. 77-23, 1977-2 C.B. 530, sets forth the procedures whereby certain sponsors may submit field prototype plans with requests for notification letters that will enable those field prototype plans to be used by the sponsor's clients (i.e. adopting employers). References in Rev. Proc. 77-23 to Rev. Proc. 77-22 should be read as references to this revenue procedure.

.11 Prior to the issuance of the amendments to the Statement of Procedural Rules (26 CFR 601), 43 F.R. 44484 (1978), Rev. Proc. 77-25, 1977-2 C.B. 534, which modified Rev. Proc. 72-6 by deleting subsections 7.02 through 7.05 thereof, set forth the general procedures of the various offices of the Service and the instructions to taxpayers pertaining to the appeal of proposed adverse determination letters issued by Key District Offices on the qualification of plans involving sections 401, 403(a) and 405(a) of the Code. The amendments to the Statement of Procedural Rules cited above set forth changes with respect to the appeal of proposed adverse determination letters to reflect a single level of appeal.

.12 Rev. Proc. 78-14, 1978-2 C.B. 486, sets forth special procedures to be followed in issuing a determination letter for a defined contribution plan if a waiver of the minimum funding standard has been requested. The reference in section 6 of Rev. Proc. 78-14 to Rev. Proc. 75-47 should be read as a reference to this revenue procedure.

.13 A trust created or organized in the United States and forming part of a pension, profit-sharing, or stock bonus plan of an employer for the exclusive benefit of its employees or their beneficiaries that meets the requirements of section 401 of the Code is a qualified trust and is exempt from federal income tax under section 501(a) unless the exemption is denied under section 502, relating to feeder organizations, or section 503, relating to prohibited transactions, if, in the latter case, the plan is one described in section 503(a)(1)(B).

.14 A nontrusteed annuity plan that meets the applicable requirements of sections 401(a)(3) through (20) and section 401(d) (other than paragraph (1)) of the Code qualifies for special tax treatment provided for under other sections of the Code, such as section 403(a(2) (relating to lump sum treatment) and section 404(a)(2) (relating to deductions for employer contributions for the purchase of retirement annuities), if the additional provisions of such other sections are also met.

.15 A favorable determination letter on the qualification of a pension, annuity, profit-sharing, stock bonus, or bond purchase plan, and the exempt status of a related trust, if any, is not required as a condition for obtaining the benefits pertaining to the plan or trust. However, Delegation Order No. 112 (Rev. 6), 45 F.R. 38200 (1980) authorizes District Directors of Key Districts, and the Appeals office, to issue determination letters on the qualification of plans and the exempt status of related trusts.

SEC. 3. DETERMINATION LETTERS

.01 District Directors of Key District Offices (described in section 5 below) or the Appeals office if appropriate (see paragraph 601.201(o)(6) of the Statement of Procedural Rules) shall issue determination letters involving the provisions of sections 401, 403(a), 405(a), 409A, and 4975(e)(7) of the Code. This includes completed and proposed transactions relating to the following:

1 Initial qualification of pension, annuity, profit-sharing, stock bonus, and bond purchase plans (including employee stock ownership plans and cash and deferred arrangements);

2 Initial exemption from federal income tax under section 501(a) of trusts forming a part of such plans, provided that the determination does not involve the application of section 502 (feeder organizations) or the question of whether a proposed transaction will be a prohibited transaction under section 503;

3 Compliance with the applicable requirements of foreign situs trusts as to taxability of beneficiaries (section 402(c)) and deductions for employer contributions (section 404(a)(4)); and

4 Amendments (including those relating to section 414(l) or terminations (including partial terminations) of plans and trusts.

.02 Determination letters issued in accordance with section 3.01 do not include determinations on other issues involving the application of other sections of the Code, such as sections 72, 402, 403 (other than 403(a)), 404, 412, 511 through 515, and 4975 (other than section 4975(e)(7)), unless such determination letters are otherwise authorized under the first sentence of section 4.01 of Rev. Proc. 80-24. Notwithstanding the foregoing, however, determination letters may be issued with respect to issues concerning the applicability of sections 402(c) and 404(a)(4) when such issues arise in connection with foreign situs trusts.

.03 Additionally, the Service will not issue determination letters with respect to the following:

1 Plans or plan amendments for which automatic approval is granted pursuant to section 15.01 or 15.02 below; however, determination letters will be issued on the sole question of whether the requirements of section 415 and, if applicable, section 401(j) of the Code are met in a case where an employer maintains two or more plans at least one of which is described in section 15.01-2 below, that are not all master or prototype defined contribution plans; and

2 Areas described in section 3.02 of Rev. Proc. 79-14, 1979-1 C.B. 496.

.04 Finally, the Service generally will not issue determination letters with respect to the following:

1 Areas described in section 4.02 of Rev. Proc. 79-14; and

2 Until regulations under section 415(b)(6) of the Code are issued, matters involving the computation of benefits under a defined contribution plan (other than a target benefit plan) or the computation of contributions under a defined benefit plan.

SEC. 4. INSTRUCTIONS TO APPLICANTS

.01 All of the provisions of section 6 of Rev. Proc. 80-24 are applicable to requests for determination letters submitted under this revenue procedure. However, the term "all interested parties" in section 6.02 of Rev. Proc. 80-24 does not mean interested parties within the meaning of section 1.7476-1(b) of the Income Tax Regulations.

.02 An applicant requesting a determination letter must file with the appropriate Key District Director, specified in section 4.16, the applicable materials required by sections 4.03 through 4.15. The filing of such application, when accompanied by all information and documents required by such sections, will generally serve to provide the Service with the information required to make the requested determination. However, in making the determination, the Service may require the submission of additional information. Information submitted to the Service in connection with an application for determination may be subject to public inspection to the extent provided by section 6104 of the Code. In addition, before filing an application, the applicant must satisfy the requirements of section 3001(a) of ERISA, and section 7476(b)(2) of the Code and the regulations thereunder, which provide that an applicant for a determination letter on the qualified status of certain retirement plans must notify interested parties of such application. Section 7 below sets forth the general rules of the Service with respect to notifying interested parties of requests for determination letters relating to the qualification of plans involving sections 401, 403(a) and 405(a). Section 8 below provides special rules for notifying interested parties with respect to the adoption of plans described in section 15.01 below.

If an applicant for a determination letter does not comply with all the provisions of this section, the Key District Director, in his discretion, may return the application and point out to the applicant those provisions which have not been met. If such a request is returned to the applicant, the 270 day period described in section 7476(b)(3) of the Code will not begin to run until such time as the provisions of this section have been satisfied.

.03 An applicant requesting a determination letter relating to the initial qualification or amendment of an individually designed defined benefit plan (other than a collectively-bargained plan, but including a plan designed to include self-employed individuals or shareholder-employees of electing small business corporations) shall file Form 5300, Application for Determination for Defined Benefit Plan (For Pension Plans Other than Money Purchase Plans), and Form 5302, Employee Census.

.04 An applicant requesting a determination letter relating to the initial qualication or amendment of an individually designed defined contribution plan (other than a collectively-bargained plan, but including a plan designed to include self-employed individuals, a target benefit plan, or an employee stock ownership plan intended to qualify under section 401(a) of the Code) or a pattern plan shall file Form 5301, Application for Determination for Defined Contribution Plan (For Profit-Sharing, Stock Bonus and Money Purchase Plans), and Form 5302, Employee Census. If the request relates to the qualification of an employee stock ownership plan which is a combination stock bonus plan and money purchase plan, a separate Form 5301 and Form 5302 shall be filed for each plan. If the request relates to an employee stock ownership plan, the applicant shall also file Form 5309, Application for Determination of Employee Stock Ownership Plan.

.05 An applicant requesting a determination letter relating to the initial qualification or amendment (i.e. a change from among the options offered by the sponsor under the plan) of:

1 An approved master or prototype plan;

2 A Service-approved field prototype plan; or

3 Any other plan, previously approved as to form by a Key District Director, and for which the Key Dis-

trict Director has approved the use of Form 5307;

as adopted by the applicant, shall, except as provided in this section, section 4.12 or section 4.13, file Form 5307, Short Form Application for Determination for Employee Benefit Plan (Other than Plans that Include Self-Employed Individuals), and Form 5302, Employee Census. Employers adopting a plan subsequent to the date of its amendment by the sponsoring organization must use the revised serial number assigned to such amendment by an opinion letter. The Form 5307 applies to both defined benefit plans and defined contribution plans but may not be used for plans that include a self-employed individual, or for collectively-bargained plans.

.06 An employer that amends any provision of an approved master or prototype plan or its adoption agreement, a field prototype plan or its adoption agreement, or any other plan the form of which has been previously approved by the Service (other than to change from among the choice of options offered by the sponsor if the plan permits or contemplates such a change), or an employer that chooses to discontinue participation in such a plan as amended by its sponsoring organization and does not substitute another approved plan referred to in this subsection is considered to have adopted an individually designed plan. The requirements stated in this revenue procedure relating to the issuance of determination letters for individually designed plans will then apply to such plan.

.07 An applicant requesting a determination letter relating to the initial qualification or amendment of a collectively-bargained plan, whether or not covering self-employed individuals, shall file Form 5303, Application for Collectively-Bargained Plan. The Form 5303 applies to both defined benefit plans and defined contribution plans.

.08 An applicant requesting a determination letter relating to the initial qualification or amendment of an individually designed bond purchase plan (i.e. other than a bond purchase plan described in section 15.01-4 below) shall file Form 5301 and Form 5302.

.09 An applicant (including the adopter of a master or prototype plan designed to include self-employed individuals or the adopter of a plan described in section 15.01 below) requesting a determination letter involving the complete termination of a plan shall file Form 5310, Application for Determination Upon Termination; Notice of Merger, Consolidation or Transfer of Plan Assets or Liabilities; Notice of Intent to Terminate. The Form 5310 applies to both defined benefit plans and defined contribution plans. In the case of a determination letter request involving the partial termination of a plan, whether or not by amendment of the plan, the applicant shall file Form 5300, 5301, or 5303, as applicable, and Form 5302.

.10 An applicant requesting a determination letter with respect to the termination of a plan subject to the jurisdiction of the Pension Guaranty Corporation (PBGC) under Title IV of ERISA shall attach to the Form 5310 a copy of the PBGC letter of sufficiency of assets under section 4041 (b) of ERISA. If such document is not attached to the application, the Service will not accept it for processing unless the applicant requests in writing that the application be processed without waiting for PBGC action. The request shall be addressed to the Key District Director for the district where the application is filed.

.11 For a controlled group of corporations, as defined in section 414 (b) of the Code, the coverage items of the application forms referred to in this section must be completed as though the controlled group constitutes a single entity.

.12 An applicant requesting a determination letter with respect to the establishment of a pooled fund arrangement described in Rev. Rul. 56-267, 1956-1 C.B. 206, or Rev. Rul. 75-530, 1975-2 C.B. 146, shall file a written statement in support of its application, together with the trust instrument and any related documents.

.13 An applicant requesting a determination letter described in section 3.03-1 above, relating to whether the requirements of section 415 and, if applicable, section 401(j) of the Code have been satisfied, need file no particular application form but must submit a written statement that identifies the plans to which the request relates and demonstrates how these requirements have been satisfied.

.14 The Key District Director will evaluate comments received from interested parties or from the Secretary of Labor with respect to an employer's adoption of a model, master, prototype, or bond purchase plan described in section 15.01 below. If the Key District Director determines that the matters mentioned cannot affect the qualification of the plan, the employer and the interested parties who commented will be so notified. If the Key District Director determines that the matters may affect the qualification of the plan, the Key District Director will inform the employer of the nature of such matters, and will notify the employer that the employer cannot rely on the provisions of section 15.01 below. The employer should then request a determination letter by submitting a written statement that discusses the matters raised and sets forth the reasons why he believes section 401(a) or 405(a) has been satisfied. However, an additional notice to interested parties will not be required. If a determination letter is requested and the determination is favorable with respect to the qualification of the plan, the employer's adoption of the plan will thereafter be treated as any other adoption of a model, master, prototype, or bond purchase plan described in section 15.01 below.

.15 When, in connection with an application for a determination on the qualification of the plan, it is necessary to determine whether an organization (including a professional service organization) is a corporation or an association classified as a corporation under section 301.7701-2 of the Regulations on Procedure and Administration, or whether an employer-employee relationship exists, the Key District Director will make such determinations. In such cases, the application with respect to the qualification of the plan should be filed in accordance with the provisions of this revenue procedure and should contain the information and documents specified in the instructions to the application. It should also be accompanied by any information and copies of documents the organization deems appropriate to establish its status. The Service may, in addition, require further information that it considers necessary to determine the status of the organization, the employment status of the individuals involved, or the qualification of the plan. After the taxable status of the organization and the employer-employee relationship have been determined, the Key District Director may issue a determination letter as to the qualification of the plan.

.16 Requests for determination letters on matters authorized by section 3 of this revenue procedure and the necessary supporting data are to be addressed to the Key District Director specified below (the entity requesting the determination letter shall be determined without regard to the application of sections 414(b) or (c) of the Code to the plan):

1 In the case of a plan of a single employer, the request shall be addressed to the Key District Director for the district in which the employer's principal place of business is located.

2 In the case of a plan of more than one employer, as described in sections 413(a) and (c) of the Code, the request shall be addressed to the Key District Director for the district in which the principal place of business of the employer or plan administrator (if one has been designated) is located.

3 In the case of an industry plan established or proposed by all subscribing employers with principal places of business located within the jurisdiction of more than one Key District Director, as an alternative to (2) above, the request may be addressed to the Key District Director for the district in which the trustee's principal place of business is located. If the plan has more than one trustee, the request may be addressed to the Key District Director for the district where the trustees usually meet.

4 In the case of a domestic employer adopting a foreign situs trust, the request shall be addressed to the Key District Director for the district in which the employer's principal place of business is located.

5 In the case of a foreign employer, the request shall be addressed to the Director of International Operations, Benjamin Franklin Station, P.O. Box 895, Washington, D.C. 20044.

6 In the case of a pooled fund arrangement, the request on behalf of the master trust shall be addressed to the Key District Director for the district where the principal place of business of the trustee is located. Requests on behalf of the participating trusts and related plans will be addressed as otherwise provided herein.

.17 If the application for determination involves an issue where contrary authorities exist, failure to disclose and distinguish such significant contrary authorities may result in requests for additional information, which will delay action on the application. (See Rev. Proc. 80-24.)

.18 The applicant's request for a determination letter may be withdrawn by a written request at any time prior to appealing a proposed adverse determination letter to the Appeals office as provided in paragraph 601.201(o)(6) of the Statement of Procedural Rules. In the case of such a withdrawal, the Service will not render a determination of any type. A failure to issue a determination letter as a result of a withdrawal will not be considered a failure of the Secretary or his delegate to make a determination within the meaning of section 7476 of the Code. However, the Service may consider the information submitted in connection with the withdrawn request in a subsequent audit or examination.

SEC. 5. KEY DISTRICT OFFICES

Following are the 17 Key District Offices that issue determination letters and the areas covered by each:

Key District	*IRS Districts Covered*
	Central Region
Cincinnati	Cincinnati, Louisville, Indianapolis.
Cleveland	Cleveland, Parkersburg.
Detroit	Detroit.
	Mid-Atlantic Region
Baltimore	Baltimore (which includes the District of Columbia and Office of International Operations), Pittsburgh, Richmond.
Philadelphia	Philadelphia, Wilmington.
Newark	Newark.
	Midwest Region
Chicago	Chicago.
St. Paul	St. Paul, Fargo, Aberdeen, Milwaukee.
St. Louis	St. Louis, Springfield, Des Moines, Omaha.
	North-Atlantic Region
Boston	Boston, Augusta, Burlington, Providence, Hartford, Portsmouth.
Manhattan	Manhattan.
Brooklyn	Brooklyn, Albany, Buffalo.
	Southeast Region
Atlanta	Atlanta, Greensboro, Columbia, Nashville, Jacksonville, Jackson, Birmingham.
	Southwest Region
Dallas	Austin, New Orleans, Albuquerque, Denver, Cheyenne, Dallas, Oklahoma City, Little Rock, Wichita.
	Western Region
Los Angeles	Los Angeles, Phoenix, Honolulu.
San Francisco	San Francisco, Salt Lake City, Reno.
Seattle	Seattle, Portland, Anchorage, Boise, Helena.

SEC. 6. RIGHTS OF NOTICE TO AND COMMENT BY INTERESTED PARTIES AND THE PENSION BENEFIT GUARANTY CORPORATION

.01 Persons who qualify as interested parties under section 1.7476-1(b) of the regulations, and the Pension Benefit Guaranty Corporation shall have the following rights:

1 To receive notice, in accordance with section 7 below, that there will be filed an application for an advance determination regarding the qualification of plans described in sections 401, 403(a), and 405(a) of the Code, or, with respect to plans described in section 15.01 below, to receive notice, in accordance with section 8 below, of the adoption or amendment of such plans;

2 To submit written comments with respect to the qualification of such plans to the Internal Revenue Service;

3 To request the Department of Labor to submit a comment to the Service on behalf of the interested parties; and

4 To submit written comments to the Service on matters with respect to which the Department of Labor was requested to comment but declined.

.02 Comments submitted by interested parties must be received by the Key District Dirctor by the 45th day after the date on which the application for determination is received by the Key District Director (see sections 6.03 and 6.04 for filing deadlines where the Department of Labor has been requested to comment). Such comments must be in writing, signed by the interested parties or by an authorized representative of such parties (as provided in section 601.201(e)(6) of the Statement of Procedural Rules), addressed to the Key District Director to whom the application for determination was submitted, and contain the following information:

1 The names of the interested parties making the comments;

2 The name and taxpayer identification number of the applicant for a determination;

3 The name of the plan, the plan identification number, and the name of the plan administrator;

4 Whether the parties submitting the comment are:

(a) Present employees eligible to participate under the plan,

(b) Present employees with accrued benefits under the plan, former employees with vested benefits under the plan, beneficiaries of deceased former employees currently receiving benefits under the plan, or

(c) Present employees not eligible to participate under the plan;

5 The specific matters raised by the interested parties on the question of whether the plan meets the requirements for qualification involving sections 401, 403(a), and 405(a) of the Code, and how such matters relate to the interests of the parties making the comment; and

6 The address of the interested party submitting the comment (or if a comment is submitted jointly by more than one party, the name and address of a designated representative) to which all correspondence, including a notice of the Service's final determination with respect to qualification, should be sent. (The address designated for notice by the Service will also be used by the Department of Labor in communicating with the parties submitting a request for comment.) The designated representative may be one of the interested parties submitting the comment or an authorized representative. If two or more interested parties submit a single comment and one person is not designated in the comment as the representative for receipt of correspondence, a notice of determination mailed to any interested party who submitted the comment shall be notice to all the interested parties who submitted the comment for purposes of section 7476(b)(5) of the Code.

.03 A request to the Department of Labor to submit to the Key District Director a comment pursuant to section 3001(b)(2) of the Act must be made in accordance with the following procedures.

1 The request must be received by the Department of Labor by the 25th day after the day the application is received by the Key District Director. However, if the parties requesting the Department to submit a comment wish to preserve the right to comment to the Key District Director in the event the Department declines to comment, the request must be received by the Department by the 15th day after the application is received by the Key District Director.

2 The request to the Department of Labor to submit a comment to the Key District Director must:

(a) Be in writing;

(b) Be signed as provided in section 6.02 above;

(c) Contain the names of the interested parties requesting the Department to comment and the address of the interested party or designated representative to whom all correspondence with respect to the request should be sent. See also section 6.02(6) above;

(d) Contain the information prescribed in section 6.02-2, 3, 4, above;

(e) Contain the address of the Key District Director to whom the application was or will be submitted;

(f) State the specific matters upon which the Department's comment is sought, as well as how such matters relate to the interested parties making the request; and

(g) Be addressed as follows:

Administrator of Pension and
Welfare Benefit Programs,
U.S. Department of Labor,
200 Constitution Avenue,
N.W.,
Washington, D.C. 20216
Attention: 3001 Comment
Request

.04 If a request described in 6.03 is made and the Department of Labor notifies the interested parties making the request that it declines to comment on a matter concerning qualification of the plan which was raised in the request, the parties submitting the request may still submit a comment to the Key District Director on such matter. The comment must be received by the later of the 45th day after the day the application for determination is received by the Key District Director or the 15th day after the day on which notification is given by the Department that it declines to submit a comment on such matter. (See section 6.07 for the date of notification.) In no event may the request be received later than the 60th day after the application for determination was received. Such a comment must comply with the requirements of section 6.02 and include a statement that the comment is being submitted on matters raised in a request to the Department upon which the Department declined to comment.

.05 For rules regarding the confidentiality of contents of written comments submitted by interested parties to the Service pursuant to section 6.02 or 6.04, see section 601.201(o)(5) of the Statement of Procedural Rules.

.06 For rules regarding the availability to the applicant of copies of all comments on the application submitted pursuant to section 6.01-1, 2, or 3 of this revenue procedure, see section 601.201(o)(5) of the Statement of Procedural Rules.

.07 An application for an advance determination, a comment to the Key District Director, or a request to the Department of Labor shall be deemed made when it is received by the Key District Director, or the Department. Notification by the Department that it declines to comment shall be deemed given when it is received by the interested party or designated representative. The notice described in section 7.01 below shall be deemed given when it is given in person, posted as prescribed in the regulations under section 7476 of the Code, or received through the mail. In any case where such an application, comment, request, notification, or notice is sent by mail, it shall be deemed received as of the date of the postmark (or if sent by certified or registered mail, the date of certification or registration), if it is deposited in the mail in the United States in an envelope or other appropriate wrapper, first class postage prepaid, properly addressed. However, if such an application, comment, request, notification, or notice is not received within a reasonable period from the date of postmark, the immediately preceding sentence shall not apply.

SEC. 7. GENERAL RULES FOR NOTICE TO INTERESTED PARTIES

.01 Notice that an application for an advance determination regarding the qualification of a plan described in sections 401, 403(a), 405(a), 409A and 4975(e)(7) of the Code is to be made must be given to all interested parties in the manner set forth in section 1.7476-2(c) of the regulations and in accordance with the requirements of this section.

.02 When the notice referred to in section 7.01 is given by posting or in person, such notice must be given not less than 7 days nor more than 21 days prior to the date the application for a determination is made. When the notice is given by mailing, it should be given not less than 10 days nor more than 24 days prior to the date the application for a determination is made. If, however, an application is returned to the applicant for failure to adequately satisfy the notification requirements with respect to a particular group or class of interested parties, the applicant need not cause notice to be given to those groups or classes of interested parties with respect to which the notice requirement was already satisfied merely because, as a result of the resubmission of the application, the time limitations of this subsection would not be met.

.03 The notice referred to in section 7.01 shall be in writing and shall contain the following information:

1 A brief description identifying the class or classes of interested parties to whom the notice is addressed (e.g., all present employees of the employer, all present employees eligible to participate);

2 The name of the plan, the plan identification number, and the name of the plan administrator;

3 The name and taxpayer identification number of the applicant for a determination;

4 That an application for a determination as to the qualified status of the plan is to be made to the Service, stating whether the application relates to an initial qualification, a plan amendment, termination, a plan merger or consolidation, or a transfer of plan assets or liabilities, and the address of the Key District Director to whom the application will be submitted;

5 A description of the class of employees eligible to participate under the plan;

6 Whether or not the Service has issued a previous determination as to the qualified status of the plan;

7 A statement that any person to whom the notice is addressed is entitled to submit, or request the Department of Labor to submit, to the Key District Director described in section 7.03(4), a comment on the question of whether the plan meets the requirements of sections 401, 403(a), or 405(a) of the Code; that two or more such persons may join in a single comment or request; and that if such persons request the Department of Labor to submit a comment and that Department declines to do so with respect to one or more matters raised in the request, the persons may still submit a comment to the Key District Director with respect to the matters on which the Department declines to comment;

8 The specific dates by which a comment to the Key District Director or a request to the Department of Labor must be received in order to preserve the right of comment (see section 6 above);

9 The number of interested parties needed in order for the Department of Labor to comment; and

10 Except to the extent that the additional informational material required to be made available by sections 7.05 through 7.09 are included in the notice, a description of a reasonable procedure whereby such additional informational material will be available to interested parties (see section 7.04). (Examples of notices setting forth the above information, in a case in which the additional information required by sections 7.05 through 7.09 will be made available at places accessible to the interested parties, are set forth in Exhibits "I" and "II" of this Revenue Procedure.)

.04 The procedure referred to in section 7.03-10, whereby the additional informational material required by sections 7.05 through 7.09 will (to the extent not included in the notice) be made available to interested parties, may consist of making such material available for inspection and copying by interested parties at a place or places reasonably accessible to such parties, or supplying such material in person or by mail, or by a combination of the foregoing, provided such procedure is immediately available to all interested parties, is designed to supply them with such additional informational material in time for them to pursue their rights within the time period prescribed, and is available until the earlier of the filing of a pleading commencing a declaratory judgment action under section 7476 of the Code with respect to the qualification of the plan or the 92nd day after the day the notice of final determination is mailed to the applicant. Reasonable charges to interested parties for copying and/or mailing such additional informational material are permissible.

.05 Unless provided in the notice, or unless section 7.06 applies, there shall be made available to interested parties under a procedure described in section 7.04:

1 An updated copy of the plan and the related trust agreement (if any); and

2 The application for determination.

.06 If there would be less than 26 participants in the plan, as described in the application (including, as participants, former employees with vested benefits under the plan, beneficiaries of deceased former employees currently receiving benefits under the plan, and employees who would be eligible to participate upon making mandatory employee contributions, if any), then in lieu of making the materials described in section 7.05 available to interested parties who are not participants (as described above), there may be made available to such interested parties a document containing the following information:

1 A description of the plan's requirements respecting eligibility for participation and benefits;

2 A description of the provisions providing for nonforfeitable benefits;

3 A description of the circumstances which may result in ineligibility, or denial or loss of benefits;

4 A description of the source of financing of the plan and the identity of any organization through which benefits are provided; and,

5 Whether the applicant is claiming in the application that the plan meets the requirements of section 410 (b)(1)(A) of the Code, and, if not, the coverage schedule required by the application in the case of plans not meeting the requirements of such section. However, once an interested party or designated representative receives a notice of final determination, the applicant must, upon request, make available to such interested party (whether or not the plan has less than 26 participants) an updated copy of the plan and related trust agreement (if any) and the application for determination.

.07 Information of the type described in section 6104(a)(1)(D) of the Code should not be included in the application, plan, or related trust agreement submitted to the Service. Accordingly, such information should not be included in any of the material required by section 7.05 or 7.06 to be available to interested parties. There may be excluded from such material the information contained in Form 5302 (Employee Census). However, information showing the number of individuals covered and not covered in the plan, listed by compensation range, shall not be excluded.

.08 Unless provided in the notice, there shall be made available to interested parties under a procedure described in section 7.04, any additional document dealing with the application which is submitted by or for the applicant to the Service, or furnished by the Service to the applicant; provided, however, if there would be less than 26 participants in the plan as described in the application (including, as participants, former employees with vested benefits under the plan, beneficiaries of deceased former employees currently receiving benefits under the plan, and employees who would be eligible to participate upon making mandatory employee contributions, if any), such additional documents need not be made available to interested parties who are not participants (as described above) until they, or their designated representative, receive a notice of final determination. The applicant may also withhold from such inspection and copying information described in section 6104(a)(1)(C) and (D) of the Code which may be contained in such additional documents.

.09 Unless provided in the notice, there shall be made available to all interested parties under a procedure described in section 7.04 the material described in sections 6.02 through 6.07 above.

SEC. 8. SPECIAL NOTICE RULES FOR MODEL, CERTAIN MASTER, PROTOTYPE AND BOND PURCHASE PLANS

.01 An employer who adopts or amends a model, master, prototype, or bond purchase plan for which no determination will be issued (as described in section 15.01 below) must comply with the requirements for notification of interested parties described in section 7 above, except as otherwise provided by this section.

.02 Reference in section 7.02 above to the date an application for determination is made should be read as a reference to the date that is 30 days after the date a model, master, prototype or bond purchase plan described in section 15.01 below is adopted or amended.

.03 The notice referred to in section 7.01 above must be in writing and contain the following information:

1 The name of the plan sponsor, if any;

2 The name and taxpayer identification number of the plan adopter;

3 The information described in sections 7.03-1, 2, 5, 6, 7, 9, 10, and 11 above; and

4 The specific dates by which a comment to the Key District Director, or a request to the Department of Labor, must be received in order to preserve the right of comment. (See section 6 above. References in section 6 above to the date an application for determination is made will be read as a reference to the date that is 30 days after the date a plan described in section 15.01 below is adopted or amended.)

.03 The procedure described in section 7.04 above, whereby additional informational material as described in sections 7.05 through 7.09 above will be made available to interested parties need only be made available until such time as the Service notifies the adopter of the plan pursuant to section 4.14 above that no determination letter need be requested, or, if the plan's adopter receives no notice from the Service, 120 days from the date the plan was adopted.

.05 The reference to the application for determination in section 7.05-2 above is not applicable to plans described in section 15 below.

.06 In determining the number of plan participants for purposes of section 7.06 above, the number of plan participants is to be determined as though an application for determination were to be made. The provisions of section 7.06-5 above are not applicable to plans described in section 15 below.

.07 Information of the type described in section 6104(a)(1)(D) of the Code should not be included in the additional informational material made available pursuant to a procedure described in section 7.04 above.

.08 Unless provided in the notice, there shall be made available to interested parties under a procedure described in section 7.04 above any additional document dealing with the adoption of the plan described in section 15.01 below which is submitted by or for the plan's adopter to the Service, or furnished by the Service to the plan's adopter; provided however, if there would be less than 26 participants in the plan (as determined by sections 7.06 above and 8.06) such additional documents need not be made available to interested parties who are not participants (as described above) until the earlier of the date the Service notifies the plan's adopter, pursuant to section 4.14 above, that no determination letter request need be made, 120 days from the date the plan was adopted, or, if the Service notifies the plan's adopter that a determination letter should be requested, the date a final determination is made. The plan's adopter may also withhold from such inspection and copying information described in section 6104(a)(1)(C) and (D) of the Code which may be contained in such documents.

.09 Unless provided in the notice, there shall be made available to all interested parties under a procedure described in section 7.04 above the material described in sections 6.02, 6.03 and 6.04 above, except that interested parties must be informed that any references in such sections to the date an application for determination is made should be read as references to the date that is 30 days from the date a plan described in section 15.01 below is adopted or amended.

SEC. 9. ADMINISTRATIVE RECORD

.01 In the case of a request for a determination letter, the determination of the Key District Director or the Appeals office on the qualification or non-qualification of the retirement plan shall be based solely upon the facts contained in the administrative record. The administrative record shall consist of the following:

1 The request for determination, the retirement plan and any related trust instruments, and any written modifications or amendments made by the applicant during the proceedings within the Service;

2 All other documents submitted to the Service by, or on behalf of, the applicant with respect to the request for determination;

3 All written correspondence between the Service and the applicant with respect to the request for determination and any other documents issued to the applicant from the Service;

4 All written comments submitted to the Service pursuant to sections 6.01-1, 2, and 3 above, and all correspondence relating to comments submitted between the Service and persons (including the Pension Benefit Guaranty Corporation and the Department of Labor) submitting comments pursuant to sections 6.01-1, 2, and 3 above;

5 In any case in which the Service makes an investigation regarding the facts as represented or alleged by the applicant in the request for determination or in comments submitted pursuant to sections 6.01-1, 2, and 3 above, a copy of the official report of such investigation;

.02 The administrative record shall be closed upon the earlier of the following events:

1 The date of mailing of a notice of final determination by the Service with respect to the application for determination; or

2 The filing of a petition with the United States Tax Court seeking a declaratory judgment with respect to the retirement plan.

.03 Any oral representation or modification of the facts as represented or alleged in the application for determination or in a comment filed by an interested party, which is not reduced to writing shall not become a part of the administrative record and shall not be taken into account in the determination of the qualified status of the retirement plan by the Key District Director or the Appeals office.

SEC. 10. NOTICE OF FINAL DETERMINATION

The notice of final determination shall be:

.01 In the case of a final determination which is favorable to the applicant, the letter issued by the Key District Director or the Appeals office which states that the applicant's plan satisfies the qualification requirements of the Code. The favorable determination letter will be sent by certified or registered mail where either an interested party, the Department of Labor, or the Pension Benefit Guaranty Corporation has commented on the application for determination.

.02 In the case of a final determination which is adverse to the applicant, the letter issued by certified or registered mail by the Key District Director or the Appeals office subsequent to a letter of proposed determination, stating that the applicant's plan fails to satisfy the qualification requirements of the Code.

SEC. 11. ISSUANCE OF THE NOTICE OF FINAL DETERMINATION

The Key District Director or the Appeals office will send the notice of final determination to the applicant, to the interested parties who have previously submitted comments on the application to the Service (or to the persons designated by them to receive such notice), to the Department of Labor in the case of a comment submitted by the Department, and to the Pension Benefit Guaranty Corporation if it has filed a comment.

SEC. 12. EXHAUSTION OF ADMINISTRATIVE REMEDIES

.01 For purposes of section 7476(b)

(3) of the Code, a petitioner shall be deemed to have exhausted the administrative remedies available within the Service upon the completion of the steps described in sections 12.02, 12.03, or 12.04, subject, however, to section 12.05. If applicants, interested parties, or the Pension Benefit Guaranty Corporation do not complete the applicable steps described below, they will not have exhausted their respective available administrative remedies as required by section 7476(b)(3) and will, thus, be precluded from seeking declaratory judgment under section 7476 except to the extent that section 12.05-2 or 12.06 apply.

.02 In the case of an applicant, with respect to any matter relating to the qualification of a plan, the steps referred to in section 12.01 are:

1 Filing a completed application with the appropriate Key District Director pursuant to section 4 above;

2 Complying with the requirements pertaining to notice to interested parties as set forth in this Revenue Procedure, and section 1.7476-2 of the regulations; and,

3 Appealing to the Appeals office pursuant to paragraph 601.201(o)(6) of the Statement of Procedural Rules, in the event of a notice of proposed adverse determination issued by the Key District Director.

.03 In the case of an interested party or the Pension Benefit Guaranty Corporation, the steps referred to in section 12.01 are, with respect to any matter relating to the qualification of the plan, submitting to the Key District Director a comment raising such matter in accordance with section 6.01-1 above, or requesting the Department of Labor to submit to the Key District Director a comment with respect to such matter in accordance with section 6.01-2 and, if the Department of Labor declines to comment, submitting the comment in accordance with section 6.01-3 above, so that it may be considered by the Service through the administrative process.

.04 An applicant, an interested party, or the Pension Benefit Guaranty Corporation shall in no event be deemed to have exhausted administrative remedies prior to the earlier of:

1 The completion of those steps applicable to each as set forth in sections 12.01 or 12.03, which constitute their administrative remedies; or,

2 The expiration of the 270 day period described in section 7476(b)(3) of the Code, which period shall be extended in a case where there has not been a completion of all the steps referred to in section 12.01-1 and the Service has proceeded with due diligence in processing the application for determination.

.05 The step described in section 12.02(3) will not be considered completed until the Service has had a reasonable time to act upon the appeal.

.06 The step described in section 12.02-3 will not be available or necessary with respect to any issue on which technical advice has been obtained from the National Office.

SEC. 13. EFFECT OF EMPLOYEE PLAN DETERMINATION LETTERS

.01 A determination letter issued pursuant to this Revenue Procedure contains only the opinion of the Service as to the qualification of the particular plan involving the provisions of sections 401, 403(a), and 405(a) of the Code and the status of a related trust, if any, under section 501(a).

.02 Determination letters issued on amendments to plans and trusts within the purview of section 3.01-4 above will merely express an opinion whether the amendment, in and of itself, affects the existing status of the plan's qualification and the exempt status of the related trust. In no event should such a determination letter be construed as an opinion on the qualification of the plan as a whole and the exempt status of the related trust as a whole.

.03 Except as otherwise provided in this section, determination letters referred to in sections 13.01 and 13.02 are governed, generally, by the provisions of sections 13 and 14 of Rev. Proc. 80-24.

.04 The prior qualification of a plan as adopted by an employer will not be considered to be adversely affected by the publication of a revenue ruling where:

1 The plan was the subject of a favorable determination letter and the request for that letter contained no misstatement or omission of material facts;

2 The facts subsequently developed are not materially different from the facts on which the determination letter was based;

3 There has been no change in the applicable law; and

4 The employer that established the plan acted in good faith in reliance on the determination letter.

However, all such plans must be amended to comply with the published revenue ruling for subsequent years. The conformity amendment to an individually designed plan must be adopted before the end of the first plan year that begins after the revenue ruling is published in the Internal Revenue Bulletin and must be effective, for all purposes, not later than the first day of the first plan year beginning after the revenue ruling is published. For the rule as to the conforming amendment to a master or prototype plan, see section 8 of Rev. Proc. 80-29.

.05 While a favorable determination letter may serve as a basis for determining deductions for employer contributions thereunder, it is not to be taken as an indication that contributions are necessarily deductible as made. This latter determination can be made only upon an examination of the employer's tax return, in accordance with the limitations, and subject to the conditions of, section 404 of the Code.

SEC. 14. ORAL ADVICE TO TAXPAYERS

.01 In conformity with the general principle set forth in section 12 of Rev. Proc. 80-24, district officials will not ordinarily confer with taxpayers or their representatives on matters regarding the formation or qualification of plans, or related matters including amendments to or termination of approved plans, prior to the submission of the plan, amendment, or termination for a determination letter.

.02 A Key District Director may grant a conference upon written request from a taxpayer or his representative, provided the request shows that a substantive plan, amendment, etc., has been developed for submission to the Service, but that special problems or issues are involved, and the Key District Director concludes that a conference would be warranted in the interest of facilitating review and determination when the plan, etc., is formally submitted.

.03 The advice or assistance furnished, whether requested by personal appearance, telephone, or correspondence, except as otherwise provided in section 14.02, will be limited to general procedures, or will direct the inquirer to source material, such as pertinent Code provisions, regulations, revenue procedures, and revenue rulings that may aid the inquirer in resolving the question or problem.

Sec. 15. Areas in Which Automatic Approval as to the Qualified and Exempt Status of an Employee Plan Shall Be Granted

.01 Plans adopted or amended as described below will, to the extent provided, be deemed to satisfy the qualification requirements of section 401(a) or 405(a) and, if applicable, section 501(a) of the Code:

1 A Model Profit-Sharing Plan, a Restated Model Profit-Sharing Plan, a Model Money Purchase Pension Plan, or a Restated Model Money Purchase Pension Plan in accordance with Rev. Proc. 77-15, 1977-1 C.B. 572;

2 A master or prototype plan designed to include self-employed individuals where the sponsoring organization of such plan has been issued a favorable opinion letter by the National Office, provided that:

(a) The employer has followed the terms of the plan, has received a favorable determination letter described in section 3.03-1 above, if applicable, and the coverage and contributions or benefits under the plan are not more favorable for owner-employees than for other employees;

(b) The employer has properly notified all interested parties of the adoption of the plan in accordance with sections 7 and 8 above; and

(c) The employer has not received, within 120 days after the date the plan was adopted, notice from the Service that the plan will not be treated as qualified pursuant to this subsection (In this regard, see section 4.14 above);

3 A standardized form corporate master or prototype plan referred to in section 3.08 of Rev. Proc. 80-29 (that is the only plan of an employer intended to qualify) where the sponsoring organization of such plan has been issued a favorable opinion letter by the National Office, provided that:

(a) The employer has followed the terms of the plan, and the coverage and contributions under the plan are not more favorable for officers, shareholders, or highly compensated employees than for other employees;

(b) The employer has properly notified all interested parties of the adoption of the plan in accordance with sections 7 and 8 above; and

(c) The employer has not received, within 120 days after the date the plan was adopted, notice from the Service that the plan will not be treated as qualified pursuant to this subsection. (In this regard, see section 4.14 above); and

4 A bond purchase plan, provided that:

(a) The employer has completed Form 4578, Bond Purchase Plan for Self-Employed Individuals, or Form 6022, Bond Purchase Plan for Corporate Employers, as applicable, and has complied with the provisions thereof (When properly completed, Form 4578 or Form 6022 will constitute a bond purchase plan. These forms are not to be filed with the Service);

(b) The employer has properly notified all interested parties of the adoption of the plan in accordance with sections 7 and 8 above; and

(c) The employer has not received, within 120 days after the date the plan was adopted, notice from the Service that the plan will not be treated as qualified pursuant to this subsection (In this regard, see section 4.14 above);

.02 The plan amendments described below will, to the extent provided, not be deemed to alter the qualified status of a plan under section 401(a) of the Code:

1 An amendment solely to permit a trust forming part of a plan to participate in a pooled fund arrangement described in Rev. Rul. 56-267, or Rev. Rul. 75-530;

2 An amendment that merely adjusts the maximum limitations under section 415 of the Code to reflect annual cost-of-living increases, other than an amendment that adds on automatic cost-of-living adjustment provision to the plan;

3 An amendment solely to include language pursuant to section 403(c)(2) of Title I of ERISA concerning the reversion of employer contributions made as a result of mistake of fact; and

4 An amendment which conforms to the requirements of section 8 of Rev. Proc. 80-29.

Sec. 16. Effect on Other Documents

.01 The following revenue procedures are hereby obsoleted:

1 Rev. Proc. 56-22, 1956-2 C.B. 1380;

2 Rev. Proc. 56-42, 1956-2 C.B. 1409; and

3 Rev. Proc. 67-26, 1967-1 C.B. 629.

.02 The following revenue procedures are hereby modified:

1 Rev. Proc. 75-48, see section 1.03 of this revenue procedure;

2 Rev. Proc. 76-15, see section 2.06 of this revenue procedure;

3 Rev. Proc. 77-23, see section 2.10 of this revenue procedure; and

4 Rev. Proc. 78-14, see section 2.12 of this revenue procedure.

.03 The following revenue procedures are hereby superseded:

1 Rev. Proc. 72-6;
2 Rev. Proc. 75-31;
3 Rev. Proc. 75-47;
4 Rev. Proc. 76-38; and
5 Rev. Proc. 77-22.

.04 The general procedures of Rev. Proc. 80-24 are applicable to requests for rulings and determination letters except to the extent inconsistent with this procedure.

Sec. 17. Effective Date

This revenue procedure is effective June 30, 1980, the date of its publication in the Internal Revenue Bulletin.

EXHIBIT 'I'
SAMPLE NOTICE TO INTERESTED PARTIES

1. Notice To: ------------------
(describe class or classes of interested parties)

An application is to be made to the Internal Revenue Service for an advance determination on the qualification of the following employee pension benefit plan:

2. ----------------------------
(name of plan)

3. ----------------------------
(plan number)

4. ----------------------------
(name and address of applicant)

5. ----------------------------
(applicant EIN)

6. ----------------------------
(name and address of plan administrator)

7. The application will be filed on -------------------------------- with the Key District Director, Internal Revenue Service at ------------ ------------- (for an advance determination as to whether the plan meets the qualification requirements of section 401, 403(a), or 405(a) of the Internal Revenue Code of 1954, with respect to the plan's -------------- -------------------------- (initial qualification, amendment, termination, merger, consolidation or transfer of plan assets or liabilities).

8. The employees eligible to participate under the plan are: --------

9. The Internal Revenue Service ----------------previously issued a
(has, has not)
determination letter with respect to the qualification of this plan.

RIGHTS OF INTERESTED PARTIES

10. You have the right to submit to the Key District Director, at the above address, either individually or jointly with other interested parties, your comments as to whether this plan meets the qualification requirements of the Internal Revenue Code.

You may instead, individually or jointly with other interested parties, request the Department of Labor to submit, on your behalf, comments to the Key District Director regarding qualification of the plan. If the Department declines to comment on all or some of the matters you raise, you may, individually, or jointly if your request was made to the Department jointly, submit your comments on these matters directly to the Key District Director.

REQUESTS FOR COMMENTS BY THE DEPARTMENT OF LABOR

11. The Department of Labor may not comment on behalf of interested parties unless requested to do so by the lesser of 10 employees or 10 percent of the employees who qualify as interested parties. The number of persons needed for the Department to comment with respect to this plan is ---------------. If you request the Department to comment, your comment must be in writing and must specify the matters upon which comments are requested, and must also include:

(1) the information contained in items 2 through 4 of this Notice; and

(2) the number of persons needed for the Department to comment.

A request to the Department to comment should be addressed as follows:

Administrator of Pension and Welfare
Benefit Programs,
U.S. Department of Labor,
200 Constitution Avenue, N.W.,
Washington, D.C. 20216
ATTN: 3001 Comment Request

COMMENTS TO THE INTERNAL REVENUE SERVICE

12. Comments submitted by you to the Key District Director must be in writing and received by him by ------ -------------. However, if there are matters that you request the Department of Labor to comment upon on your behalf, and the Department declines, you may submit comments on these matters to the Key District Director to be received by him within 15 days from the time the Department notifies you that it will not comment on a particular matter, or by ------- --------------, whichever is later. A request to the Department to comment on your behalf must be received by it by ------------------- if you wish to preserve your right to comment on a matter upon which the Department declines to comment, or by --------- --------------- if you wish to waive that right.

ADDITIONAL INFORMATION

13. Detailed instructions regarding the requirements for notification of interested parties may be found in sections 6, 7 and 8 of Revenue Procedure 80-30. Additional information concerning this application (including, where applicable, an updated copy of the plan and related trust; the application for determination; any additional documents dealing with the application that have submitted to the IRS; and copies of section 6 of Revenue Procedure 80-30) is available at -------------------------------- during the hours of --------------- for inspection and copying. (There is a nominal charge for copying and/or mailing.)

EXHIBIT 'II'
SAMPLE NOTICE TO INTERESTED PARTIES

(Where no application for determination is filed with IRS)

Notice To: ------------------
(describe class or classes of interested parties)

2. ----------------------------
(name of adopter)

has ----------------------------
(adopted, amended)

the employee pension benefit plan described below on ----------------

3. ----------------------------
(name of plan)

4. ----------------------------
(plan identification number)

5. ----------------------------
(Opinion Letter number)

6. ----------------------------
(name and address of sponsor)

7. ----------------------------
(adopter's EIN)

8. ----------------------------
(name and address of plan administrator)

9. ----------------------------
(address of Key District Director having jurisdiction of plan)

10. It is not contemplated that the plan will be submitted to the Internal Revenue Service for an advance determination as to whether or not it meets the qualification requirements of sections 401, 403(a) or 405(a) of the Internal Revenue Code with respect to its ----------------------------
(initial qualification, amendment)

11. The employees eligible to participate under the plan are:

(describe by class)

----

12. The Internal Revenue Service

(has, has not)

previously issued a determination letter with respect to the qualification of this plan.

RIGHTS OF INTERESTED PARTIES

13. You have the right to submit to the Key District Director, at the above address, either individually or jointly with other interested parties, your comments as to whether this plan meets the qualification requirements of the Internal Revenue Code. You may instead, individually or jointly with other interested parties, request the Department of Labor to submit, on your behalf, comments to the Key District Director regarding qualification of the plan. If the Department declines to comment on all or some of the matters you raise, you may, individually, or jointly if your request was made to the Department jointly, submit your comments on these matters directly to the Key District Director.

REQUESTS FOR COMMENTS BY THE DEPARTMENT OF LABOR

14. The Department of Labor may not comment on behalf of interested parties unless requested to do so by the lesser of 10 employees or 10 percent of the employees who qualify as interested parties. The number of persons needed for the Department to comment with respect to this plan is --------------. If you request the Department to comment, your comment must be in writing and must specify the matters upon which comments are requested, and must also include:

(1) the information contained in items 2 through 9 of this Notice; and

(2) the number of persons needed for the Department to comment.

A request to the Department to comment should be addressed as follows:

Administrator of Pension and Welfare
Benefit Programs,
U.S. Department of Labor,
200 Constitution Avenue, N.W.,
Washington, D.C. 20216
ATTN: 3001 Comment Request

COMMENTS TO THE INTERNAL REVENUE SERVICE

15. Comments submitted by you to the Key District Director must be in writing and received by him by -----------------. However, if there are matters that you request the Department of Labor to comment upon on your behalf, and the Department declines, you may submit comments on these matters to the Key District Director to be received by him within 15 days from the time the Department notifies you that it will not comment on a particular matter, or by ---------------------, whichever is later. A request to the Department to comment on your behalf must be received by it by ------------------ if you wish to preserve your right to comment on a matter upon which the Department declines to comment, or by ---------------------- if you wish to waive that right.

ADDITIONAL INFORMATION

16. Detailed instructions regarding the requirements for notification of interested parties may be found in sections 6, 7, and 8 of Revenue Procedure 80-30. Additional information concerning this ------------------
(adoption, amendment)
(including where applicable, a description of the provisions providing for nonforfeitable benefits; a description of the circumstances which may result in ineligibility or loss of benefits; a description of the source of financing of the plan; and copies of section 6 of Revenue Procedure 80-30 is available at --------------------------
during the hours of --------------
for inspection and copying. (There is a nominal charge for copying and/or mailing.)

Part IV. Items of General Interest

Foundation Status of Certain Organizations

Announcement 80-86

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3) of the Code, eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Ahepa Cooley's Anemia Foundation, The, New York, NY
Aishel Avraham Nursing Home Corp., Brooklyn, NY
Americle Foundation, Houston, TX
Atlanta Biscayne Room, Inc., Atlanta, GA
Augusta Repertory Theatre Co., Atlanta, GA
Banks, Finley, Thomas & White Foundation, Memphis, TN
Blue Ridge Evangelistic Association, The, Spartanburg, SC
Bricklayers Local Union No. 11 Pennsylvania Joint Apprenticeship and Training Fund, Washington, PA
Burke County Community Resources Center, Morganton, NC
Bushwick Black Womens Guild, Inc., Brooklyn, NY
Carthage Baseball Association, Carthage, IL
Center for Counseling Services, Inc., Sunrise, FL
Chattanooga Wheelchair Sports Association, Inc., Chickamauga, GA
Christ Unlimited for the People Ministries, Calhoun County, Alabama, Jacksonville, AL
College Point Historical Society Inc., College Point, NY
Creative Theatrical Organization, Centerport, NY
DADS of America, Inc., Omaha, NE
Distinguished Virginians Fund, The, Richmond, VA
East New York Cultural Council, Inc., Brooklyn, NY
Eman Group Homes, Inc., Philadelphia, PA
Faith Fellowship Church, Inc., Memphis, TN
Faith Prison Ministries, Mt. Holly, NC
Farmingdale High School Dad's Club, Farmingdale, NY
Feed the Hungry Foundation, Inc., Decatur, GA
Fiesta de la Nivas Day Care Center, Brooklyn, NY
Fleming Day Care Center, Inc., Roanoke Rapids, NC
Florida Drug Abuse Prevention and Education Trust, Tallahassee, FL
Gibson Foundation for the Prevention of Child Abuse, The Melisha, Cleveland, TN
Golf Foundation of Wisconsin, Inc., Brookfield, WI
Greenwood Metro Rescue Squad, Greenwood, SC
Hineni, Inc., North Woodmere, NY
Hubbard Hall Projects, Inc., Cambridge, NY
Institute for Research on the Economics of Taxation, Washington, DC
Jewish Care Service of Long Island, Inc., Rego Park, NY
Knights Boxing Team, Alpharetta, GA
Kuumba Community Theatre, Chicago, IL
Lincoln Institute for Research and Education, The, Washington, DC
Long Beach Friends of the Library, Inc., Long Beach, NY
Maranatha Ministries, Inc., New Orleans, LA
Medical Health Education Institute Ltd., Eau Claire, WI
Mendon Manor Inc., Mendon, NY
Ministry of the Written Word, San Antonio, TX
Mobile Meal Service of Spartanburg County, Inc., Spartanburg, SC
New Directions, Inc., Greenville, NC
Nineteenth & Fernon Community Action Group, Philadelphia, PA
North Louisiana Museum of Natural History, Monroe, LA
Northeast United Campus Ministries, Monroe, LA
Northwest Community Action Association, Inc., Charlotte, NC
Operation Comeback, Inc., Nashville, TN
Pacific Community Child Development Center, Brooklyn, NY
Parent Support Center, Inc., Jacksonville, FL
Poor People's Foundation, The, Huntsville, AL
Project Help, Inc., Brooklyn, NY
Reality House, Orefield, PA
Rehoboth Foundation, Inc., Decatur, GA
Richardson Day Care Center, Inc., Lake City, FL
Slaves of God, Inc., The, Memphis, TN
Southside Childbirth Association, Forest Park, GA
Syracuse Symphony Foundation, Inc., Syracuse, NY
Technology Institute, Inc., Atlanta, GA
Texas Air Rescue Inc., Austin, TX
Texas Gulf Coast Crime Prevention Association, Pasadena, TX
Urbandale Little League, Inc., Urbandale, IA
Voters Aware, Inc., Nicoma Park, OK
Word of Reality, Inc., Tucker, GA
World-Wide Missions, Inc., Charlotte, NC
Wyoming Paradise Ranch Inc., Gillette, WY
Zugay "Jaws of Life" Memorial Fund, Michael L, College Park, GA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Repeal of Tax on Coin-Operated Gaming Devices

Announcement 80-90 [1]

The $250 annual special tax on coin-operated gaming devices will no longer have to be paid after June 30, 1980. The tax is imposed on persons who permit coin-operated gaming devices to be located on property they own or operate.

The Revenue Act of 1978, Pub. L. 96-600, 1980-3 C.B. (Vol. 1) 1, repealed, effective June 30, 1980, the coin-operated gaming device tax. Therefore, it is not necessary to file Form 11-B, Special Tax Return—Gaming Devices or pay the tax after that date.

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[1] Based on News Release IR-80-64, dated May 23, 1980.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing, the following individuals have been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
Robert B. Clarkson	Anderson, SC	Attorney	April 25, 1980
John E. DeSantis	Belmont, CA	Certified Public Accountant	May 12, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.6073-1 through 1.6073-3, amended.	Time for filing declarations of estimated tax by farmers, fishermen, and certain nonresident aliens.	May 21, 1980	July 21, 1980
27 CFR 1.217-2 revised.	Special rules for foreign moving expenses and the allowance of moving expense deductions in the case of retirees or dependents of decedents who were working abroad.	May 22, 1980	July 21, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified, above*).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] See footnote at end of list.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1, dated January 7, 1980.

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* Denotes entry since last publication

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57 (Rev. 3)
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57 (Rev. 4), 1980-17 I.R.B. **22**

66 (Rev. 9)
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66 (Rev. 10), 1980-14 I.R.B. **27**

77 (Rev. 13)
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70-6
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74-23
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74-24
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Rev. Proc. 80-7, 1980-8 I.R.B. **24**

74-25
Superseded by
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77-40
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77-47
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79-9
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80-49, 1980-8 I.R.B. **13**

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56-497
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60-330
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80-124, 1980-18 I.R.B. **12**

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62-197
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63-180
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80-16, 1980-3 I.R.B. **6**

64-149
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80-17, 1980-3 I.R.B. **5**

64-264
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66-16
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80-128, 1980-19 I.R.B. **6**

66-307
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80-80, 1980-12 I.R.B. **10**

67-25
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80-49, 1980-8 I.R.B. **13**

67-181
Superseded by
80-138, 1980-22 I.R.B. **8**

67-431
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68-89
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68-178
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68-350
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80-144, 1980-23 I.R.B. **7**

68-382
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80-30, 1980-5 I.R.B. **7**

68-608
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69-368
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70-125
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[1] See footnote at end of list.

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70-336
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71-27
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71-89
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71-95
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71-252
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71-312
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71-399
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71-542
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72-201
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72-395
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80-123, 1980-18 I.R.B. **10**

72-452
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80-144, 1980-23 I.R.B. **7**

72-587
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80-143, 1980-23 I.R.B. **6**

73-17
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80-129, 1980-19 I.R.B. **7**

73-46
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80-167, 1980-25 I.R.B. **12***

73-198
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80-89, 1980-13 I.R.B. **10**

73-413
Superseded by
80-129, 1980-19 I.R.B. **7**

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74-96
Superseded by
80-47, 1980-8 I.R.B. **11**

74-99
Clarified by
80-63, 1980-10 I.R.B. **7**

74-206
Amplified & Clarified by
80-65, 1980-10 I.R.B. **10**

74-381
Modified by
80-136, 1980-22 I.R.B. **5**

74-419
Superseded by
80-146, 1980-23 I.R.B. **10**

74-433
Superseded by
80-62, 1980-8 I.R.B. **9**

74-512
Revoked by
80-53, 1980-8 I.R.B. **15**

75-296
Distinguished by
80-34, 1980-6 I.R.B. **9**

75-368
Modified by
80-6, 1980-1 I.R.B. **16**

75-461
Amplified by
80-124, 1980-18 I.R.B. **12**

76-415
Clarified by
80-59, 1980-9 I.R.B. **18**

76-439
Revoked by
80-85, 1980-13 I.R.B. **6**

76-587
Superseded by
80-36, 1980-6 I.R.B. **11**

77-40
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80-134, 1980-19 I.R.B. **10**

77-392
Revoked by
80-31, 1980-5 I.R.B. **8**

77-410
Superseded by
80-62, 1980-8 I.R.B. **9**

77-489
Amplified by
80-70, 1980-11 I.R.B. **5**

78-110
Clarified by
80-22, 1980-3 I.R.B. **15**

78-161
Distinguished by
80-9, 1980-2 I.R.B. **5**

78-201
Amplified by
80-163, 1980-25 I.R.B. **6***

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78-427
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79-72
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80-157, 1980-24 I.R.B. **13**

79-248
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80-162, 1980-25 I.R.B. **5***

79-309
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80-131, 1980-19 I.R.B. **11**

80-36
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80-78
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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1 I.R.B., dated January 7, 1980.

NOTES

INTERNAL REVENUE CUMULATIVE BULLETINS

______	1927–1	$6.90
______	*1927–2*	*2.95*
______	1928–1	6.95
______	1928–2	9.50
______	1929–1	12.00
______	*1929–2*	*3.15*
______	1930–1	7.30
______	1930–2	9.50
______	*1931–1*	*3.60*
______	1931–2	13.00
______	*1932–1*	*2.80*
______	1932–2	8.65
______	*1933–1*	*3.35*
______	*1933–2*	*3.45*
______	*1934–1*	*3.70*
______	1934–2	14.00
______	1935–1	6.90
______	*1935–2*	*4.00*
______	*1936–1*	*3.55*
______	*1936–2*	*3.90*
______	*1937–1*	*3.75*
______	1937–2	7.70
______	*1938–1*	*4.05*
______	*1938–2*	*3.50*
______	1939–1–1	8.25
______	1939–1–2	10.90
______	1939–2	9.40
______	1940–1	5.55
______	1940–2	14.00
______	1941–1	*$6.95*
______	*1941–2*	*3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
______	*1944*(*)	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*2.65*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$10.10
______	1957–2	13.00
______	1958–1	9.60
______	1958–2	13.00
______	1958–3	15.00
______	1959–1	15.00
______	1959–2	9.60
______	1960–1	9.00
______	1960–2	11.50
______	1961–1	14.00
______	1961–2	10.00
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______	1962–2	13.00
______	1962–3	20.00
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______	1964–1–1	10.00
______	1964–1–2	11.00
______	1964–2	9.80
______	1965–1	10.70
______	1965–2	12.25
______	1966–1	14.00
______	1966–2	14.05
______	1967–1	10.00
______	1967–2	15.00
______	1968–1	14.00
______	1968–2	11.75
______	1969–1	7.50
______	1969–2	6.50
______	1969–3	$12.50
______	1970–1	11.00
______	1970–2	14.00
______	1971–1	10.55
______	1971–2	8.50
______	1972–1	13.50
______	1972–2	13.70
______	1973–1	16.00
______	1973–2	8.30
______	1974–1	11.00
______	1974–2	9.95
______	*1974–3*	*8.20*
______	1974–3 Supp.	10.00
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______	1976–3–1	9.50
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______	1977–1	10.75
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July 7, 1980
Bulletin No. 1980-27

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-171, page 7.
Industrial development bonds; reserve fund. Bond proceeds are reduced by the amount of the issuance cost and the amount of a reasonable required debt reserve fund for purposes of determining if substantially all of the bond proceeds will be used for the purposes described in section 103(b)(4), (5), and (6) of the Code.

Rev. Rul. 80-172, page 7.
Sale of residence; exclusion of gain; ownership and use tests. A taxpayer who otherwise meets the requirements of section 121 of the Code may make the election to exclude gain on the sale of a personal residence if the ownership and use tests are met, even though the tests are not met simultaneously.

Rev. Rul. 80-173, page 8.
Educational expenses; veterans; flight training. An airplane pilot may not deduct any otherwise allowable flight training expenses to the extent the expenses are directly reimbursed by the Veterans' Administration pursuant to 38 U.S.C. section 1677; Rev. Rul. 62-213 distinguished and clarified.

Rev. Rul. 80-174, page 9.
Charitable contributions; depreciable property; multiple asset account. The method is provided for determining the amount of a charitable contribution for property retired from a multiple asset account for which the CLADR system had not been elected.

Rev. Rul. 80-175, page 18.
Nonrecognition of gain; timber damaged by storm; voluntary sale. The nonrecognition of gain provisions of section 1033(a) of the Code are applicable to proceeds received from the voluntary sale of timber downed by high winds, earthquake, or volcanic eruption when the proceeds are used to purchase other standing timber; Rev. Rul. 72-372 revoked.

Rev. Rul. 80-176, page 10.
Oil and gas leases; acquisition fees; option fees. The tax treatment of fees paid by taxpayers for assistance in participating in programs to acquire noncompetitive federal oil and gas leases in two situations is discussed. The transactions are incomplete in the year the programs are begun in each situation and the taxpayers do not recognize gain or loss in that year. Amounts allocable to the rights or options to sell fractional lease interests are not part of the basis of any lease acquired but are capital expenditures. Rev. Rul. 77-395 modified and clarified; Rev. Rul. 71-191 distinguished.

(Continued on page 4)

A List of Announcements of Actions on Decisions of the Tax Court published in the Bulletin from January through June 1980 begins on page 5.
Finding List of Revenue Rulings, Revenue Procedures, Treasury Decisions, etc. published in the Bulletin from January through June 1980 begins on page 28.
Finding List of Previously Published Rulings currently mentioned in the Bulletin from January through June 1980 begins on page 30.
Index of Items published in the Bulletin from January through June 1980 begins on page 33.
Announcement of Disbarments and Voluntary Suspension on page 25.
Announcement of Proposed Rulemaking begins on page 26.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

Rev. Rul. 80-177, page 13.

Liquidating distribution; constructive receipt; surrender of shares. A domestic corporation, pursuant to a plan of complete liquidation, notified its shareholders that they would be entitled to receive a distribution in liquidation upon surrender of their shares of stock after a given date. All the corporation's liabilities had been discharged, its assets had been reduced to cash, and there was no likelihood that the liquidation would not be consummated. A cash method individual shareholder is in constructive receipt of the liquidating distribution as of the date the distribution first becomes payable.

Rev. Rul. 80-178, page 19.

Capital gain deduction; small business corporation; taxable year including November 1, 1978. An example of the computation of the capital gain deduction is provided for an electing small business corporation that had a taxable year that included November 1, 1978 and that had net capital gains both before and after that date.

Announcement 80-87, page 24.

Various areas of the States of Idaho, Louisiana, Michigan, Missouri, and Washington have been declared disaster areas in which losses qualify for the special tax treatment under section 165 (h) of the Code.

EMPLOYEE PLANS

Prohibited Transaction Exemption 80-26, page 21.

Certain transactions involving interest-free loans to employee benefit plans are exempt from the prohibited transaction provisions of the Employee Retirement Income Security Act of 1974 and taxes imposed by section 4975 of the Code.

EXEMPT ORGANIZATIONS

T.D. 7698, page 14.

Amendments to the regulations under section 501 (c)(2) and (13) of the Code relate to exempt title holding companies and to exempt cemetery companies and crematoria.

T.D. 7699, page 16.

Amendments to the regulations under section 513 of the Code relate to the treatment of proceeds from bingo games conducted by tax-exempt organizations.

ESTATE TAX

Rev. Rul. 80-179, page 20.

Special use value; farms; interest rates. The interest rates to be used under section 2032A(e)(7)(A)(ii) of the Code in computing the special use value of farm real property for which an election is made under section 2032A are listed for estates of decedents dying in the period 1977-1980; Rev. Rul. 79-189 superseded.

ADMINISTRATIVE

Announcement 80-88, page 24.

Publication 198, Preliminary Report, Statistics of Income—1978, Individual Income Tax Returns, may be purchased from the Superintendent of Documents, Washington, D.C.

Cumulative List of Announcements Relating to Decisions of the Tax Court Published in the Internal Revenue Bulletin from January 1, 1980 thru June 30, 1980

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issue or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the tax court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Belz Investment Co.[1]	7079-77	72	1209
Bolnick, Ted, et ux[15]	3503-62	44	245
Buse, Delmer H., et ux[16]	5619-76	71	1129
Buse, Norman M., et ux[16]	5618-76		
Globe Products Corp.[2]	9070-75	72	609
Goodwin, David C.[3]	2087-77	73	215
Horne, J. E., Est. of, Andrew Berry, executor, & Amelia S. Horne[4]	3904-74	64	1020
Hyde, Gordon I.[5]	9044-72	64	300
Hyde, Janet C.[5]	9045-72		
Johnson, Frankie Lee (formerly Frankie Lee Yancey)[6]	3047-77	72	37
Koch, Carl E., et ux[17]	8953-74	67	71
Middle Atlantic Distributors, Inc.[7]	1982-78	72	1136
Moseley, Ned W., et ux[8]	925-76	72	183
Seaboard Coast Line Railroad Co.[9]	3771-71	72	855
United Telecommunications, Inc.[19]	7866-72	65 67	278 760
Wendle Ford Sales, Inc.[20]	7614-76	72	447
Whiteco Industries, Inc.[21]	3918-73 3919-73	65	664
Whiteco Industries, Inc., & Subs.[21]	7188-74		
Yancey, Richard R.[6]	2453-77	72	37

The Commissioner does NOT ACQUIESCE in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Bankers Union Life Insurance Co.[10]	5807-71 442-73	62	661
Chronicle Publishing Co.[11]	8550-74	67	964
Hoover Co.[12]	2697-77 9646-77	72	206

Taxpayer	Docket No.	Report	
		Volume	Page
Hyde, Gordon I.[13]	9044-72	64	300
Hyde, Janet C.[13]	9045-72		
Lee, Elizabeth M., Est. of, Rhoady R. Lee, Sr., executor & Rhoady R. Lee, Sr., individually [14]	8782-75	69	860
Warren Jones Co.[18]	424-71	60	663

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[1] Acquiescence in the issues relating to (1) whether payments made pursuant to a lease agreement in connection with a sale-leaseback with option to repurchase are deductible as rental expenses, and (2) whether a part of the understatement of tax is due to negligence or intentional disregard of rules and regulations.

[2] Acquiescence relating to whether an accrual basis taxpayer was entitled to a deduction for deficiency interest when it contested its liability for the underlying deficiency and interest in the following year.

[3] Acquiescence relating to whether petitioner received kickbacks which represented unreported income to him or whether he was merely acting as a conduit for the monies.

[4] Acquiescence in result relating to whether life insurance proceeds paid to a shareholder are taxable as a dividend where the corporation is the owner of the policy and pays all premiums. Acquiescence "in result" means acceptance of the decision of the Court but disagreement with some or all of the reasons assigned for the decision.

[5] Acquiescence in the issues relating to (1) whether the acquisition of property on December 1, 1967 through a quitclaim deed resulted in the realization of income, and (2) whether petitioner must recognize gain on the sale of certain stock in 1968.

[6] Acquiescence in the issues relating to (1) which of the petitioners, who are divorced, is entitled to a dependency exemption for their minor child, and (2) whether petitioner is entitled to a child care expense deduction.

[7] Acquiescence in result relating to whether payments made by the petitioner pursuant to the settlement of a suit are nondeductible "fines or similar penalties" within the meaning of section 162(f) of the Code. Acquiescence "in result" means acceptance of the decision of the Court but disagreement with some or all of the reasons assigned for the decision.

[8] Acquiesence relating to whether the premiums applicable to a "special reserve" provision of a twenty payment life insurance policy or all premiums paid under the policy as a whole should be an offset against the "special reserve" distribution in computing taxable income.

[9] Acquiescence relates to the fair market value approach in valuing reusable or relay rail and is limited to the deduction claimed for retirements and replacements for years ended prior to May 8, 1967, pursuant to Rev. Rul. 67-145, 1967-1 C.B. 54, and Rev. Proc. 68-46, 1968-2 C.B. 961.

[10] Nonacquiescence in the issues relating to (1) whether policy loan interest, not prepaid in cash, is includable in gross investment income under section 804(b)(1) of the Code, and (2) whether mortgage escrow funds, given to petitioner as mortgagee to pay taxes and insurance on realty, is includable in "assets" under section 805(b)(4) of the Code.

[11] Nonacquiescence relating to whether certain cable television franchises have determinable useful lives for the purpose of depreciating their costs of acquisition under section 167(a) of the Code.

[12] Nonacquiescence relating to whether petitioner's purported sale of a "future sell contract" for foreign currency shortly before the time set for performance but subsequent to the devaluation of the currency resulted in short-term or long-term capital gain.

[13] Nonacquiescence in the issue relating to whether a statutory redemption fee is deductible as interest.

[14] Nonacquiescence in the issues relating to (1) whether decedent's community property interest in a block of stock amounting to 80% of a corporation's common and 100% of its preferred stock should be included in the gross estate at one-half of the value of the entire block or whether it should be valued as a minority interest comprised of 40% of the common and 50% of the preferred stock, and (2) whether the court properly determined the fair market value of 50% of the preferred stock to be $1,973,494.80.

[15] Nonacquiescence published in 1967-1 C.B. 3 is withdrawn and acquiescence is substituted therefor in the issue relating to the taxation of gain upon the redemption, at full face value but prior to maturity, of debentures which had been issued to petitioners in 1953 at an original issue discount. Acquiescence also in the issue relating to the offset of a tax deficiency for the year 1954 to the extent of an alleged overpayment of taxpayer's 1954 income tax for which a refund was claimed in the tax return filed for that year. See Rev. Rul. 80-143, 1980-23 I.R.B. 6.

[16] Acquiescence in the issues relating to (1) whether the taxpayers held a contract right to cut for the required holding period thereby entitling them to elect section 631(a) treatment, and (2) what was the fair market value of the timber for section 631(a) purposes.

[17] Acquiescence in the issues relating to (1) whether payments made pursuant to "option agreements" were in substance interest payments, and (2) whether the option agreements provided for a series of options, each expiring at the end of a three-month period.

[18] Nonacquiescence in the issue relating to whether a real estate contract received by petitioner upon a sale of property not in the ordinary course of business, which contract provides for deferred payments to be made by the purchaser in an amount that is certain, constitutes "property (other than money)" under section 1001, so that, to the extent of its fair market value, it represents an amount realised by petitioners in the year of the sale.

[19] Acquiescence in result relating to whether construction-related depreciation of assets that are not "section 38 property" should be included in the basis of self-constructed "section 38 property" for purposes of determining the qualified investment in that property under section 46 of the Code. Acquiescence "in results" means acceptance of the decision of the Court but disagreement with some or all the reasons assigned for the decision.

[20] Acquiescence relating to whether petitioner, an automobile dealer who has properly elected the LIFO method of inventory valuation, must add to its cost of "base-year" units an additional charge for catalytic converters and electronic (solid state) ignition systems which were not present on base-year models.

[21] Acquiescence relating to whether petitioner's highway advertising signs are "inherently permanent" property which does not qualify for the investment credit under section 48 of the Code. See Rev. Rul. 80-151, 1980-24 I.R.B. 6.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-7: Interest.

Whether interest on obligations of a political subdivision of a state will be exempt from tax. See Rev. Rul. 80-171, page 7.

Section 103.—Interest on Certain Governmental Obligations

26 CFR 1.103-8: Interest on bonds to finance certain exempt facilities.
(Also Section 61; 1.61-7.)

Industrial development bonds; reserve fund. Bond proceeds are reduced by the amount of the issuance cost and the amount of a reasonable required debt reserve fund for purposes of determining if substantially all of the bond proceeds will be used for the purposes described in section 103(b)(4), (5), and (6) of the Code.

Rev. Rul. 80-171

ISSUE

Are bond proceeds reduced by the amount of a reserve fund for purposes of determining if substantially all of the bond proceeds will be used to provide exempt facilities described in section 103(b)(4) of the Internal Revenue Code?

FACTS

A political subdivision of a state proposes to issue 100*x* dollars of industrial development bonds to finance certain exempt facilities described in section 103(b)(4) of the Code for use by an industrial corporation. The cost of issuing the bonds will be 5*x* dollars and the political subdivision will use bond proceeds to establish a reserve fund of 15*x* dollars. This reserve fund will qualify as a reasonably required debt reserve fund. Of the remaining bond proceeds, 75*x* dollars will be used to construct the exempt facility and 5*x* dollars will be loaned to the corporation for working capital. Over the term of the bonds, the corporation will make periodic payments to the political subdivision that will equal total principal and interest payments on the bonds. The bonds will not be arbitrage bonds within the meaning of section 103(c).

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include interest on the obligations of a state or a political subdivision thereof.

Section 103(b)(1) of the Code provides that, with certain exceptions, the interest on "industrial development bonds" is not excludable from gross income.

Section 103(b)(4) of the Code provides that section 103(b)(1) shall not apply to industrial development bonds if substantially all of the bond proceeds are to be used to provide certain exempt facilities.

The "substantially all" test in section 103(b)(4) of the Code will be satisfied if 90 percent or more of the proceeds of an issue of governmental obligations are used to provide an exempt facility. For purposes of this test, proceeds are reduced by amounts properly allocable on a pro rata basis between providing the exempt facility and other uses of the proceeds ("neutral costs"). Section 1.103-8(a)(1)(i) of the Income Tax Regulations.

The example in section 1.103-8(a)(6) of the regulations demonstrates that proceeds are reduced by the costs of issuing the state bonds for purposes of arriving at the amount of bond proceeds to which the substantially all test will be applied.

In this case, the portion of the bond proceeds (75*x* dollars) that will be used to construct the exempt facility will be a qualifying use of such proceeds. The portion of the bond proceeds (5*x* dollars) to be used to furnish working capital to the corporation will be a nonqualifying use of such proceeds. The proceeds used for the cost of issuing the bonds and the amount of proceeds to be placed in the reserve fund will be considered neutral costs because they will be attributable to both the qualifying and nonqualifying uses of bond proceeds. The example in section 1.103-8(a)(6) of the regulations illustrates that the cost of issuing bonds are deducted in arriving at bond proceeds. The amount to be placed in the reserve fund will qualify for similar treatment. See section 1.103-8(a)(1)(i).

HOLDING

Bond proceeds will be reduced by the amount of the issuance cost (5*x* dollars) and by the amount of the reserve fund (15*x* dollars). Because substantially all (75*x* dollars/80*x* dollars equals 93.75 percent) of the bond proceeds will be used to provide exempt facilities, the bonds will qualify for the exception provisions of section 103(b)(4) of the Code and the interest on the bonds will be excludable from the gross incomes of the bondholders under section 103(a)(1).

The result would be the same if the bonds were issued to finance industrial parks described in section 103(b)(5) of the Code or were issued as an exempt small issue under section 103(b)(6).

Section 121.—One-Time Exclusion of Gain from Sale of Principal Residence by Individual Who Has Attained Age 55

26 CFR 1.121-1: Gain from sale or exchange of residence of individual who has attained age 55.

Sale of residence; exclusion of gain; ownership and use tests. A taxpayer who otherwise meets the requirements of section 121 of the Code may make the election to exclude gain on the sale of a personal residence if the ownership and use tests are met, even though the tests are not met simultaneously.

Rev. Rul. 80-172

ISSUE

May a taxpayer elect, under section 121 of the Internal Revenue Code, to exclude gain from the sale of the taxpayer's principal residence under the circumstances described below?

FACTS

In 1970, *A*, who was 60 years old, occupied a rental apartment as *A*'s principal residence. The building in which the apartment is located was subsequently converted to condominium ownership, and on July 15, 1974, *A* purchased the apartment, which remained *A*'s principal residence. In 1977, *A* became seriously ill and on April 15, 1977, was moved to a convalescent home. On February 15, 1980, while still at the convalescent home, *A* sold the apartment.

LAW

Section 121(a) of the Code provides that at the election of the taxpayer, gross income does not include gain from the sale or exchange of property if (1) the taxpayer has attained the age of 55 before the date of the sale or exchange and (2) during the 5-year period ending on the date of the sale or exchange, the property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 3 years or more. Under section 121(b), the amount of gain excluded from gross income may not exceed $100,000.

Section 1.121-1(b) of the Income Tax Regulations provides that in the case of a sale or exchange of a residence before July 26, 1981, a taxpayer who has attained age 65 on the date of such sale or exchange may elect to have section 121 of the Code applied if during the 8-year period ending on the date of the sale or exchange, the property has been owned and used by the taxpayer as the taxpayer's principal residence for periods aggregating 5 years or more.

In this case, because the sale occurred before July 26, 1981, and because *A* had attained age 65 on the date of the sale, the 8- and 5-year periods set forth in section 1.121-1(b) of the regulations may be elected. *A* sold the apartment on February 15, 1980; therefore, the 8-year period began on February 16, 1972, and ended on February 15, 1980. *A* purchased the apartment in 1974 and, therefore, owned the apartment for more than 5 years during the 8-year period. *A* resided in the apartment from 1970 until April 15, 1977, and, therefore, resided in the apartment for more than 5 years during the 8-year period beginning February 16, 1972. Thus, *A* has met both the ownership and use tests required by section 121 of the Code.

HOLDING

A may elect, under section 121 of the Code, to exclude gain from the sale of *A*'s principal residence.

Section 162.—Trade or Business Expenses

26 CFR 1.162-5: Expenses for education. (Also Section 262; 1.262-1.)

Educational expenses; veterans; flight training. An airplane pilot may not deduct any otherwise allowable flight training expenses to the extent the expenses are directly reimbursed by the Veterans' Administration pursuant to 38 U.S.C. section 1677; Rev. Rul. 62-213 distinguished and clarified.

Rev. Rul. 80-173

ISSUE

Are an airline pilot's expenditures on tuition and fees for an aviation program involving the flying of certain types of small aircraft, deductible as ordinary and necessary business expenses under section 162 of the Internal Revenue Code when such expenses are directly reimbursed by veterans' benefit payments paid pursuant to 38 U.S.C. section 1677 (1976), as amended by Act of Nov. 23, 1977, Pub. L. 95-202, section 102 (1), 91 Stat. 1433?

FACTS

The taxpayer, a captain-pilot with a major airline, enrolled in an aviation program in which licensed pilots receive training in certain types of small aircraft. The total cost of the course was 10*x* dollars.

The taxpayer is a veteran, and therefore was receiving reimbursement from the Veterans' Administration under 38 U.S.C. section 1677 (1976) to the extent of 90 percent of the training expenditure. Such reimbursement is exempted from taxation by 38 U.S.C. section 3101 (1976), as amended by Act of Oct. 18, 1978, Pub. L. 95-479, section 301, 1978-2 C.B. 377.

LAW AND ANALYSIS

Section 262 of the Code provides that except as otherwise expressly provided, no deduction shall be allowed for personal, living, or family expenses.

Section 162 of the Code provides for the deduction of all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Whether expenditures for education are deductible under section 162 of the Code and section 1.162-5 of the Income Tax Regulations is highly factual and cannot be determined on the basis of the facts described above. However, as a general rule, if the training is necessary to maintain or improve skills required in the taxpayer's employment, the expense would be deductible. If the expenditure is necessary to meet the minimal educational requirements of the employment, or if the education qualifies the taxpayer for a new trade or business, the expenditure is not deductible.

If under the facts of a particular case, it is determined that an expense is otherwise properly deductible under section 162 of the Code, a taxpayer is not allowed a deduction for an expense to the extent it is allocable to a payment for which the taxpayer has been reimbursed (or for which the taxpayer's right to reimbursement has become fixed or mature). See Rev. Rul. 78-388, 1978-2 C.B. 110. Rev. Rul. 78-388 holds that certain moving expenses and the loss attributable to abandoned leasehold improvements, to the extent they are reimbursable, are not deductible under either section 162 or 165 of the Code.

If an expense has been (or will be) reimbursed in whole or in part, any deduction otherwise allowable with respect to the expense is disallowed to the extent of the reimbursement. In such a case, the taxpayer suffers no economic detriment and incurs no expense in making the expenditure to the extent of the reimbursement.

HOLDING

Provided it is determined that a deduction is allowable to the taxpayer under section 162 of the Code and section 1.162-5 of the regulations, the taxpayer may not deduct the 9*x* dollars under section 162 of the Code, which is the amount of the reimbursement to the taxpayer by the Veterans' Administration under 38 U.S.C. section 1677. Whether 1*x* dollars is deductible will depend on all the facts and circumstances in each case.

This holding applies only to reimbursement payments made under 38 U.S.C. section 1677. For treatment of subsistence and educational allowance payments made under 38 U.S.C. section 1681 (1976), which are not reimbursement payments determined by reference to amounts actually expended for tuition and fees, but rather are in the nature of a living stipend determined without regard to amounts expended, see Rev. Rul. 62-213, 1962-2 C.B. 59.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 62-213 is distinguished and clarified.

Section 165.—Losses

26 CFR 1.165-1: Losses.

Upon the exercise of the option to sell *X* a fractional interest in an acquired lease, the taxpayer will recognize gain or loss. Whether such gain or loss is subject to the provisions of section 1221 or 1231 of the Code requires a factual determination of the holding period, and whether, in the hands of the taxpayer, such leases were property used in the trade or business or as investment property. See Rev. Rul. 80-176, page 10.

Section 167.—Depreciation

26 CFR 1.167(a)-8: Retirements.

How to determine the amount of a charitable contribution when the donated property is retired from multiple asset accounts for which the Class Life Asset Depreciation Range system under section 1.167(a)-11 of the Income Tax Regulations has not been elected. See Rev. Rul. 80-174, this page.

Section 170.—Charitable, Etc., Contributions and Gifts

26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance of deduction.
(Also Sections 167; 1.167(a)-8.)

Charitable contributions; depreciable property; multiple asset account. The method is provided for determining the amount of a charitable contribution for property retired from a multiple asset account for which the CLADR system has not been elected.

Rev. Rul. 80-174

ISSUE

How is the amount of the charitable contribution determined when property is retired from a multiple asset account and donated to a charitable organization?

FACTS

The taxpayer has a multiple asset account of machinery that is used in a trade or business as defined in section 1231(b) of the Internal Revenue Code. The Class Life Asset Depreciation Range (CLADR) system provided for by section 1.167(a)-11 of the Income Tax Regulations was not elected for use with respect to eligible property. The depreciation rate is based on the average expected useful life of the items. The depreciation method being used is the straight line method and pursuant to section 1.167 (a)-1(c) salvage value has been determined to be zero.

The taxpayer donated two items of machinery, identical types of property, to a charitable organization in the taxable year 1977. The use of the contributed property by the charitable organization is unrelated to the purpose or function constituting the basis for its exemption under section 501. Item *A* cost $200 in taxable year 1971 when it was added to the account, had a fair market value (FMV) of $50 as of the date of the contribution, and had reached a condition at which the taxpayer customarily retires similar assets.

Item *B* cost $300 when it was added to the account in the taxable year 1975 and it had a FMV of $250 on the date of the contribution. An average useful life of 5 years was estimated for these items and others of their type in establishing the depreciation rate for the account. Normally, the taxpayer retires assets similar to items *A* and *B* when they are 4 to 6 years old.

LAW AND ANALYSIS

Section 170(e)(1) of the Code provides that the amount of any charitable contribution of property otherwise taken into account under that section shall be reduced by the sum of (A) the amount of the gain that would not have been long-term capital gain if the property had been sold by the taxpayer at its FMV at the time of such contribution, and (B) in the case of a charitable contribution of tangible personal property, if the use by the donee is unrelated to the purpose or function constituting the basis for its exemption under section 501, 40 percent (28/46 percent in the case of a corporation) of the amount of gain which would have been long-term capital gain if the property contributed had been sold by the taxpayer at its FMV at the time of such contribution.

Under the facts of this ruling the taxpayer would not have realized any long-term capital gain if the property contributed had been sold at its FMV at the time of the contribution. Thus, the amount described in section 170 (e)(1)(B) of the Code is zero. As a result the amount of the charitable contribution otherwise allowed shall be reduced only by the amount described in section 170((e)(1)(A).

Section 1.170A-4(a)(1) of the regulations provides that in the case of a contribution of ordinary income property, as defined in paragraph (b)(1) of that section, the amount of charitable contribution which would be taken into account under section 170(a) of the Code without regard to section 170(e) shall be reduced by the amount of gain which would have been recognized as gain which is not long-term capital gain if the property had been sold by the donor at its FMV at the time of its contribution to the charitable organization.

Section 1.170A-4(b)(4) of the regulations provides that for purposes of applying subparagraphs (1) and (2) of that paragraph, property that is used in the trade or business, as defined in section 1231(b) of the Code, shall be treated as a capital asset except that any gain in respect of such property that would have been recognized if the property had been sold by the donor at its FMV at the time of its contribution to the charitable organization shall be treated as ordinary income to the extent that such gain would have constituted ordinary income by reason of the application of section 1245(a).

Section 1245(a) of the Code provides, in pertinent part, that for depreciable personal property sold during a taxable year beginning after December 31, 1962, the amount by which the lower of (1) the recomputed basis or (2) the amount realized exceeds the adjusted basis of the property shall be treated as ordinary income. "Recomputed basis" in the instant case means the original cost of the items since they were acquired after December 31, 1961 and all of the adjustments reflected in the adjusted basis of such property are on account of deductions allowed for depreciation. *See* section 1.1245-2(a) of the regulations.

Section 1.167(a)-8(c)(1) of the regulations provides that for normal retirements from multiple asset accounts for which the depreciation rate is based on average expected useful life, "adjusted basis" is the salvage value estimated in determining the depreciation deduction in accordance with section 1.167(a)-1(c).

Section 1.167(a)-8(c)(3) of the regulations provides that for an abnormal retirement from a multiple asset account, the adjustment for depreciation applicable to the retired asset shall be made at the rate that would have been proper had the asset been depreciated in a single asset account (under the method of depreciation used for the multiple asset account) and is based upon either the average expected useful life or the maximum expected useful life of the asset, depending upon the method of determining the date of depreciation used in connection with the multiple asset account.

Section 1.167(a)-8(b) of the regulations provides that a retirement is considered normal if made within the range of years taken into consideration in fixing the depreciation rate and the asset is in a condition at which the taxpayer customarily retires similar assets. If the retirement comes earlier it may be considered abnormal.

Since item *A* is 6 years old and the taxpayer ordinarily retires similar items when they are 4 to 6 years old, its withdrawal from the account is a normal retirement under section 1.167(a)-8(b) of the regulations. By the same measure, the removal of item *B* after 2 years is an abnormal retirement.

Based on the fact that item *A* has zero salvage value, its adjusted basis is also zero pursuant to section 1.167(a)-8(c)(1) of the regulations. For item *B*, the adjusted basis is the original cost of $300 less 2 years' allowable depreciation determined at the rate that would have been applicable if the item had been depreciated separately using the same method that was used for the multiple asset account. Therefore, 2 years' depreciation using a useful life of 5 years and a straight line method is $120 and the adjusted basis is $180.

The amount that would be recognized as ordinary income under section 1245(a) of the Code, if item *A* had been sold at its FMV at the time of its contribution, is the amount by which the lower of its recomputed basis ($200) or its FMV ($50) exceeds its adjusted basis ($0). Therefore, the amount of ordinary income gain is $50.

Similarly, if item *B* had been sold at its FMV at the time of its contribution, the amount that would have been recognized as ordinary income under section 1245(a) of the Code would be $70, the amount by which its FMV ($250) exceeds its adjusted basis ($180).

HOLDING

The amount of the contribution before applying the percentage limitations of section 170(b) of the Code would be, with respect to item *A*, $0 (the FMV of $50 reduced by the $50 ordinary income gain if sold). With respect to item *B*, it would be $180 (the FMV of $250 reduced by the $70 ordinary income gain if sold).

Section 262.—Personal, Living, and Family Expenses

26 CFR 1.262-1: Personal, living and family expenses.

Deductibility of an airline pilot's expenditures on tuition and fees for an aviation program, where the expenses are directly reimbursed by veterans' benefit payments. See Rev. Rul. 80-173, page 8.

Section 263.—Capital Expenditures

26 CFR 1.263(a)-1: Capital expenditures; in general.
(Also Sections 165, 7805; 1.165-1, 301.7805-1.)

Oil and gas leases; acquisition fees; option fees. The tax treatment of fees paid by taxpayers for assistance in participating in programs to acquire noncompetitive federal oil and gas leases in two situations is discussed. The transactions are incomplete in the year the programs are begun in each situation and the taxpayers do not recognize gain or loss in that year. Amounts allocable to the rights or options to sell fractional lease interests are not part of the basis of any lease acquired but are capital expenditures. Rev. Rul. 77-395 modified and clarified; Rev. Rul. 71-191 distinguished.

Rev. Rul. 80-176

ISSUES

1. Under the circumstances described below, are the fees paid by the taxpayers, *A* and *B*, for assistance in participating in programs to acquire federal oil and gas leases capital expenditures?

2. Is the cost of an option to sell a fractional interest in all leases acquired as part of the program properly treated as a reduction of the amount realized from the subsequent sale of a fractional interest in any leases acquired?

FACTS

A and *B* are individual investors that use the cash receipts and disbursements method of accounting and file their federal income tax returns on a calendar year basis. *A* and *B* desired to participate in the federal program for the noncompetitive leasing of government lands for oil and gas exploration and development, administered by the Bureau of Land Management (BLM).

In awarding leases under the noncompetitive program, BLM utilizes its simultaneous filing procedure, which provides all applicants with an equal chance to obtain leases on federal lands available for re-leasing. Applications to lease designated parcels must be submitted, signed, completed, and accompanied by a nonrefundable \$10 filing fee. An applicant may file only one application for each numbered parcel on the list, but the applicant may make as many filings as there are available parcels.

Rather than file applications directly with BLM, in October 1976, *A* and *B* elected to participate in separate federal oil and gas lease acquisition programs offered by corporation *X*. For both programs *X* provided expert geological advice on United States Government land available for noncompetitive leasing, timely and accurate filing of offers to lease approved lands on behalf of the applicants, and payment of the filing fees to BLM.

Situation 1: Upon entering the program *A* paid *X* a fee of \$100*x*. In return *X* was required to file on *A*'s behalf a monthly minimum of 10*y* lease applications for a 12-month period. *A* simultaneously purchased, for \$10*x*, a 12-month option that required *X*, at *A*'s request, to purchase, for \$50*x*, a specified fractional interest in all leases awarded to *A* as a result of the drawings. In relation to the total cost of the program to *A*, *X*'s allocation between the fee and option was reasonable. In January 1977 *A* was awarded its only lease under the program and exercised the option in October 1977.

Situation 2: For a 12-month period beginning in October 1976, *B* participated in a federal oil and gas lease acquisition program offered by *X* that was similar to the program *A* participated in. However, instead of paying a lump-sum fee of \$100*x* and \$10*x* for the put option, *B* elected to pay a monthly fee of \$10*x*. This fee was due before the first day of each month in which *B* elected to participate in the program. *X* was required to file, on *B*'s behalf, a minimum of 10*y* lease applications in each month that *B* elected to participate in the program.

X did not offer *B* an option in writing that required *X* to purchase a specified fractional interest in all leases awarded to *B* as a result of the drawings. However, *B* knew that each person who had participated in *X*'s program for 12 consecutive months had received at least one lease and that *X* had made a practice of offering to purchase for \$75*x* a specified fractional interest in all leases acquired by persons who participated in this monthly program for a minimum of 12 consecutive months. A reasonable allocation of the total cost (\$120*x*) of the program to *B* would be \$108*x* to the lease application filing service and \$12*x* to *X*'s practice of offering to purchase for \$75*x* a specified fractional interest in all leases acquired by participants. In reliance on this practice, *B* participated in the program each month for 12 consecutive months. In February 1977, *B* was awarded its only lease. In October 1977, *X* offered to purchase, and *B* agreed to sell, for \$75*x*, a specified fraction of this lease.

LAW AND ANALYSIS

Section 263(a) of the Internal Revenue Code provides that deductions are not allowable for capital expenditures.

Section 165(a) of the Code provides that there shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise. Section 165(c) provides that, in the case of an individual, the deduction under section 165(a) shall be limited to losses incurred in a trade or business; incurred in any transaction entered into for profit, though not connected with a trade or business; or arising from a casualty or theft.

Section 1.165-1(b) of the Income Tax Regulations provides that to be allowable as a deduction under section 165(a) of the Code, a loss must be evidenced by closed and completed transactions, fixed by identifiable events, and actually sustained during the taxable year.

Section 1.165-2 of the regulations provides that there shall be allowed as a deduction under section 165(a) of the Code, for the taxable year in which actually sustained, a loss incurred in a business or in a transaction entered into for profit and arising from the sudden termination of the usefulness in such business or transaction of any nondepreciable property, when such business or transaction is discontinued or such property is permanently discarded from use therein.

Rev. Rul. 67-141, 1967-1 C.B. 153, states that fees paid by an applicant rendered in connection with the acquisition of federal noncompetitive oil and gas leases are not deductible expenses and must be capitalized as part of the cost of the leases acquired and are recoverable through depletion.

Rev. Rul. 71-191, 1971-1 C.B. 77, provides that in cases in which a lease is not acquired, the fees paid for services rendered in connection with the attempted acquisition of noncompetitive government oil and gas leases are deductible under section 165(a) of the Code.

Rev. Rul. 77-395, 1977-2 C.B. 80, considers a program similar to that under consideration except that if no leases are acquired, the filing service company would assign a lease to the taxpayer and then buy it back for the option price. Rev. Rul. 77-395 concludes that because the services were rendered in connection with an integrated arrangement under which the investor was to acquire at least one lease on federal lands, all of the amounts expended, including the option fee, must be capitalized as part of the one assigned lease acquired by the taxpayer in that ruling. In that ruling, the taxpayer sustained a loss upon reassignment of the lease, which was recognized under section 1231(a) of the Code.

In *Larsen v. Commissioner,* 66 T.C. 478 (1976), *acq.,* 1977-2 C.B. 1, taxpayers incurred various expenses in seeking to acquire oil and gas leases in two project areas. Taxpayers acquired some leases but were unsuccessful in attempts to acquire other leases. The tax court concluded that expenses incurred in unsuccessfully attempting to lease specific acreage from a specific landowner constituted losses deductible under section 165(a) and (c) of the Code.

Rev. Rul. 71-521, 1971-2 C.B. 313, discusses the treatment, for federal income tax purposes, of premiums paid by an individual taxpayer for the purchase of a "put" option contract for sales of stock. The purchase of a put is a transaction entered into without respect to any particular share of stock and its cost should be carried to a deferred account as a capital expenditure made in an incomplete transaction entered into for profit. If the taxpayer exercises the put, the cost of the put is offset against the sum received for the sale of stock. Although Rev. Rul. 71-521 is connected with an option involving stock, the transaction in the instant revenue ruling is of a similar nature because it involves the purchase of an option to sell an interest in an oil and gas lease property for a specified amount within a certain period of time.

Situation 1: *A*'s participation in *X*'s program is a single transaction because it was a contract for a specified number of filings during a 12-month period for a lump sum. The transaction remained open until completion of the last filing to which *A* was entitled under the program. Until all filings were completed, there was no closed and completed transaction; therefore, the treatment of the cost cannot be fixed until it is determined whether one or more leases are acquired.

Under the BLM simultaneous filing procedure, an individual can expect to have its application chosen at few, if any, public drawings. However, the multiple filings on *A*'s behalf under *X*'s program improved *A*'s opportunity of acquiring a lease. *A* paid a lump sum for a specified number of filings during the 12-month period, and the cost of the program is a capital cost of the leases successfully acquired. *Larsen v. Commissioner* is distinguishable since there the overall success rate in acquiring leases depended on various factors peculiar to each negotiation and was not affected solely by the number of separate leasing opportunities.

In the instant case, a lease was acquired in 1977 as a result of the drawings. Therefore, the cost of the services rendered in connection with the acquisition must be capitalized as part of the cost of the lease. No loss under section 165(a) of a Code is allowable in 1976 because the transaction was not complete as of the end of 1976. Rev. Rul. 71-191 is distinguishable because there the facts do not specify that the transaction occurred in more than one year.

Situation 2: As in *Situation 1,* the multiple filings on *B*'s behalf under *X*'s program improved *B*'s opportunity of acquiring a lease. In addition, the tacit agreement by *X* to buy a specified fractional interest in all leases acquired by *B* was conditioned on *B*'s monthly participation for 12 consecutive months. If *B* participated for this period, *B* could substantially reduce the cost of participation because *B* would recover at least five-eighths of its payments to *X* when *B* sold the specified interest to *X*. This recovery feature combined with *X*'s practice of awarding at least one lease to each person participating for 12 consecutive months and the effect of multiple filings shows that *B*'s participation in the 12-month program is a single transaction under which monthly payments are made for *X*'s services during the entire 12-month period. Thus, following the same rationale as in *Situation 1,* the transaction remained open until the completion of the last filing in which *B* was required to participate to be eligible for *X*'s practice of offering to purchase the specified fraction of any leaseholds *B* acquired. Until the filings are completed, there is no closed and completed transaction. Therefore, the treatment of the costs cannot be fixed until it is determined whether one or more leases are acquired.

HOLDINGS

Situation 1

1. The fee paid by *A* in the taxable year 1976 to participate in a program to acquire federal oil and gas leases is a capital expenditure includable in the basis of the single lease acquired in 1977. Furthermore, no part of such fee is allowable as a deduction in taxable year 1976 because the transaction was incomplete since all the applications had not been filed.

2. Upon the exercise of the option to sell *X* a fractional interest in the lease acquired, *A* will recognize gain or loss measured by the difference between the amount received for the fractional interest reduced by the cost of the option and the portion of the basis in the lease allocable to such fractional interest.

Situation 2

1. Nine *x* dollars of each monthly fee paid by *B* in the taxable years 1976 and 1977 to participate in a program to acquire federal oil and gas leases are capital expenditures includable in the basis of the single lease acquired in 1977. Furthermore, no part of such fee is allowable as a deduction in taxable year 1976 because the transaction was incomplete since all applications had not been filed.

2. Upon the sale of the specified fractional interest in the lease acquired, *B* will recognize gain or loss measured by the difference between the amount received from the fractional interest reduced by the $12*x* allocable to *X*'s practice of offering to purchase a specified fractional interest and that portion of the basis in the lease allocable to such fractional interest.

Whether such gain or loss, in both *Situation 1* and *Situation 2* is subject to the provisions of sections 1221 or 1231 of the Code requires a factual determination of the holding period, and whether, in the hands of the participant, such leases were properly regarded as property used in the trade or business or as investment property.

EFFECT ON OTHER REVENUE RULINGS

Consistent with Rev. Rul. 71-521, and this revenue ruling, Rev. Rul. 77-395 is modified to the extent that in the first situation, the option fee and, in the second situation, the amount allocated to the taxpayer's understood right to sell a fractional interest in any lease acquired, is not a part of the basis of the leasehold. Further, Rev. Rul. 77-395 is clarified with respect to the application of section 1231(a) of the Code to the loss incurred by *A* and *B;* specifically, to determine if section 1231(a) applies, a factual determination must be made as to the length of the holding period and the purpose for which the taxpayer held the lease. Also, Rev. Rul. 71-191 is distinguished.

PROSPECTIVE APPLICATION

Pursuant to the authority contained in section 7805(b) of the Code, the conclusion of this revenue ruling that the cost of the option is not to be added to the basis of the oil and gas properties when such properties are acquired will not be applied adversely to taxpayers who acquire oil and gas properties under written agreements of the type described in Rev. Rul. 77-395 that were entered into prior to July 7, 1980, the date of publication in the Internal Revenue Bulletin.

Section 331.—Gain or Loss to Shareholders in Corporate Liquidations

26 CFR 1.331-1: Corporate liquidations. (Also Section 451; 1.451-2.)

Liquidating distribution; constructive receipt; surrender of shares. A domestic corporation, pursuant to a plan of complete liquidation, notified its shareholders that they would be entitled to receive a distribution in liquidation upon surrender of their shares of stock after a given date. All the corporation's liabilities had been discharged, its assets had been reduced to cash, and there was no likelihood that the liquidation would not be consummated. A cash method individual shareholder is in constructive receipt of the liquidating distribution as of the date the distribution first becomes payable.

Rev. Rul. 80-177

ISSUE

Is a shareholder of a liquidating corporation under the circumstances described below in receipt of the liquidating distribution at the time the distribution first becomes payable rather than on the date it is actually received by the shareholder upon surrender of his stock?

FACTS

Pursuant to a plan of complete liquidation adopted by a domestic corporation, each shareholder was notified prior to February 15, 1978, that he would be entitled to receive a distribution in liquidation upon surrender of his shares of stock at any time after March 1, 1978. As of March 1, 1978, all of the corporation's liabilities had been discharged and its assets had been reduced to cash, and events had progressed to such a point that there was no likelihood that the liquidation would not be consummated. Under the circumstances, the shareholders' rights "as shareholders" were effectively terminated when the distribution first became payable, rather than upon the shareholders' actual receipt when they surrendered their stock. All that the shareholders had to do was turn in their shares and receive their money. Under local law the surrender of their stocks did not cause them to relinquish any rights which would constitute a "substantial limitation or restriction" on receipt of the money within the meaning of section 1.451-2(a) of the Income Tax Regulations.

The taxpayer, a United States person who had been a shareholder of the corporation for several years prior to 1978, used the cash receipts and disbursements method of accounting and filed federal income tax returns on the basis of a calendar year. In January 1979, the taxpayer surrendered all of the shares of stock to the corporation and received a single liquidating distribution in complete liquidation on that date.

LAW AND ANALYSIS

Section 331 of the Code provides the general rule that amounts distributed in complete liquidation of a corporation will be treated as in full payment in exchange for the stock. Neither section 331 nor the regulations thereunder set forth rules for determining when a distribution is received by the shareholder. The legislative history of section 331 indicates that its purpose was to characterize a liquidating distribution as an exchange (before the enactment in 1924 of the predecessor of section 331 such a distribution had been treated as a dividend) and there is no indication that Congress was concerned with establishing rules as to when a liquidating distribution is received by a shareholder. S. Rep. No. 398, 68th Cong., 1st Sess. 11-12 (1924), 1939-1 (Part 2) C.B. 266, 274 and H.R. Rep. No. 179, 68th Cong., 1st Sess. 11 (1924), 1939-1 (Part 2) C.B. 241, 249. Thus, all rules applicable to the receipt of income, including the constructive receipt doctrine, are applicable in determining when a liquidating distribution is received by a shareholder under section 331. However, with regard to the requirement of section 337(a) that all of the assets of a corporation be distributed in complete liquidation (less assets retained to meet claims) within the 12-month period beginning on the date of adoption of a plan of complete liquidation, see *Vern Realty, Inc. v. Commissioner,* 58 T.C. 1005, 1012 (1972), *aff'd.,* Civil No. 73-1030 (1st Cir. April 26, 1973), in which it was indicated that such requirement is not met unless the corporation actually distributes all of its assets within the 12-month period.

Section 451(a) of the Code provides that the amount of any item of gross income will be included in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Section 1.451-1(a) of the Income Tax Regulations provides that gains, profits, and income are to be included in gross income for the taxable year in which they are actually or constructively received by the taxpayer unless includible for a different year in accordance with the taxpayer's method of accounting. Section 1.451-1(a) also provides that under the cash receipts and disbursements method of accounting, the amount is includible in gross income when actually or constructively received.

Section 1.451-2(a) of the regulations provides that income, although not actually reduced to a taxpayer's possession, is constructively received by the taxpayer in the taxable year during which it is credited to the taxpayer's account, set apart for the taxpayer, or otherwise made available so that the taxpayer may draw upon it at any time, or so that the taxpayer could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, section 1.451-2(a) further provides that income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

In the present case, the liquidating distribution was payable March 1, 1978. There was no doubt that the liquidation would be consummated and that the distribution would be made since all liabilities had been discharged, the assets had been reduced to cash, and events had advanced to such a point that there was no likelihood that the liquidation would not be consummated. Furthermore, under the circumstances, the shareholders' rights "as shareholders" were effectively terminated when the distribution first became payable, rather than upon the shareholders' actual receipt when they surrendered their stock, since all they had to do was present the certificates and receive their money. The requirement that the certificates had to be presented for payment of the distribution is indistinguishable from the presentation of a pass book for crediting of interest earned on a savings account, and it did not represent a substantial restriction on the shareholders' right to the money under section 1.451-2 of the regulations. Since the shareholder used the cash receipts and disbursements method of accounting, and filed federal income tax returns on the basis of a calendar year, this item of income should have been included in gross income in 1978, the year the distribution was constructively received and not in 1979 when it was actually received.

HOLDING

Under the facts and circumstances of this case, the shareholder was in constructive receipt of the liquidating distribution on March 1, 1978, the time the distribution first became payable.

Section 451.—General Rule for Taxable Year of Inclusion

26 CFR 1.451-2: Constructive receipt of income.

Whether a shareholder of a liquidating corporation, who is an individual that uses the cash receipts and disbursements method of accounting, is in receipt of the liquidating distribution, under the circumstances described, at the time the distribution first becomes payable, rather than on the date it is actually received by the shareholder upon surrender of his stock. See Rev. Rul. 80-177, page 13.

Section 501.—Exemption From Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(c)(13)-1: Cemetery companies and crematoria.

T.D. 7698

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Exemption From Taxation of Certain Cemetery Companies and Crematoria; Exempt Title Holding Companies

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations under sections 501(c)(2) and 501(c)(13) of the Internal Revenue Code of 1954, relating to exempt title holding companies and to exempt cemetery companies and crematoria, respectively. These regulations make clerical changes in the regulations under section 501(c)(2), so as to reflect the revision of section 514 by the Tax Reform Act of 1969 (Pub. L. 91-172, 83 Stat. 543) [1969-3 C.B. 10] and to reflect changes made in section 501(c)(13) by the Act of December 31, 1970 (Pub. L. 91-618, 84 Stat. 1855) [1971-1 C.B. 539], exempting certain crematoria from the corporate income tax. The regulations under section 501(c)(13) also clarify the standards for exemption from income tax and help identify when certain transfers to cemetery companies and crematoria are in exchange for equity interests rather than for debt obligations. Furthermore, the regulations correct two clerical errors contained in Treasury Decision 7229 [1973-1 C.B. 265], published December 21, 1972, relating to unrelated debt-financed income of certain tax-exempt organizations. These regulations provide necessary guidance to the public for compliance with these Acts, and affect certain title holding companies and certain cemetery companies and crematoria that are exempt from taxation.

DATE: The regulations are effective for various taxable years as specified in the regulations.

FOR FURTHER INFORMATION CONTACT: Harry Beker of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:EE) (202-566-6212) (not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On July 8, 1975, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 501(c)(2) and 501(c)(13) of the Internal Revenue Code of 1954 (40 FR 28613). The amendments were proposed to conform the regulations to the Tax Reform Act of 1969 (83 Stat. 543) and to the Act of December 31, 1970 (84 Stat. 1855). On November 29, 1978, the Federal Register published proposed amendments to the proposed regulations under section 501(c)(13) (43 FR 55797). A public hearing was held on March 29, 1979. After consideration of all comments regarding the proposed amendments, those amendments are adopted, as revised, by this Treasury decision.

The comments received with respect to the proposed amendments generally concerned three issues relating to exempt cemetery companies and crematoria. First, it was recommended that § 1.501(c)(13)-1(a) be revised to permit mutual cemeteries to be exempt even if operated for profit. As proposed on July 8, 1975, § 1.501(c)(13)-1(a) makes it clear that only nonprofit mutual cemetery companies would be exempt. It has been concluded that the phrase "or which are not operated for profit" was added to section 501(c)(13) not as a separate qualification for exemption, but to take care of mutual cemetery companies that would not be operating "exclusively" for the benefit of members because of additional charitable activities, such as the burial of paupers. Additional support for this position is contained in section 170(c)(5), the counterpart to section 501(c)(13) for purposes of charitable contributions. Section 170(c)(5) reflects the emphasis placed by Congress on the "quasi charitable" nature of the type of organizations intended to be exempt under section 501(c)(13) by providing that only contributions to nonprofit mutual cemetery companies and nonprofit cemetery corporations are deductible. Accordingly, no change has been made to § 1.501(c)(13)-1(a) in the final regulations.

Second, it was recommended that § 1.501(c)(13)-1(c)(1), relating to the issuance of preferred stock, be withdrawn or substantially modified so that the use of preferred stock could continue to be available to tax-exempt cemeteries and crematoria. As proposed on November 29, 1978, § 1.501(c)(13)-1(c)(1) provides that a cemetery company or crematorium which issues preferred stock on or after November 28, 1978, will not be exempt from income tax. It has been concluded that the rule which permitted the issuance of preferred stock was inconsistent with the requirement of section 501(c)(13) that no part of the net earnings of an organization otherwise described in that section may inure to the benefit of any private shareholder or individual. The amendments, however, recognize the continued exempt status of cemeteries and crematoria which, prior to November 28, 1978, issued preferred stock meeting certain restrictions. The general prohibition on the issuance of preferred stock has been retained.

The comments relating to preferred stock also suggested that, if the amendment barring the use of preferred stock is adopted, § 1.501(c)(13)-1(c)(2) (the transitional rule) should be modified to include a clause protecting those cemeteries and crematoria which, prior to November 28, 1978, were in the process of issuing such stock. This recommendation has been adopted in new § 1.501(c)(13)-1(c)(3) which provides that a cemetery company or crematorium shall not fail to be exempt solely because it issues preferred stock on or after November 28, 1978, if such stock meets certain restrictions and is issued pursuant to a plan which had been reduced to writing and adopted prior to November 28, 1978.

Third, it was recommended that § 1.501(c)(13)-1(d) be revised to indicate that where the vendor of property to a cemetery company does not control the cemetery, tax-exempt status should not be denied merely because the payments do not take the form of a traditional debt obligation. As proposed on July 8, 1975, § 1.501(c)(13)-1(d) provides that a cemetery company or crematorium is not exempt from income tax if property is transferred to such organization in exchange for an equity interest so long as the equity interest remains outstanding.

Section 1.501(c)(13)-1(d) previously listed several factors that would be considered in determining whether a bona fide debt obligation existed. The factors previously listed have been eliminated and paragraph (d) now simply provides that no person may have any interest in the net earnings of a tax-exempt cemetery company or crematorium, including any interest that constitutes equity under section 385 or the regulations thereunder.

Finally, minor technical clarifications have been made to reflect the fact that section 501(c)(13) does not grant exemption but merely describes organizations which are exempt under section 501(a).

DRAFTING INFORMATION

The principal author of these regulations is Harry Beker of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended as follows:

Paragraph 1. Section 1.501(c)(2)-1(a) is amended to read as follows:

§ 1.501(c)(2)-1 Corporations organized to hold title to property for exempt organizations.

(a) A corporation described in section 501(c)(2) and otherwise exempt from tax under section 501(a) is taxable upon its unrelated business taxable income. For taxable years beginning before January 1, 1970. see § 1.511-2(c)(4). Since a corporation described in section 501(c)(2) cannot be exempt under section 501(a) if it engages in any business other than that of holding title to property and collecting income therefrom, it cannot have unrelated business taxable income as defined in section 512 other than income which is treated as unrelated business taxable income solely because of the applicability of section 512(a)(3)(C); or debt financed income which is treated as unrelated business taxable income solely because of section 514; or certain interest, annuities, royalties, or rents which are treated as unrelated business taxable income solely because of section 512(b)(3)(B)(ii) or (13). Similarly, exempt status under section 501(c)(2) shall not be affected where certain rents from personal property leased with real property are treated as unrelated business taxable income under section 512(b)(3)(A)(ii) solely because such rents attributable to such personal property are more than incidental when compared to the total rents received or accrued under the lease, or under section 512(b)(3)(B)(i) solely because such rents attributable to such personal property exceed 50 percent of the total rents received or accrued under the lease.

* * * * *

Par. 2. Section 1.501(c)(13) is deleted.

Par. 3. Section 1.501(c)(13)-1 is amended to read as follows:

§ 1.501(c)(13)-1 Cemetery companies and crematoria.

(a) *Nonprofit mutual cemetery companies.* A nonprofit cemetery company may be entitled to exemption if it is owned by and operated exclusively for the benefit of its lot owners who hold such lots for bona fide burial purposes and not for the purpose of resale. A mutual cemetery company which also engages in charitable activities, such as the burial of paupers, will be regarded as operating in conformity with this standard. Further, the fact that a mutual cemetery company limits its membership to a particular class of individuals, such as members of a family, will not affect its status as mutual so long as all the other requirements of section 501(c)(13) are met.

(b) *Nonprofit cemetery companies and crematoria.* Any nonprofit corporation, chartered solely for the purpose of the burial, or (for taxable years beginning after December 31, 1970) the cremation of bodies, and not permitted by its charter to engage in any business not necessarily incident to that purpose, is exempt from income tax, provided that no part of its net earnings inures to the benefit of any private shareholder or individual.

(c) *Preferred stock*—(1) *In general.* Except as provided in subparagraph (3) of this paragraph, a cemetery company or crematorium is not described in section 501(c)(13) if it issues preferred stock on or after November 28, 1978.

(2) *Transitional rule for preferred stock issued prior to November 28, 1978.* In the case of preferred stock issued prior to November 28, 1978, a cemetery company or crematorium which issued such stock shall not fail to be exempt from income tax solely because it issued preferred stock which entitled the holders to dividends at a fixed rate, not exceeding the legal rate of interest in the State of incorporation or 8 percent per annum, whichever is greater, on the value of the consideration for which the stock was issued, if its articles of incorporation require:

(i) That the preferred stock be retired at par as rapidly as funds therefor become available from operations, and

(ii) That all funds not required for the payment of dividends upon or for the retirement of preferred stock be used by the company for the care and improvement of the cemetery property.

The term "legal rate of interest" shall mean the rate of interest prescribed by law in the State of incorporation which prevails in the absence of an agreement between contracting parties fixing a rate.

(3) *Transitional rule for preferred stock issued on or after November 28, 1978.* In the case of preferred stock issued on or after November 28, 1978, a cemetery company or crematorium shall not fail to be exempt from income tax if its articles of incorporation and the preferred stock meet the requirements of subparagraph (2) and if such stock is issued pursuant to a plan which has been reduced to writing and adopted prior to November 28, 1978. The adoption of the plan must be shown by the acts of the duly constituted responsible officers and appear upon the official records of the cemetery company or crematorium.

(d) *Sales to exempt cemetery companies and crematoria.* Except as provided in paragraph (c)(2) or (c)(3) of this section (relating to transitional rules for preferred stock), no person may have any interest in the net earnings of a tax-exempt cemetery company or crematorium. Thus, a cemetery company or crematorium is not exempt from tax if property is transferred to such organization in exchange for an interest in the net earnings of the organization so long as such interest remains outstanding. An interest in a cemetery or crematorium that constitutes an equity interest within the meaning of section 385 will be considered an interest in the net earnings of the cemetery. However, an interest in a cemetery company or crematorium that does not constitute an equity interest within the meaning of section 385 may nevertheless constitute an interest in the net earnings of the organization. Thus, for example, a bond or other evidence of indebtedness issued by a cemetery company or crematorium which provides for a fixed rate of interest but which, in addition, provides for additional interest payments contingent upon the revenues or income of the organization is considered an interest in the net earnings of the organization. Similarly, a convertible debt obligation issued by a cemetery company or crematorium after July 7, 1975, is considered an interest in the net earnings of the organization.

Par. 4. Section 1.514(c)-1 is amended by striking out from the second sentence of paragraph (f) "section 221(d)(3) (12 U.S.C. 1715(d)(3)) or section 236 (12 U.S.C. 1715x-1)" and inserting in lieu thereof "section 221(d)(3) (12 U.S.C. 1715(l)(d)(3)) or section 236 (12 U.S.C. 1715z-1)".

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved April 25, 1980.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on May 20, 1980, 8:45 a.m., and published in the issue of the Federal Register for May 21, 1980, 45 F.R. 33971)

Section 513.—Unrelated Trade or Business [Exempt Organizations]

26 CFR 1.513-5: Certain bingo games not unrelated trade or business.

T.D. 7699 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAP-

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[1] This publication of the Treasury Decision contains the complete text of the amendments to the regulations. The instructions for modifying the notice of proposed rulemaking have been omitted.

TER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Treatment of proceeds from bingo games

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the treatment of proceeds from bingo games conducted by tax-exempt organizations. Changes in the applicable tax law were made by the Act of October 21, 1978 [Pub L. 95-502, 1978-2 C.B. 393, 395]. The regulations provide tax-exempt organizations with the guidance needed to comply with that Act and would affect tax-exempt organizations that conduct bingo games.

DATE: The regulations are effective for taxable years beginning after December 31, 1969.

FOR FURTHER INFORMATION CONTACT: Charles Kerby of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:EE-180-78 (202-566-3422) (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On August 28, 1979, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 513 and 527 of the Internal Revenue Code of 1943 (44 F.R. 50361). The amendments were proposed to conform the regulations to sections 301 and 302 of the Act of October 21, 1978 (92 Stat. 1702). Three comments were received from the public. No hearing was held. After consideration of all comments, the proposed regulations under section 513 are adopted as revised by this Treasury decision. The proposed amendments to the regulations under section 527 remain as proposed regulations. It is intended that the proposed amendments will be adopted by the Treasury decision to be published with respect to the proposed regulation under section 527 that were published in the Federal Register on November 24, 1976 (41 F.R. 51840).

COMMENTS ON THE PROPOSED REGULATIONS

Two of the three comments received from the public objected to Example (1)(ii) of § 1.513-5(c)(3) of the proposed regulations. That example illustrates § 1.513-5(c)(1) of the proposed regulations and provides that where the laws of a State prohibit all forms of gambling activity, including bingo games, a bingo game conducted by a tax-exempt organization in the State constitutes unrelated trade or business regardless of whether, or to what degree, the State law is enforced. The commentators suggested that bingo should not be considered an illegal activity if State gambling statutes are not generally enforced against tax-exempt organizations that conduct bingo games.

To determine whether bingo is illegal in a given State, the Internal Revenue Service must necessarily look to State statutes and decisions of the State courts interpreting those statutes. It would not be appropriate for the Internal Revenue Service to independently determine that a statute proscribing gambling is, nevertheless, not the law of the State. In the legislative history of the Act of October 21, 1978, Congress specified that the requirement of section 513(f)(2) that an organization not conduct bingo games in violation of State or local law was "designed to ensure that no Federal tax benefit is provided for activities which are conducted illegally." H. Rep. No. 95-1608, 95th Cong., 2nd Sess. 6 (1978), 1978-2 C.B. 395, 397. Accordingly, the final regulations are not materially different from the proposed regulations on this point.

The other comment received from the public suggested that the regulations contain a clear, concise example of a bingo game that would be excluded from the term "unrelated trade or business" under section 513(f). The final regulations contain such an example. In addition, the examples in the final regulations have been clarified.

DRAFTING INFORMATION

The principal author of this regulation is Charles Kerby of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to the regulations are hereby adopted:

§ 1.513-5 Certain bingo games not unrelated trade or business.

(a) *In general.* Under section 513(f), and subject to the limitations in paragraph (c) of this section, in the case of an organization subject to the tax imposed by section 511, the term "unrelated trade or business" does not include any trade or business that consists of conducting bingo games (as defined in paragraph (d) of this section).

(b) *Exception.* The provisions of this section shall not apply with respect to any bingo game otherwise excluded from the term "unrelated trade or business" by reason of section 513(a)(1) and § 1.513-1(e)(1) (relating to trades or businesses in which substantially all the work is performed without compensation).

(c) *Limitations*—(1) *Bingo games must be legal.* Paragraph (a) of this section shall not apply with respect to any bingo game conducted in violation of State or local law.

(2) *No commercial competition.* Paragraph (a) of this section shall not apply with respect to any bingo game conducted in a jurisdiction in which bingo games are ordinarily carried out on a commercial basis. Bingo games are "ordinarily carried out on a commercial basis" within a jurisdiction if they are regularly carried on (within the meaning of § 1.513-1(c)) by for-profit organizations in any part of that

jurisdiction. Normally, the entire State will constitute the appropriate jurisdiction for determining whether bingo games are ordinarily carried out on a commercial basis. However, if State law permits local jurisdictions to determine whether bingo games may be conducted by for-profit organizations, or if State law limits or confines the conduct of bingo games by for-profit organizations to specific local jurisdictions, then the local jurisdiction will constitute the appropriate jurisdiction for determining whether bingo games are ordinarily carried out on a commercial basis.

(3) *Examples.* The application of this paragraph is illustrated by the examples that follow. In each example, it is assumed that the bingo games referred to are operated by individuals who are compensated for their services. Accordingly, none of the bingo games would be excluded from the term "unrelated trade or business" under section 513(a)(1).

Example (1). Church Z, a tax-exempt organization, conducts weekly bingo games in State O. State and local laws in State O expressly provide that bingo games may be conducted by tax-exempt organizations. Bingo games are not conducted in State O by any for-profit businesses. Since Z's bingo games are not conducted in violation of State or local law and are not the type of activity ordinarily carried out on a commercial basis in State O, Z's bingo games do not constitute unrelated trade or business.

Example (2). Rescue Squad X, a tax-exempt organization, conducts weekly bingo games in State M. State M has a statutory provision that prohibits all forms of gambling including bingo games. However, that law generally is not enforced by State officials against local charitable organizations such as X that conduct bingo games to raise funds. Since bingo games are illegal under State law, X's bingo games constitute unrelated trade or business regardless of the degree to which the State law is enforced.

Example (3). Veterans' organizations Y and X, both tax-exempt organizations, are organized under the laws of State N. State N has a statutory provision that permits bingo games to be conducted by tax-exempt organizations. In addition, State N permits bingo games to be conducted by for-profit organizations in city S, a resort community located in county R. Several for-profit organizations conduct nightly bingo games in city S. Y conducts weekly bingo games in city S. X conducts weekly bingo games in county R. Since State law confines the conduct of bingo games by for-profit organizations to city S, and since bingo games are regularly carried on there by those organizations, Y's bingo games conducted in city S constitute unrelated trade or business. However, X's bingo games conducted in county R outside of city S do not constitute unrelated trade or business.

(d) *Bingo game defined.* A bingo game is a game of chance played with cards that are generally printed with five rows of five squares each. Participants place markers over randomly called numbers on the cards in an attempt to form a preselected pattern such as a horizontal, vertical, or diagonal line, or all four corners. The first participant to form the preselected pattern wins the game. As used in this section, the term "bingo game" means any game of bingo of the type described above in which wagers are placed, winners are determined, and prizes or other property is distributed in the presence of all persons placing wagers in that game. The term "bingo game" does not refer to any game of chance (including, but not limited to, keno games, dice games, card games, and lotteries) other than the type of game described in this paragraph.

(e) *Effective date.* Section 513(f) and this section apply to taxable years beginning after December 31, 1969.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved April 21, 1980.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on May 20, 1980, 8:45 a.m., and published in the issue of the Federal Register for May 21, 1980, 45 F.R. 33969)

Section 1033.—Involuntary Conversions

26 CFR 1.1033(a)-2: Involuntary conversion into similar property, into money or into dissimilar property.

Nonrecognition of gain; timber damaged by storm; voluntary sale. The nonrecognition of gain provisions of section 1033(a) of the Code are applicable to proceeds received from the voluntary sale of timber downed by high winds, earthquake, or volcanic eruption when the proceeds are used to purchase other standing timber; Rev. Rul. 72-372 revoked.

Rev. Rul. 80-175

ISSUE

Reconsideration has been given to Rev. Rul. 72-372, 1972-2 C.B. 471, which deals with the application of the nonrecognition of gain provisions of section 1033(a) of the Internal Revenue Code with respect to the proceeds received from a sale of timber downed by high winds.

FACTS

In Rev. Rul. 72-372 the taxpayer was the owner of timberland. As a result of a hurricane, a considerable number of trees were uprooted. The timber was not insured, and once downed, was subject to decay or being rendered totally worthless by insects within a relatively short period of time. The taxpayer was, however, able to sell the damaged timber and realized a gain from such sale. The proceeds of the sale were used to purchase other standing timber.

Rev. Rul. 72-372 holds that a gain from a voluntary sale of such timber under these circumstances does not qualify for nonrecognition of gain under section 1033(a) of the Code because there was no direct conversion into money nor was such sale precipitated by the threat or imminence of requisition or condemnation.

LAW AND ANALYSIS

Section 1033(a)(1) of the Code provides rules under which no gain is to be recognized where property is compulsorily or involuntarily converted into property similar or related in service or use to the property so converted. Section 1.1033(a)-1(a) of the Income Tax Regulations provides that an involuntary conversion may be, among other things, the result of the destruction of property in whole or in part.

Section 1033(a)(2)(A) of the Code provides for the nonrecognition of gain if property is involuntarily converted into money and that money is invested within a specified period of time, in other property similar or related in service or use to the property so converted.

Section 1033(a)(2)(B) of the Code states the time period within which converted property must be replaced. That time period commences with the date of the disposition of the converted property. The term "disposition of the converted property" is defined by section 1033(a)(2)(E)(ii) to mean the destruction, theft, seizure, requisition, or condemnation of the converted property, or the sale or exchange of such property under threat or imminence of requisition or condemnation. Thus, the term "disposition of the converted property" is defined for the purpose of establishing the beginning of the replacement period and not for the purpose of defining the term "involuntary conversion." Section 1.1033(a)-1(a) of the regulations defines the latter term to include the destruction of property. In the present case, the taxpayer's property was destroyed by a hurricane.

In *S. H. Kress and Co. v. Commissioner*, 40 T.C. 142, 153 (1963), *acq.*, 1965-1 C.B. 4 the Tax Court of the United States stated that the basic purpose of section 1033 of the Code is to allow the taxpayer to replace his property without realization of gain "where he is compelled to give up such property because of circumstances beyond his control." In *S & B Realty Co. v. Commissioner*, 54 T.C. 863, 871 (1970), *acq.*, 1970-2 C.B. xxi the court stated that "When Congress enacted sections 214(a)(12) and 234(a)(14) of the Revenue Act of 1921 [the predecessors of section 1033] it obviously intended to grant a measure of tax relief to those who were compelled by the specified circumstances to convert their property into cash." The involuntary conversion provisions allow recognition of gain to be postponed on the theory that the taxpayer was compelled to dispose of property and had no economic choice in the matter. The taxpayer in the instant case was compelled by the destruction of the timber to sell it for whatever the taxpayer could or suffer a total loss. Consequently, the facts of this case place it within the ambit of those circumstances contemplated by the provisions of section 103

Both the Internal Revenue Service and the Tax Court have considered this application of section 1033(a) of the Code to sales of property not threatened by requisition or condemnation. Rev. Rul. 54-395, 1954-2 C.B 143, holds that any gain from the sale of poisoned cattle at salvage value or in settlement of damage claims against manufacturers of contaminated feed pellets was subject to the involuntary conversion relief provisions. In *Masser v. Commissioner*, 30 T.C. 741 (1958), *acq.*, 1959-2 C.B. 5 the court considered this application of section 1033 to a sale of property that was part of an economic unit, a portion of which was sold under threat of condemnation. It found that the sale of both pieces of property constituted an involuntary conversion because it was no longer practical to use the remaining property for the purpose intended.

The present case and *Masser* share three common features. First, an event specified by the statute as one that may result in an involuntary conversion occurred. Second, that event rendered the property unfit or impractical for its intended use. Third, the property was sold and the proceeds invested in similar property. Furthermore, the argument for applying section 1033 of the Code to the instant case is stronger than in *Masser*. In the instant case, the property sold was the very property directly affected by the casualty while in *Masser* the property sold was only indirectly affected by the condemnation.

In *C. G. Willis, Inc. v. Commissioner*, 41 T.C. 468 (1964), the court considered the application of section 1033 of the Code to the proceeds from the sale of a partially damaged ship. The ship was repairable; however, the owners chose to sell the ship (at a gain) rather than make the necessary repairs. The proceeds from the sale, along with the insurance proceeds for the repair cost, were invested in a barge that would cover the same ports and carry the same kind of cargo as the damaged ship. The ship owners claimed nonrecognition treatment for this transaction under the provisions of section 1033(a).

In denying the claim for nonrecognition treatment, the court stated that "Involuntary conversion, within the meaning of section 1033(a) of the Code, means that the taxpayer's property, through some outside force or agency beyond his control, is no longer useful or available to him for his purposes." The court concluded that "It cannot be said that the sale of the unrepaired ship was a result of its partial destruction. The sale was the result of a business decision by the owner that the money equivalent of the unrepaired ship would serve its business interests better."

In the present case, the downed timber was not repairable and was generally no longer useful to the taxpayer in the context of its original objective. The destruction caused by the hurricane forced the taxpayer to sell the downed timber for whatever price it could get. Unlike the situation in *Willis*, the sale of the downed timber was dictated by the damage caused by the hurricane.

HOLDING

Upon reconsideration of Rev. Rul. 72-372, and in light of the court decisions cited above, it is now the Service's position that the nonrecognition of gain provisions of section 1033(a) of the Code are applicable with respect to the proceeds received from the sale of timber downed by high winds. The same treatment would be accorded if, for example, the timber in question was downed as a consequence of an earthquake or a volcanic eruption.

EFFECT ON OTHER DOCUMENTS

Rev. Rul .72-372 is revoked.

Section 1202.—Deduction for Capital Gains

26 CFR 1.1202-1: Deduction for capital gains.
(Also Section 1375; 1.1375-1.)

Capital gain deduction; small business corporation; taxable year

including November 1, 1978. An example of the computation of the capital gain deduction is provided for an electing small business corporation that had a taxable year that included November 1, 1978 and that had net capital gains both before and after that date.

Rev. Rul. 80-178

ISSUE

How is the capital gain deduction provided by section 1202 of the Internal Revenue Code determined under the circumstances described below?

FACTS

X, an electing small business corporation within the meaning of section 1371 of the Code, files its returns on a calendar year basis. In 1978 *X* had a net capital gain of 100*x* dollars, 60*x* dollars of which resulted from sales or exchanges prior to November 1, 1978. *X*'s taxable income (including capital gains) for 1978 was 80*x* dollars. *X*'s election under section 1372(a) has been in effect for each of its taxable years, and *X* did not have any long-term capital gain in 1978 attributable to property with a substituted basis. Thus, section 1378 does not apply.

LAW

Section 1202(a) of the Code provides that if for any taxable year a taxpayer other than a corporation has a net capital gain, 60 percent of the amount of the net capital gain shall be a deduction from gross income.

Section 1202(c)(1) of the Code provides that if for any taxable year beginning before November 1, 1978, and ending after October 31, 1978, a taxpayer other than a corporation has a net capital gain, the deduction under section 1202(a) shall be the sum of 60 percent of the lesser of the net capital gain for the taxable year, or the net capital gain taking into account only sales and exchanges after October 31, 1978, plus an amount computed in accordance with section 1202(c)(2), that is, 50 percent of the excess of the net capital gain for the taxable year, over the amount of net capital gain taken into account under section 1202(c)(1).

Section 1375(a)(1) of the Code provides that the amount includible in the gross income of a shareholder as dividends (including amounts treated as dividends under section 1375(b)) from an electing small business corporation during any taxable year of the corporation, to the extent that such amount is a distribution of property out of earnings and profits of the taxable years as specified in section 316(a)(2), shall be treated as a long-term capital gain to the extent of the shareholder's pro rata share of the corporation's net capital gain for such taxable year. For purposes of this paragraph, such net capital gain shall be deemed not to exceed the corporation's taxable income (computed as provided in section 1373(d)) for the taxable year.

Section 104(a)(2)(C) of the Technical Corrections Act of 1979, Pub. L. 96-222, 1980-20 I.R.B. 5, 15, makes clear that for purposes of determining the proper period of the capital gain income taxable to a shareholder of an electing small business corporation, reference shall be made to when the gain was realized by the corporation.

HOLDING

In this case *X*'s taxable income for 1978 (80*x* dollars) is less than *X*'s net capital gain (100*x* dollars). Therefore pursuant to section 1375(a)(1) of the Code the amount of *X*'s net capital gain includible in the income of the shareholders is limited to 80*x* dollars. The 80*x* dollars of capital gain represents a pro rata portion of pre-November 1, 1978 gain and post-October 31, 1978 gain. 48*x* dollars $\left(\frac{60x}{100x} \times 80x = 48x\right)$ is pre-November 1, 1978 gain and 32*x* dollars $\left(\frac{40x}{100x} \times 80x = 32x\right)$ is post-October 31, 1978 gain for puropses of computing the capital gain deduction allowable to the shareholders of *X* under section 1202 of the Code.

Section 1375.—Special Rules Applicable to Distributions of Electing Small Business Corporations

26 CFR 1.1375-1: Special rules applicable to capital gains.

Treatment of pre-November 1, 1978 gain and post-October 31, 1978, gain. See Rev. Rul. 80-178, page 19.

Section 2032A.—Valuation of Certain Farm, Etc., Real Property

Special use value; farms; interest rates. The interest rates to be used under section 2032A(e)(7)(A)(ii) of the Code in computing the special use value of farm real property for which an election is made under section 2032A are listed for estates of decedents dying in the period 1977-1980; Rev. Rul. 79-189 superseded.

Rev. Rul. 80-179

ISSUE

This revenue ruling contains a cumulative list of the average annual effective interest rates on new Federal Land Bank loans to be utilized under section 2032A(e)(7)(A)(ii) of the Internal Revenue Code in computing the special use value of real property used as a farm for which an election is made under the provisions of section 2032A. The interest rates listed are those applicable for the estates of decedents dying in 1977, 1978, 1979, and 1980. The rates applicable in the case of decedents dying in 1977, 1978 and 1979 were previously listed in Rev. Rul. 79-189, 1979-1 C.B. 293.

This revenue ruling also contains a list of the states within each land bank district.

Average annual effective interest rate to be utilized under section 2032A (e) (7) (A) (ii):

Federal Land Bank District in which property is located	Year of Death			
	1977	1978	1979	1980
Baltimore	8.65%	8.86%	9.04%	9.24%
Columbia	8.58%	8.79%	8.96%	9.17%
Houston	8.29%	8.48%	8.60%	8.76%
Louisville	8.64%	8.80%	8.88%	9.21%
New Orleans	8.26%	8.48%	8.72%	8.96%
Omaha	8.70%	8.92%	9.05%	9.25%
Sacramento	8.67%	8.82%	9.04%	9.35%
St. Louis	8.50%	8.71%	8.93%	9.20%
St. Paul	8.21%	8.47%	8.69%	8.95%
Spokane	8.63%	8.88%	9.10%	9.31%
Springfield	8.42%	8.55%	8.65%	8.81%
Wichita	8.52%	8.72%	8.88%	9.08%

Federal Land Bank Districts:

District	*States*
Baltimore	Delaware, District of Columbia, Maryland, Pennsylvania, Virginia, West Virginia.
Columbia	Florida, Georgia, North Carolina, South Carolina.
Houston	Texas.
Louisville	Indiana, Kentucky, Ohio, Tennessee.
New Orleans	Alabama, Louisiana, Mississippi.
Omaha	Iowa, Nebraska, South Dakota, Wyoming.
Sacramento	Arizona, California, Hawaii, Nevada, Utah.
St. Louis	Arkansas, Illinois, Missouri.
St. Paul	Michigan, Minnesota, North Dakota, Wisconsin.
Spokane	Alaska, Idaho, Montana, Oregon, Washington.
Springfield	Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, Vermont.
Wichita	Colorado, Kansas, New Mexico, Oklahoma.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 79-189 is superseded.

Section 4975.—Tax on Prohibited Transactions

Prohibited Transaction Exemption 80-26

Pension and Welfare Benefit Programs

Class Exemption for Certain Interest Free Loans to Employee Benefit Plans

AGENCY: Department of Labor.

ACTION: Grant of class exemption.

SUMMARY: This class exemption permits parties in interest with respect to employee benefit plans to make interest free loans to such plans. Such loans would be prohibited by the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1] (the Act) and the Internal Revenue Code of 1954 (the Code). The exemption affects all employee benefit plans, their participants and beneficiaries, and parties in interest with respect to those plans.

EFFECTIVE DATE: January 1, 1975.

FOR FURTHER INFORMATION CONTACT: Jane M. Kheel: Plan Benefits Security Division, Office of the Solicitor, U.S. Department of Labor (202) 523-9141. (This is not a toll-free number.)

SUPPLEMENTARY INFORMATION: On February 8, 1980, notice was published in the Federal Register (45 FR 8761) of the pendency before the Department of Labor (the Department) of a proposed class exemption from the restrictions of section 406(a) (1) (B) and (D) and section 406(b) (2) of the Act and from the taxes imposed by section 4975(a) and (b) of the Code by reason of section 4975 (c) (1) (B) and (D) of the Code[1] in connection with certain interest free loans to employee benefit plans. The class exemption was proposed in response to an application filed by the National Coordinating Committee for Multiemployer Plans. The notice set forth a summary of facts and representations contained in the application, and referred interested persons to the application for a complete statement of the facts and representations. The application has been available for public inspection at the Department in Washington, D.C. The notice invited interested parties to submit written comments or requests for a hearing on the proposed exemption to the Department. The exemption was proposed and comments received in accordance with the procedures set forth in ERISA Procedure 75-1 (40 FR 18471, April 28, 1975). No requests for a public hearing were received by the Department.

Discussion of Comments

All of the comments received by the Department in response to the notice favor the proposed exemption.

One comment concerns the second condition of the proposed exemption, which requires that the proceeds of a covered loan or other extension of credit be used only for ordinary operating expenses of the plan. The commentator requests that the exemption be expanded to cover certain transactions that might constitute interest free loans but which might not be considered to be made for the purpose of paying ordinary operating expenses.

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[1] The authority of the Secretary of Labor to issue exemptions under section 4975(c) (2) of the Code is set forth in section 102 of Reorganization Plan No. 4 of 1978 (43 FR 47713, October 17, 1978), effective December 31, 1978.

The commentator gives two examples of such transactions. One involves temporary overdrafts incurred by a plan trustee to pay for securities purchased for the plan. It explains that cash to cover the purchase might be invested in Treasury bills or commercial paper that could not be liquidated until the following day. Under ordinary circumstances, the commentator asserts, the bank trustee would simply advance the purchase price and obtain reimbursement in a day or two when cash becomes available.

The other example of such transaction involves the crediting, by a bank trustee, of dividends or interest to a plan on the due date, even though the dividend or interest has not in fact been received by the bank.

The Department agrees that such extensions of credit, although incidental to the operation of a plan and beneficial to a plan, may not be covered by the exemption as proposed. Therefore, the second condition has been modified in order to cover the transactions discussed above and similar incidental extensions of credit.

Another commentator suggested that the proposed exemption may cause confusion concerning the permissibility of maintaining unallocated suspense accounts in defined contribution plans. He noted that, under certain circumstances, the maintenance of an unallocated suspense account in a defined contribution plan is prohibited by the Internal Revenue Service.[2] According to the commentator, some plan sponsors may be misled into thinking that the proposed exemption permits such unallocated suspense accounts. The Department notes that the exemption has no effect on any such prohibitions.

Two commentators suggested that the second condition of the proposed exemption, which requires that the proceeds of the loan or extension of credit be used only for the payment of ordinary operating expenses, including the payment of benefits and periodic premiums under an insurance or annuity contract, be expanded to permit the proceeds of the loan to be used by an employee stock ownership plan (ESOP) to purchase employer securities from beneficiaries of the ESOP who have received the securities as plan distributions. One of the commentators stated that, although the employer sponsoring an ESOP is required to repurchase the securities from a distributee, in actual operation, many ESOPs repurchase the securities. The Department notes, however, that the requirement that an employer repurchase employer securities distributed by an ESOP relates only to certain securities that are purchased by an ESOP with the proceeds of a loan from a party in interest or a loan that is guaranteed by a party in interest. Such a loan is permitted by sections 408(b)(3) of the Act and 4975(d)(3) of the Code if the conditions of those sections and the regulations issued thereunder are met.[3] Since those sections permit a party in interest to make a loan to an ESOP for the purpose of purchasing employer securities from any person (including participants and beneficiaries of the ESOP), the Department does not believe that the requested expansion of the proposed exemption is either necessary or appropriate.

Another commentator suggested that the proposed exemption be broadened to include arrangements under which employee benefit plans could receive valuable services or facilities, at no cost, from parties in interest. The Department has considered this comment and has decided that such arrangements, if prohibited at all, are not within the scope of the application for exemption and are not properly included within this exemption. In this regard, the Department notes that section 408(b)(2) of the Act and section 4975(d)(2) of the Code, and regulations thereunder, provide statutory exemptions from the prohibitions of sections 406(a) of the Act and 4975(c)(1)(A) through (D) of the Code, respectively, for contracting or making reasonable arrangements with a partiy in interest (or disqualified person) for the leasing of office space to a plan, or the provision of legal, accounting, or other services necessary for the establishment or operation of a plan, and for the provision of goods incidental to such services, if no more than reasonable compensation is paid therefor.[4]

One commentator also requested that the exemption make it clear that an interest free loan to a plan covered by the exemption would not give rise to an indirect contribution to the plan for tax purposes.[5] The Department notes that this issue is outside the scope of the exemption.

General Information

The attention of interested persons is directed to the following:

(1) The fact that a transaction is the subject of an exemption under section 408(a) of the Act and section 4975(c)(2) of the Code does not relieve a fiduciary or other party in interest or disqualified person from certain other provisions of the Act and the Code. These provisions include any prohibited transaction provisions to which the exemption does not apply and the general fiduciary responsibility provisions of section 404 of the Act, which, among other things, require a fiduciary to discharge his duties respecting the plan solely in the interests of participants and beneficiaries of the plan and in a prudent fashion in accordance with section 404(a)(1)(B) of the Act; nor does it affect the requirement of section 401(a) of the Code that the plan must operate for the exclusive benefit of employees of employers maintaining the plan and their beneficiaries.

(2) This exemption does not extend to transactions prohibited under section 406(b)(1) and (3) of the Act

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[2] *See* Revenue Ruling 70-125, 1970-1 C.B. 87.

[3] *See* 29 CFR § 2550.408b-3 and 26 CFR § 54.4975-7(b).

[4] See, as to the leasing of office space and the provision of services, 29 CFR § 2550.408b-2 and 26 CFR § 54.4975-6(a); See, as to the meaning of "reasonable compensation", 29 CFR § 2550.408c-2 and 26 CFR § 54.4975-6(e).

[5] Such an extension of credit might constitute an excess contribution under section 415 of the Code.

or section 4975(c)(1)(E) and (F) of the Code.

(3) This exemption is supplemental to, and not in derogation of, any other provisions of the Act and the Code, including statutory or administrative exemptions and transitional rules. Furthermore, the fact that a transaction is subject to an administrative or statutory exemption is not dispositive of whether the transaction is in fact a prohibited transaction.

(4) This class exemption is applicable to a particular transaction only if the transaction satisfies the conditions specified in the class exemption.

Exemption

In accordance with section 408(a) of the Act and section 4975(c)(2) of the Code, and based upon the entire record including the written comments submitted in response to the notice of February 8, 1980, the Department makes the following determinations:

(a) The class exemption set forth herein is administratively feasible;

(b) It is in the interests of plans and of their participants and beneficiaries; and

(c) It is protective of the rights of participants and beneficiaries of plans.

Accordingly, the following exemption is hereby granted under the authority of section 408(a) of the Act and section 4975(c)(2) of the Code and in accordance with the procedures set forth in ERISA Procedure 75-1.

Effective January 1, 1975, the restrictions of section 406(a)(1)(B) and (D) and section 406(b)(2) of the Act, and the taxes imposed by section 4975(a) and (b) of the Code by reason of section 4975(c)(1)(B) and (D) of the Code, shall not apply to the lending of money or other extension of credit from party in interest or disqualified person to an employee benefit plan, nor to the repayment of such loan or other extension of credit in accordance with its terms or written modifications thereof, if:

(a) No interest or other fee is charged to the plan, and no discount for payment in cash is relinquished by the plan, in connection with the loan or extension of credit;

(b) The proceeds of the loan or extension of credit are used only:

(1) For the payment of ordinary operating expenses of the plan, including the payment of benefits in accordance with the terms of the plan and periodic premiums under an insurance or annuity contract; or

(2) For a period of no more than three days, for a purpose incidental to the ordinary operation of the plan;

(c) The loan or extension of credit is unsecured; and

(d) The loan or extension of credit is not directly or indirectly made by an employee benefit plan.

Section 7805.—Rules and Regulations

26 CFR 301.7805-1: Rules and regulations.

Whether service fees paid for assistance in participating in programs to acquire federal oil and gas leases are capital expenditures, and whether the cost of an option to sell a fractional interest in all leases acquired as part of the program is properly treated as a reduction of the amount realized from the subsequent sale of a fractional interest in any leases acquired. See Rev. Rul. 80-176, page 10.

Part IV. Items of General Interest

Disaster Areas

Announcement 80-87

The President of the United States has determined that the areas listed below were adversely affected by disasters of sufficient severity and magnitude to warrant federal disaster assistance.

Taxpayers who suffered losses in these areas as a result of these disasters may elect the special tax treatment provided under section 165(h) of the Internal Revenue Code. Section 1.165-11 of the Income Tax Regulations sets forth the procedure for making this election. Losses not incurred with respect to a trade or business or any transaction entered into for profit will not qualify for treatment under section 165(h) unless such losses qualify as casualty losses.

State: Idaho

Counties affected: Benewah, Bonner, Boundary, Clearwater, Kootenai, Latah, Nez Perce, Shoshone

Type of disaster: Volcanic eruption of Mount St. Helens

Begun on or about: May 18, 1980

State: Louisiana

Parishes affected: Acadia, Calcasieu, Jefferson Davis, LaFayette, Pointe Coupee, Vermilion

Type of disaster: Severe storms and flooding

Begun on or about: May 15, 1980

State: Michigan

Counties affected: Kalamazoo, Van Buren

Type of disaster: Severe storms and tornadoes

Begun on or about: May 13, 1980

State: Missouri

County affected: Pettis

Type of disaster: Severe storms and tornadoes

Begun on or about: May 12, 1980

State: Washington

Area affected: Entire area of the State of Washington

Type of disaster: Volcanic eruption of Mount St. Helens

Begun on or about: May 18, 1980

Statistics from 1978 Individual Income Tax Returns

Announcement 80-88 [1]

Publication 198, Preliminary Report, Statistics of Income—1978, Individual Income Tax Returns, is now available and may be purchased for $3.25 from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

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[1] Based on News Release IR 80-67, dated June 5, 1980.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing, the following individual has been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
John E. DeSantis	Belmont, CA	Certified Public Accountant	May 12, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.6073-1 through 1.6073-3, amended.	Time for filing declarations of estimated tax by farmers, fishermen, and certain nonresident aliens.	May 21, 1980	July 21, 1980
26 CFR 1.217-2 revised.	Special rules for foreign moving expenses and the allowance of moving expense deductions in the case of retirees or dependents of decedents who were working abroad.	May 22, 1980	July 21, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1979-27 through 1979-53 will be found in Internal Revenue Bulletin 1980-1, dated January 7, 1980.

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Key to Abbreviations:

RR	Revenue Ruling
RP	Revenue Procedure
TD	Treasury Decision
CD	Court Decision
PL	Public Law
EO	Executive Order
DO	Delegation Order
TDO	Treasury Department Order
TC	Tax Convention
SPR	Statement of Procedural Rules
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1935–2	*4.00*	*1951–1*	*2.65*	1964–1–2	11.00	1976–3–1	9.50
1936–1	*3.55*	*1951–2*	*5.05*	1964–2	9.80	1976–3–2	16.00
1936–2	*3.90*	*1952–1*	*2.55*	1965–1	10.70	1976–3–3	10.00
1937–1	*3.75*	1952–2	7.05	1965–2	12.25	1977–1	10.75
1937–2	7.70	*1953–1*	*4.25*	1966–1	14.00	1977–2	11.75
1938–1	*4.05*	1953–2	12.00	1966–2	14.05	1978–1	11.75
1938–2	*3.50*	1954–1	12.00	1967–1	10.00	1978–2	13.00
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July 14, 1980
Bulletin No. 1980-28

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-180, page 7.

Bad debts; banks; charge off; instructions of supervisory federal authority. A bank charged off the entire outstanding balance of a loan in accordance with a specific order by the bank's supervisory federal authority and deducted the balance on that year's tax return as a bad debt. In a later year, the authority reconsidered its charge off action and took the position that only two-thirds of the balance should be classified as a loss. The bank's bad debt deduction was proper and the later action by the authority does not constitute a recovery.

Rev. Rul. 80-181, page 14.

Controlled corporations; split-off; active business requirement. Rev. Rul. 79-394 is amplified to hold that the wholly owned subsidiary corporation whose stock was to be distributed in the transaction described in that ruling would satisfy the active business requirement of section 355(b) of the Code even if the related corporations were not reimbursed for the services performed by their officers and employees for the subsidiary. In the absence of reimbursement, section 482 would be applicable to allocated income and deductions among the corporations to reflect an arm's length charge for the services.

Rev. Rul. 80-182, page 15.

Oil and gas leases; removal of offshore platforms and wells. A corporation using the accrual method of accounting entered into long-term offshore oil and gas leases with the federal government under which the corporation was required to remove the platforms and well fixtures upon abandonment of the wells or termination of the leases. The corporation may deduct the cost of removing the platforms and well fixtures only in the taxable year during which the removal services are performed by the corporation or by a separate contractor.

Rev. Rul. 80-183, page 16.

Depletion; gross income from mining; transportation in excess of 50 miles. A domestic corporation is engaged in mining a mineral for export in a foreign country that required the location of processing facilities in an area that is more than 50 miles from the point of extraction to encourage economic development of the area. The corporation derived economic benefit by developing the processing facilities in the required area. The transportation of the mineral in excess of 50 miles from the point of extraction to the processing facilities is "mining" within the meaning of section 613(c)(2) of the Code.

Rev. Rul. 80-184, page 17.

Involuntary conversions; severance-damage award reinvested; similar property. Part of a severance-damage award was used to demolish a building leased to retail stores and to construct a warehouse for lease in its place. The remaining part of the award was used to purchase another parcel of land and to construct an office building thereon. The business risks and responsibilities in managing the warehouse and office building were

(Continued on page 4)

Finding Lists begin on page 33.
Announcement of Disbarment and Suspensions on page 31.
Announcement of Proposed Rulemaking on page 32.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

substantially similar to those under the leases with the retail stores. The investments constitute reinvestments in property similar or related in service or use for purposes of deferring the recognition of gain under section 1033(a)(2)(A) of the Code.

Rev. Rul. 80-193, page 5.
Arbitrage bonds; grant anticipation notes. A description is given of grant anticipation notes issued to provide interim financing for the construction of additions to a sewer system that are arbitrage bonds within the meaning of section 103(c)(2) of the Code.

T.D. 7700, page 7.
Amendments to the regulations under section 191 of the Code relate to amortization of certain rehabilitation expenditures for certified historic structures.

Announcement 80-89, page 30.
The Technical Corrections Act of 1979 provides that the new jobs credit is retroactively elective rather than mandatory and that the targeted jobs credit expiration date is extended.

EMPLOYEE PLANS

Announcement 80-92, page 30.
Form 3672, Application for Approval of Master or Prototype Defined Contribution Plan for Self-Employed Individuals, has been revised and should be available in Service offices by the end of July. Applicants are requested to use the new form as soon as it becomes available.

ESTATE TAX

Rev. Rul. 80-185, page 19.
Gift tax credit; "second limitation"; donee other than spouse. For the purpose of computing the "second limitation" of the credit for gift tax, the value of the gift made to a donee other than the decedent's spouse is not reduced under section 2012(b)(2) of the Code by the additional marital deduction that results from inclusion of the gift in the gross estate.

GIFT TAX

Rev. Rul. 80-186, page 19.
Option transferred; nominal consideration; related party. A transfer to a related party for nominal consideration of an option to purchase real property, for a specified period at a price below fair market value, is a completed gift on the date the option is transferred if under state law the option is binding and enforceable on the date of transfer.

EMPLOYMENT TAXES

T.D. 7701, page 20.
Amendments to the regulations under section 6302 of the Code relate to the deposit requirements for social security and withheld income taxes.

ADMINISTRATIVE

Pub. L. 96-249, page 25.
The Food Stamp Act Amendments of 1980 provide that the Social Security Administration may disclose certain return information to the Department of Agriculture and to a state food stamp agency for purposes of, and to the extent necessary in, determining an individual's eligibility for benefits or the amounts of the benefits under the food stamp program.

Del. Order 156 (Rev. 1), Amend. 1, page 29.
Disclosure of returns and return information. Authority to disclose returns and return information to federal officers or employees for administration of nontax federal criminal laws has been decentralized; Del. Order 156 (Rev. 1) amended.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-7: Interest.

Whether interest on obligations of a political subdivision will be exempt from tax. See Rev. Rul. 80-193, below.

Section 103.—Interest on Certain Governmental Obligations

26 CFR 1.103-13: Arbitrage bonds.
(Also Section 61; 1.61-7.)

Arbitrage bonds; grant anticipation notes. A description is given of grant anticipation notes issued to provide interim financing for the construction of additions to a sewer system that are arbitrage bonds within the meaning of section 103(c)(2) of the Code.

Rev. Rul. 80-193

ISSUE

Will a sewer authority fail to comply with the arbitrage yield restrictions of section 103(c) of the Internal Revenue Code with respect to an issue of grant anticipation notes in the circumstances described below?

FACTS

On January 2, 1981, sewer authority *M*, a political subdivision of the state of *O*, will issue $4,500,000 in grant anticipation notes, the proceeds of which will be used to provide interim financing for the construction of additions to *M*'s sewer system. The total cost of the project will be $6,000,000. Construction will begin shortly after the notes are issued and is scheduled for completion by March 31, 1982.

On December 31, 1980, *M* expects to have $1,500,000 and a "reasonably required cash balance" of $400,000 on hand to begin the project. *M* anticipates that it will spend $400,000 a month and that grant installments of $1,500,000 will be forthcoming from the Environmental Protection Agency on June 30, 1981, December 31, 1981, and on June 30, 1982, and plans to retire $1,500,000 of notes within 6 months of the receipt of each installment. Thereafter, *M* expects to receive revenues in the nature of connection fees from hookups to the sewer system.

During the construction period, the note proceeds not being used to pay for construction expenses will be invested in federal obligations at a yield that is materially higher than the yield on the notes under section 1.103-13(b)(5)(iv) of the Income Tax Regulations.

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include interest on the obligations of a state or a political subdivision of a state.

Section 103(c)(1) of the Code provides that, with certain minor exceptions, the interest on any arbitrage bond will not be excludable from gross income.

Section 103(c)(2) of the Code provides that the term "arbitrage bond" means any obligation that is issued as part of an issue all or a major portion (more than 15 percent) of the proceeds of which are reasonably expected to be used directly or indirectly (A) to acquire securities or obligations that may be reasonably expected at the time of issuance of such issue, to produce a yield over the term of the issue that is materially higher than the yield on obligations of such issue, or (B) to replace funds that were used directly or indirectly to acquire securities or obligations described in section 103(c)(2)(A).

Section 103(c)(4) of the Code provides that an obligation shall not be treated as an arbitrage bond solely by reason of the fact that the proceeds of the issue of which such obligation is a part may be invested for a temporary period in securities or other obligations until such proceeds are needed for the purpose for which such issue was issued.

Section 1.103-14(b)(1) of the regulations provides that original proceeds and investment proceeds of an issue of governmental obligations that are invested in acquired obligations during a 3-year period (or a longer period if determined to be necessary under paragraph (b)(5) of this section) beginning on the date of issue are invested for a temporary period if the expenditure test of paragraph (b)(2), the time test of paragraph (b)(3), and the due diligence test of paragraph (b)(4) are satisfied. However, section 1.103-14(b)(1) further provides that section 1.103-14(c) applies in the case of an issue of obligations issued in anticipation of taxes or other revenues.

Section 1.103-14(c)(1) of the regulations provides that in the case of an issue of obligations issued in anticipation of taxes or other revenues, proceeds that are invested are an investment for a temporary period if such obligations—

(i) Will not be outstanding after (A) a period ending 13 months after the date on which such obligations are issued, (B) a period ending 60 days (but not more than 24 months after such obligations are issued) after the last date for payment without interest or penalty of the anticipated tax (or last installment thereof) imposed by an annual tax levy or the first year's tax (or last installment thereof) of the anticipated tax imposed by a levy for more than 1 year, or (C) in the case of obligations issued in anticipation of governmental grants or advances and not in anticipation of taxes or revenues from other sources, a period ending 6 months after the date on which the issuer expects to receive such grants or advances (but not more than 30 months after such obligations are issued), and

(ii) Will not be issued in an amount greater than the maximum anticipated cumulative cash flow deficit to be financed by such anticipated tax or other revenue sources for the period for which such taxes or other revenues are anticipated and during which such obligations are outstanding.

Section 1.103-14(c)(2) of the regulations defines the cumulative cash flow deficit at any time during a period as an amount equal to:

(i) The amount that the issuing state or local government unit will expend from the beginning of such period to such computation date to pay expenditures that would ordinarily be paid out of or financed by the anticipated tax or other revenues, plus

(ii) The amount reasonably required by the issuer as a cash balance on hand at all times (the amount of the anticipated expenditures for a period of 1 month from such time being deemed to be reasonably required for this purpose), minus

(iii) The sum of the amounts (other than the proceeds of the issue in question), whether in the form of cash, marketable securities, or otherwise that will be available for the payment of such expenditures from the beginning of such period to such time.

Section 1.103-14(c)(3) of the regulations provides that amounts in accounts will be considered to be available for the payment of such expenditures to the extent that such accounts may, without legislative or judicial action, be invaded to pay such expenditures without a legislative, judicial, or contractual requirement that such accounts be reimbursed.

The following table illustrates the projected month-to-month financial status of *M* for the period beginning one month before the notes are issued and ending when the last installment is received:

Month	Cumulative Surplus (or Deficit) At End of Month *	Expenditures	Receipts
Dec. 1980	$1,500,000	$ —0—	—0—
Jan. 1981	1,100,000	400,000	—0—
Feb. 1981	700,000	400,000	—0—
March 1981	300,000	400,000	—0—
April 1981	(100,000)	400,000	—0—
May 1981	(500,000)	400,000	—0—
June 1981	600,000	400,000	$1,500,000
July 1981	200,000	400,000	—0—
Aug. 1981	(200,000)	400,000	—0—
Sept. 1981	(600,000)	400,000	—0—
Oct. 1981	(1,000,000)	400,000	—0—
Nov. 1981	(1,400,000)	400,000	—0—
Dec. 1981	(300,000)	400,000	$1,500,000
Jan. 1982	(700,000)	400,000	—0—
Feb. 1982	(1,100,000)	400,000	—0—
March 1982	(1,500,000)	400,000	—0—
April 1982	(1,500,000)	—0—	—0—
May 1982	(1,500,000)	—0—	—0—
June 1982	—0—	—0—	$1,500,000

* Does not include amount of reasonably required cash balance of $400,000.

In this case the maximum anticipated cumulative cash flow deficit is the $1,500,000 deficit to be reached in March of 1982. This amount is determined by subtracting $4,900,000, the sum of the amounts that will be available to *M* until that date for the payment of expenditures, from $6,400,000, *M*'s total expenditures until that date plus one month's reasonably required cash balance. Although *M* will retire a portion of the note within 6 months of the receipt of each installment, this does not mean that these installments are unavailable to *M*. Evidence of this can be found by the fact that under prior versions of the regulations in existence before current section 1.103-14(c)(2)(iii) was promulgated as part of the proposed regulations of May 8, 1978 (43 FR 19675), the parenthetical in subparagraph (2)(ii) read "other than the proceeds of the anticipated tax or other revenues." This change in language indicates a specific intent that the grants be available. Thus, section 1.103-14(c)(1)(i)(C) does not require that *M* retire the notes until the earlier of 6 months after the last installment is received or 30 months after the notes were issued.

Because *M*'s issuance of notes will be in excess of the maximum anticipated cumulative cash flow deficit, *M*'s investment of the note proceeds in the federal obligations will not qualify as an investment for a temporary period under section 1.103-14(c)(1) of the regulations.

Section 1.103-13(b)(5)(i) of the regulations provides that the yield produced by acquired obligations is materially higher than the yield produced by a yield on an issue of governmental obligations if the yield produced by the acquired obligations exceeds the yield produced by the issue of governmental obligations by more than one-eighth of one percentage point.

Section 1.103-13(b)(5)(iv) of the regulations defines the term "materially higher" in those situations in which it is reasonably expected that the original proceeds of an issue will exceed the amount necessary for the governmental purpose or purposes of the issue by more than 5 percent of such amount. Any portion of the issue issued solely for the purpose of investing such portion at a materially higher yield as less than a major portion is not issued for a governmental purpose. The yield produced by acquired obligations acquired with the proceeds of such issue is materially higher than the yield produced by an issue of governmental obligations if the yield produced by the acquired obligations is higher than $Y + [(\$5,000 \times Y) \div P]$ where "Y" stands for the yield on the issue and "P" stands for the amount of the original proceeds of the issue.

M's issuance of the notes in the amount of $4,500,000 will exceed by more than 5 percent the amount necessary to satisfy the governmental purpose of the issue. Therefore, *M* will be subject to the yield restrictions of section 1.103-13(b)(5)(iv) of the regulations in determining the permissible yield for the note proceeds.

HOLDING

The issuance of *M*'s notes will fail to comply with the arbitrage yield restrictions of section 1.103-13(b)(5)(iv) of the regulations, and the notes will be arbitrage bonds within the meaning of section 103(c)(2) of the Code. Therefore, the interest on the notes will not be excludable from gross income under section 103(a)(1).

Section 111.—Recovery of Bad Debts, Prior Taxes, and Delinquency Amounts

26 CFR 1.111-1: Recovery of certain items previously deducted or credited.

Whether an expression of doubt issued subsequent to the issuance of a charge off order by a supervisory federal authority constitutes a recovery of a bank's previously deducted bad debt. See Rev. Rul. 80-180, below.

Section 166.—Bad Debts

26 CFR 1.166-2: Evidence of worthlessness. (Also Section 111; 1.111-1.)

Bad debts; banks; charge off; instructions of supervisory federal authority. A bank charged off the entire outstanding balance of a loan in accordance with a specific order by the bank's supervisory federal authority and deducted the balance on that year's tax return as a bad debt. In a later year, the authority reconsidered its charge off action and took the position that only two-thirds of the balance should be classified as a loss. The bank's bad debt deduction was proper and the later action by the authority does not constitute a recovery.

Rev. Rul. 80-180

ISSUES

Does a subsequent expression of doubt as to the worthlessness of a bank's loan by a supervisory federal authority affect the conclusive presumption of worthlessness arising from a specific order by that federal authority to charge off the entire outstanding balance of the questionable loan?

Does such an expression of doubt constitute a recovery of a previously deducted bad debt?

FACTS

A commercial bank made an unsecured loan to *X*, a corporation, in 1972. In 1973, *X* filed a petition for voluntary bankruptcy and has since been operating under section 77 of the Bankruptcy Act. In 1974, in obedience to the specific order of its supervisory federal authority, the bank charged off the entire outstanding balance of the *X* debt. The bank, which employs the specific charge off method of accounting for bad debts, deducted the balance of the *X* debt on its 1974 federal income return.

In 1976, the supervisory federal authority advised the bank by letter that it had reconsidered its charge off action regarding the *X* loan and had taken the position that only two-thirds of the *X* debt will be classified as a loss and the balance will be viewed as doubtful.

LAW AND ANALYSIS

Section 1.166-2(d)(1) of the Income Tax Regulations provides that if a bank, which is subject to supervision by federal authorities, charges off a debt in whole or in part in obedience to the specific orders of such authority, then the debt shall, to the extent charged off and deducted for federal income tax purposes, be conclusively presumed to be worthless during the taxable year.

The purpose of this regulation is to insure that a taxpayer receives fair and consistent treatment when dealing with the Service and another branch of the federal government. *United States v. Beckman,* 104 F. 2d 260 (3d Cir. 1939). Thus a debt charged off pursuant to the orders of a supervisory federal authority is conclusively presumed to be worthless during the taxable year pursuant to section 1.166-2(d) of the regulations. An expression of doubt on a subsequent year cannot affect the conclusive presumption. Therefore, the bad debt deduction claimed by the bank in 1974 is proper.

Section 1.111-1(a)(2) of the regulations provides that recoveries result from the receipt of amounts in respect of the previously deducted section 111 items, such as from the collection or sale of a bad debt. For there to be a recovery of a bad debt there must be a receipt of amounts attributable to such debt or an event inconsistent with the prior deduction. In this context, an event is inconsistent with the prior deduction only if the taxpayer's actual dealings with, as opposed to book entries with respect to, the item are inconsistent with such deduction. The mere expression of doubt does not constitute a receipt or an inconsistent event.

HOLDINGS

Because the expression of doubt, which was issued in a year subsequent to the issuance of the original charge off order, did not affect the conclusive presumption of worthlessness, the bank's bad debt deduction in 1974 was proper.

The expression of doubt does not constitute a recovery for purposes of the tax benefit rule.

Section 191.—Amortization of Certain Rehabilitation Expenditures of Certified Historic Structures

26 CFR 1.191-1: Amortization of certain rehabilitation costs for certified historic structures.

T.D. 7700

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 7.—TEMPORARY INCOME TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1976

Amortization of Certain Rehabilitation Costs for Certified Historic Structures

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to amortization of certain rehabilitation expenditures for certified historic structures. Changes to the applicable tax law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1] and the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1]. The regulations affect all persons desiring to amortize such rehabilitation expenditures and provide them with the guidance needed to comply with the law.

DATE: The regulations are effective for additions to capital account after June 14, 1976, and before June 15, 1981.

FOR FURTHER INFORMATION CONTACT: H. B. Hartley of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224, Attention: CC:LR:T, 202-566-3287 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On August 30, 1978, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) and the Temporary Income Tax Regulations under the Tax Reform Act of 1976 (26 CFR Part 7), all under section 191 of the Internal Revenue Code of 1954 ("Code") (43 FR 38731). The amendments were proposed to conform the regulations to section 2124 (a)(1) and (3)(B) of the Tax Reform Act of 1976 (90 Stat. 1916).

Technical amendments were made to section 191 of the Code by section 701(f)(1), (2), and (7) of the Revenue Act of 1978 (92 Stat. 2900, 2903). These statutory amendments made by the Revenue Act of 1978 were only technical changes and prescribe rules favorable to taxpayers. For this reason and because there is a need for immediate guidance for taxpayers, the relevant provisions of the Administrative Procedure Act (5 U.S.C. 553) requiring further notice of proposed rulemaking, opportunity for public participation, and delay in effective date are found to be inapplicable to changes to the August 1978 proposed regulations necessitated by these statutory changes.

A public hearing on the proposed regulations was held on March 15, 1979. After consideration of all written and oral comments regarding the proposed amendments, final regulations are adopted by this Treasury decision.

PROVISIONS OF THE REGULATIONS

Under section 191, owners of historic structures certified by the Secretary of the Interior may elect to amortize the amortizable basis attributable to costs incurred in certified rehabilitation of these structures. If this election is made, the rehabilitation costs are amortized over a 60-month period rather than depreciated over their actual useful life. Amortization deductions under section 191 may not be claimed if any part of the costs of the certified rehabilitation are deducted under any other provision of the Internal Revenue Code. However, allowable depreciation deductions of the basis of the historic structure, exclusive of the rehabilitation costs, may be continued during the amortization period. If an election involving the historic structure is made under section 191, no election may be made under section 167(o).

The election is available to owners, life tenants, and certain lessees of certified historic structures. In general, these persons may amortize only those expenditures made while they own (or lease) the property and only those expenditures for rehabilitation of an existing historic structure.

In the event of a disposition of the property, part or all of the amounts deducted under section 191 may be recaptured as ordinary income. In addition, the difference between rapid amortization and straight-line depreciation (based on the actual useful life of the structure) may be subject to the minimum tax.

All costs of a certified rehabilitation are generally amortizable. However, costs attributable to nondepreciable portions of a certified historic structure (where only part of the structure is used in a trade or business or for the production of income) and costs of new construction associated with a certified rehabilitation are not amortizable.

To elect the 60-month amortization, the taxpayer indicates that the election is being made as directed on the taxpayer's return for the taxable year in which falls the first month of the amortization period chosen pursuant to section 191(a). The election may be made after a request has been made for, but before, certification of the project by the Department of the Interior. If the election is made before final certification is received, proof of certification is to be submitted with the first tax return filed by the taxpayer after receipt of the certification. If proof of certification is not submitted within 30 months after commencement of the amortization period, the taxpayer may be asked to agree to an extension of time for assessment of additional tax for the period for which amortization deductions are claimed.

Once made, the election may be discontinued at any time by filing written notice with the taxpayer's income tax return for the year in which amortization is to cease.

ADDITIONAL CONSIDERATIONS

These regulations are needed in order to provide guidance to the public as well as to government employees responsible for the implementation of section 191 of the Code. Considering both the direct and indirect effects of these regulations, it is believed that they satisfactorily implement section 2124(a)(1) and (3) of the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 392], as amended by section 701(f)(1), (2), and (7) of the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, 134]. Evaluation of the effectiveness of the regulations after issuance will be based upon comments received from offices within the Internal Revenue Service and the Treasury Department, the Department of the Interior, other government agencies, and the public.

PUBLIC COMMENTS

Twenty-five comments were received in response to the proposed regulations. As a general matter, these comments pointed out that the proposed regulations did not reflect changes made in the law by the Revenue Act of 1978. The technical amendments made by that Act (which became law after publication of the proposed regulations) have been incorporated at the appropriate places throughout the regulations. See, for example, § 1.191-1 (b)(3) on the relation of section 191 to other Code provisions, § 1.191-1(c) (2)(vi) on rules for lessees, § 1.191-1 (e) on the relation of section 191 to the minimum tax, and §§ 1.191-2(a) and (b) for amended definitions of "certified historic structure" and "registered historic district." One comment urged permitting separate amortization periods to be established for any expenditures made during a given month. This suggestion was not adopted since section 167, which applies if section 191 is not elected, requires the presence of a component part of a structure for depreciation to be allowable. This rule has been restated in § 1.191-1(b)(1)(i) to remove any doubt concerning whether a component part is required for a separate amortization period to be established. Another comment requested express provisions governing demolition undertaken as part of certified rehabilitation. New § 1.191-1(b)(4) and § 1.191-2(e)(7) have been added to provide specific rules on demolition. Under new § 1.191-1(b)(4), if an historic structure is expanded to the site of another demolished historic structure by certified rehabilitation, section 191 treatment is still available despite the provisions of section 167(n). Portions of the rehabilitated historic structure actually on the demolition site would, however, be subject to the limitations of section 167(n). This position was adopted because it is believed that the requirement that the rehabilitation be certified by the Secretary of the Interior will insure protection of all structures intended to be protected by section 167(n). Two comments requested clarification of the rule contained in the proposed regulations making certain transferees of certified historic structures eligible for section 191 treatment. Section 1.191-1(b)(6) was amended to clarify that, if amortization deductions are discontinued during the 60-month period, the remaining depreciable life of the structure is determined at time amortization ceases. Section 1.191-1(c)(2)(iii) was amended to indicate that transferees at the completion of rehabilitation are eligible for section 191 treatment even where the structure was not taken out of service during rehabilitation. Another change to § 1.191-1(c)(2)(iii) clarifies that, for a transferee to elect section 191, the transfer to him must occur before the property is placed in service after rehabilitation, even though the transferor could elect to delay amortization deductions until the first month of the following taxable year and had in fact claimed no amortization deductions at the time of the transfer. In response to other requests, § 1.191-1(c)(viii) was amended to accord treatment as lessees to all concessionaires where Federal government restrictions prevent leasing the property. Two comments requested extension of section 191 treatment to ships that are individually listed on the National Register of Historic Places whether or not they are permanently anchored so as to become real property. This suggestion was not adopted because section 191, as is true of all of section 2124 of the Tax Reform Act of 1976 is applicable only to real property. See § 1.191-2(c). Some comments expressed confusion as to the meaning of a "reconstruction" of an historic structure which is excluded from section 191 treatment. This term had been used because it is used in Interior Department guidelines. To eliminate this confusion, however, § 1.191-2(d) was amended to substitute the term "reproduction" for "reconstruction." Thus, "reproductions" of historic structures are excluded from section 191 treatment. Section 1.191-2(e)(1) was expanded in response to comments which revealed a misunderstanding of the respective roles of the Internal Revenue Service and the Department of the Interior in implementing section 191. That paragraph now expressly states that the Interior Department certifies that standards of historic character are met while the Internal Revenue Service determines other rules governing eligibility for section 191 treatment. Section 48 on investment tax credits for rehabilitated buildings contains a requirement that 75 percent of the existing exterior walls of a structure remain after rehabilitation. Similarly, regulations under 167(k) state that if one or more outer walls and the internal structural framework of a building are replaced, expenditures are generally attributable to new construction. In response to the comments and to provide more consistent rules throughout the Code, § 1.191-2(e)(5) now contains a comparable rule. Section 1.191-2(e)(5) was also amended to indicate that buildings may be disassembled and reassembled and a part of certified rehabilitation because this is a frequent rehabilitation technique. In response to a request from the Department of the Interior, new §§ 1.191-2(e)(6) and (7) were added to provide rules on costs of relocating structures and demolition expenses incurred as part of certified rehabilitation. One comment questioned the rule on when additions to capital account are made which is contained in § 1.191-2(e)(8). To provide more nearly equal treatment for rehabilitations begun before June 14, 1976, and those ending after June 14, 1981, § 1.191-2(e)(8) was changed to permit amortization of costs attributable to completed components of rehabilitations still in progress on June 14, 1981. A conforming paragraph, § 1.191-3(b)(4), was added to permit elections to be made after June 14, 1981, for expenditures attributable to these completed components.

DRAFTING INFORMATION

The principal author of these regulations was H. B. Hartley of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, amendments to the regulations (26 CFR Parts 1 and 7), are hereby adopted as set forth below.

INCOME TAX REGULATIONS
(26 CFR Part 1)

Paragraph 1. The following new sections are added immediately after § 1.190-3.

§ 1.191-1. Amortization of certain rehabilitation costs for certified historic structures.

(a) *In general.* Section 191 allows an owner of a certified historic structure who rehabilitates that structure to elect to amortize over a 60-month period certain expenditures attributable to certified rehabilitation. The election may be made only if the certified historic structure (as defined in § 1.191-2(a)) and the improvements made are otherwise of a character subject to depreciation under section 167. In general, only those rehabilitation expenditures which result in additions to capital account after June 14, 1976, and before June 15, 1981, are eligible for this special amortization procedure. To qualify for the election, the rehabilitation must be certified by the Secretary of the Interior to the Internal Revenue Service as consistent with the historic character of the structure. See § 1.191-2(d) for the definition of certified rehabilitation. Along with the amortization deductions, the taxpayer may continue otherwise allowable depreciation deductions of the basis of the structure, exclusive of rehabilitation costs which are a part of the amortizable basis (as defined in § 1.191-2(e)).

(b) *Allowance of deduction*—(1) *Determination of amortization period*—(i) *General rule.* The taxpayer may elect to begin the 60-month amortization period with the month following the month in which the amortizable basis is acquired, or with the first month of the succeeding taxable year. Generally amortizable basis must be acquired after June 14, 1976, and before June 15, 1981. For purposes of this section, the month in which the amortizable basis is acquired is the latest of the month in which the work (or a component part of the work) is completed, the month in which costs are added to capital account, or the month in which depreciation deductions under section 167 would be first allowable with respect to the structure. See, however, § 1.191-2(e)(8) for special rules for certified rehabilitations in part occurring outside the effective period of section 191. No amortization deduction may be claimed before a building is used (or held for use) in a trade or business or for the production of income.

(ii) *Multiple amortization periods.* After a structure is eligible for depreciation, a separate amortization period may be established for each month's expenditures and completed work as that portion of the rehabilitation is placed in service in a depreciable use. The completed work for which a separate amortization period is established must, however, be an identifiable separate component of the entire project and not simply progress payments upon partial completion of overall rehabilitation activities. For example, a single structure could have a series of amortization periods based upon the component parts of the work completed and expenditures made for those component parts during each month in which the certified rehabilitation is in progress if the structure were already depreciable before completion of the rehabilitation activities. Alternatively, the taxpayer may treat his entire amortizable basis as acquired upon completion of the entire rehabilitation project rather than allocating amounts to each month in which the costs of component parts could have been added to basis. This treatment applies although rehabilitation extends over more than one taxable year, if there is no interruption in rehabilitation activities. If the taxpayer chooses to delay amortization deductions until completion of an entire project, then depreciation deductions with respect to any portion of the rehabilitation expenditures are treated as not allowable until the completion.

(2) *Amount of deduction.* The allowable deduction for each month is determined by dividing the amortizable basis as of the last day of the month by the number of months (including the current month) which remain in the 60-month amortization period. This calculation is repeated for each month of the 60-month period to determine each month's allowable amount of amortization deduction.

(3) *Relation to section 167(o) and other provisions.* If an election involving a certified historic structure is made under section 191, no election may be made under section 167(o) either for the same rehabilitation or for any subsequent rehabilitation of the same structure undertaken by the taxpayer making an election under section 191. Additionally, no election is permitted under section 191 if depreciation deductions or credits against tax based upon any part of the costs qualifying for amortization under section 191, are at any time claimed (or allowable (under any depreciation or other provision of the Internal Revenue Code of 1954. However, this limitation with respect to investment tax credits under section 18 applies only to structures placed in service after October 31, 1978. If section 191 treatment is timely elected on a structure placed in service after October 31, 1978, the investment tax credit under section 38 is considered not to have been allowable with respect to that structure.

(4) *Expansions of rehabilitated structures to sites of demolished structures.* If a certified rehabilitation results in expansion of a certified historic structure to the site of a separate certified historic structure which is demolished as part of the rehabilitation, section 191 treatment is not available with respect to any expenditures attributable to that demolition or to any expenditures attributable to portions of the rehabilitated historic structure actually located on the demolition site. (See § 1.191-2(e)(7).) Subject to this restriction, however, section 191 treatment is available for expenditures for certified rehabilitation of the remaining historic structure which form a part of amortizable basis under § 1.191-2(e). See section 167(n) for special rules on depreciation of structures on sites previously occupied by certified historic structures and section 280B for rules on demolition costs.

(5) *Depreciation upon notice to discontinue amortization deductions.* If the taxpayer chooses to discontinue amortization deductions, the unamortized rehabilitation costs are added to the adjusted basis of the structure as of the first day of the month for which the notice to discontinue amortization deductions is effective. Deductions for depreciation of the structure under section 167 may then be computed on the resulting adjusted basis beginning at that time and are based on the estimated remaining useful life of the rehabilitated structure, determined as of the date amortization deductions cease.

(6) *Examples.* The provisions of this paragraph (b) may be illustrated by the following examples:

Example (i). A, a calendar-year taxpayer, secured the necessary certifications from the Secretary of the Interior and began rehabilitation of a 100-year-old townhouse previously rented as a one-family dwelling, in order to convert it into two equally-sized apartments. In June 1977, the exterior work was completed, and A paid his contractor the cost of $20,000. Apartment #1 was completed and rented in September, and the cost of $40,000 was paid. In November, Apartment #2 was finished and rented, and A paid the cost of $47,500. A elects to use the 60-month amortization allowed under section 191. A chooses to establish separate amortization periods for each of these phases of the work, each period beginning at the earliest possible date. These periods and the amortizable basis for each period are as follows:

Apartment No. 1, and Allocable Portion of Exterior, beginning October 1, 1977, $50,000 basis.

Apartment No. 2, and Allocable Portion of Exterior, beginning December 1, 1977, $57,500 basis.

If A had chosen to do so, A could have selected an amortization period for the entire amortizable basis of $107,500 beginning on December 1, 1977, or January 1, 1978.

Example (*ii*). B owns a 19th Century warehouse building which is listed in the National Register. In a certified rehabilitation B converted the building into a small shopping mall at a cost of $480,000. The rehabilitation was begun in January 1977, and was completed, placed in service, and paid for in November 1977. B elected to claim amortization deductions under section 191 and to begin the amortization period in December 1977. B's allowable amortization deductions are $8,000 per month, computed as follows:

December 1977: $480,000 amortizable basis/60 months in period = $8,000 deduction.

January 1978: $472,000 amortizable basis/59 months in period = $8,000 deduction.

(c) *Person to claim deduction*—(1) *In general.* Except as otherwise provided in this paragraph (c)—

(i) Only the owner of a fee-simple interest in a certified historic structure and the site on which the structure is located may elect to amortize certified rehabilitation costs; and

(ii) The electing owner must have acquired ownership of the property before commencement of rehabilitation activities, the costs of which are to be amortized.

An electing owner need not have owned the property before commencement of all rehabilitation activities. Where the property is not acquired before rehabilitation begins, however, only those costs incurred subsequent to the acquisition of ownership of the site and structure may be considered for purposes of amortization deductions under section 191.

(2) *Exceptions and special rules*—(i) *Life tenant and remainderman.* For purposes of section 191, the holder of a life estate in property is considered to own the property. A remainderman taking the property on the death of the life tenant is permitted to amortize only those rehabilitation costs which are incurred for improvements begun following termination of all preceding interests in the property and paid by the remainderman.

(ii) *Owners of joint or undivided interests in historic structures.* Joint tenants, tenants by the entirety, tenants in common, and owners of other joint or undivided interests in a certified historic structure may, under section 191, amortize expenditures made for certified rehabilitation. The right of any one such owner to make an election under section 191 is not dependent upon any other co-owner making such an election. Each electing owner's amortizable basis consists of the full amount of expenditures actually made by that individual owner for certified rehabilitation. See paragraph (c)(2)(v) of this section for rules on partnerships.

(iii) *Certain transferees of historic structures.* If expenditures for certified rehabilitation are in fact made by the owner of a certified historic structure, and if one or more transferees then acquire the ownership of the rehabilitated structure directly from that owner before the structure is placed in service in its rehabilitated use, the transferees, solely for purposes of section 191, may be treated as having made the rehabilitation expenditures at the later of the time the structure is acquired or the rehabilitation is completed. Transferees acquiring structures in transfers occurring after the structure is placed in service after its rehabilitation but before the first day of the following taxable year, are not eligible for section 191 treatment, because depreciation deductions for rehabilitation costs are allowable to the transferor before the transfer. The amount of rehabilitation expenditures treated as made by the transferees under this subdivision (iii) is the lesser amount of—

(A) The rehabilitation expenditures actually made before the date on which the transferee acquired ownership of the structure, or

(B) The portion of the transferee's cost or other basis for the property (determined according to the rules of section 167) which is attributable to rehabilitation expenditures made before the date on which the transferee acquired ownership of the structure.

(iv) *Estates and trusts.* The amortization deduction provided by section 191 is allowable to estates and trusts; see sections 642(f) and 1.642(f)-1.

(v) *Partnerships.* Partnerships owning certified historic structures may elect to amortize expenditures for certified rehabilitations made by the partnerships. Any election for partnership property must be made by the partnership and not by the partners individually.

(vi) *Lessees of historic structures.* A lessee of an historic structure (including a structure which is not depreciable to the lessor) which is certified by the Secretary of the Interior and which is used by the lessee in a depreciable use can elect under section 191 to amortize rehabilitation expenditures actually made by the lessee. A lessee can make an election under section 191 only if the remaining term of the lease equals or exceeds both a period of 30 years and the actual useful life of the improvements constituting the certified rehabilitation. The lessee's remaining lease term is measured as of the date on which the full certified rehabilitation is completed. Under section 191(f)(2), renewal periods are not treated as part of the remaining lease term. However, if, before the date on which the full rehabilitation is completed, the lessee becomes obligated for periods beyond the current term of the lease to the same extent that the lessee is obligated during the current term, those additional periods are considered to be part of the current lease term and not renewal periods.

(vii) *Concessionaires from governmental entities.* For purposes of section 191 and this section, holders of concession contracts on properties owned by the Federal government or by any State or local government who do not lease the property because of express Federal government restrictions, are, nevertheless, considered to be lessees.

(d) *Recapture.* If a taxpayer disposes of property for which the taxpayer has claimed amortization deductions under section 191, part or all of any gain on the disposition may be recaptured as ordinary income under the applicable provisions of the Code.

(e) *Minimum tax on preference income under section 56.* Amortization deductions under section 191 are items of tax preference for purposes of the minimum tax to the extent the deductions exceed the amount that may be claimed under straight-line depreciation using the actual useful life of the property. See section 57(a)(2). For special rules for elevators and escalators, see section 57(a)(1).

§ 1.191-2 Definitions and special rules.

(a) *Certified historic structure.* A certified historic structure is a building or other structure which is of a character subject to depreciation under section 167 and is either—

(1) Listed in the National Register of Historic Places, or

(2) Located in a registered historic district and certified by the Secretary of the Interior as being of historic significance to the district.

Under section 191, a structure is considered to be of a character subject to depreciation only if its first use following completion of certified rehabilitation is a use in a trade or business or for the production of income.

(b) *Registered historic district.* A registered historic district is—

(1) A district listed in the National Register of Historic Places, or

(2) A district designated under a statute (including an ordinance) of a State (or local government), but only if the Secretary of the Interior certifies that—

(i) The statute contains criteria which achieve the purpose of preserving historically significant buildings; and

(ii) The district meets substantially all of the requirements for districts to be listed in the National Register of Historic Places.

(c) *Structure.* A structure is a specific building or other man-made construction which constitutes depreciable real property under section 167 of the Code. The term structure does not include ships, other vessels, aircraft, railway cars, or other construction which does not constitute real property even though the other items are listed in the National Register of Historic Places. The term structure also does not include site work or other related items associated with the building or other construction. Examples of structures include rental housing, office buildings, lighthouses, hotels, factories, and bridges.

(d) *Certified rehabilitation.* A certified rehabilitation consists of improvements to or restoration of an existing certified historic structure, which the Secretary of the Interior certifies to be consistent with Interior Department standards for rehabilitation. Reproduction (as opposed to restoration) of an historic structure is not a certified rehabilitation even in cases where the reproduction is listed in the National Register upon its completion since it does not enhance the historic value of an existing historic structure.

(e) *Amortizable basis*—(1) *In general.* The amortizable basis of a certified historic structure consists of any otherwise depreciable additions to the capital account of the structure during the effective period of section 191. See § 1.191-2(e)(8) for rules on the time amounts are added to capital account and on the effective period of section 191. Only amounts expended by the electing person directly for rehabilitation of existing historic structures are part of amortizable basis. Amortizable basis does not include new construction even though the certification of rehabilitation by the Secretary of the Interior certifies that the entire project is consistent with Interior Department standards and makes no distinction between rehabilitation of the existing historic structure and new construction relating to the historic structure. Amortizable basis also does not include certain additions which do not meet the requirements of paragraphs (d) and (e) of this section even though such additions are considered under local law to be rehabilitation. For purposes of section 191, architectural and engineering fees, real estate commissions, site survey fees, legal expenses, insurance premiums, developers' fees, and other construction-related costs are a part of amortizable basis. Any costs for which a deduction is claimed under any other section of the Code or for which specific provision is made in another section of the Code (such as section 189 on construction period interest and taxes or section 266 on carrying charges) are not a part of amortizable basis. Any costs which must be added to the basis of land associated with the historic structure, rather than depreciated under section 167, are not a part of the amortizable basis.

(2) *Partially depreciable property.* A certified historic structure may be depreciable only in part, as, for example, a private residence which includes a separate rental apartment. In such case, only that portion of the costs of the certified rehabilitation which is attributable to the portion of the total structure that is depreciable propery under section 167 is a part of amortizable basis. The determination of the portion of the expenditures which is included in amortizable basis is made according to the rules of section 167. The remaining certified rehabilitation costs must be added to the nondepreciable portion of the basis of the historic structure.

(3) *Rehabilitations which include new construction.* If a rehabilitation project only partially qualifies for amortization deductions because a portion of the project is new construction (as defined in this paragraph (e)), the apportionment rules of section 167 apply to determine the amount of the taxpayer's amortizable basis. For example, the cost of a single heating system used both for a rehabilitated historic structure and for a nonhistoric new wing added thereto would be apportioned between the amortizable rehabilitation costs and nonamortizable new construction costs.

(4) *Modernization of existing structure included.* Expenditures for structural modernization of an existing historic structure, which are made in a rehabilitation certified by the Secretary of the Interior to be consistent with the historic character of the structure, are a part of amortizable basis. Examples of such expenditures include the costs of modern plumbing and electrical wiring and fixtures, heating and air conditioning systems, elevators, esca-

lators, and improvements required by local building or fire codes. The addition of an attached facility exclusively for elevators, fire stairs, or barrier-free access will also be considered rehabilitation, if the construction of elevators, fire stairs, or barrier-free access within the existing structure is prohibited by the Secretary of the Interior as destructive of the historic character of the structure. Carpeting, draperies, office equipment, furniture (even where it is built in), nonpermanent (demountable) walls or partitions, and other similar items of personal property are not a part of amortizable basis.

(5) *New construction excluded.* Expenditures attributable to new construction associated with a certified rehabilitation are not a part of amortizable basis. Whether expenditures are attributable to the rehabilitation of an existing structure, or are attributable to new construction, will be determined upon the basis of all the facts and circumstances. Expenditures will generally be considered attributable to rehabilitation if the foundation and outer walls of the existing building are retained and the costs are attributable to work done within that existing framework. Where the internal structural framework of a building is replaced and one or more outer walls are also replaced, all expenditures are normally attributable to new construction even though the construction may qualify as rehabilitation under local law. The internal structural framework and outer walls are not considered to have been replaced if they are disassembled and reassembled as part of rehabilitation so long as the reassembled framework and outer walls consist of at least 75% of materials original to that structure. Except as otherwise provided in this paragraph (e), any expansion of the existing structure is considered new construction even if the expansion consists of the reproduction of portions of the structure which no longer existed when rehabilitation was started. For example, the addition of a new story to an existing building is new construction. Likewise, related construction such as a garage, sidewalk, or parking lot (or the addition of landscaping) will not be considered rehabilitation even though the related construction may be physically attached to the historic structure.

(6) *Relocation of certified historic structures.* Costs attributable to relocation of an existing certified historic structure (other than costs that are not depreciable under section 167) are included in amortizable basis if the relocation is expressly approved by the Secretary of the Interior.

(7) *Rehabilitations which include expenditures for demolition.* Expenditures attributable to demolition of a portion of an existing certified historic structure as part of certified rehabilitation are included in amortizable basis. However, costs attributable to demolition of related facilities not forming a part of the existing certified historic structure, or to demolition of separate certified historic structures as part of an overall rehabilitation plan, are not included in amortizable basis. For a special rule on costs attributable to demolition of certified historic structures, see section 280B, and for rules limiting depreciation and amortization deductions for structures constructed or used in whole or in part on the site of a demolished certified historic structure, see section 167(n) and § 1.191-1(b)(4).

(8) *Time when amounts are added to capital account.* Under section 191, expenditures are treated as added to capital account at the time they are actually made (paid or accrued). However, amortizable basis includes only expenditures attributable to component parts of the structure completed before June 15, 1981. Therefore, expenditures for improvements completed after June 14, 1981, are not a part of the taxpayer's amortizable basis even though they may have been paid or accrued prior to that date. In the case of a single and continuous rehabilitation project all of which is certified by the Secretary of the Interior, expenditures for rehabilitation begun before June 14, 1976, but completed and charged thereafter, are a part of the taxpayer's amortizable basis. However, even where there is a single and continuous rehabilitation project, expenditures made for any component part of the improvements completed and charged before June 14, 1976, are not a part of the taxpayer's amortizable basis.

§ 1.191-3 Time and manner of making election.

(a) *In general.* Under section 191 (b), an election by the taxpayer (including a partnership) to claim amortization deductions with respect to a certified historic structure is made by so electing at the appropriate place on the taxpayer's return for each year in which amortization deductions are claimed. Additionally, in any year in which falls the first month of a 60-month amortization period selected pursuant to § 1.191-1(b), the amount of amortizable basis from which deductions are to be claimed during that 60-month period must be entered at the appropriate place on the return. If an election is made for more than one certified historic structure, the amount of amortizable basis for each structure must be separately entered on the return.

(b) *Special rules*—(1) *Letters of certification.* A copy of the letter of certification issued by the Secretary of the Interior qualifying each certified rehabilitation must be submitted with taxpayer's return on which an election to amortize rehabilitation expenditures for any structure is first made. If final certification of a rehabilitation has not been issued by the Secretary of the Interior by the date of the election, a copy of the first page of the application for certification of the completed rehabilitation work must be attached to the return.

(2) *Certifications not issued and failure to submit proof of certification.* If final certification of rehabilitation has not been issued at the time amortization deductions begin, the electing party must submit a copy of that certification with the first income tax return filed after the receipt by the taxpayer of the certification. If the required notice of certifications is not received by the Internal Revenue Service within 30 months after the date of the commencement of the 60-month amortization period, the electing taxpayer may be requested to consent to an agreement under section 6501(c)(4) extending the period of assessment for any tax relating to the

time for which amortization deductions are claimed.

(3) *Election of multiple amortization periods for a single structure.* If the taxpayer elects a separate amortization period for each month in which rehabilitation expenditures for a single structure are made and component work completed, the taxpayer must combine all such elections for periods beginning in one taxable year in a single election, and must enter on the return the total amount of amortizable basis from which deductions are first claimed in that year. If multiple amortization periods are selected for a single structure to commence in different taxable years, a copy of the letter certifying the rehabilitation must be attached to each return on which a deduction for a separate amortization period is first claimed.

(4) *Elections to begin amortization deductions after June 14, 1981.* Notwithstanding the rules of § 1.191-1(b)(1)(i), expenditures for component parts of a rehabilitation project which is not completed and placed in service until after June 14, 1981, are included in amortizable basis if the component parts are completed and the expenditures are added to capital account under § 1.191-2(e)(8) by that date. Amortization deductions for the costs of such component parts are allowable beginning with the month in which the entire rehabilitation would qualify under § 1.191-1(b)(1), but for the expiration of section 191 on June 14, 1981.

(c) *Notice to discontinue amortization*—(1) *In general.* A notice to discontinue amortization deductions as provided by section 191(c) may be made at any time during the amortization period. This notice is made by a statement attached to the return of the taxpayer filed for the taxable year in which falls the first month for which the election terminates. In the case of a partnership, the statement is to be attached to the partnership return. The statement must specify the month as of the beginning of which the taxpayer chooses to discontinue amortization deductions. The statement must be filed with the taxpayer's income tax return for the year in which amortization is to cease. In addition, the statement must contain a description clearly identifying the certified historic structure and rehabilitation with respect to which the taxpayer elects to discontinue the amortization deduction. In the case of multiple amortization periods relating to the same structure, an election to discontinue any amortization deductions terminates all amortization periods that have been established. If final certification of the rehabilitation has been issued, a copy of the letter of certification must be attached to the taxpayer's return. If, at the time of the election to discontinue amortization deductions, final certification has not been issued, the taxpayer must submit a copy of the first page of the application for that certification and must submit a copy of the letter of certification with the next succeeding tax return after its receipt. If the required certification has not been issued and 30 months or more have elapsed since amortization deductions under section 191 were first claimed, the taxpayer may be requested to consent to an agreement under section 6501(c)(4) extending the period of assessment for any tax relating to the time for which amortization deductions were claimed.

(2) *Notification by Secretary of the Interior.* For purposes of this paragraph (c), notification to the Secretary or his delegate from the Secretary of the Interior that he has notified the owner of the historic structure that the structure or the rehabilitation no longer meets the requirements for certification has the same effect as notice from the taxpayer electing to terminate amortization deductions as of the first day of the month following the month that the structure or rehabilitation ceased to meet the requirements of section 191.

Par. 2. Section 1.642(f)-1 is amended to read as follows:

§ 1.642(f)-1 Amortization deductions.

An estate or trust is allowed amortization deduction with respect to an emergency facility as defined in section 168(d), with respect to a certified pollution control facility as defined in section 169(d), with respect to qualified railroad rolling stock as defined in section 184(d), with respect to certified coal mine safety equipment as defined in section 187(d), with respect to on-the-job training and child-care facilities as defined in section 188(b), and with respect to certain rehabilitations of certified historic structures as defined in section 191, in the same manner and to the same extent as in the case of an individual. However, the principles governing the apportionment of the deductions for depreciation and depletion between fiduciaries and the beneficiaries of an estate or trust (see sections 167(h) and 611(b) and the regulations thereunder) shall be applicable with respect to such amortization deductions.

TEMPORARY INCOME TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1976

(26 CFR Part 7)

Par. 3. Section 7.191-1 is deleted.

This Treasury decision is issued under the authority contained in sections 191 and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1916, 92 Stat. 2900, 68A Stat. 917, 26 U.S.C. 191, 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved May 15, 1980.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on June 4, 1980, 8:45 a.m., and published in the issue of the Federal Register for June 6, 1980, 45 F.R. 38050)

Section 355.—Distribution of Stock and Securities of a Controlled Corporation

26 CFR 1.355-1: Distribution of stock and securities of controlled corporation.
(Also Section 482; 1.482-2.)

Controlled corporations; split-off; active business requirement. Rev. Rul. 79-394 is amplified to hold that the wholly owned subsidiary corporation whose stock was to be distributed in the transaction described in that ruling would satisfy the active business requirement of

section 355(b) of the Code even if the related corporations were not reimbursed for the services performed by their officers and employees for the subsidiary. In the absence of reimbursement, section 482 would be applicable to allocate income and deductions among the corporations to reflect an arm's length charge for the services.

Rev. Rul. 80-181

ISSUE

Whether the active trade or business requirement of section 355(b) of the Internal Revenue Code is satisfied if the wholly owned subsidiary corporation in the transaction described in Rev. Rul. 79-394, 1979-2 C.B. 141, does not reimburse related corporations for the use of their employees and officers in the conduct of the subsidiary's real estate activities.

ANALYSIS

In Rev. Rul. 79-394 a corporation (*P*) owned all of the stock of another corporation (*Y*) for more than 5 years, and during that period *Y* was engaged in renting real estate to unrelated third parties. *Y*'s business required considerable day to day management and operational functions and also involved acquiring, renovating, refurbishing, and servicing the real estate which it leased. *Y* had no salaried employees, but its activities were performed by employees of another corporation (*X*), which was wholly owned by *P*, who were under the supervision and control of *Y*'s officers who were also officers of *P* and *X*. *Y* reimbursed *X* for the services performed by *X*'s employees, and *Y* also reimbursed *P* and *X* for the services performed by their officers. *P* then proposed to distribute the *Y* stock to one of its (*P*'s) shareholders in a transaction intended to meet the requirements of section 355 of the Code, which, if satisfied, would make the distribution nontaxable to the *P* shareholders. After the distribution, *Y* would directly employ most of those employees who had worked on *Y*'s behalf prior to the distribution.

In considering the issue of whether before the distribution *Y* was engaged in the conduct of an active trade or business within the meaning of section 355(b) of the Code, Rev. Rul. 79-394 states that the presence or absence of formal employment of employees (other than officers) by the controlled corporation (or the distributing corporation) is only one factor to be considered in the determination under section 355(b). Rev. Rul. 79-394 concludes that the scope of *Y*'s management and operation activities was sufficient to distinguish these activities from a passive investment in real estate, even though it had no salaried employees prior to the distribution, and holds that the active trade or business requirement of section 355(b) was satisfied under these circumstances.

The fact that *Y* reimbursed *X* and *P* for the services performed by their employees and officers in connection with *Y*'s rental activities was one of the factors in favor of concluding that *Y* was engaged in the conduct of an active trade or business within the meaning of section 355(b) of the Code, and the absence of reimbursement is a negative factor in this determination. However, *Y*'s failure to reimburse *X* and *P* for the services performed by their employees and officers would not materially change the nature of *Y*'s predistribution management and operational activities, especially since *Y* would continue to supervise and control *X*'s employees in the conduct of these activities. Moreover, the fact that these services were performed by employees of *X*, which was wholly owned by *Y*'s parent (*P*), is significant in determining whether an active business was conducted by the distributing or controlled corporation during the five-year period prior to the distribution. Compare Rev. Rul. 73-234, 1973-1 C.B. 180; Rev. Rul. 73-236, 1973-1 C.B. 183; and Rev. Rul. 73-237, 1973-1 C.B. 184.

HOLDING

The active trade or business requirement of section 355(b) of the Code is satisfied even though *Y* does not reimburse *P* and *X* for the use of their employees and officers in the conduct of *Y*'s real estate activities.

If *Y* did not reimburse *X* and *P* for the services rendered to *Y* by the employees of *X* and the officers of *X* and *P*, then section 482 of the Code would be applicable to allocate income to *X* and *P* in an amount equal to an arm's length charge, pursuant to section 1.482-1(b) and section 1.482-2(b) of the Income Tax Regulations, for the services rendered by the employees of *X* and the officers of *X* and *P* to *Y*. In addition, *Y* would then be entitled to a deduction under section 162 provided the amounts deemed paid by *Y* to *X* and *P* for the services rendered represent ordinary and necessary business expenses to *Y*.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 79-394 is amplified.

Section 461.—General Rule for Taxable Year of Deduction

26 CFR 1.461-1: General rule for taxable year of deduction.

Oil and gas leases; removal of offshore platforms and well. A corporation using the accrual method of accounting entered into long-term offshore oil and gas leases with the federal government under which the corporation was required to remove the platforms and well fixtures upon abandonment of the wells or termination of the leases. The corporation may deduct the costs of removing the platforms and well fixtures only in the taxable year during which the removal services are performed by the corporation or by a separate contractor.

Rev. Rul. 80-182

ISSUE

When may a taxpayer using the accrual method of accounting deduct the cost of removing offshore platforms and well fixtures installed pursuant to a long-term oil and gas lease with the federal government?

FACTS

Situation 1

X is a corporation that files its federal income tax return on a calendar year basis using the accrual method of accounting. During 1978 *X* entered into offshore oil and gas leases with the federal government. The leases provide that *X* is obligated to remove offshore platforms and well fixtures used in the drilling operation upon *X*'s abandonment of the wells or on termination of the leases. The typical offshore lease has a duration of 20 years or more. *X* installed the offshore platforms and well fixtures in 1978 and in its federal income tax return for the year deducted the estimated cost of removing them. *X* will perform all services incidental to removing the offshore platforms and well fixtures.

Situation 2

The facts are the same as *Situation 1* except that instead of *X* performing the removal services it contracts with *Y*, an unrelated corporation, to perform them.

LAW AND ANALYSIS

Section 461 of the Internal Revenue Code provides that the amount of any deduction shall be taken for the taxable year that is the proper taxable year under the method of accounting used in computing taxable income.

Section 1.461-1(a)(2) of the Income Tax Regulations provides that under an accrual method of accounting an expense is deductible for the taxable year in which (1) all the events have occurred that determine the fact of the liability and (2) the amount thereof can be determined with reasonable accuracy. If the taxpayer is to be entitled to a deduction in 1978 for the cost of removing the platforms and fixtures, both of these conditions must be satisfied.

The specific question is whether the existence during a taxable year of a contractual obligation requiring a taxpayer to incur a deductible expense at some time in the future is sufficient to permit the accrual of such expenditure under section 1.461-1(a)(2) of the regulations even though the contractually mandated services have not been rendered by either the taxpayer or a third-party contractor at the end of the taxable year.

An accrual basis obligor is not permitted to deduct an expense stemming from a bilateral contractual arrangement, that is, mutual promises, prior to the performance of the contracted for services by the obligee. See *Levin v. Commissioner,* 21 T.C. 996 (1954), *aff'd* 219 F.2d 588 (3rd Cir. 1955) and *Amalgamated Housing Corporation v. Commissioner,* 37 B.T.A. 817 (1938), *aff'd per curiam,* 108 F.2d 1010 (2nd Cir. 1940). The taxpayer obligor, through the vehicle of a bare contractual obligation, has incurred no liability but has merely agreed to become liable to pay in the event the future services called for are performed. The liability under the contract is contingent upon performance. All events are not fixed within the meaning of section 1.461-1(a)(2) of the regulations until the required performance is rendered.

In *National Bread Wrapping Machine Co. v. Commissioner,* 30 T.C. 550 (1958), the taxpayer was denied a deduction for guaranteed installation services for machines sold but uninstalled. The court held that although the taxpayer was obligated to render installation services, until the installation services were rendered there was no definite liability on the part of the taxpayer to pay any amount to any person. The liability was contingent until performance occurred. See also *Spencer, White and Prentis Inc. v. Commissioner,* 144 F.2d 45 (2nd Cir. 1944), *cert. denied,* 323 U.S. 780 (1944), in which the taxpayer was denied a deduction for the estimated cost of future restoration work that the taxpayer was obligated to perform under a construction contract.

In both *Situation 1* and *2*, *X* has a contractual obligation under its lease with the federal government to remove the platforms and fixtures. In *Situation 1,* as *X*'s employees perform the services required to remove the platforms and fixtures the fact of the liability will become fixed. In *Situation 2, X*'s liability to *Y* for removing the platforms and fixtures is contingent on *Y*'s performance. As *Y* performs the actual removal services the fact of the liability will become fixed and *X* will be entitled to deduct the cost of the removal services actually performed by *Y*. The fact that *X* is contractually liable for the cost of the entire removal services does not entitle it to deduct the cost of such services before they are performed.

HOLDING

A taxpayer using the accrual method of accounting may deduct the costs of removing offshore platforms and well fixtures installed pursuant to a long-term oil and gas lease with the federal government in the taxable years during which the removal services are performed. This same conclusion results whether the removal services are performed by the taxpayer or a third-party contractor.

Section 482.—Allocation of Income and Deductions among Taxpayers

26 CFR 1.482-2: Determination of taxable income in specific situations.

Whether section 482 of the Code would be applicable to allocate income from one subsidiary to another subsidiary and their common parent in an amount equal to an arm's length charge for services rendered by the employees of the second subsidiary and the parent to the first subsidiary. See Rev. Rul. 80-181, page 14.

Section 613.—Percentage Depletion

26 CFR 1.613-4: Gross income from the property in the case of minerals other than oil and gas.

Depletion; gross income from mining; transportation in excess of 50 miles. A domestic corporation is engaged in mining a mineral for export in a foreign country that required the location of processing facilities in an area that is more than 50 miles from the point of extraction to encourage economic development of the area. The corporation derived economic benefit by developing the processing facilities in the required area. The transportation of the mineral in excess of 50 miles from the point of extraction to the processing facilities is "mining" within the meaning of section 613(c)(2) of the Code.

Rev. Rul. 80-183

ISSUE

Does the taxpayer's transportation in excess of 50 miles qualify as "mining" within the meaning of section 613(c)(2) of the Internal Revenue Code?

FACTS

Corporation *X* is incorporated in the United States and does business in foreign country *R*. *X* is engaged in mining mineral *y* for export.

Mineral *y* is drilled, blasted, and loaded with power shovels directly into railroad cars for shipment to a port 90 miles away from the mine.

The railroad and port facilities are owned by *R*.

At the port, the ore is crushed, dried, and either stockpiled in covered storage areas or loaded directly in ships for ocean transportation to markets.

R required location of the crushing and drying facilities at the port to encourage economic development of the port area. *X* derived the following economic advantages by developing the processing facilities at the port: During the rainy season, *X* would not have to ship ore in covered cars or re-dry the ore when it reached port as it would if the facilities were located at the mine. The lower mean annual temperature at the port is more conducive to operations there than at the mine site. By locating at the port, the crushing and drying facilities could be constructed simultaneously with the mine development, accelerating the start-up of actual production of the mineral. Other efficiencies in the overall operation would be increased because fuel and other supplies would not have to be reshipped to the mine from the port.

LAW AND ANALYSIS

Section 613(c)(2) of the Code provides that the term "mining" includes that portion of the transportation of ores from the point of extraction from the ground to the plant or mills in which the treatment processes are applied thereto as is not in excess of 50 miles unless the Secretary finds that the physical and other requirements are such that the ore or mineral must be transported a greater distance to such plants or mills. See also section 1.613-4(d)(3)(i) of the Income Tax Regulations.

Section 1.613-4(h) of the regulations provides that the application to treat as mining transportation in excess of 50 miles must include a statement setting forth in detail the facts concerning physical and other requirements that prevented the construction and operation at a place nearer to the point of extraction from the ground.

In this case the mineral is extracted and shipped by rail to the port, a distance in excess of fifty miles, for the application of crushing and drying processes that are recognized in section 613(c)(4)(I) of the Code and section 1.613-4(f)(5) of the regulations as mining. Therefore, transportation of the mineral for fifty miles is mining.

The control that *R* had over the location and magnitude of mining operations and the other reasons given fulfilled the "physical and other reasons" requirement for performing the crushing and drying at the port.

HOLDING

In this case, the transportation of the mineral *y* in excess of fifty miles is mining.

Section 1033.—Involuntary Conversions

26 CFR 1.1033(f)-1: Condemnation of real property held for productive use in trade or business or for investment.

Involuntary conversions; severance-damage award reinvested; similar property. Part of a severance-damage award was used to demolish a building leased to retail stores and to construct a warehouse for lease in its place. The remaining part of the award was used to purchase another parcel of land and to construct an office building thereon. The business risks and responsibilities in managing the warehouse and office building were substantially similar to those under the leases with the retail stores. The investments constitute reinvestments in property similar or related in service or use for purposes of deferring the recognition of gain under section 1033 (a)(2)(A) of the Code.

Rev. Rul. 80-184

ISSUES

(1) May a taxpayer under section 1033(a)(2)(A) of the Internal Revenue Code defer the recognition of gain realized as a result of a severance-damage award for the part of such award used to demolish a building on the retained land that was leased to retail stores and to construct in its place a warehouse for lease?

(2) May a taxpayer under section 1033(a)(2)(A) of the Code defer the recognition of gain realized as a result of a severance-damage award for the part of such award used to purchase another parcel of land and to construct an office building for lease on it if the taxpayer retains the damaged land for which the severance-damage award was received?

FACTS

The taxpayer owned a parcel of land in a business district. The land contained a building owned by the taxpayer that was leased to retail stores.

The state condemned the entire frontage of the taxpayer's land for construction of a highway interchange. The state paid 1,000*x* dollars to the taxpayer for this condemnation. Of the 1,000*x* dollars paid to the taxpayer, 350*x* dollars was paid for the property actually taken by the state. The remaining 650*x* dollars represented severance damages to compensate the taxpayer because the rest of the taxpayer's land was no longer readily accessible and therefore was no longer suited to the business that had operated there.

Within the prescribed period of time set forth in section 1033(a)(2)(B) of the Code, the taxpayer used 500*x* dollars of the severance damages to demolish the existing building and construct a warehouse on the remaining land. The taxpayer leased the warehouse to a warehouse operator. It was not economically feasible or practical to invest any more funds in constructing additional rental structures on the remaining property. Therefore, the taxpayer used the 500*x* dollar balance of the condemnation award (which included 150*x* dollars of the 650*x* dollars severance damages) to acquire another parcel of land and to construct an office building on it that it leased to another person. The business risks and the taxpayer's responsibilities in the way of management, services and relations to the tenants under the leases involving the warehouse and the office building are substantially similar to the risks and responsibilities under the former leases involving the retail stores.

LAW AND ANALYSIS

Section 1033(a) of the Code provides that if property, as a result of a condemnation, is compulsorily or involuntarily converted into money, the gain (if any) shall be recognized except to the extent provided in section 1033(a)(2)(A).

Section 1033(a)(2)(A) of the Code provides that if during a specified period the taxpayer purchases other property similar or related in service or use to the property so converted, at the election of the taxpayer the gain shall be recognized only to the extent that the amount realized on the conversion exceeds the cost of such other property.

Section 1033(g)(1) of the Code provides that for purposes of section 1033(a), if real property held for productive use in trade or business or for investment is (as the result of its seizure, requisition, or condemnation, or threat or imminence thereof) compulsorily or involuntarily converted, property of a like kind to be held either for productive use in trade or business or for investment shall be treated as property similar or related in service or use to the property so converted. The 350*x* dollars received for the land actually taken was invested in land and the construction of a building which is like-kind property, and the taxpayer can defer the recognition of gain attributable to these proceeds.

Severance damages are compensation in addition to the award paid for the property actually condemned when the value of the retained property has decreased as a result of the condemnation. Rev. Rul. 68-37, 1968-1 C.B. 359, provides that an award of severance damages reduces the basis of the retained property and any amount received in excess of basis is treated as gain.

The recognition of gain realized as a result of an award of severance damages may be deferred under section 1033(a)(2)(A) if, assuming the other requirements of section 1033 are met, the money reinvested restores the retained property to its former use. See, for example, Rev. Rul. 72-433, 1972-2 C.B. 470; Rev. Rul. 69-240, 1969-1 C.B. 199; Rev. Rul. 60-69, 1960-1 C.B. 294; Rev. Rul. 271, 1953-2 C.B. 36.

Issue 1

The specific question raised by Issue 1 is whether this part of the severance-damage award was used to restore the retained property to its former use or to change the use of the retained property.

Rev. Rul. 64-237, 1964-2 C.B. 319, provides that in considering whether replacement property acquired by an investor is similar in service or use to the converted property, attention will be directed primarily to the similarity in the relationship of the services or uses that the original and replacement properties have to the taxpayer-owner. In applying this test, a determination will be made as to whether the properties are of a similar service to the taxpayer, the nature of the business risks connected with the properties, and what such properties demand of the taxpayer in the way of management, services and relations to his tenants. ***See also Liant Record, Inc. v. Commissioner,*** 303 F.2d 326 (2d Cir. 1962).

In the owner-investor situation the important factor is the similarity in the taxpayer's relationship to the use of the original and replacement properties. This relationship can be sufficiently similar even though the use by the respective tenants changes. See, for example, Rev. Rul. 71-41, 1971-1 C.B. 223. However, the fact that the taxpayer leases both properties is not alone sufficient to justify nonrecognition of the gain because both properties might be leased yet represent materially different investments to the owner-investor. See Rev. Rul. 76-391, 1976-2 C.B. 243.

In the present situation, the taxpayer's risks and responsibilities remained substantially the same despite the change in the nature of the tenants. Therefore, the reinvestment of the severance damages in the retained property to demolish the building leased to retail stores and to construct in its place a warehouse for lease constitutes a reinvestment of the severance damages in property similar or related in service or use to the damaged property.

Issue 2

The remaining part of the severance-damage award was used to purchase another parcel of land and to improve that land by constructing an office building thereon. The business risks and the taxpayer's responsibilities under the leases involving the office building are substantially similar to the risks and responsibilities under the former leases involving the retail stores.

Rev. Rul. 72-433 indicates that if it is necessary for the taxpayer to purchase additional land in order to restore the volume of production that existed before the involuntary granting of an easement, such use of the proceeds will qualify as an investment in property similar or related in service or use. Similarly, in this case, the taxpayer could only restore his original rental capacity by purchasing additional land and constructing rental units thereon. Since the taxpayer restored the damaged land to its maximum similar or related use, the remaining part of the severance-damage award can be invested in other property to return the taxpayer to his pre-damage business position, and such property will be considered similar or related in service or use.

HOLDINGS

(1) Under section 1033(a)(2)(A) of the Code the taxpayer may defer the recognition of gain realized as a result of a severance-damage award for the part of such award used to demolish a building on the retained land that was leased to retail stores

and to construct in its place a warehouse for lease.

(2) Under section 1033(a)(2)(A) of the Code the taxpayer may defer the recognition of gain realized as a result of a severance-damage award for the part of such award used to purchase another parcel of land and to construct an office building for lease on it even though the taxpayer retains the damaged land for which the severance-damage award was received.

Section 2012.—Credit for Gift Tax

26 CFR 20.2012-1: Credit for gift tax. (Also Section 2056; 20.2056(a)-1.)

Gift tax credit; "second limitation"; donee other than spouse. For the purpose of computing the "second limitation" of the credit for gift tax, the value of the gift made to a donee other than the decedent's spouse is not reduced under section 2012(b)(2) of the Code by the additional marital deduction that results from inclusion of the gift in the gross estate.

Rev. Rul. 80-185

ISSUE

In computing the "second limitation" of the credit for gift tax under section 2012 of the Internal Revenue Code, what is the value of the gift made to a donee other than the spouse, if the inclusion in the gross estate has the effect of increasing the marital deduction?

FACTS

The decedent, *D*, made gifts of future interests in property of 100*x* dollars to each of *D*'s two children on December 7, 1976. A federal gift tax return was filed and a gift tax was paid.

D died on January 27, 1977. On the federal estate tax return filed for *D*'s estate, the executor included the gifts in the gross estate pursuant to section 2035 of the Code. The inclusion of the transfers under section 2035 resulted in an increase in the adjusted gross estate and a corresponding increase in the maximum marital deduction, the computation of which was based on the adjusted gross estate.

The executor claimed a credit against the federal estate tax liability for the gift tax paid with respect to the included gifts. The credit was based upon the "second limitation" under section 2012.

LAW AND ANALYSIS

Under section 2012 of the Code, a credit is allowed against the federal estate tax for federal gift tax paid with respect to the transfer of property by gift if the gift is subsequently included in the donor-decedent's gross estate. Section 2012(e), as added by the Tax Reform Act of 1976, Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, provides that the credit is allowed only as to gifts made before January 1, 1977.

The credit is limited to the lesser of two "limitations." Section 20.2012-1(b) of the Estate Tax Regulations. The "first limitation" is the amount of the gift tax attributable to the included gift. The "second limitation" is the amount of estate tax attributable to the inclusion of the gift in the gross estate. The "second limitation" is expressed as:

$$\frac{\text{the value of the gift (at the time of the gift or at time of death, whichever is lower)}}{\text{the value of the gross estate, less all marital and charitable deductions allowable}} \times \text{gross estate tax, less credit for state death taxes}$$

Section 2012(b)(2) of the Code provides that the value of the gift in the ratio shall be reduced if a deduction *with respect to such gift* is allowed under section 2056(a) (relating to marital deduction).

Section 20.2012-1(d)(2)(ii) of the regulations provides, in part, that the value of the gift is reduced if any portion of the value of property is allowed as a marital deduction under section 2056 of the Code.

Section 2056 of the Code, as amended by the Tax Reform Act of 1976, provides that the value of the taxable estate shall be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to the surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate. The maximum allowable marital deduction is limited to the greater of $250,000 or fifty percent of the adjusted gross estate.

The inclusion of the gift property in the decedent's gross estate resulted in an increase in the adjusted gross estate and in the allowable marital deduction. However, the gift property itself could not qualify for the marital deduction since the property did not pass to the surviving spouse. Thus, no marital deduction was allowed with respect to such gift. However, compare the example in section 20.2012-1(d)(3) where the value of the gift was reduced because the gift was to the spouse and qualified for the estate tax marital deduction.

HOLDING

For purposes of computing the "second limitation" of the credit for gift tax, the value of the gift made to a donee other than the spouse is not reduced by the amount of the additional marital deduction resulting from the inclusion of the gift in the gross estate. Therefore, the value of the gift in the subject case is 100*x* dollars for each gift.

Section 2056.—Bequests, Etc., to Surviving Spouse

26 CFR 20.2056(a)-1: Marital deduction; in general.

Whether in computing in the "second limitation" of the credit for gift tax under section 2012 of the Code, the value of the gift made to a donee other than the spouse is reduced where the inclusion in the gross estate has the effect of increasing the marital deduction. See Rev. Rul. 80-185, above.

Section 2511.—Transfers in General

26 CFR 25.2511-2: Cessation of donor's dominion and control.

Option transferred; nominal consideration; related party. A transfer to a related party for

nominal consideration of an option to purchase real property, for a specified period at a price below fair market value, is a completed gift on the date the option is transferred if under state law the option is binding and enforceable on the date of transfer.

Rev. Rul. 80-186

ISSUE

Is the transfer, to a related party for nominal consideration, of an option to purchase real property for a specified period a completed gift under section 2511 of the Internal Revenue Code on the date the option is transferred or on the date the option is exercised?

FACTS

On January 2, 1978, *A* transferred to *B*, A's child, an option to purchase real property located in State *X* and owned by *A*. *B* paid *A* $10 upon receipt of the option. Under the option, *B* had the right to purchase the property at any time during a two-year period for $475,000. The option could be sold or assigned by *B*. The transfer was not made in the ordinary course of business. The fair market value of the property on the date of the transfer was $500,000.

On January 1, 1980, *B* exercised the option by delivering to *A* $475,000. Upon receipt of the option price, *A* delivered to *B* a deed transferring the property to *B*.

Under the law of State *X*, an option is defined as a contract by which a person acquires from the owner of property, for consideration, the right or privilege to buy property at a fixed price within a specified time, without imposing any obligation on the optionee to do so. While an option to purchase land is property and the optionee gets valuable property rights, the option does not, before exercise, vest in the optionee any interest, estate or title in the land.

State *X* law further provides that an option supported by consideration may not be withdrawn during the time stipulated, and therefore is binding upon the parties. The fact that only nominal consideration is given for the option does not make it unenforceable. Adequacy of consideration, as measured by the general market, is not a prerequisite to enforcement.

LAW AND ANALYSIS

Section 2501 of the Code imposes a tax on the transfer of property by gift by any individual. The gift tax is not imposed upon the receipt of the property by the donee, nor is it necessarily determined by the measure of enrichment resulting to the donee at the time of the transfer. The tax is a primary and personal liability of the donor, is an excise upon his act of making the transfer, is measured by the value of the property passing from the donor, and attaches at the time the property passes, regardless of the fact that the identity of the donee may not then be known or ascertainable. Section 25.2511-2(a) of the Gift Tax Regulations.

The gift tax is aimed at every kind of transfer by way of gift, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible. Section 25.2511-1 (a) of the regulations. The term property is used in its broadest and most comprehensive sense and reaches "every species of right or interest protected by law and having an exchangeable value." H.R. Rep. No. 708, 72d Cong., 1st Sess. 27 (1932); S. Rep. No. 665, 72d Cong., 1st Sess. 39 (1932); both reprinted in 1939-1 C.B. (Part 2) at 476, 524.

Generally, a gift is complete and subject to the gift tax when the donor has so parted with dominion and control over the property transferred as to leave in him no power to change its disposition, whether for his own benefit or for the benefit of another. Section 25.2511-2(b) of the regulations.

Under section 2512(b) of the Code, if property is transferred for less than adequate and full consideration in money or money's worth, the excess of the value of the transferred property over the value of any consideration received is a gift for federal gift tax purposes. Consideration not reducible to a value in money or money's worth, such as love and affection, is to be wholly disregarded for federal gift tax purposes. Section 25.2512-8 of the regulations.

On January 2, 1978, *B* received an enforceable right to acquire land owned by *A* provided *B* exercised the option within two years. *A*'s promise was binding and could not be withdrawn because it was supported by consideration. Although *B* received no interest or title in the land, the option itself was valuable property that was protected by law, could be transferred, and had an exchangeable value.

The gift was complete and subject to the gift tax on January 2, 1978, the date *A* transferred the option to *B*. The amount of the gift is the difference between the fair market value of the option on the date it was given to *B* and the consideration in money or money's worth paid by *B* ($10). *See Hoffman v. Commissioner*, 2 T.C. 1160 (1943), *aff'd on other issue*, 148 F. 2d 285 (9th Cir.), *cert denied*, 326 U.S. 730 (1945).

The value of the option is a factual question for determination by the district director on audit of the gift tax return. However, factors to be considered in determining the option's fair market value include the fair market value of the land on the date the option was given, the option price, any potential for appreciation or depreciation during the period, and the time period of the option.

HOLDING

The transfer, to a related party for nominal consideration, of an option to purchase real property for a specified period is a completed gift under section 2511 of the Code on the date the option is transferred if under state law the option is binding and enforceable on the date of transfer.

Section 6302.—Mode or Time of Collection

26 CFR 31.6302(c)-1: Use of Government depositaries in connection with taxes under Federal Insurance Contributions Act and income tax withheld.

T.D. 7701 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAP-

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[1] This publication of the Treasury Decision contains the complete text of the amendments to the regulations. The instructions for modifying the notice of proposed rulemaking have been omitted.

TER C, PART 31.—EMPLOYMENT TAXES; APPLICABLE ON AND AFTER JANUARY 1, 1955

Changes in the deposit requirements for social security and withheld income taxes

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the requirements with regard to depositing social security and withheld income taxes. The regulations affect certain employers with undeposited amounts of those taxes, and provide necessary guidance to such employers.

DATES: The regulations are generally effective with respect to wages paid after December 31, 1980. However, the "safe haven" provision for large employers will be effective with respect to wages paid after December 31, 1981.

FOR FURTHER INFORMATION CONTACT: John A. Tolleris of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3294).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On February 8, 1980, the Federal Register published proposed amendments to the Employment Tax Regulations (26 CFR Part 31) under section 6302 of the Internal Revenue Code of 1954 (45 FR 8666). The amendments were proposed to balance the administrative burden of the deposit requirements for social security and withheld income taxes against the benefits of more rapid deposits of those taxes. In addition, the amendments were proposed to reduce the administrative burdens for small- and medium-sized employers. After consideration of all comments received in response to the notice of proposed rulemaking and at the public hearing on the proposed amendments which was held on April 16, 1980, those amendments are adopted as modified by this Treasury decision.

EXPLANATION OF PROVISIONS

Section 6302(c) of the Internal Revenue Code of 1954 authorizes the Secretary to prescribe the manner, times, and other conditions with which employers must comply in depositing social security and withheld income taxes in authorized depositaries. These amendments establish new deposit requirements pursuant to that authorization.

Among the modifications made to the proposed rules after consideration of the public comments received is the reduction to $500 (from the $1,000 level proposed in the notice) in the end-of-month level of accumulated employment taxes which subjects an employee to the monthly deposit requirement. This amendment was made as a result of the concern expressed at the public hearing that the proposal allowing small employers to defer payment of up to $1,000 of accumulated employment taxes until the end of a calendar quarter could cause compliance difficulties for these employers. The rule adopted represents a relaxation of the currently applicable $200 threshold for the monthly deposit requirement. Employers with aggregate taxes of under $500 during a calendar quarter may remit them with their quarterly returns, effective on January 1, 1981.

After review of the comments regarding the difficulties medium-sized employers would face in making monthly deposits of at least 95 percent of the taxes within 7 days after the end of the month, this Treasury decision revises the proposed rule to provide that such employers must deposit the full amount of the undeposited taxes within 15 days after the end of the month. This is generally the same as the presently applicable rule, except that the deposit with respect to the final month of a return period will also be due on the 15th day of the following month rather than, as under current rules, on the last day of the following month.

In view of the generally unfavorable comments on the proposal to permit employers with under $13,000 of employment taxes in each of the 4 preceding calendar quarters to make monthly deposits of such taxes during the current calendar quarter, this provision is not adopted by the Treasury decision. Instead, the Treasury decision eases the deposit requirement for a number of medium-sized employers by providing that those employers with less than $3,000 (instead of the present $2,000) of aggregate taxes with respect to wages paid at the end of a month will, effective on January 1, 1981, be permitted to make a monthly deposit. In lieu of the $13,000 "safe haven", the Treasury decision also provides that most employers who can establish to the Commissioner's satisfaction that they had not been required to make any quarter-monthly or eighth-monthly deposit during the previous 4 calendar quarters or during earlier months of the current quarter may make a monthly deposit for the first month in which they have accumulated $3,000 or more by the end of the month. Such employers thus would not be penalized for failure to make a 3-banking-day deposit for the first month in which they otherwise would be required to comply with the eighth-monthly deposit provision.

After consideration of the adverse comments regarding administrative burdens caused by the acceleration from the present quarterly-monthly deposit schedule to the proposed eighth-monthly deposit schedule, it was determined that the eighth-monthly rule should be adopted but revised to provide that an employer will be required to make a deposit with respect to an eighth-monthly period only when the aggregate undeposited taxes with respect to the period (and any prior eighth-monthly period with respect to which no deposit was made) reaches or exceeds $3,000, thus relaxing the proposed $1,000 rule as well as the currently applicable $2,000 threshold for 3-banking-day deposits. This change will substantially reduce (as compared with the proposed rule) the number of employers who will be required to make more than 4 deposits a month.

In addition, the Treasury decision does not adopt the proposed rule which would have required aggregating any undeposited "safe haven" amount for purposes of determining when the first eighth-monthly deposit after the 15th day of the following month must be made.

A number of commentators criticized the proposal to reduce the "safe haven" for deposits by large employers from 90 percent to 95 percent; this change, they argued, would make even more difficult those employers' task in correctly estimating the amount of deposit required without risking a penalty for an underdeposit. Upon consideration of these comments, it was determined that a 5 percent margin is sufficient for purposes of estimating deposit amounts. Therefore, the Treasury decision adopts the proposed requirement that, effective on January 1, 1982, employers deposit at least 95 percent of the taxes with respect to wages paid during an eighth-monthly period.

A number of commentators expressed confusion regarding whether large employers would be required to make 8 deposits per month, even if they paid their employees less frequently, such as on a weekly or semimonthly schedule. As is the case under the current quarter-monthly deposit requirements, an eighth-monthly deposit will only be required when aggregate taxes with respect to wages actually paid during the eighth-monthly period (and earlier periods with respect to which no deposit was made) equal or exceed the threshold amount. Taxes with respect to wages earned by but not yet paid to employees are not aggregated for purposes of determining the frequency or amount of deposits.

Following is a table which summarizes the rules provided by this decision:

Payment Schedule for Withheld Income Tax and FICA Tax Liabilities
(Effective January 1, 1981)

If the accumulated unpaid liability is:	Then the payment requirement is:
$3,000 or more at end of any eighth-monthly period (eighth-monthly periods end on the 3rd, 7th, 11th, 15th, 19th, 22nd, 25th, and the last day of each month)	Employer must deposit accumulated liability within 3 banking days after close of eighth-monthly period. No penalty imposed provided employer deposits at least 95 percent (90 percent in 1981) of liability within 3 banking days, with remainder paid by specified dates. Exception provided for most first-time 3-banking-day depositors.
$500 or more at the end of any month (unless an eighth-monthly deposit was required during the month pursuant to above rule)	Employer must deposit the accumulated liability by the 15th of the following month.
Less than $500 at the end of the calendar quarter.	Employer must pay the accumulated liability by the end of the following month (the due date of the quarterly return). Liability may be paid with the return or deposited.

Office of the Secretary of the Treasury; Office of Tax Analysis
May 29, 1980

Evaluation of the effectiveness of these regulations will be based on comments received from offices within the Treasury and the Internal Revenue Service, other governmental agencies, the Congress, State and local governments, and the public. Although these regulations will impose no new reporting requirement, they may impose additional recordkeeping and administrative burdens for certain large employers due to the acceleration of deposits provided by this Treasury decision.

DRAFTING INFORMATION

The principal author of these proposed regulations is John A. Tolleris of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department developed the substance of the regulations.

Adoption of amendments to the regulations

Accordingly, the following amendments to the regulations are hereby adopted:

Subparagraph (1)(i), (ii), and (iv) of § 31.6302(c)-1(a) is amended to read as follows:

§ 31.6302(c)-1 Use of Government depositaries in connection with taxes under Federal Insurance Contributions Act and income tax withheld.

(a) *Requirement*—(1) *In general.* (i) In the case of a calendar month which begins after December 31, 1980—

(*a*) Except as provided in paragraph (b) of this section and hereinafter in this subdivision (i), if at the close of any calendar month the aggregate amount of undeposited taxes (as defined in subdivision (iii) of this subparagraph) is $500 or more, the employer shall deposit the undeposited taxes in a Federal Reserve bank or authorized financial institution within 15 calendar days after the close of such calendar month. However, this (*a*) of subdivision (i) shall not apply if the employer was required to make a deposit of taxes pursuant to (*b*) of this subdivision (i) with respect to an eighth-monthly period which occurred during the calendar month.

(*b*) Except as provided in paragraph (b) of this section and except in the case of first-time 3-banking-day depositors, if at the close of any eighth-monthly period the aggregate amount of undeposited taxes is $3,000 or more, the employer shall deposit the undeposited taxes in a Federal Reserve bank or authorized financial institution within 3 banking days after the close of such eighth-monthly period.

For purposes of determining the amount of undeposited taxes at the close of an eighth-monthly period, undeposited taxes with respect to wages paid during a prior eighth-monthly period shall not be taken into account if the employer has made a deposit with respect to such prior eighth-monthly period. An employer will be considered to have complied with the requirements of this subdivision (i) (*b*) for a deposit with respect to the close of an eighth-monthly period if—

(*1*) His deposit is not less than 95 percent (90 percent before January 1, 1982) of the aggregate amount of the taxes with respect to wages paid during the period for which the deposit is made, and

(*2*) If such eighth-monthly period occurs in a month other than the last month of a period for which a return is required to be filed (hereinafter in this subparagraph referred to as a return period), he deposits any underpayment with his first deposit which is otherwise required by this subdivision (i) (*b*) to be made after the 15th day of the following month.

For purposes of this subdivision (i) (*b*), a "first-time 3-banking-day depositor" is an employer who establishes to the satisfaction of the Commissioner that he was not required (but for this exception) to make a deposit pursuant to this subdivision (i) (*b*) (or pursuant to subdivision (ii) (*b*) of this subparagraph) with respect to each period in any preceding month of the current calendar quarter and with respect to each period in the 4 calendar quarters preceding the current calendar quarter. An employer may in no event qualify as a "first-time 3-banking-day depositor" with respect to any eighth-monthly period if the undeposited taxes at the close of that period are $10,000 or more. The excess (if any) of a deposit over the actual taxes for a deposit period shall be applied in order of time to each of the employer's succeeding deposits with respect to the same return period, until exhausted, to the extent that the amount by which the taxes for a subsequent deposit period exceed the deposit for such subsequent deposit period. For purposes of this subdivision (i), "eighth-monthly period" means the first 3 days of a calendar month, the 4th day through the 7th day of a calendar month, the 8th day through the 11th day of a calendar month, the 12th day through the 15th day of a calendar month, the 16th day through the 19th day of a calendar month, the 20th day through the 22nd day of a calendar month, the 23rd day through the 25th day of a calendar month, or the portion of a calendar month following the 25th day of such month.

(ii) In the case of a calendar month which begins after January 31, 1971, and before January 1, 1981—

(*a*) Except as provided in paragraph (b) of this section and hereinafter in this subdivision (ii), if at the close of any calendar month other than the last month of a period for which a return is required to be filed, the aggregate amount of taxes (as defined in subdivision (iii) of this subparagraph) is $200 or more, the employer shall deposit the undeposited taxes in a Federal Reserve bank or authorized financial institution within 15 days after the close of such calendar month. However, the preceding sentence shall not apply if the employer has made a deposit of taxes pursuant to (*b*) of this subdivision (ii) with respect to a quarter-monthly period which occurred during such month; or

(*b*) If at the close of any quarter-monthly period the aggregate amount of undeposited taxes is $2,000 or more, the employer shall deposit the undeposited taxes in a Federal Reserve bank or authorized commercial bank within 3 banking days after the close of such quarter-monthly period. For purposes of determining the amount of undeposited taxes at the close of a quarter-monthly period, undeposited taxes with respect to wages paid during a prior quarter-monthly period shall not be taken into account if the employer has made a deposit with respect to such prior quarter-monthly period. An employer will be considered to have complied with the requirements of this subdivision (ii) (*b*) for a deposit with respect to the close of a quarter-monthly period if—

(*1*) His deposit is not less than 90 percent of the aggregate amount of the taxes with respect to wages paid during the period for which the deposit is made, and

(*2*) If such quarter-monthly period occurs in a month other than the last month of a return period, he deposits any underpayment with his first deposit which is otherwise required by this subdivision (ii) to be made after the 15th day of the following month.

The excess (if any) of a deposit over the actual taxes for a deposit period shall be applied in order of time to each of the employer's succeeding deposits with respect to the same return period, until exhausted, to the extent that the amount by which the taxes for a subsequent deposit period exceed the deposit for such subsequent deposit period. For purposes of this subdivision (ii), "quarter-monthly period" means the first 7 days of a calendar month, the 8th day through the 15th day of a calendar month, the 16th day through the 22nd day of a calendar month, or the portion of a calendar month following the 22nd day of such month.

* * * * *

(iv) If the aggregate amount of taxes reportable on a return (other than a return on Form 942) for a return period exceeds the total amount deposited by the employer pursuant to subdivision (i) or (ii) of this subparagraph for such return period (*a*) by $500 or more in the case of a return period which ends after December 31, 1980, or (*b*) by more than $200 in the case of a return period which ends after December 31, 1970, and before January 1, 1981, the employer shall, on or before the last day of the first calendar month following the return period, deposit with a Federal Reserve bank or authorized financial institution an amount equal to the amount by which the taxes reportable on the return exceed the total deposits (if any) made pursuant to subdivision (i) or (ii) of this subparagraph for such period. As used in this subdivision, the term "taxes" shall have the meaning assigned to such term in subdivision (iii) of this subparagraph, except that the term shall include the taxes referred to in (*a*), (*b*), and (*c*) of such subdivision (iii) of this subparagraph with respect to any wages for domestic service in a private home of the employer which the employer elects to report on a quarterly return other than a quarterly return made on Form 942.

This Treasury decision is issued under the authority contained in sections 6302 and 7805 of the Internal Revenue Code of 1954 (68A Stat. 775, 917; 26 U.S.C. §§ 6302, 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved June 6, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on June 9, 1980, 8:45 a.m., and published in the issue of the Federal Register for June 11, 1980, 45 F.R. 39499)

Part II. Treaties and Tax Legislation

Subpart B.—Legislation and Related Committee Reports

Public Law 96-249
96th Congress, H.R. 4303 [1]
May 26, 1980

An Act to amend the Food Stamp Act of 1977 to improve food stamp program fiscal accountability through reductions in inaccurate eligibility and benefit determinations; to improve the system of deductions; to increase the specific dollar limitations on appropriations for the fiscal years 1980 and 1981 food stamp programs; and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Food Stamp Act Amendments of 1980."

TITLE I—REDUCTION IN FOOD STAMP ERROR AND FRAUD AND REVISION OF DEDUCTIONS

* * * * *

DISCLOSURE PROVISIONS

SEC. 127.(a)(1) Subsection (i) of section 6103 of the Internal Revenue Code of 1954 (relating to disclosure of returns and return information for purposes other than tax administration) is amended by adding at the end thereof the following new paragraph:

"(7) DISCLOSURE OF CERTAIN RETURN INFORMATION BY SOCIAL SECURITY ADMINISTRATION TO DEPARTMENT OF AGRICULTURE AND TO STATE FOOD STAMP AGENCIES.—

"(A) IN GENERAL.—The Commissioner of Social Security may disclose return information from returns with respect to net earnings from self-employment (as defined in section 1402), wages (as defined in section 3121(a) or 3401(a)), and payments of retirement income which have been disclosed to the Social Security Administration as provided by paragraph (1) or (5) of this subsection—

"(i) upon request, to officers and employees of the Department of Agriculture, and

"(ii) upon written request, to officers and employees of a State food stamp agency.

"(B) RESTRICTION ON DISCLOSURE. —The Commissioner of Social Security shall disclose return information under subparagraph (A) only for purposes of, and to the extent necessary in, determining an individual's eligibility for benefits, or the amounts of benefits, under the food stamp program established under the Food Stamp Act of 1977.

"(C) STATE FOOD STAMP AGENCY. —For purposes of this paragraph, the term 'State food stamp agency' means any agency described in section 3(n)(1) of the Food Stamp Act of 1977 which administers the food stamp program established under such Act.".

(2)(A) Subparagraph (A) of section 6103(p)(3) of such Code (relating to records of inspection and disclosure) is amended by striking out "(l)(1) or (4)(B) or (5)" and inserting in lieu thereof "(l)(1), (4)(B), (5), or (7)".

(B) Paragraph (4) of section 6103 (p) of such Code (relating to safeguards) is amended by striking out "(l)(3) or (6)" in so much of such paragraph as precedes subparagraph (A) thereof and inserting in lieu thereof "(l)(3), (6), or (7)".

(C) Clause (i) of section 6103 (p)(4)(F) of such Code is amended by striking out "(l)(6)" and inserting in lieu thereof "(l)(6) or (7)".

(D) The first sentence of paragraph (2) of section 7213(a) of such Code is amended—

(i) by striking out "or any educational institution" and inserting in lieu thereof "any educational institution, or any State food stamp agency (as defined in section 6103(l)(7)(C))", and

(ii) by striking out "subsection (d), (l)(6), or (m)(4)(B)" and inserting in lieu thereof "subsection (d), (l)(6) or (7), or (m)(4)(B)".

(3) The amendments made by this subsection shall take effect on the date of the enactment of this Act.

* * * * *

Approved May 26, 1980.

House Report No. 96-788
2d Session

[Bracketed numerals indicate official report page numbers]

FOOD STAMP ACT AMENDMENTS OF 1980

FEBRUARY 27, 1980

Mr. FOLEY, from the Committee on Agriculture, submitted the following report together with supplemental views, dissenting views, additional, dissenting views, and separate views to accompany S. 1309.[1]

* * * * *

[24] III. BACKGROUND, PURPOSE, AND NEED FOR THE LEGISLATION

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[68] B. CONTROL OF ERROR AND FRAUD

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[101] 7. DEDUCTION OF ERROR AND FRAUD THROUGH COMPUTER MATCHING

* * * * *

[106] *d. Present legal barriers*

This Committee commenced its efforts to foster computer matching in Public Law 96-58 when it required food stamp recipients to provide social security numbers as a condition for eligibility with the intent of using those numbers in computer matching to compare the income reported by food stamp households against wage and benefit information in the files of the Social Security Administration.

Requiring the social security number was only the first step in achieving that goal. This bill removes other legal barriers to access to the Social Security Administration's files (by way of the necessary social security number) as well as State unemployment compensation files and the files of any other

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[1] This publication of the law, House Report No. 96-788, this page, and Conference Report No. 96-957, page 27 is restricted to excerpts involving tax matters. Senate Report No. 96-236 and Conference Report No. 96-704 are not published.

[1] Public Law 96-249, this page.

Federal agency with benefit data that could affect the eligibility or benefit levels of a significant part of the food stamp applicant and recipient population.

The legal barriers that need to be lowered or, in some instances, withdrawn entirely, are substantial, appropriately so in light of the privacy considerations involved and the danger of abuse of confidential information for illegitimate purposes by both Federal and State food stamp personnel. The program need for certain information is great, but it must be carefully balanced by the need to protect needy individuals from having their privacy bartered away in order to assuage their hunger. Existing protections should not be reduced without careful consideration and without the substitution of other meaningful safeguards. The Committee's bill attempts to achieve this balanced approach to disclosure of relevant wage and benefit information.

Under present law, tax returns and return information are confidential and generally are not subject to disclosure except as provided in section 6103 of the Internal Revenue Code (hereafter "Code"). Disclosure is permitted, in certain circumstances, to the Social Security Administration, the Department of Health, Education, and Welfare, and Federal, State, and local child support enforcement agencies.

Under present law, tax returns and return information are confidential and generally are not subject to disclosure except as provided in section 6103 of the Internal Revenue Code. Disclosure is permitted, in certain circumstances, to the Social Security Administration, the Department of Health, Education, and Welfare, and Federal, State, and local child support enforcement agencies.

Upon written request, the Social Security Administration may obtain returns and return information concerning employment taxes for purposes of the administration of the Social Security Act (Code sec. 6103(l)(1)). In addition, copies of annual registration statements of employee benefit plans and related information concerning vested benefits of employees may be furnished to the Social Security Administration. The Secretary of Health, Education, and Welfare may also receive, upon written request, certain information returns for the purpose of carrying out an effective return processing program (Code sec. 6103 (l)(5)).

Federal, State, and local child support enforcement agencies may receive, upon written request, certain return information with respect to individuals for whom child support obligations are sought to be enforced or established and with respect to individuals to whom support obligations are owing (Code sec. 6103(l)(6)). This return infor-[107]mation may be disclosed only for purposes of, and to the extent necessary in, establishing and collecting child support obligations from, and locating, individuals owing such obligations.

Where disclosure or inspection of return information is permitted under the Code, it is permitted only at the times, in the manner, and at the places prescribed by the Internal Revenue Service. Present law generally requires the IRS to maintain a standardized system of permanent records on the use and disclosure of returns and return information. (Code sec. 6103 (p)(3)). This requirement applies with respect to disclosures made to Federal, State, and local child support enforcement agencies but does not apply in the case of disclosure made to the Social Security Administration or to the Department of Health, Education, and Welfare. In addition to the recordkeeping requirements imposed on the IRS, present law requires each Federal and State agency that receives tax information to maintain, pursuant to Treasury regulations, a standardized system of permanent records on the use and disclosure of that information. Maintaining these records is a prerequisite to obtaining, and continuing to receive, tax information.

Under present law, no tax information may be furnished by the IRS to another agency unless the other agency establishes procedures satisfactory to the IRS for safeguarding the tax information it receives (Code sec. 6103 (p)(4)). Disclosure by the IRS of tax information to other agencies is conditioned upon the recipient maintaining a secure place for storing the information, restricting access to the information to individuals whose duties require access and to whom disclosure is permitted, providing other safeguards necessary to keeping the information confidential, and returning or destroying the information when the agency is finished with it. The IRS is required to review, on a regular basis, the safeguards established by agencies to whom disclosure is made. In the event of unauthorized disclosure by the employees of another agency, the IRS may discontinue disclosure to that agency.

Any unauthorized disclosure of a return or return information is a felony which is punishable by a fine of up to $5,000, imprisonment of up to five years, or both (Code sec. 7213).

e. Safeguards and limitations

The safeguards and limitations contained in section 6103 of the Code with respect to the disclosure of tax returns and return information ought to be applied to similar disclosure in the context of the food stamp program.

The Committee on Ways and Means of the House of Representatives in preparing H.R. 4904, the Social Welfare Reform Amendments Act of 1979, which passed the House on November 7, 1979, extended those safeguards and limitations to such disclosure for purposes of administering the AFDC program by inserting a new section in the Social Security Act containing a cross reference to section 6103 of the Code for provisions relating to the disclosure of return information to State welfare agencies and by amending another section of the Social Security Act to provide that the disclosure of returns or return information transmitted from the Internal Revenue Service to the Department of Health, Education, and Welfare would be permitted only as prescribed under section 6103 of the Code.

[108] To further cement this into law and in light of the express desire of the Internal Revenue Service, repeated in testimony to this Committee by Emil Sunley, Deputy Assistant Secretary of the Treasury for Tax Policy, on October 30, 1979, to "ensure a degree of uniformity in applying confi-

dentiality standards to, and safeguards on, the use of tax data for nontax related purposes" by consolidating "in the tax code all of the rules relating to disclosure of tax information" rather than reverting "to the piecemeal approach to tax disclosure that existed prior to 1976" when Congress performed the consolidation, the welfare reform bill also amended section 6103 of the Code to incorporate this new form of disclosure and thereby subject it to all of the existing uniform safeguards and limitations.

This Committee, unlike the Ways and Means Committee, lacks the jurisdictional authority to amend the Code in order to make the Code's specific provisions applicable to the disclosure of return information, but this Committee intends to make certain insofar as it legally can that the same safeguards and limitations apply. It is the Committee's understanding that the preferable way to handle the matter would be by way of direct amendment to the Code, but, lacking that authority, the Committee notes its confirmed desire to reach the safe objective indirectly, with the hope that the appropriate Committees will propose the necessary accompanying changes in section 6103 of the Code.

Accordingly, this bill would provide that the Secretary of Health, Education, and Welfare would have to disclose to officers and employees of the Department and to officers and employees of a State welfare agency (the "State agency" within the meaning of section 3(n) of the Act) information with respect to wages, net earnings from self-employment, benefits, and payments of retirement income (the latter two appear to be synonymous, but the former includes any other Federal program benefits, if any, as to which information is available) that is contained in the records of the Social Security Administration, including such information which previously was disclosed to the Social Security Administration (that is the Secretary of Health, Education, and Welfare or his officers and employees) in the form of information from returns from the Internal Revenue Service's files pursuant to law (that is, under the authority of sections 6103(l)(1) or (5) of the Code).

The safeguards and limitations that would confine this disclosure are multiple and would be made effective by way of regulations promulgated by the Secretary of Health, Education, and Welfare, whom the bill empowers to establish such safeguards as the Secretary determines to be necessary to insure that any information made available is used only for authorized purposes:

(1) The Department's officers and employees would have to make a request in order to obtain the information, which request could be oral as well as written.

(2) The Department's officers and employees, despite a request, could not obtain the information unless their duties required them to have access to such information and unless disclosure legally could be made to them.

(3) The State agency's officers and employees would have to make a written request in order to obtain the information.

[109] (4) The State agency's officers and employees would not be entitled to the requested information unless their duties required them to have access to it and unless disclosure legally could be made to them. This limitation would have to be enforced with particular ease in the case of any tribal organization of an Indian tribe that became the State agency in accordance with the provisions of section 3(n)(2), 4(b), and 11(d) of the Act.

(5) Disclosure could be made only for three purposes and only to the extent necessary to accomplish them—(a) initially determining a household's eligibility to receive food stamps (on the amount thereof) at the point of certification or recertification, (b) auditing a household's eligibility to receive food stamps (and the amount thereof) during quality control or post-certification reviews or in light of reported changes, and (c) verifying any information related to the processes referred to in (a) or (b).

(6) The recordkeeping requirements, safeguard requirements, and penalties for unauthorized disclosure contained in section 6103 of the Code would govern this expanded disclosure through the regulations promulgated by the Secretary of Health, Education, and Welfare. For example, the Social Security Administration would be required to maintain a permanent system of standardized records on the use and disclosure of tax information permitted to be disclosed under the bill, and the Department of Health, Education, and Welfare, the Department, and State agencies would be required to maintain a strict accounting with respect to return information they receive from the Social Security Administration: In addition, the Department of Health, Education, and Welfare, the Department, and State agencies would be required to establish procedures satisfactory to the Internal Revenue Service for safeguarding the return information they receive from the Social Security Administration. See 45 C.F.R. § 431.300 et. seq.

The concerns for privacy would, we believe, be more than adequately protected by these safeguards modeled on section 6103 of the Code, and in particular section 6103(p)(4), of restricting access only to people who have legitimate need for the information, of making sure that those persons are thoroughly trained in privacy issues, and of guaranteeing proper physical security with respect to the storage of such sensitive information. The Privacy Act, 5 U.S.C. § 552a, and, in particular, section 552a(b) would be satisfied by these legal limitations.

* * * * *

Conference Report No. 96-957
2d Session

[Bracketed numerals indicate official report page numbers]

FOOD STAMP ACT AMENDMENTS OF 1980

May 14, 1980

Mr. Foley, from the committee of conference, submitted the following conference report to accompany S. 1309.[1]

* * * * *

[17] JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

* * * * *

[26] (25) *Disclosure provisions*

The *House* amendment required the disclosure of certain income tax information in the files of the Social Security Administration and certain wage and unemployment insurance (UI) information in the records of State UI agencies to the Department and State food stamp agencies only for the purpose of, and to the extent necessary for, determining a person's eligibility for food stamps. The *House* amendment requires that tax return information be disclosed in accordance with the procedures, conditions and safeguards specified in section 6103 of the Internal Revenue Code. The *House* amendment, effective January 1, 1983, further provides that as a condition of receipt of its Federal UI administrative grant, each State UI agency would have to make available, under procedures and safeguards to be established by the Secretary of Labor, information in its records pertaining to an individual's wages, home address, UI eligibility, and offers of employment.

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[1] Public Law 96-249, page 25.

The *Senate* bill contains no comparable provisions.

The *Conference* substitute adopts the *House* provisions.

Part III. Administrative, Procedural, and Miscellaneous

Delegation Order No. 156 (Rev. 1), Amend. 1 (Effective June 1, 1980)

Authority to Disclose Returns and Return Information to Federal Officers or Employees for Administration on Nontax Federal Criminal Laws

Pursuant to the authority vested in the Commissioner of Internal Revenue by Treasury Department Order No. 150-37, dated March 17, 1955, authority is hereby delegated as follows:

1. The Deputy Commissioner; Assistant Commissioner (Taxpayer Service and Returns Processing); Deputy Assistant Commissioner (Taxpayer Service and Returns Processing); Director, Disclosure Operations Division; Regional Commissioners; District and Service Center Directors; Assistant District and Service Center Directors; Director of International Operations; and Assistant Director of International Operations are authorized:

a. To disclose or in specific instances, authorize the disclosure of returns or taxpayer return information to officers and employees of a Federal agency pursuant to an *ex parte* order by a Federal district court judge when needed for use in the enforcement of a Federal criminal statute (not involving tax administration), subject to the conditions prescribed in IRC 6103(i)(1) and the Treasury Regulations thereunder. This authority may not be redelegated.

b. To disclose or, in specific instances, authorize the disclosure of return information (other than taxpayer return information) to officers and employees of a Federal agency upon written request by the head of such agency, or in the case of the Department of Justice, the Attorney General, the Deputy Attorney General, or an Assistant Attorney General, when needed for use in the enforcement of a Federal criminal statute (not involving tax administration) subject to the conditions prescribed in IRC 6103(i)(2). This authority may not be redelegated.

2. The Deputy Commissioner; Assistant Commissioner (Taxpayer Service and Returns Processing); Deputy Assistant Commissioner (Taxpayer Service and Returns Processing); Director, Disclosure Operations Division; and Regional Commissioners are authorized:

a. To withhold any return or taxpayer return information pursuant to IRC 6103(i)(1) or (i)(4), upon a determination that such disclosure would identify a confidential informant or seriously impair any civil or criminal tax investigation. This authority may not be redelegated.

b. To withhold return information (other than taxpayer return information), pursuant to IRC 6103(i)(2) or (i)(4), upon a determination that such disclosure would identify a confidential informant or seriously impair any civil or criminal tax investigation. This authority may not be redelegated.

c. To disclose or, in specific instances, authorize the disclosure in writing of return information (other than taxpayer return information), which may constitute evidence of a violation of Federal criminal laws, to the extent necessary to apprise the head of the appropriate Federal agency enforcing such laws, subject to the conditions prescribed in IRC 6103(i)(3). The authority to withhhold return information (other than taxpayer return information), pursuant to IRC 6103(i)(4) upon a determination that such disclosure would identify a confidential informant or seriously impair a civil or criminal tax investigation is also delegated. The authority delegated in this paragraph may be redelegated to Assistant Regional Commissioners (Taxpayer Service and Returns Processing) and Regional Disclosure Officers, but such redelegation shall not extend to the authority to withhold return information (other than taxpayer return information). This authority is in addition to the authority previously delegated in paragraph (1)(g) of Delegation Order No. 156 (Rev. 1) [1979-2 C.B. 485].

3. This Amendment amends paragraphs (6)(b), (c), and (d) of Delegation Order No. 156 (Rev. 1). Delegation Order No. 156 (Rev. 1), issued July 30, 1979, is printed in the Federal Register dated August 1, 1979, Vol. 44, No. 149, Page 45275.

JEROME KURTZ,
Commissioner.

(Filed by the Office of the Federal Register on June 5, 1980, 8:45 a.m., and published in the issue of the Federal Register for June 6, 1980, 45 F.R. 38199)

Part IV. Items of General Interest

New Provisions Relative to Jobs Tax Credits

Announcement 80-89

Section 103(a)(6) of the Technical Corrections Act of 1979, Pub. L. 96-222, 1980-20 I.R.B. 5, 12, provides that the new jobs tax credit, which was in effect for taxable years beginning after December 31, 1976, and which expired December 31, 1978, is now elective rather than mandatory. Under the prior law, an employer was required to reduce its wage and salary expense deduction by the amount of the new jobs tax credit, even in situations where the full amount of the credit was not allowable in the current year because of the limitations of section 53 of the Internal Revenue Code. Under section 44B, as now amended, however, employers are allowed to forego the new jobs tax credit and thus take the full wage and salary deduction.

Taxpayers may make a retroactive election not to take the credit and thus not to reduce their deduction, by filing amended returns for any taxable years beginning after December 31, 1976, that include wages paid from January 1, 1977, through December 31, 1978. The amended returns must be filed before expiration of the statute of limitations.

Section 103(a)(6) of the Act also extended through December 31, 1981, the existing targeted jobs tax credit, which was to have expired with respect to wages paid and incurred through December 31, 1980.

Form 3672, Application for Approval of Master or Prototype Defined Contribution Plan for Self-Employed Individuals

Announcement 80-92

Form 3672, Application for Approval of Master or Prototype Defined Contribution Plan for Self-Employed Individuals, has been substantially revised. The expanded format should speed approval of applications for master and prototype plans that use this application by reducing or eliminating the need for follow up contact with applicants.

The revised form (Revised June 1980) should be available in Service offices by the end of July. Applicants are requested to use the new form as soon as it becomes available.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing, the following individual has been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
John E. DeSantis	Belmont, CA	Certified Public Accountant	May 12, 1980

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
John H. Frazier	Nashville, TN	Certified Public Accountant	Fifteen months effective June 16, 1980
Clifford Y. Pierce	Miami, FL	Certified Public Accountant	Indefinite effective June 13, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 48.4221-3 amended.	Tax treatment of articles previously sold tax free for exportation under section 4221(a)(2).	June 9, 1980	Aug. 8, 1980
26 CFR 48.4042-1 through 48.4042-3 added.	Tax on the use of fuel in commercial waterway transportation.	June 9, 1980	Aug. 8, 1980
26 CFR 1.170A-4, 1.301-1, 1.312-3, 1.341-6, 1.453-9, 1.751-1, 1.1502-14 amended; 1.1254-1 through 1.1254-5 added.	Treatment of gain from the disposition of certain oil, gas, or geothermal property.	June 11, 1980	Aug. 11, 1980
26 CFR 1.411(d)-1 as proposed in the Federal Register for April 9, 1980, 45 F.R. 24201, withdrawn; 1.411(d)-1 amended.	Coordination of vesting and discrimination requirements for qualified pension, etc. plans.	June 12, 1980	Aug. 11, 1980

Numerical Finding List[1]

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

Finding List of Current Action on Previously Published Rulings[1]

Bulletin 1980-27

* Denotes entry since last publication.

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79-189
Superseded by
80-179, 1980-27 I.R.B. **20***

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27, dated July 7, 1980.

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______	*1929–2*	*3.15*
______	1930–1	7.30
______	1930–2	9.50
______	*1931–1*	*3.60*
______	1931–2	13.00
______	*1932–1*	*2.80*
______	1932–2	8.65
______	*1933–1*	*3.35*
______	*1933–2*	*3.45*
______	*1934–1*	*3.70*
______	1934–2	14.00
______	1935–1	6.90
______	*1935–2*	*4.00*
______	*1936–1*	*3.55*
______	*1936–2*	*3.90*
______	*1937–1*	*3.75*
______	1937–2	7.70
______	*1938–1*	*4.05*
______	*1938–2*	*3.50*
______	1939–1–1	8.25
______	1939–1–2	10.90
______	1939–2	9.40
______	1940–1	5.55
______	1940–2	14.00
______	1941–1	*$6.95*
______	*1941–2*	*3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
______	*1944*(*)	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*2.65*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$10.10
______	1957–2	13.00
______	1958–1	9.60
______	1958–2	13.00
______	1958–3	15.00
______	1959–1	15.00
______	1959–2	9.60
______	1960–1	9.00
______	1960–2	11.50
______	1961–1	14.00
______	1961–2	10.00
______	1962–1	14.00
______	1962–2	13.00
______	1962–3	20.00
______	1963–1	9.00
______	1963–2	10.75
______	1964–1–1	10.00
______	1964–1–2	11.00
______	1964–2	9.80
______	1965–1	10.70
______	1965–2	12.25
______	1966–1	14.00
______	1966–2	14.05
______	1967–1	10.00
______	1967–2	15.00
______	1968–1	14.00
______	1968–2	11.75
______	1969–1	7.50
______	1969–2	6.50
______	1969–3	$12.50
______	1970–1	11.00
______	1970–2	14.00
______	1971–1	10.55
______	1971–2	8.50
______	1972–1	13.50
______	1972–2	13.70
______	1973–1	16.00
______	1973–2	8.30
______	1974–1	11.00
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______	1974–3 Supp.	10.00
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______	1975–2	13.00
______	1976–1	11.00
______	1976–2	10.25
______	1976–3–1	9.50
______	1976–3–2	16.00
______	1976–3–3	10.00
______	1977–1	10.75
______	1977–2	11.75
______	1978–1	11.75
______	1978–2	13.00
______	1978–3–1	12.25
______	1978–3–2	9.00
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contin

July 21, 1980
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9258

Internal Revenue
bulletin

Highlights
of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-187, page 5.
Railway road crossings; investment credit; retirement-replacement depreciation method. Costs for replacement of railway road crossings over railroad tracks are included in the term "section 38 property." The retirement-replacement method of accounting for depreciation of crossings and the charge to expense of replacement costs are not proper.

Rev. Rul. 80-189, page 7.
Parent's stock purchased by subsidiary; basis. The purchase of a parent corporation's stock from its sole shareholder by its subsidiary will not result in a constructive distribution to the parent. The parent's adjusted basis in the subsidiary's stock will remain the same as it was prior to the transaction, and the subsidiary, under section 1012 of the Code, will have a basis in the parent's stock acquired in the transaction equal to the amount paid. Rev. Rul. 69-261 modified.

Rev. Rul. 80-190, page 17.
LIFO; freight-in added to cost of inventory; accounting method. A taxpayer's change in the cost computation of its LIFO inventory to include the cost of freight-in is a change in method of accounting under section 446 of the Code that requires the consent of the Secretary. The exclusion of the cost of freight-in from the cost of inventory does not warrant disallowance of the LIFO election.

Rev. Rul. 80-191, page 18.
Deductions; workmen's compensation. The Service will not follow the decisions of the Court of Appeals in *Crescent Wharf and Warehouse Company* and *Wien Consolidated Airlines, Inc.*, which held that an employer's liability for workmen's compensation is deductible in the year of an employee's death or injury even if the amount of the liability is contingent upon the occurrence of certain subsequent events; Rev. Rul. 70-262 amplified.

Rev. Rul. 80-203, page 6.
Travel expenses; reimbursement; mileage allowances. With respect to expenses paid or incurred after 1979, mileage allowances not exceeding 20 cents per mile for transportation paid by employers to employees will satisfy the subtantiation and adequate accounting requirements of sections 1.162-17(b) and 1.274-5 of the regulations; Rev. Rul. 80-62 modified.

Rev. Proc. 80-32, page 27.
Automobile expenses; standard mileage rates. With respect to transportation expenses paid or incurred after 1979, the standard mileage rate for the optional, simplified method of computing deductible costs of operating passenger automobiles for business purposes is 20 cents per mile for the first 15,000 miles and 11 cents per mile for any excess over 15,000 miles each year. The standard mileage rate for charitable, medical, or moving expenses purposes is 9 cents per mile. Rev. Proc. 80-7 modified.

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Finding Lists begin on page 32.
Announcement of Voluntary Suspensions on page 29.
Announcement of Proposed Rulemaking on page 30.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Continued

Announcement 80-91, page 28.

The application of the carryover basis election rules contained in the Crude Oil Windfall Profit Tax Act of 1980 to certain estates is explained.

EMPLOYEE PLANS

T.D. 7702, page 15.

Amendments to the regulations under section 412 of the Code relate to the election of an alternative amortization method of funding certain pension plans.

T.D. 7703, page 7.

Amendments to the regulations under sections 410 and 411 of the Code relate to the elapsed time method of crediting service of employees under qualified plans.

EXCISE TAXES

Rev. Rul. 80-192, page 19.

Tread rubber; credit or refund; intercity, local, or school buses. The credit or refund provided by section 6416(b)(2)(M) of the Code is available to a tread rubber manufacturer who sells tread rubber tax-paid to its franchised retail dealers for use in retreading or recapping tires that are used by their customers on intercity, local, or school buses.

ADMINISTRATIVE

Ct. D. 2000, page 20.

Criminal prosecutions; aiding revenue agent in accepting unlawful compensation. An individual accused of aiding a revenue agent in accepting unlawful compensation may properly be convicted of the offense despite the prior acquittal of the agent. *F. W. Standefer,* Supreme Court of the United States.

Del. Order 96 (Rev. 4), page 25.

Revocation of determination letters; retroactivity. Authorization is delegated to the Directors, Employee Plans Division, Actuarial Division, and each EP/EO Key District to limit the retroactive effect of the revocation of an employee plans determination letter if certain conditions are met; Del. Order 96 (Rev. 3) superseded.

Del. Order 112 (Rev. 6), page 26.

Employee plans; determination and revocation letters; extension of remedial amendment period; examination reports. Authority is delegated to certain Service officials to issue certain determination and revocation letters with regard to employee plans, to issue certain examination reports, to issue decisions on appealed examination reports or statutory notices, to require preissuance review of certain final revocation letters, and to extend the remedial amendment period in certain cases; Del. Order 112 (Rev. 5) superseded.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 48.—Definitions; Special Rules

26 CFR 1.48-1: Definition of section 38 property.
(Also Sections 167, 263; 1.167(a)-1, 1.263(a)-1.)

Railway road crossings; investment credit; retirement-replacement depreciation method. Costs for replacement of railway road crossings over railroad tracks are included in the term "section 38 property." The retirement-replacement method of accounting for depreciation of crossings and the charge to expense of replacement costs are not proper.

Rev. Rul. 80-187

ISSUES

(1) Whether, under the circumstances described below, the term "section 38 property" includes the material and installation costs for replacement of private and public railway road crossings over the taxpayer's railroad tracks.

(2) Whether, for federal income tax purposes, it is proper to use the retirement-replacement method of accounting for depreciation of crossings and charge such replacement costs to expense.

FACTS

The material and installation costs at issue are for replacement of railway road crossings (in Interstate Commerce Commission (ICC) capital accounts 2½ and 39) that are paid for by the taxpayer, and involve items such as wooden planking laid parallel to the track, hardware, and paving or fill material directly adjacent to the track. The area inside of and surrounding the track is built up so that automobiles and other vehicles, including railroad work equipment, can cross the track and so that trains can operate through the crossings.

For book purposes, the replacement costs of these road crossing assets are capitalized and ratably depreciated. Retirements are charged to the depreciation reserve.

For tax purposes, the taxpayer has treated the initial costs of these road crossing assets as capital costs subject to recovery upon retirement without replacement. However, when such capitalized assets are replaced (retired for books), the costs of replacement have been currently expensed. Thus, the taxpayer has been using the same retirement-replacement method of accounting for depreciation of its crossings in ICC capital accounts 2½ and 39 that it uses for depreciation of its railroad track in ICC capital accounts 8, 9, 10, 11, and 12, on which investment credit is allowable for costs of replacement track materials and their installation under section 48(a)(9) of the Internal Revenue Code.

The average life of the private road crossings is 10 years, and the average life of the public road crossings is 8 years. The present trend in the industry is to eliminate road crossings at grade with underpasses and overpasses.

LAW AND ANALYSIS

Section 48(a)(9) of the Code, which was enacted by the Revenue Act of 1971, Pub. L. 92-178, 1972-1 C.B. 443, provides that section 38 property includes material for track on which the retirement-replacement method of accounting for depreciation is used. Replacements include the costs of rail, ties, ballast, other track materials, and their related installation costs.

Section 167(a) of the Code provides the general rule that there shall be allowed as a depreciation deduction a reasonable allowance for the exhaustion, wear and tear, and obsolescence of property used in the trade or business or of property held for the production of income.

Section 263(a) of the Code provides the general rule that no deduction shall be allowed for any amount paid out for permanent improvements or betterments made to increase the value of any property, or for any amount expended in restoring property or making good the exhaustion thereof for which an allowance is or has been made.

Section 1.48-1(a) of the Income Tax Regulations provides the general rule that "section 38 property" means property (1) on which depreciation is allowable to the taxpayer, (2) that has an estimated useful life of 3 years or more, and (3) that is tangible personal property or other tangible property (excluding buildings and structural components) used as an integral part of furnishing transportation.

The road crossings are permanent improvements under section 263(a) of the Code for which ratable depreciation deductions are allowable under section 167(a). Their use as integral parts of furnishing transportation by allowing trains to operate through and vehicles to cross over the tracks qualify them as section 38 property eligible for the investment tax credit under section 1.48-1(a) of the regulations.

Rev. Rul. 78-199, 1978-1 C.B. 66, provides that the entire track structure of a railroad, including the main line, branch lines, spurs, and sidings, constitutes one unit of property for purposes of computing depreciation under the retirement-replacement method since the economic value of one element of the structure lies only on its relationship to the use of another or other elements of the structure as a whole. This single unit of property concept supports the underlying theory of the retirement-replacement method that the charges to expense on account of all track items retired or replaced in any particular year are taken as a rough equivalent of what would be a proper depreciation allowance for all the working track assets of the taxpayer for that year. Section 48(a)(9) of the Code recognizes the peculiarity of the retirement-replacement method for track.

Although the crossings are within and around the track at specific locations, and provide the necessary means for vehicles to cross over the track and allow trains to operate through them, they are not track nor accounted for as part of the track structure, which is accounted for in ICC capital accounts 8, 9, 10, 11, and 12. Each crossing is a distinct unit of property having a determinable useful life while the entire track structure of a railroad, including the main line, branch line, spurs and sidings, is treated as a unit of property having an indeterminate life under the retirement-replacement method of accounting for depreciation. Accordingly, deduction of replacement costs of crossings is not proper because the crossings are distinct units of property and have determinable useful lives over which ratable deductions may be taken annually.

HOLDINGS

(1) The term "section 38 property" includes the material and installation costs for replacement of private and public railroad road crossings over the taxpayer's railroad tracks.

(2) For federal income tax purposes, it is not proper to use the retirement-replacement method of accounting for depreciation of crossings and charge their replacement costs to expense. Such costs must be capitalized and depreciated over the useful lives of the crossings.

Section 62.—Adjusted Gross Income Defined

26 CFR 1.62-1: Adjusted gross income.

Whether interest and state and local taxes are deductible in addition to the amount of passenger vehicle expenses determined by use of the standard mileage rate. See Rev. Proc. 80-32, page 27.

Section 162.—Trade or Business Expenses

26 CFR 1.162-17: Reporting and substantiation of certain business expenses of employees.

Substantiation of certain subsistence and travel expenses. See Rev. Rul. 80-203, this page.

26 CFR 1.162-17: Reporting and substantiation of certain business expenses of employees.

Simplified, optional method for computing the allowable deduction for the cost of operating an automobile for business purposes. See Rev. Proc. 80-32, page 27.

Section 167.—Depreciation

26 CFR 1.167(a)-1: Depreciation in general.

Treatment of material and installation costs paid for by a railroad taxpayer for replacement of private and public railway road crossings over the taxpayer's railroad track. Also, whether the retirement-replacement method of accounting for depreciation of the railway road crossings is permissible. See Rev. Rul. 80-187, page 5.

Section 170.—Charitable, Etc., Contributions and Gifts

26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance of deduction.

Standard mileage for computing the allowable deduction for the cost of operating an automobile for transportation in connection with rendering gratuitous services to a charitable organization. See Rev. Proc. 80-32, page 27.

Section 213.—Medical, Dental, Etc., Expenses

26 CFR 1.213-1: Medical, dental, etc., expenses.

Standard mileage rate for computing the allowable deduction for the cost of operating an automobile in connection with transportation for medical care. See Rev. Proc. 80-32, page 27.

Section 217.—Moving Expenses

26 CFR 1.217-2: Deduction for moving expenses paid or incurred in taxable years beginning after December 31, 1969.

Simplified, optional method that may be used for computing deductions for the costs of operating a passenger automobile for moving expense purposes. See Rev. Proc. 80-32, page 27.

Section 263.—Capital Expenditures

26 CFR 1.263(a)-1: Capital expenditures; in general.

Treatment of material and installation costs paid for by a railroad taxpayer for replacement of private and public railway road crossings over the taxpayer's railroad track. Also, whether the retirement-replacement method of accounting for depreciation of the railway road crossings is permissible. See Rev. Rul. 80-187, page 5.

Section 274.—Disallowance of Certain Entertainment, Etc., Expenses

26 CFR 1.274-5: Substantiation requirements.
(Also Section 162; 1.162-17.)

Travel expenses; reimbursement; mileage allowances. With respect to expenses paid or incurred after 1979, mileage allowances not exceeding 20 cents per mile for transportation paid by employers to employees will satisfy the substantiation and adequate accounting requirements of sections 1.162-17(b) and 1.274-5 of the regulations; Rev. Rul. 80-62 modified.

Rev. Rul. 80-203

This revenue ruling modifies Rev. Rul. 80-62, 1980-8 I.R.B. 9, with respect to the mileage allowance for transportation paid by employers to employees.

The sixth paragraph of Rev. Rul. 80-62 is amended to read as follows:

If a fixed mileage allowance not exceeding 20 cents per mile is used by an employer in payment of an employee's ordinary and necessary expenses of transportation while traveling away from home and the elements of time, place, and business purpose of the travel are substantiated in accordance with paragraphs (b)(2) and (c) (other than subparagraph (2)(iii)(a) thereof) of section 1.274-5 of the regulations, such an allowance shall be deemed as satisfying with respect to such travel amounts, the substantiation requirements of section 1.274-5 (c) and the adequate accounting requirements of section 1.274-5(e). Also, if an employer grants an allowance not exceeding 20 cents per mile to an employee for ordinary and necessary transportation expenses not involving travel away from home, such an arrangement shall be considered to be an accounting to the employer within the meaning of section 1.162-17(b). However, an employer may grant an additional allowance for parking fees and tolls attributable to the traveling and transportation expenses as separate items.

This amendment is effective with respect to expenses paid or incurred after December 31, 1979.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 80-62 is modified.

26 CFR 1.274-5: Substantiation requirements.

Simplified, optional method for computing allowable deductions for the cost of operating an automobile for business purposes. See Rev. Proc. 80-32, page 27.

Section 304.—Redemption Through Use of Related Corporations

24 CFR 1.304-3: Acquisition by a subsidiary.
(Also Section 1012; 1.1012-1.)

Parent's stock purchased by subsidiary; basis. The purchase of a parent corporation's stock from its sole shareholder by its subsidiary will not result in a constructive distribution to the parent. The parent's adjusted basis in the subsidiary's stock will remain the same as it was prior to the transaction, and the subsidiary, under section 1012 of the Code, will have a basis in the parent's stock acquired in the transaction equal to the amount paid. Rev. Rul. 69-261 modified.

Rev. Rul. 80-189

ISSUE

Whether a parent corporation is in receipt of a constructive distribution from its subsidiary when the subsidiary purchases the parent's stock from a third party.

FACTS, LAW, AND ANALYSIS

In Rev. Rul. 69-261, 1969-1 C.B. 94, *S* corporation purchased for cash some of the stock of *P* corporation, its sole shareholder, from a third party, *A*, the sole shareholder of *P*. Section 304(a)(2) of the Internal Revenue Code provides that, for purposes of sections 302 and 303, if in return for property, a subsidiary acquires stock of its parent from a shareholder of the parent, such property will be treated as a distribution in redemption of the stock of the parent. Section 304(b)(2)(B) provides that in such a case, the determination of the amount that is a dividend will be made as if the property were distributed by the subsidiary to the parent and immediately thereafter distributed by the parent. Rev. Rul. 69-261 holds that the amount received by *A* is a constructive dividend to *A*.

Rev. Rul. 69-261 further holds that the amount deemed distributed by *S* to *P*, by operation of section 304(b)(2)(B) of the Code, is a constructive dividend to *P* under section 301. This position was sustained by the United States Tax Court in *Union Bankers Insurance Co. v. Commissioner,* 64 T.C. 807 (1975), and by the United States District Court in *Broadview Lumber Co. v. United States,* Civil Nos. 73 F 104, 105 (N.D. Ind., Oct. 15, 1975). However, the Tax Court reversed its position in the case of *Webb v. Commisioner,* 67 T.C. 293 (1976), *aff'd per curiam,* 572 F.2d 135 (5th Cir. 1978), reasoning that section 304(b)(2)(B) is directed only toward adjusting the earnings and profits of the parent for the purpose of determining the amount that is a dividend to the shareholder, and has nothing to do with determining the parent corporation's income. Later, the Tax Court in *Virginia Materials Corp. v. Commissioner,* 67 T.C. 372 (1976), *aff'd without opinion* (4th Cir., June 20, 1978) reached a similar decision. Further, the District Court in *Broadview Lumber* was reversed on this issue on appeal, 561 F.2d 698 (7th Cir., 1977).

HOLDING

The Internal Revenue Service will follow the decisions in *Webb, Broadview Lumber,* and *Virginia Materials* on this issue. Consequently, *P* is not in receipt of a constructive distribution from *S* when *S* purchases *P*'s stock from a third party.

P's adjusted basis in *S*'s stock will remain the same as it was prior to the transaction, and *S*, under section 1012 of the Code, will have a basis in *P*'s stock acquired in the transaction equal to the amount paid therefor.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 69-261 is modified to the extent that it holds that *P* is in receipt of a constructive dividend by operation of section 304(b)(2)(B).

Section 410.—Minimum Participation Standards [Pension, Profit-Sharing, Stock Bonus Plans, Etc.]

26 CFR 1.410(a)-7: Elapsed time.

T.D. 7703

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Elapsed time method of crediting service of employees under qualified plans

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the elapsed time method of crediting service of employees under qualified plans. Changes in the applicable tax law were made by the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1]. These regulations provide necessary guidance to the public for compliance with the law, and affect all qualified plans which elect to use the elapsed time method of crediting service of employees.

DATE: The regulations have varying effective dates, the earliest of which, for plans not in existence on January 1, 1974, is plan years beginning after September 2, 1974.

FOR FURTHER INFORMATION CONTACT: Kirk F. Maldonado of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3430) (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On December 28, 1976, the Department of Labor published in the Federal Register a proposed amendment to the Minimum Standards for Employee Pension Benefit Plans (29 CFR § 2530.200b-9) under sections 202, 203, and 204 of the Employee Retirement Income Security Act of 1974 (ERISA) (88 Stat. 853). Section 2530.200b-9 was published both as a temporary regulation effective immediately, and as a proposed regulation on which public comments were solicited.

Section 101 of the Reorganization Plan No. 4 of 1978 (43 FR 47713) transferred jurisdiction over the subject matter of this regulation from the Secretary of Labor to the Secretary of the Treasury.

Section 106 of the Reorganization Plan requires that the Secretary of the Treasury notify the Secretary of Labor before any regulations are issued on certain subject matters, listed therein, if the regulations would significantly impact on or substantially affect collectively bargained plans. This Treasury decision affects sections 410(a)(3) and 411(a)(5) and (6) of the Code, which are subject matters listed in section 106. The Secretary of the Treasury is also prohibited from issuing such regulations unless, within 100 calendar days after this notice is given, the Secretary of Labor certifies that he has no objection or fails to respond. These requirements of section 106 have been satisfied.

Although numerous comments were submitted on this regulation, a public hearing was neither requested nor held. After consideration of all the comments submitted regarding the proposed amendment, the amendment is adopted as revised by this Treasury decision.

OVERVIEW

The elapsed time method is an alternative method of crediting the service of employees for purposes of determining eligibility to participate, vesting, and benefit accrual. Under the elapsed time method, the amount of service to be credited to an individual is not determined by the number of hours worked in a particular year, but rather, with reference to the total period of time which elapses while that individual is employed by the employer or employers maintaining the plan. Accordingly, the rules regarding breaks in service contained in Code sections 410(a)(5) and 411(a)(6) are recast in this regulation in a manner compatible with the elapsed time concepts.

TRANSFERS BETWEEN METHODS OF CREDITING SERVICE

Section 1.410(a)-7(f)(1) provides the rules for plans using the general method of crediting service for some classes of employees, and the elapsed time method of crediting service for other classes of employees. This provision has been changed as a result of comments so that employees transferring from the general method class to the elapsed time method class will receive the greater of the credit they would receive under the elapsed time method for the entire year in which the transfer occurs, or the service they were credited with under the general method as of the date of the transfer.

Section 1.410(a)-7(f)(2) provides the rules applicable when an employee transfers from a plan using either the general method of crediting service or the elapsed time method, to a plan using the other method. This provision has been changed as a result of comments so that an employee's service required to be credited under the transferee plan will be determined under the rules for transfers within a plan that uses different methods of crediting service for different classes of employees.

Some of the plans in existence may be required to be amended to conform with the new rules of the final regulations. Those plans which may have to be amended are those which use the elapsed time method for crediting the service of some classes of employees and the general method for other classes. Also such plans are required to be amended only if they provide for partial years of service for purposes of benefit accrual.

Because the changes in the final regulations may require plan amendments, a transitional rule is provided for the provisions of paragraph (f) of § 1.410(a)-7. For plans in existence on June 17, 1980, the provisions of paragraph (f) apply to plan years beginning after December 31, 1983.

MISCELLANEOUS

Certain changes of a clerical nature and for the purpose of clarity are made in these final regulations. No substantive change is intended by the deletion in the final regulations of the citations to the "mirror image" provisions of Title I of ERISA. Also, certain conforming changes to the Income Tax Regulations are made on account of this regulation.

DRAFTING INFORMATION

The principal author of these regulations is Kirk F. Maldonado of the Employee Plans and Exempt Organizations Division of the Office of the Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing this regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to the regulations are hereby adopted:

Paragraph 1. Section 1.410(a)-1 is amended by redesignating paragraph (b)(7) and (b)(8) as (b)(8) and (b)(9), respectively, and by adding a new paragraph (b)(7) to read as follows:

§ 1.410(a)-1 Minimum participation standards; general rules.

* * * * *

(b) *Organization of regulations relating to minimum participation standards.* * * *

(7) *Elapsed time.* Section 1.410(a)-7 provides rules under section 410 and 411 relating to the elapsed time method of crediting years of service.

* * * * *

Par. 2. Section 1.410(a)-4(b)(1) is revised by deleting "Department of Labor Regulations" and inserting in lieu thereof "§ 1.410(a)-7".

Par. 3. Section 1.410(a)-5(a) is revised by deleting from the second sentence "elapsed time,".

Par. 4. Section 1.410(a)-7 is added at the appropriate place to read as follows:

§ 1.410(a)-7 Elapsed time.

(a) *In general*—(1) *Introduction to elapsed time method of crediting service.* (i) 29 CFR § 2530.200b-2 sets forth the general method of crediting service for an employee. The general method is based upon the actual counting of hours of service during the applicable 12-consecutive-month computation period. The equivalencies set forth in 29 CFR § 2530.200b-3 are also methods for crediting hours of service during computation periods. Under the general method and the equivalencies, an employee receives a year's credit (in units of years of service or years of participation) for a computation period during which the employee is credited with a specified number of hours of service. In general, an employee's statutory entitlement with respect to eligibility to participate, vesting and benefit accrual is determined by totalling the number of years' credit to which an employee is entitled.

(ii) Under the alternative method set forth in this section, by contrast, an employee's statutory entitlement with respect to eligibility to participate, vesting and benefit accrual is not based upon the actual completion of a specified number of hours of service during a 12-consecutive-month period. Instead, such entitlement is determined generally with reference to the total period of time which elapses while the employee is employed (*i.e.,* while the employment relationship exists) with the employer or employers maintaining the plan. The alternative method set forth in this section is designed to enable a plan to lessen the administrative burdens associated with the maintenance of records of an employee's hours of service by permitting each employee to be credited with his or her total period of service with the employer or employers maintaining the plan, irrespective of the actual hours of service completed in any 12-consecutive-month period.

(2) *Overview of the operation of the elapsed time method.* (i) Under the elapsed time method of crediting service, a plan is generally required to take into account the period of time which elapses while the employee is employed (*i.e.,* while the employment relationship exists) with the employer or employers maintaining the plan, regardless of the actual number of hours he or she completes during such period. Under this alternative method of crediting service, an employee's service is required to be taken into account for purposes of eligibility to participate and vesting as of the date he or she first performs an hour of service within the meaning of 29 CFR § 2530.200b-2(a)(1) for the employer or employers maintaining the plan. Service is required to be taken into account for the period of time from the date the employee first performs such an hour of service until the date he or she severs from service with the employer or employers maintaining the plan.

(ii) The date the employee severs from service is the earlier of the date the employee quits, is discharged, retires or dies, or the first anniversary of the date the employee is absent from service for any other reason (*e.g.,* disability, vacation, leave of absence, layoff, etc.). Thus, for example, if an employee quits, the severance from service date is the date the employee quits. On the other hand, if an employee is granted a leave of absence (and if no intervening event occurs), the severance from service date will occur one year after the date the employee was first absent on leave, and this one year of absence is required to be taken into account as service for the employer or employers maintaining the plan. Because the severance from service date occurs on the earlier of two possible dates (*i.e.,* quit, discharge, retirement or death *or* the first anniversary of an absence from service for any other reason), a quit, discharge, retirement or death within the year after the beginning of an absence for any other reason results in an immediate severance from service. Thus, for example, if an employee dies at the end of a four-week absence resulting from illness, the severance from service date is the date of death, rather than the first anniversary date of the first day of absence for illness.

(iii) In addition, for purposes of eligibility to participate and vesting under the elapsed time method of crediting service, an employee who has severed from service by reason of a quit, discharge or retirement may be entitled to have a period of time of 12 months or less taken into account by the employer or employers maintaining the plan if the employee returns to service within a certain period of time and performs an hour of service within the meaning of 29 CFR § 2530.200b-2(a)(1). In general, the period of time during which the employee must return to service begins on the date the employee severs from service as a result of a quit, discharge or retirement and ends on the first anniversary of such date. However, if the employee is absent for any other reason (*e.g.,* layoff) and then quits, is discharged or retires, the period of time during which the employee may return and receive credit begins on the severance from service date and ends one year after the first day of absence (*e.g.,* first day of layoff). As a result of the operation of these rules, a severance from service (*e.g.,* a quit), or an absence (*e.g.,* layoff) followed by a severance from service, never results in a period of time of more than one year being required to be taken into account after an employee severs from service or is absent from service.

(iv) For purposes of benefit accrual under the elapsed time method of crediting service, an employee is entitled to have his or her service taken into account from the date he or she begins to participate in the plan until the severance from service date. Periods of severance under any circumstances are not required to be taken into account. For example, a participant who is discharged on December 14, 1980 and rehired on October 14, 1981 is not required to be credited with the 10 month period of severance for benefit accrual purposes.

(3) *Overview of certain concepts relating to the elapsed time method*—(i) *In general.* The rules with respect to the elapsed time method of crediting service are based on certain concepts which are defined in paragraph (b) of this section. These concepts are applied in the substantive rules contained in paragraphs (c), (d), (e), (f) and (g) of this section. The purpose of this subparagraph is to summarize these concepts.

(ii) *Employment commencement date.* (A) A concept which is necessary in order to credit service accurately under any service crediting method is the establishment of a starting point for crediting service. The employment commencement date, which is the date on which an employee first performs an hour of service within the meaning of 29 CFR

§ 2530.200b-2(a)(1) for the employer or employers maintaining the plan, is used to establish the date upon which an employee must begin to receive credit for certain purposes (*e.g.*, eligibility to participate and vesting).

(B) In order to credit accurately an employee's total service with an employer or employers maintaining the plan, a plan also may provide for an "adjusted" employment commencement date (*i.e.*, a recalculation of the employment commencement date to reflect noncreditable periods of severance) or a reemployment commencement date as defined in paragraph (b)(3) of this section. Fundamentally, all three concepts rely upon the performance of an hour of service to provide a starting point for crediting service. One purpose of these three concepts is to enable plans to satisfy the requirements of this section in a variety of ways.

(C) The fundamental rule with respect to these concepts is that any plan provision is permissible so long as it satisfies the minimum standards. Thus, for example, although the rules of this section provide that credit must begin on the employment commencement date, a plan is permitted to "adjust" the employment commencement date to reflect periods of time for which service is not required to be credited. Similarly, a plan may wish to credit service under the elapsed time method as discrete periods of service and provide for a reemployment commencement date. Certain plans may wish to provide for both concepts, although it is not a requirement of this section that plans so provide.

(iii) *Severance from service date.* Another fundamental concept of the elapsed time method of crediting service is the severance from service date, which is defined as the earlier of the date on which an employee quits, retires, is discharged or dies, or the first anniversary of the first date of absence for any other reason. One purpose of the severance from service date is to provide the endpoint for crediting service under the elapsed time method. As a general proposition, service is credited from the employment commencement date (*i.e.*, the starting point) until the severance from service date (*i.e.*, the endpoint). A complementary purpose of the severance from service date is to establish the starting point for measuring a period of severance from service in order to determine a "break in service" (see paragraph (a)(3)(v) of this section). A third purpose of such date is to establish the starting point for measuring the period of time which may be required to be taken into account under the service spanning rules (see paragraph (a)(3)(vi) of this section).

(iv) *Period of service.* A third elapsed time concept is the use of the "period of service" rather than the "year of service" in determining service to be taken into account for purposes of eligibility to participate, vesting and benefit accrual. For purposes of eligibility to participate and vesting, the period of service runs from the employment commencement date or reemployment commencement date until the severance from service date. For purposes of benefit accrual, a period of service runs from the date that a participant commences participation under the plan until the severance from service date. Because the endpoint of the period of service is marked by the severance from service date, an employee is credited with the period of time which runs during any absence from service (other than for reason of a quit, retirement, discharge or death) which is 12 months or less. Thus, for example, a three week absence for vacation is taken into account as part of a period of service and does not trigger a severance from service date.

(v) *Period of severance.* A period of severance begins on the severance from service date and ends when an employee returns to service with the employer or employers maintaining the plan. The purpose of the period of severance is to apply the statutory "break in service" rules to an elapsed time method of crediting service.

(vi) *Service spanning.* Under the elapsed time method of crediting service, a plan is required to credit periods of service and, under the service spanning rules, certain periods of severance of 12 months or less for purposes of eligibility to participate and vesting. Under the first service spanning rule, if an employee severs from service as a result of quit, discharge or retirement and then returns to service within 12 months, the period of severance is required to be taken into account. Also, a situation may arise in which an employee is absent from service for any reason other than quit, discharge, retirement or death and during the absence a quit, discharge or retirement occurs. The second service spanning rule provides in that set of circumstances that a plan is required to take into account the period of time between the severance from service date (*i.e.*, the date of quit, discharge or retirement) and the first anniversary of the date on which the employee was first absent, if the employee returns to service on or before such first anniversary date.

(4) *Organization and applicability.* (i) The substantive rules for crediting service under the elapsed time method with respect to eligibility to participate are contained in paragraph (c), the rules with respect to vesting are contained in subparagraph (d), and the rules with respect to benefit accrual are contained in paragraph (e). The format of the rules is designed to enable a plan to use the elapsed time method of crediting service either for all purposes or for any one or combination of purposes under sections 410 and 411. Thus, for example, a plan may credit service for eligibility to participate purposes by the use of the general method of crediting service set forth in 29 CFR § 2530.200b-2 or by the use of any of the equivalencies set forth in 29 CFR § 2530.200b-3, while the plan may credit service for vesting and benefit accrual purposes by the use of the elapsed time method of crediting service.

(ii) A plan using the elapsed time method of crediting service for one or more classifications of employees covered under the plan may use the general method of crediting service set forth in 29 CFR § 2530.200b-2 or any of the equivalencies set forth in 29 CFR § 2530.200b-3 for other classifications of employees, provided that such classifications are reasonable and are consistently applied. Thus, for example, a plan may provide that part-time employees are credited under the general method of crediting service set forth in 29 CFR § 2530.200b-2 and full-time employees are credited under the elapsed time method. A classification, however, will not be deemed to be reasonable or consistently applied if such classification is designed with an intent to preclude an employee or employees from attaining his or her statutory entitlement with respect to eligibility to participate, vesting or benefit accrual. For example, a classification applied so that any full-time employee credited with less than 1,000 hours of service during a given 12-consecutive-month period would be considered part-time and subject to the general method of crediting service rather than the elapsed time method would not be reasonable.

(iii) Notwithstanding paragraph (a)(4)(i) and (ii) of this section, the use of the elapsed time method for some purposes or the use of the elapsed time method for some employees may, under certain circumstances, result in discrimination prohibited under section 401(a)(4), even though the use of the elapsed time method for such purposes, and for such employees, is permitted under this section.

(5) *More than one employer plans.* For special rules for computing years of service in the case of a plan maintained by more than one employer, see 29 CFR Part 2530 (Department of Labor regulations relating to minimum standards for employee pension benefit plans).

(b) *Definitions*—(1) *Employment commencement date.* For purposes of this section, the term "employment commencement date" shall mean the date on which the employee first performs an hour of service within the meaning of 29 CFR § 2530.200b-2(a)(1) for the employer or employers maintaining the plan.

(2) *Severance from service date.* For purposes of this section, a "severance from service" shall occur on the earlier of—

(i) The date on which an employee quits, retires, is discharged or dies; or

(ii) The first anniversary of the first date of a period in which an employee remains absent from service (with or without pay) with the employer or employers maintaining the plan for any reason other than quit, retirement, discharge or death, such as vacation, holiday, sickness, disability, leave of absence or layoff.

(3) *Reemployment commencement date.* For purposes of this section, the term "reemployment commencement date" shall mean the first date, following a period of severance from service which is not required to be taken into account under the service spanning rules in paragraphs (c)(2)(iii) and (d)(1)(iii) of this section, on which the employee performs an hour of service within the meaning of 29 CFR § 2530.200b-2(a)(1) for the employer or employers maintaining the plan.

(4) *Participation commencement date.* For purposes of this section, the term "participation commencement date" shall mean the date a participant first commences participation under the plan.

(5) *Period of severance.* For purposes of this section, the term "period of severance" shall mean the period of time commencing on the severance from service date and ending on the date on which the employee again performs an hour of service within the meaning of 29 CFR § 2530.200b-2(a)(1) for an employer or employers maintaining the plan.

(6) *Period of service*—(i) *General rule.* For purposes of this section, the term "period of service" shall mean a period of service commencing on the employee's employment commencement date or reemployment commencement date, whichever is applicable, and ending on the severance from service date.

(ii) *Aggregation rule.* Unless a plan provides in some manner for an "adjusted" employment commencement date or similar method of consolidating periods of service, periods of service shall be aggregated unless such periods may be disregarded under section 410(a)(5) or 411(a)(4).

(iii) *Other federal law.* Nothing in this section shall be construed to alter, amend, modify, invalidate, impair or supersede any law of the United States or any rule or regulation issued under such law. Thus, for example, nothing in this section shall be construed as denying an employee credit for a "period of service" if credit is required by a separate federal law. Furthermore, the nature and extent of such credit shall be determined under such law.

(c) *Eligibility to participate*—(1) *General rule.* For purposes of section 410(a)(1)(A), a plan generally may not require as a condition of participation in the plan that an employee complete a period of service with the employer or employers maintaining the plan extending beyond the later of—

(i) The date on which the employee attains the age of 25; or

(ii) The date on which the employee completes a one-year period of service.

See the regulations under section 410(a) (relating to eligibility to participate).

(2) *Determination of one-year period of service.* (i) For purposes of determining the date on which an employee satisfies the service requirement for initial eligibility to participate under the plan, a plan using the elasped time method of crediting service shall provide that an employee who completes the 1-year period of service requirement on the first anniversary of his employment commencement date satisfies the minimum service requirement as of such date. In the case of an employee who fails to complete a one-year period of service on the first anniversary of his employment commencement date, a plan which does not contain a provision permitted by section 410(a)(5)(D) (rule of parity) shall provide for the aggregation of periods of service so that a one-year period of service shall be completed as of the date the employee completes 12 months of service (30 days are deemed to be a month in the case of the aggregation of fractional months) or 365 days of service.

(ii) For purposes of section 410(a)(1)(B)(i), a "3-year period of service" shall be deemed to be "3 years of service."

(ii) *Service spanning rules.* In determining a 1-year period of service for purposes of initial eligibility to participate and a period of service for purposes of retention of eligibility to participate, in addition to taking into account an employee's period of service, a plan shall take into account the following periods of severance—

(A) If an employee severs from service by reason of a quit, discharge or retirement and the employee then performs an hour of service within the meaning of 29 CFR § 2530.200b-2(a)(1) within 12 months of the severance from service date, the plan is required to take into account the period of severance; and

(B) Notwithstanding paragraph (c)(2)(iii)(A) of this service, if an employee severs from service by reason of a quit, discharge or retirement during an absence from service of 12 months or less for any reason other than a quit, discharge, retirement or death, and then performs an hour of service within the meaning of 29 CFR § 2530.200b-2(a)(1) within 12 months of the date on which the employee was first absent from service, the plan is required to take into account the period of severance.

(iv) For purposes of determining an employee's retention of eligibility to participate in the plan, a plan shall take into account an employee's entire period of service unless certain periods of service may be disregarded under section 410(a)(5) of the Code.

(v) *Example.* Employee W, age 31, completed 6 months of service and was laid off. After 2 months of layoff, W quit. Five months later, W returned to service. For purposes of eligibility to participate, W was required to be credited with 13 months of service (8 months of service and 5 months of severance). If, on the other hand, W had not returned to service within the first 10 months of severance (*i.e.*, within 12 months after the first day of layoff), W would be required to be credited with only 8 months of service.

(3) *Entry date requirements*—(i) *General rule.* For purposes of section 410(a)(4), it is necessary for a plan to provide that any employee who has satisfied the minimum age and service requirements, and who is otherwise entitled to participate in the plan, commences participation in the plan no later than the earlier of—

(A) The first day of the first plan year beginning after the date on which such employee satisfied such requirements, or

(B) The date six months after the date on which he satisfied such requirements,

unless such employee was separated from service before the date referred to in subdivision (i)(A) or (B), whichever is applicable. See the regulations under section (a) (relating to eligibility to participate).

(ii) *Separation from service*—(A) *Definition.* For purposes of this section, the term "separated from service" includes a severance from service or an absence from service for any reason other than a quit, discharge, retirement or death, regardless of the duration of such absence. Accordingly, if an employee is laid off for a period of six weeks, the employee shall be deemed to be "separated from service" during such period for purposes of the entry date requirements.

(B) *Application.* A period of severance which is taken into account under the service spanning rules in paragraph (c)(2)(iii) of this section or an absence of 12 months or less may result in an employee satisfying the plan's minimum service requirement during such period of time. In addition, once an employee satisfies the plan's minimum service requirement, either before or during such period of time, such period of time may contain an entry date applicable to such employee. In the case of an employee whose period of severance is taken into account and such period contains an entry date applicable to the employee, he or she shall be made a participant in the plan (if otherwise eligible) no later than the date on which he or she ended the period of severance. In the case of an employee whose period of absence contains an entry date applicable to such employee, he or she, no later than the date such absence ended, shall be made a participant in the plan (if otherwise eligible) as of the first applicable entry date which occurred during such absence from service.

(iii) *Examples.* For purposes of the following examples, assume that the plan provides for a minimum age requirement of 25 and a minimum service requirement of one year, and provides for semi-annual entry dates.

(A) Employee A, age 35, worked for 10 months in a job classification covered under the plan, became disabled for nine consecutive months and then returned to service. During the period of absence, A completed a 1-year period of service and passed a semi-annual entry date after satisfying the minimum service requirement. Accordingly, the plan is required to make A a participant no later than his return to service effective as of the applicable entry date.

(B) Employee B, after satisfying the minimum age and service requirements, quit work before the next semi-annual entry date, and then returned to service before incurring a 1-year period of severance, but after such semi-annual entry date. Employee B is entitled to become a participant immediately upon his return to service effective as of the date of his return.

(4) *Break in service.* For purposes of applying the break in service rules under section 410(a)(5)(B) and (C), the term "1-year period of severance" shall be substituted for the term "1-year break in service." A 1-year period of severance shall be determined on the basis of a 12-consecutive-month period beginning on the severance from service date and ending on the first anniversary of such date, provided that the employee during such 12-consecutive-month period does not perform an hour of service within the meaning of 29 CFR § 2530.200b-2(a)(1) for the employer or employers maintaining the plan.

(5) *One-year hold-out*—(i) *General rule.* (A) For purposes of section 410(a)(5)(C), in determining the period of service of an employee who has incurred a 1-year period of severance, a plan may disregard the employee's period of service before such period of severance until the employee completes a 1-year period of service after such period of severance.

(B) *Example.* Assume that a plan provides for a minimum service requirement of 1 year and provides for semi-annual entry dates, but does not contain the provisions permitted by section 410(a)(5)(D) (relating to the rule of parity). Employee G, age 40, completed a seven-month period of service, quit and then returned to service 15 months later, thereby incurring a 1-year period of severance. After working four months, G was laid off for nine months and then returned to work again. Although the plan may hold employee G out from participation in the plan until the completion of a 1-year period of service after the 1-year (or greater) period of severance, once the 1-year hold-out is completed, the plan is required to provide the employee with such statutory entitlement as arose during the 1-year hold-out. Accordingly, employee G satisfied the 1-year hold-out requirement as of the eighth month of layoff, and G is entitled to become a participant in the plan immediately upon his return to service after the nine-month layoff effective as of the first applicable entry date occurring after the date on which he satisfied the 1-year of service requirement (*i.e.,* the first applicable entry date after the first month of layoff). See the regulations under section 410 (a) (relating to eligibility to participate).

(6) ***Rule of parity***—(i) ***General rule.*** For purposes of section 410(a) (5)(D), in the case of a participant who does not have any nonforfeitable right under the plan to his accrued benefit derived from employer contributions and who incurs a 1-year period of severance, a plan, in determining an employee's period of service for purposes of section 410 (a)(1), may disregard his period of service if his latest period of severance equals or exceeds his prior periods of service, whether or not consecutive, completed before such period of severance. See the regulations under section 410(a) (relating to eligibility to participate).

(ii) In determining whether a completely nonvested employee's service may be disregarded under the rule of parity, a plan is not permitted to apply the rule until the employee incurs a 1-year period of severance. Accordingly, a plan may not disregard a period of service of less than one year until an employee has incurred a period of severance of at least one year.

(iii) ***Example.*** Assume that a plan provides for a minimum service requirement of one year and provides for the rule of parity. An employee works for three months, quits and then is rehired 10 months later. Such employee is entitled to receive 13 months of credit for purposes of eligibility to participate and vesting (see the service spanning rules). Although the period of severance exceeded the period of service, the three months of service may not be disregarded because no 1-year period of severance occurred.

(d) ***Vesting***—(1) ***General rule.*** (i) For purposes of section 411(a)(2), relating to vesting in accrued benefits derived from employer contributions, a plan which determines service to be taken into account on the basis of elapsed time shall provide that an employee is credited with a number of years of service equal to at least the number of whole years of the employee's period of service, whether or not such periods of service were completed consecutively.

(ii) In order to determine the number of whole years of an employee's period of service, a plan shall provide that nonsuccessive periods of service must be aggregated and that less than whole year periods of service (whether or not consecutive) must be aggregated on the basis that 12 months of service (30 days are deemed to be a month in the case of the aggregation of fractional months) or 365 days of service equal a whole year of service.

(iii) ***Service spanning rules.*** In determining a participant's period of service for vesting purposes, a plan shall take into account the following periods of severance—

(A) If an employee severs from service by reason of a quit, discharge or retirement and the employee then performs an hour of service within the meaning of 29 CFR §2530.200b-2(a) (1) within 12 months of the severance from service date, the plan is required to take into account the period of severance; and

(B) Notwithstanding paragraph (d)(1)(iii)(A) of this section, if an employee severs from service by reason of a quit, discharge or retirement during an absence from service of 12 months or less for any reason other than a quit, discharge, retirement or death, and then performs an hour of service within the meaning of 29 CFR § 2530.200b-2(a)(1) within 12 months of the date on which the employee was first absent from service, the plan is required to take into account the period of severance.

(iv) For purposes of determining an employee's nonforfeitable percentage of accrued benefits derived from employer contributions, a plan, after calculating an employee's period of service in the manner prescribed in this paragraph, may disregard any remaining less than whole year, 12-month or 365-day period of service. Thus, for example, if a plan provides for the statutory five to fifteen year graded vesting, an employee with a period (or periods) of service which yield 5 whole year periods of service and an additional 321-day period of service is twenty-five percent vested in his or her employer-derived accrued benefits (based solely on the 5 whole year periods of service).

(2) ***Service which may be disregarded.*** (i) For purposes of section 411(a)(4), in determining the nonforfeitable percentage of an employee's right to his or her accrued benefits derived from employer contributions, all of an employee's period or periods of service with an employer or employers maintaining the plan shall be taken into account unless such service may be disregarded under paragraph (d)(2) (ii) of this section.

(ii) For purposes of paragraph (d) (2)(i) of this section, the following periods of service may be disregarded—

(A) The period of service completed by an employee before the date on which he attains age 22;

(B) In the case of a plan which requires mandatory employee contributions, the period of service which falls within the period of time to which a particular employee contribution relates, if the employee had the opportunity to make a contribution for such period of time and failed to do so;

(C) The period of service during any period for which the employer did not maintain the plan or a predecessor plan;

(D) The period of service which is not required to be taken into account by reason of a period of severance which constitutes a break in service within the meaning of paragraph (d) (4) of this section;

(E) The period of service completed by an employee prior to January 1, 1971, unless the employee completes a period of service of at least 3 years at any time after December 31, 1970; and

(F) The period of service completed before the first plan year for which this section applies to the plan, if such service would have been disregarded under the plan rules relating to breaks in service in effect at that time.

See the regulations under section 411(a) (relating to vesting).

(3) ***Seasonal industry.*** [Reserved.]

(4) ***Break in service.*** For purposes of applying the break in service rules, the term "1-year period of severance" shall be substituted for the term "1-year break in service." A 1-year period of severance shall be a 12-consecutive-

month period beginning on the severance from service date and ending on the first anniversary of such date, provided that the employee during such 12-consecutive-month period fails to perform an hour of service within the meaning of 29 CFR § 2530.200b-2(a)(1) for an employer or employers maintaining the plan.

(5) *One-year hold-out.* For purposes of section 411(a)(6)(B), in determining the nonforfeitable percentage of the right to accrued benefits derived from employer contributions of an employee who has incurred a 1-year period of severance, the period of service completed before such period of severance is not required to be taken into account until the employee has completed a 1-year period of service after his return to service. See the regulations under section 411(a) (relating to vesting).

(6) *Vesting in pre-break accruals.* For purposes of section 411(a)(6)(C), a "1-year period of severance" shall be deemed to constitute a "1-year break in service." See the regulations under section 411(a) (relating to vesting).

(7) *Rule of parity*—(i) *General rule.* For purposes of section 411(a)(6)(D), in the case of an employee who is a nonvested participant in employer-derived benefits at the time he incurs a 1-year period of severance, the period of service completed by such participant before such period of severance is not required to be taken into account for purposes of determining the vested percentage of his or her right to employer-derived benefits if at such time the consecutive period of severance equals or exceeds his prior periods of service, whether or not consecutive, completed before such period of severance. See the regulations under section 411(a) (relating to vesting).

(e) *Benefit accrual.* (1) For purposes of section 411(b), a plan may provide that a participant's service with an employer or employers maintaining the plan shall be determined on the basis of the participant's total period of service beginning on the participation commencement date and ending on the severance from service date.

(2) Under section 411(b)(3)(A), a defined benefit pension plan may determine an employee's service for purposes of benefit accrual on any basis which is reasonable and consistent and which takes into account all service during the employee's participation in the plan which is included in a period of service required to be taken into account under section 410(a)(5) (relating to service which must be taken into account for purposes of determining an employee's eligibility to participate). A plan which provides for the determination of an employee's service with an employer or employers maintaining the plan on the basis permitted under paragraph (e)(1) of this section will be deemed to meet the requirements of section 411(b)(3)(A), provided that the plan meets the requirements of 29 CFR § 2530.204-3, relating to plans which determine an employee's service for purposes of benefit accrual on a basis other than computation periods. Specifically, under 29 CFR § 2530.204-3, it must be possible to prove that, despite the fact that benefit accrual under such a plan is not based on computation periods, the plan's provisions meet at least one of the three benefit accrual rules of section 411(b)(1) under all circumstances. Further, 29 CFR § 2530.204-3 prohibits such a plan from disregarding service under section 411(b)(3)(C) (which would otherwise permit a plan to disregard service performed by an employee during a computation period in which the employee is credited with less than 1,000 hours). See the regulations under section 411(b) (relating to benefit accrual).

(f) *Transfers between methods of crediting service*—(1) *Single plan.* A plan may provide that an employee's service for purposes of eligibility to participate, vesting or benefit accrual shall be determined on the basis of computation periods under the general method set forth in 29 CFR § 2530.200b-2 for certain classes of employees but under the alternative method permitted under this section for other classes of employees if the plan provides as follows—

(i) In the case of an employee who transfers from a class of employees whose service is determined on the basis of computation periods to a class of employees whose service is determined on the alternative basis permitted under this section, the employee shall receive credit for a period of service consisting of—

(A) A number of years equal to the number of years of service credited to the employee before the computation period during which the transfer occurs; and

(B) The greater of *(1)* the period of service that would be credited to the employee under the elapsed time method for his service during the entire computation period in which the transfer occurs, or *(2)* the service taken into account under the computation periods method as of the date of the transfer.

In addition, the employee shall receive credit for service subsequent to the transfer commencing on the day after the last day of the computation period in which the transfer occurs.

(ii) In the case of an employee who transfers from a class of employees whose service is determined on the alternative basis permitted under this section to a class of employees whose service is determined on the basis of computation periods—

(A) The employee shall receive credit, as of the date of the transfer, for a number of years of service equal to the number of 1-year periods of service credited to the employee as of the date of the transfer, and

(B) The employee shall receive credit, in the computation period which includes the date of the transfer, for a number of hours of service determined by applying one of the equivalencies set forth in 29 CFR § 2530.200b-3(e)(1) to any fractional part of a year credited to the employee under this section as of the date of the transfer. Such equivalency shall be set forth in the plan and shall apply to all similarly situated employees.

(2) *More than one plan.* In the case of an employee who transfers from a plan using either the general method of determining service on the basis of computation periods set forth in 29 CFR § 2530.200b-2 or the method of determining service permitted under this section to a plan using the other method of determining service, all

service required to be credited under the plan to which the employee transfers shall be determined by applying the rules of paragraph (f)(1) of this section.

(g) *Amendments to change method of crediting service.* A plan may be amended to change the method of crediting service for any purpose or for any class of employees between the general method set forth in 29 CFR § 2530.200b-2 and the method permitted under this section, if such amendment contains provisions under which each employee with respect to whom the method of crediting service is changed is treated in the same manner as an employee who transfers from one class of employees to another under paragraph (f)(1) of this section.

(h) *Transitional rule.* For plans in existence on June 17, 1980, the provisions of paragraph (f) of this section are effective for plan years beginning after December 31, 1983.

Par. 5. Section 1.411(a)-5(b) is revised by deleting from suparagraphs (1)(iii) and (2) "Department of Labor regulations" and inserting in lieu thereof "§ 1.410(a)-7".

Par. 6. Section 1.411(a)-6(c)(1)(iii) is revised by deleting from the second sentence "Department of Labor Regulations" and inserting in lieu thereof "§ 1.410(a)-7".

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of Internal Revenue.

Approved June 2, 1980

DONALD C. LUBICK,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on June 16, 1980, 8:45 a.m., and published in the issue of the Federal Register for June 17, 1980, 45 F.R. 40979)

Section 412.—Minimum Funding Standards

26 CFR 1.412(b)-5: Election of the alternative amortization method of funding.

T.D. 7702

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Election of Alternative Amortization Method of Funding Certain Pension Plans

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the procedure for electing an alternative amortization method of funding certain pension plans. These regulations implement section 1013(d) of the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1, 92], and provide necessary guidance to the public for compliance with the Internal Revenue Code of 1954, as amended. The regulations would affect certain multiemployer pension plans which were in existence on January 1, 1974.

DATES: The regulations are effective generally for plan years beginning after 1975, but earlier (or later) in the case of some plans as provided by section 1017 of the Employee Retirement Income Security Act of 1974.

FOR FURTHER INFORMATION CONTACT: Mr. Russell Greenblatt of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3544, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On November 23, 1979, proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 412 of the Internal Revenue Code of 1954 were published in the Federal Register (44 FR 67178). The amendments were proposed to conform the regulations to section 1013(d) of the Employee Retirement Income Security Act of 1974 (ERISA) (Pub. L. 93-406, 88 Stat. 923). One comment concerning the proposed regulations was received. No public hearing was requested or held.

EXPLANATION OF PROVISIONS

Section 412 of the Internal Revenue Code of 1954, added by section 1013 of ERISA, provides minimum funding requirements with respect to certain pension plans. These requirements include the maintenance of a minimum funding standard account, to which is charged (among other items), in accordance with section 412(b)(2)(B), an amount necessary to amortize in equal annual installments the plan's unfunded past service liability.

With respect to certain multiemployer plans which were in existence on January 1, 1974, section 1013(d) of ERISA allows an election by the plan to fund certain unfunded past service liability on the basis of an equal annual percentage of the aggregate pay of all participants of the plan in lieu of the level dollar charges referred to above. This alternative amortization method applies to the amount of unfunded past service liability which exists as of the date 12 months after the date on which section 412 first applies to the plan.

The regulations prescribe the means by which certain multiemployer plans can elect the alternative amortization method. The multiemployer plans to which this election is available are those plans which (a) on January 1, 1974, had contributions under the plan based on a percentage of pay, (b) have actuarial assumptions with respect to pay which are reasonably related to past and projected experience, and (c) have rate of interest under the plan which are determined on the basis of reasonable actuarial assumptions. The election consists of the attachment of a statement to the annual report required under section 6058(a) for the plan year for which the election is made, stating that the alternative method is being adopted. Advance approval from the Internal Revenue

Service is not required. The alternative method must be adopted on or before the deadline for filing the annual report corresponding to the last plan year beginning before January 1, 1982. If the election is made after the first plan year to which section 412 applies, recomputation of the contributions due in the prior years (to which section 412 applied) will be necessary.

COMMENTS ON THE PROPOSED REGULATIONS

The one written comment submitted concerned proposed § 1.412-5(d). That provision construes section 1013 (d)(2) of ERISA, which establishes minimum charges to the funding standard account for a plan year by a plan making the election. Under the proposed regulations, these minimum charges equal the interest on certain past service liabilities, determined as of the date 12 months after the date on which section 412 first applies to the plan.

The comment recommended that the determination of the minimum charges should also take into account additional liabilities generated by plan amendments after the initial 12-month period, and interest thereon. The Treasury Department does not regard this suggestion as a reasonable construction of the statute, as the election provided by section 1013(d)(1) applies only to the unfunded past service liability existing as of the date 12 months after section 412 first became applicable to the plan.

Accordingly, the proposed regulations are adopted without change.

DRAFTING INFORMATION

The principal author of these regulations is Mr. Russell Greenblatt of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

The following amendments to 26 CFR Part 1 are hereby adopted:

§ 1.412(b)-5 Election of the alternative amortization method of funding.

(a) *Alternative amortization method in general.* Section 1013(d) of the Employee Retirement Income Security Act of 1974 provides an alternative method which may be used by certain multiemployer plans (as defined in section 414(f)) which were in existence on January 1, 1974, for funding certain unfunded past service liability. The multiemployer plans which may elect to use this alternative method are those plans (1) under which, on January 1, 1974, contributions were based on a percentage of pay, (2) which use actuarial assumptions with respect to pay that are reasonably related to past and projected experience, and (3) which use rates of interest that are determined on the basis of reasonable actuarial assumptions. The unfunded past service liability to which this method applies is that amount existing as of the date 12 months after the date on which section 412 first applies to the plan. The alternative method allows the plan to fund this liability over a period of 40 plan years by charging the funding standard account with an equal annual percentage of the aggregate pay of all participants in the plan instead of the level dollar charges required under section 412 (b)(2)(B). Paragraphs (b), (c), (d) and (e) of this section contain procedural rules for electing this alternative method.

(b) *Election procedure.* To elect the alternative amortization method, a multiemployer plan must attach a statement to the annual report required under section 6058(a) for the plan year for which the election is made, stating that the alternative method for funding unfunded past service liability is being adopted. Advance approval from the Internal Revenue Service is not required. The alternative method must be adopted on or before the last day prescribed for filing the annual report corresponding to the last plan year beginning before January 1, 1982.

(c) *Charges to which the alternative amortization method is applicable.* Once elected, the alternative amortization method is applicable to the unfunded past service liability existing as of the date 12 months after the date on which section 412 first applies to the plan. This results in charges to the funding standard account which are in lieu of—

(1) Charges required under clause (i) of section 412(b)(2)(B), and

(2) Charges required under clause (iii) of section 412(b)(2)(B) if the plan amendments referred to in such clause result in a net increase in the unfunded past service liability existing as of the date 12 months after the date on which section 412 first applies to the plan. Such charges generally will arise only with respect to plan amendments adopted in the first plan year to which section 412 applies.

If the election is made on an annual report corresponding to a plan year after the first plan year to which section 412 applies, recomputation of the contributions due in the prior years (to which section 412 applied) will be necessary.

(d) *Limitation.* The sum of the charges described in this paragraph may not be less than the interest on the unfunded past service liabilities described in section 412(b)(2)(B)(i) and (iii), determined as of the date 12 months after the date on which section 412 first applies to the plan.

(e) *Reporting requirements.* Each annual report required by section 6058 (a) and periodic report of the actuary required by section 6059 must include all additional information relevant to the use of the alternative amortization method as may be required by the applicable forms and the instructions for such forms.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805), and section 1013(d)(1) of ERISA (88 Stat. 923).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved May 30, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on June 12, 1980, 8:45 a.m., and published in the issue of the Federal Register for June 13, 1980, 45 F.R. 40113)

Section 446.—General Rule for Methods of Accounting

26 CFR 1.446-1: General rule for methods of accounting.
(Also Sections 471, 472, 481; 1.471-1, 1.472-1, 1.481-1.)

LIFO; freight-in added to cost of inventory; accounting method. A taxpayer's change in the cost computation of its LIFO inventory to include the cost of freight-in is a change in method of accounting under section 446 of the Code that requires the consent of the Secretary. The exclusion of the cost of freight-in from the cost of inventory does not warrant disallowance of the LIFO election.

Rev. Rul. 80-190

ISSUES

(1) Is the taxpayer's change in the cost computation of its last-in, first-out (LIFO) inventory to include the cost of freight-in a change in method of accounting under section 446 of the Internal Revenue Code that requires the advance consent of the Secretary?

(2) Does the taxpayer's exclusion of the cost of freight-in from the cost of its merchandise warrant disallowance or termination of the taxpayer's LIFO election?

FACTS

The taxpayer uses the accrual method of accounting. In 1974, the taxpayer adopted the LIFO inventory method provided in section 472 of the Code. In valuing its inventory at cost, the taxpayer consistently used the purchase price of the merchandise carried on its books, but the taxpayer excluded the cost of freight-in. The taxpayer instead, deducted the amount of freight-in for the taxable year in which it was incurred. In 1979, the taxpayer determined that the cost of freight-in should be included in the cost of its merchandise for purposes of valuing its inventory pursuant to section 1.471-3(b) of the Income Tax Regulations. In 1979, the taxpayer unilaterally changed the manner for determining the value of its inventory to include the cost of freight-in without securing the consent of the Commissioner.

LAW AND ANALYSIS

Section 472(b)(2) of the Code provides that goods inventoried under the last-in, first-out (LIFO) method are inventoried at cost.

Section 1.471-3(b) of the regulations provides that in the case of merchandise purchased since the beginning of the taxable year, cost means the invoice price less trade or other discounts. To this net invoice price should be added transportation charges incurred in acquiring possession of the goods.

Section 446(e) of the Code provides that a taxpayer who changes its method of accounting on the basis of which it regularly computes its income in keeping its books shall secure the consent of the Secretary of the Treasury before computing its taxable income under the new method.

Section 1.446-1(e)(2)(ii)(a) of the regulations provides that a change of accounting method includes a change in the overall plan of accounting for gross income or deductions, as well as a change in any material item within the plan, and a method of accounting is not established for an item unless there is a pattern of consistent treatment. A material item is defined as any item that involves the proper time for the inclusion of the item in income or the taking of a deduction.

Section 1.446-1(e)(2)(ii)(c) of the regulations provides that a change in the treatment of any material item used in an overall plan for identifying or valuing inventory is a change of accounting method.

Rev. Proc. 79-23, 1979-1 C.B. 564, sets forth the types of situations that warrant disallowance or termination of a taxpayer's LIFO election. In addition, in that revenue procedure certain situations have been identified that do not warrant a disallowance or termination of a LIFO election. Section 3.01(c) of Rev. Proc. 79-23 provides that the failure by the taxpayer to value its LIFO inventory at cost for federal income tax purposes, for the year preceding the year of the LIFO election, and all subsequent taxable years may warrant the disallowance or termination of a LIFO election. However, in determining cost for the year of the LIFO election and any subsequent year, the failure to include (or exclude) an item of cost, such as in accordance with the full absorption inventory rules of section 1.471-11 of the regulations, will not warrant disallowance or termination.

Rev. Rul. 77-134, 1977-1 C.B. 132 states that the Internal Revenue Service will not follow the decision in *Korn Industries, Inc. v. United States,* 532 F.2d 1352 (Ct. Cl 1976). The United States Court of Claims held in that case that the taxpayer's change in its standard cost computation for finished goods to include 14 cost elements, where previously only 11 had been included, was not a change of accounting method but rather the correction of a mathematical or posting error. Rev. Rul. 77-134 holds that in *Korn Industries, Inc.* the taxpayer has changed its method of accounting under section 446 of the Code and such a change requires the consent of the Secretary.

Rev. Rul. 77-134 also states that if a taxpayer has consistently treated an item of income or expense in a particular manner, any change from that consistent treatment is a change of accounting method regardless of whether the consistent treatment was a proper method of accounting.

In the present situation, the taxpayer's exclusion of an item of cost (freight-in) for purposes of valuing the merchandise in its inventory established a consistent pattern of treating the cost of freight-in and the cost of the merchandise. The freight-in cost that was excluded by the taxpayer prior to 1979 in valuing its inventory is a material item because it involves the proper timing of an item of expense that is used in the overall plan for valuing the taxpayer's inventory.

Freight-in as provided in section 1.471-3 of the regulations is an item of cost. Its inclusion or exclusion in valuing the taxpayer's inventory is another example along with the full absorption rules mentioned in section 3.01(c) of Rev. Proc. 79-23 that will not warrant disallowance or termination of the taxpayer's LIFO election.

HOLDINGS

(1) The taxpayer's change in the cost computation of its LIFO inven-

tory to include the cost of freight-in is a change in method of accounting under section 446 of the Code and the regulations thereunder, and such a change requires the consent of the Secretary. See section 1.446-1(e) of the regulations. When the Commissioner approves a change in method of accounting, both the opening and closing inventory in the year of change are placed on the new method. To the extent the opening inventory in the year of change exceeds the closing inventory at the end of the year preceding the year of change, there is an adjustment under section 481 solely by reason of the change to prevent an amount from being duplicated. The section 481 adjustment is taken into account in determining taxable income in the manner determined by the Commissioner in accordance with Rev. Proc. 70-27, 1970-2 C.B. 509, as clarified by Rev. Proc. 75-18, 1975-1 C.B. 687.

(2) The taxpayer's exclusion of the cost of freight-in from the cost of its merchandise alone does not warrant the disallowance or termination of the taxpayer's LIFO election.

Section 461.—General Rule for Taxable Year of Deduction

26 CFR 1.461-1: General rule for taxable year of deduction.

Deductions; workmen's compensation. The Service will not follow the decisions of the Court of Appeals in *Crescent Wharf and Warehouse Company* and *Wien Consolidated Airlines, Inc.*, which held that an employer's liability for workmen's compensation is deductible in the year of an employee's death or injury even if the amount of the liability is contingent upon the occurrence of certain subsequent events; Rev. Rul. 70-262 amplified.

Rev. Rul. 80-191

ISSUE

Whether the Internal Revenue Service will follow the decisions of the United States Court of Appeals for the 9th Circuit in *Crescent Wharf and Warehouses Company v. Commissioner*, 518 F.2d 772 (9th Cir. 1975), *rev'g and rem'g* 59 T.C. 751 (1973), and *Wien Consolidated Airlines, Inc. v. Commissioner*, 528 F.2d 735 (9th Cir. 1976), *aff'g* 60 T.C. 13 (1973), *nonacq.*, 1978-1 C.B. 3, with regard to when workmen's compensation expenses are deductible.

LAW AND ANALYSIS

In *Crescent* the taxpayer-employer was required to compensate its employees for certain injuries suffered by them in the course of their employment. One of the elements of the taxpayer's liability was the cost of necessary medical treatment. Another element of liability was compensation for disability. The taxpayer treated the liability as fixed when an employee was injured and accrued (deducted) the estimated cost of medical treatment and disability compensation. The court held that the deduction was allowable at this time if the amount could be determined with reasonable accuracy.

In *Wien*, which involved the same situation considered in Rev. Rul. 70-262, 1970-1 C.B. 122, the taxpayer-employer was liable for workmen's compensation benefits to spouses and minor children of employees killed in the course of their employment. The spouse was entitled to payments until death or remarriage, the children until death or their nineteenth birthday. The taxpayer accrued (deducted) the total amounts estimated to be payable when an employee was killed, rather than deducting each year only the amounts that actually became due. The court held, contrary to Rev. Rul. 70-262, that deduction for the children's benefits was allowable, but that deduction for the spouse's benefits was not determinable with reasonable accuracy and therefore not allowable.

The Supreme Court of the United States in *Brown v. Helvering*, 291 U.S. 193 (1934), Ct. D. 786, XIII-1 C.B. 223 (1934), dealt with the question of whether an insurance agent that uses the accrual method of accounting to report commission income on premiums for multi-year insurance contracts written in the taxable year can claim a current deduction on account of contract cancellations expected to occur in later years. The taxpayer computed the ratio of cancellations to premiums based on its experience for the 5-year period preceding the taxable year and used that ratio as the basis for the current deduction. The Court rejected this basis for claiming a deduction by an accrual basis taxpayer because the liability of the taxpayer for expected future cancellations was not fixed and absolute. In respect to no particular policy written within the year could it be known that it would be cancelled in a future year. Nor could it be known that a definite percentage of all the policies would be cancelled in the future years. The event necessary to create a liability was a cancellation, not the premium payment, and since the cancellation was not certain to occur, the liability was contingent. If a liability is contingent, the expense that it represents cannot accrue and a deduction therefor is not allowable.

The 9th Circuit in the *Crescent* and *Wien* decisions did not follow the *Brown* holding that a contingent liability does not generate an accruable expense even though the amount of such expense is determinable in the aggregate with reasonable accuracy.

In *Crescent*, the taxpayer-employer was liable for the cost of medical treatment only if medical treatment was received by an employee. If the employee never received treatment, the mere fact of injury would not be enough to establish liability. Similarly, the taxpayer was liable for disability payments only if the employee was absent from work for a required period.

In *Wien*, the taxpayer was liable to the spouse of an employee for death benefits only if (1) the spouse was alive, and (2) the spouse had not remarried. Each condition had to be satisfied for each taxable year in order for the taxpayer to be liable for that year. The fact, alone, of the employee's death would not be enough to establish liability, since if the spouse remarries or dies, the employer will clearly not be liable for further benefits. Similarly, the taxpayer was liable to a child of an employee for death benefits only if the child was alive.

HOLDING

The Service will not follow *Crescent* and *Wien* and will continue to disallow deductions for workmen's compensation expenses that are not based on a fixed liability.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 70-262 is amplified.

Section 471.—General Rule for Inventories

26 CFR 1.471-1: Need for inventories.

Whether a taxpayer's change in the cost computation of its last-in, first-out (LIFO) inventory to include the cost of freight-in is a change in method of accounting under section 446 of the Code that requires the advance consent of the Secretary, and whether the exclusion of the cost of freight-in from the cost of its merchandise warrants disallowance or termination of the taxpayer's LIFO election. See Rev. Rul. 80-190, page 17.

Section 472.—Last-In, First-Out Inventories

26 CFR 1.472-1: Last-in, first-out inventories.

Whether a taxpayer's change in the cost computation of its last-in, first-out (LIFO) inventory to include the cost of freight-in is a change in method of accounting under section 446 of the Code that requires the advance consent of the Secretary, and whether the exclusion of the cost of freight-in from the cost of its merchandise warrants disallowance or termination of the taxpayer's LIFO election. See Rev. Rul. 80-190, page 17.

Section 481.—Adjustments Required by Changes in Method of Accounting

26 CFR 1.481-1: Adjustments in general.

Whether a taxpayer's change in the cost computation of its last-in, first-out (LIFO) inventory to include the cost of freight-in is a change in method of accounting under section 446 of the Code that requires the advance consent of the Secretary, and whether the exclusion of the cost of freight-in from the cost of its merchandise warrants disallowance or termination of the taxpayer's LIFO election. See Rev. Rul. 80-190, page 17.

Section 1012.—Basis of Property—Cost

26 CFR 1.1012-1: Basis of property.

Whether a parent corporation is in receipt of a constructive distribution from its subsidiary when the subsidiary purchases the parent's stock from a third party and the effect, if any, that such transaction will have on the parent's adjusted basis in the subsidiary's stock and the determination of the subsidiary's basis in the parent's stock acquired in the transaction. See Rev. Rul. 80-189, page 7.

Section 1016.—Adjustments to Basis

26 CFR 1.1016-3: Exhaustion, wear and tear, obsolescence, amortization, and depletion for periods since February 28, 1913.

Automobiles used in a trade or business by employees or self-employed individuals. See Rev. Proc. 80-32, page 27.

Section 4071.—Imposition of Tax [Tires and Tubes]

26 CFR 48.4071-1: Imposition and rates of tax.

Whether a credit or refund of the manufacturers excise tax on tread rubber is available where a retreader uses tax-paid tread rubber to recap or retread tires used by its customers on intercity, local, or school buses. See Rev. Rul. 80-192, below.

Section 4221.—Certain Tax-Free Sales [Exemptions, Registration, Etc.]

Whether a credit or refund of the manufacturers excise tax on tread rubber is available where a retreader purchases tread rubber tax paid, rather than tax free, and uses it in recapping or retreading tires that are used by its customers on intercity, local, or school buses. See Rev. Rul. 80-192, below.

Section 6416.—Certain Taxes on Sales and Services

26 CFR 48.6416(a)-1: Refund or credit of tax under chapter 31 or 32.
(Also Sections 4071, 4221; 48.4071-1.)

Tread rubber; credit or refund; intercity, local, or school buses. The credit or refund provided by section 6416(b)(2)(M) of the Code is available to a tread rubber manufacturer who sells tread rubber tax-paid to its franchised retail dealers for use in retreading or recapping tires that are used by their customers on intercity, local, or school buses.

Rev. Rul. 80-192

ISSUE

Is a credit or refund of the manufacturers excise tax on tread rubber available under the circumstances described below?

FACTS

A manufacturer of tread rubber sells tread rubber tax-paid to its franchised retail dealers. The dealers use the tread rubber in retreading or recapping tires they intend to sell and also in retreading or recapping customer-owned tires. In either instance many of the retreaded tires are used by the dealers' customers on intercity, local, or school buses as defined in section 4221(d)(7) of the Internal Revenue Code.

LAW AND ANALYSIS

Section 4071(a)(4) of the Code imposes a tax on tread rubber sold by the manufacturer, producer or importer. Under section 4221(e)(5)(B), as amended by the Energy Tax Act of 1978, Pub. L. 95-618, section 233, 1978-3 C.B. (Vol. 2) 1, 16, the tax on tread rubber does not apply where it is sold for use by the purchaser in the recapping or retreading of any tire to be used by the purchaser on or in connection with a qualified bus as defined in section 4221(d)(7).

Under section 6416(b)(2)(M) of the Code, as amended by the Energy Tax Act, a credit or refund is available in the case of tax-paid tread rubber used in the recapping or retreading of a tire sold to any person for use on or in connection with a qualified bus. This credit or refund is available provided the conditions to allowance set forth in section 6416 (a) have been satisfied.

It was the intention of Congress to remove the excise tax from tread rubber and other taxable articles that are used in private intercity, local, and school bus operations. See Senate Report No. 95-529, 95th Cong., 1st Sess. (1978), 1978-3 C.B. (Vol. 2) 199, 247, accompanying the Energy Tax Act. By enacting the credit or refund provision as well as the tax-free sale provision, Congress ensured tax relief wherever the ultimate use of tread rubber is in the recapping or retreading of a tire that is used on any intercity, local, or school bus. The fact that there may be an intervening party between the tread rubber manufacturer and the bus operator who uses the retreaded tires does not preclude the availability of the credit or refund. However, the credit or refund must be claimed by the tread rubber manufacturer, who paid the tax, rather than by the retreader or bus operator.

HOLDING

The credit or refund provided by section 6416(b)(2)(M) of the Code is available to the tread rubber manufacturer under the above circumstances, provided the conditions to allowances set forth in 6416(a) have been satisfied.

Section 7214.—Offenses by Officers and Employees of the United States

Ct. D. 2000

SUPREME COURT
OF THE
UNITED STATES
No. 79-383

F. W. Standefer, Petitioner,
v. United States

[447 U.S.]

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit

[June 9, 1980]

Syllabus

No. 79-383. Argued April 14, 1980—
Decided June 9, 1980

Petitioner was indicted for, *inter alia,* aiding and abetting a named Internal Revenue Service agent in accepting unlawful compensation, in violation of 26 U.S.C. § 7214(a)(2) and 18 U.S.C. § 2, which provides that whoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal. Prior to the indictment, the IRS agent was acquitted of certain of the § 7214(a)(2) violations which petitioner was accused of aiding and abetting. Petitioner moved to dismiss his indictment as to aiding and abetting these violations on the ground that since the agent had been acquitted of such violations, petitioner could not be convicted of aiding and abetting them. The District Court denied the motion, and after trial petitioner was convicted. The Court of Appeals affirmed.

Held: A defendant accused of aiding and abetting in the commission of a federal offense may properly be convicted despite the prior acquittal of the alleged actual perpetrator of the offense.

(a) Read against its common-law background, 18 U.S.C. § 2 evinces a clear congressional intent to permit such a conviction. The section gives general effect to what had always been a common-law rule for second-degree principals (principals who were actually or constructively present at the scene of the crime and aided and abetted its commission) and for all misdemeanants. The legislative history of § 2 confirms this understanding. With the enactment of § 2, all participants in conduct violating a federal criminal statute are "principals," and as such they are punishable for their criminal conduct, the fate of other participants being irrelevant.

(b) The Government is not barred, under the doctrine of nonmutual collateral estoppel, from relitigating the issue of whether the IRS agent accepted unlawful compensation. Application of that doctrine is not appropriate here. In a criminal case, the Government is often without the kind of "full and fair opportunity to litigate" that is a prerequisite of estoppel. The application of collateral estoppel in criminal cases is also complicated by rules of evidence and exclusion unique to criminal law. Finally, in this case the important federal interest in the enforcement of the criminal law outweighs the economy concerns undergirding the collateral estoppel doctrine.

610 F. 2d 1076, affirmed.

BURGER, C. J., delivered the opinion for a unanimous Court.

MR. CHIEF JUSTICE BURGER delivered the opinion of the Court.

We granted certiorari in this case to decide whether a defendant accused of aiding and abetting in the commission of a federal offense may be convicted after the named principal has been acquitted of that offense.

I

In June 1977, petitioner Standefer was indicted on four counts of making gifts to a public official, in violation of 18 U.S.C. § 201(f), and on five counts of aiding and abetting a revenue official in accepting compensation in addition to that authorized by law, in violation of 26 U.S.C. § 7214(a)(2) and 18 U.S.C. § (2).[1] The indictment charged that petitioner, as head of Gulf Oil Company's tax department, had authorized payments for five vacation trips to Cyril Niederberger, who then was the Internal Revenue Service agent in charge of the audits of Gulf's federal income tax returns.[2] Specifically, the indictment alleged that Gulf, on petitioner's authorization, had paid for vacations for Niederberger in Pompano Beach (July 1971), Miami (January 1973), Absecon (August-September 1973), Pebble Beach (April 1974), and Las Vegas (June 1974). The four counts under 18 U.S.C. § 201(f) related to the Miami, Absecon, Pebble Beach, and Las Vegas vacations; the five counts under 26 U.S.C. § 7214(a)(2) and 18 U.S.C. § 2 were one for each vacation.[3]

Prior to the filing of this indictment, Niederberger was separately charged in a 10-count indictment—two counts for each of the five vacations—with violating 18 U.S.C. § 201(g) and 26 U.S.C. § 7214(a)(2).[4] In February 1977, Niederberger was tried on these charges. He was convicted on four counts of violating § 201(g) in connection with the vacations in Miami, Absecon, Pebble Beach, and Las Vegas and of two counts of violating § 7215(a)(2) for the Pebble Beach and Las Vegas trips. He was acquitted on the § 201(g) count involving the Pompano Beach trip and on the three counts under § 7214(a)(2) charging him with accepting payments from Gulf for trips to Pompano Beach, Miami, and Absecon.[5]

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[1] 18 U.S.C. § 201(f) provides, in relevant part, as follows:

"Whoever, otherwise than as provided by law for the proper discharge of official duty, directly or indirectly gives, offers, or promises anything of value to any public official . . . for or because of any official act performed or to be performed by such public official . . . [is guilty of an offense]."

26 U.S. § 7214(a)(2) punishes:

"Any officer or employee of the United States acting in connection with any revenue law of the United States . . . who knowingly demands other or greater sums than are authorized by law, or receives any fee, compensation, or reward, except as by law prescribed, for the performance of any duty."

18 U.S.C. § 2 provides in relevant part:

"Whoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal."

[2] The indictment also named Gulf Oil Corporation and Joseph Fitzgerald, a manager in Gulf's tax department, as defendants. Gulf pleaded guilty and Fitzgerald *nolo contendere* to all nine counts.

[3] It appears that the statute of limitations had run on any violation of 18 U.S.C. § 201(f) in connection with the Pompano Beach vacation.

[4] 18 U.S.C. § 201(g) punishes:

"Whoever, being a public official . . . , otherwise than as provided by law for the proper discharge of official duty, directly or indirectly asks, demands, exacts, solicits, seeks, accepts, receives, or agrees to receive anything of value for himself for or because of any official act performed or to be performed by him."

In July 1977, following Niederberger's trial and before the trial in his own case commenced, petitioner moved to dismiss the counts under § 7214(a)(2) and 18 U.S.C. § (2) which charged him with aiding and abetting Niederberger in connection with the Pompano Beach, Miami, and Absecon vacations. Petitioner argued that because Niederberger, the only named principal, had been acquitted of accepting unlawful compensation as to those vacations, he could not be convicted of aiding and abetting in the commission of those offenses. The District Court denied the motion.

Petitioner's case then proceeded to trial on all nine counts. At trial, petitioner admitted authorizing payment for all five vacation trips, but testified that the trips were purely social and not designed to influence Niederberger in the performance of his official duties. The jury returned guilty verdicts on all nine counts.[6] Petitioner was sentenced to concurrent terms of six months' imprisonment followed by two years' probation; he was fined a total of $18,000—$2,000 on each count.

Petitioner appealed his convictions to the Court of Appeals for the Third Circuit claiming, *inter alia*, that he could not be convicted of aiding and abetting a principal, Niederberger, when that principal had been acquitted of the charged offense. By a divided vote, the Court of Appeals, sitting en banc, rejected that contention. 610 F.2d 1076 (1979). It concluded that "the outcome of Niederberger's prosecution has no effect on [petitioner's] convictions." *Id.*, at 1078.

Because the question presented is one of importance to the administration of criminal justice on which the Courts of Appeals are in conflict, we granted certiorari.[7] We affirm.

II

Petitioner makes two main arguments: first, that Congress in enacting 18 U.S.C. § 2 did not intend to authorize prosecution of an aider and abettor after the principal has been acquitted of the offense charged; second, that, even if § 2 permits such a prosecution, the government should be barred from relitigating the issue of whether Niederberger accepted unlawful compensation in connection with the Pompano Beach, Miami, and Absecon vacations.[8] The first contention relies largely on the common law as it prevailed before the enactment of 18 U.S.C. § 2. The second rests on the contemporary doctrine of nonmutual collateral estoppel.

A

At common law, the subject of principals and accessories was riddled with "intricate" distinctions. 2 J. Stephen, History of the Criminal Law of England 231 (1883). In felony cases, parties to a crime were divided into four distinct categories: (1) principals in the first degree who actually perpetrated the offense; (2) principals in the second degree who were actually or constructively present at the scene of the crime and aided or abetted its commission; (3) accessories before the fact who aided or abetted the crime, but were not present at its commission; and (4) accessories after the fact who rendered assistance after the crime was complete. See W. LaFave & A. Scott, Criminal Law § 63 (1972); 4 W. Blackstone, Commentaries on the Laws of England, 33 (1765); Perkins, Parties to Crime, 89 U. Pa. L. Rev. 581 (1941). By contrast, misdemeanor cases "d[id] not admit of accessaries [*sic*] either before or after the fact," *United States* v. *Hartwell*, 26 F. Cas. 196, 199 (1869); instead, all parties to a misdemeanor, whatever their roles, were principals. *United States* v. *Dotterweich*, 320 U.S. 277, 281 (1943); C. Torcia, 1 Wharton's Criminal Law, § 33 (1978).

Because at early common law all parties to a felony received the death penalty, certain procedural rules developed tending to shield accessories from punishment. See W. LaFave & A. Scott, at 499. Among them was one of special relevance to this case: the rule that an accessory could not be convicted without the prior conviction of the principal offender. See 1 M. Hale, Pleas of the Crown, 623-624 (1847). Under this rule, the principal's flight, death, or acquittal barred prosecution of the accessory. And if the principal were pardoned or his conviction reversed on appeal, the accessory's conviction could not stand. In every way, "an accessory follow[ed], like a shadow, his principal." 1 J. Bishop, Criminal Law § 666 (8th ed. 1892).

This procedural bar applied only to the prosecution of accessories in felony cases. In misdemeanor cases, where all participants were deemed principals, a prior acquittal of the actual perpetrator did not prevent the subsequent conviction of a person who rendered assistance. *R. Humphreys and Turner*, 3 All Eng. L. Rep. 689 (1965); *R.* v. *Burton*, 13 Cox, C.C. 71, 75 (1875). And in felony cases a principal in the second degree could be convicted notwithstanding the prior acquittal of the first-degree principal. *King* v. *Taylor and Shaw*, 168 Eng. Rep. 283 (1785); *R.* v. *Wallis*, 91 Eng. Rep. 294 (1703); *Brown* v. *State*, 28 Georgia 199 (1859); *State* v. *Whitt*, 113 N.C. 716, 18 S.E. 715 (1897). Not surprisingly, considerable effort was expended in defining the categories—in determining, for instance, when a person was

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[5] Niederberger was sentenced to six months' imprisonment followed by a five-year period of probation, and he was fined $5,000. His convictions were affirmed by the Court of Appeals. *United States* v. *Niederberger*, 580 F.2d 63 (CA3 1978).

[6] The jury was instructed that in order to render a guilty verdict on the § 7214(a) counts it must determine (1) that Niederberger knowingly "received a fee, compensation or reward except as prescribed by law . . . for the performance . . . of any duty" and (2) that petitioner "willfully aided and abetted [him]." App. 52a-56a.

[7] The Courts of Appeals for the Fifth Circuit, the Ninth Circuit, and the District of Columbia have reached the same conclusion as the Third Circuit. See *United States* v. *Musgrave*, 483 F.2d 327, 331-332 (CA5 1973); *United States* v. *Azadian*, 436 F.2d 81 (CA9 1971); *Perkins* v. *United States*, 315 F.2d 120, 122 (CA9 1963); *Gray* v. *United States*, 104 U.S. App. D.C. 153, 260 F.2d 483 (1958). The Court of Appeals for the Fourth Circuit has taken the contrary view that "where the only potential principal has been acquitted, no crime has been established and the conviction of an aider and abettor cannot be sustained." *United States* v. *Shuford*, 454 F.2d 772, 779 (1971). Accord, *United States* v. *Prince*, 430 F.2d 1325 (CA4 1970). See also n. 11, *infra*.

[8] Petitioner also challenges the instructions to the jury on criminal intent. We agree with the Court of Appeals that the instructions were correct.

"constructively present" so as to be a second-degree principal. 4 Blackstone Commentaries on the Laws of England 34 (1765). In the process, justice all too frequently was defeated.

To overcome these judge-made rules, statutes were enacted in England and in the United States. In 1848 the Parliament enacted a statute providing that an accessory before the fact could be "indicted, tried, convicted, and punished in all respects *as if he were a principal felon.*" 11 & 12 Vic. ch. 46. s. 1 (emphasis added). As interpreted, the statute permitted an accessory to be convicted "although the principal be acquitted." *R* v. *Hughes*, Bell's Crown Cases 242, 248 (1860). Several state legislatures followed suit.[9] In 1899, Congress joined this growing reform movement with the enactment of a general penal code for Alaska which "abrogated" the common-law distinctions and provided that "all persons concerned in the commission of a felony . . . must be indicted, tried, and punished as principals, *as in the case of a misdemeanor.*" Act of Mar. 3, 1899, ch. 429, §§ 184-187, 30 Stat. 1282 (emphasis added). In 1901 Congress enacted a similar provision for the District of Columbia.[10]

The enactment of 18 U.S.C. § 2 in 1909 was part and parcel of this same reform movement. The language of the statute, as enacted, unmistakably demonstrates the point:

> "Whoever directly commits any act constituting an offense defined in any law of the United States, or aids, abets, counsels, commands, induces or procures its commission, *is a principal.*" Act of March 4, 1909, ch. 321, 35 Stat. 1152 (emphasis added).[11]

The statute "abolishe[d] the distinction between principals and accessories and [made] them all principals." *Hammer v. United States,* 271 U.S. 620, 628 (1926). Read against its common-law background, the provision evinces a clear intent to permit the conviction of accessories to federal criminal offenses despite the prior acquittal of the actual perpetrator of the offense. It gives general effect to what had always been the rule for second-degree principals and for all misdemeanants.

The legislative history of § 2 confirms this understanding. The provision was recommended by the Commission to Revise and Codify the Criminal and Penal Laws of the United States as "in accordance with the policy of recent legislation" by which "those whose relations to a crime would be that of accessories before the fact according to the common law are made principals." Final Report of the Commission to Revise and Codify the Laws of the United States 118-119 (1906). The Commission's recommendation was adopted without change. The House and Senate Committee reports, in identical language, stated its intended effect:

> "The committee has deemed it wise to make those who are accessories before the fact at common-law principal

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[9] By 1909, when § 2 was enacted, 13 states had enacted legislation providing that the acquittal of the actual perpetrator was not a bar to the conviction of one charged with giving him aid. See Cal. Stat. ch. 99, §§ 11-12 (1850) (see *People* v. *Bearss,* 10 Cal. 68-70 (1858)); Del. Laws (Rev. Code) §§ 2919-2921 (1852); Iowa Rev. Code § 4314 (1882) (see *State* v. *Lee,* 91 Iowa 499, 501-502, 60 N. W. 119, 120 (1894)); Kan. Gen Stat. § 5180 (1889) (see *State* v. *Bogue,* 52 Kan. 79, 86-87, 34 P. 410, 412 (1893)); Ky. Stat. § 1128 (1903) (see *Commonwealth* v. *Hicks,* 118 Ky. 637, [illegible], 82 S. W. 265, 266 (1904); Miss. Code § 1026 (1906) (see *Fleming* v. *State,* 142 Miss. 872, 880-881, 108 S. 143, 144-145 (1926)); Mont. Codes Ann. (Penal Code) § 1854 (1895); N. Y. Penal Code § 29 (1895) (see *People* v. *Kief,* 126 N. Y. 661, 663-664, 27 N. E. 556, 557 (1891)); N. D. Rev. Codes § 8060 (1895); Okla. Stat. § 5523 (1890); S. D. Ann. Stat. § 8520 (1899); Utah Comp. Laws § 4752 (1907); Wash. Code of Proc. § 1189 (1891) (see *State* v. *Gifford,* 19 Wash. 464, 467-468, 53 P. 709, 710 (1898).

Since then, at least 21 other states have enacted legislation with that effect. See 1977 Ala. Laws, Act. No. 607, § 425; Ariz. Rev. Stat. Ann. § 13-304-1 (1978); Ark. Stat. Ann. § 41-304 (1977); Colo. Rev. Stat. § 18-1-605 (1973) (see *Robert* v. *People,* 103 Colo. 250, 87 P. 2d 251 (1938)); Conn. Gen. Stat. § 53a-9 (1979); Fla. Stat. § 777.011 (1976) (see *Butts* v. *State,* 286 So. 2d 28 (1973)); Ga. Code § 26-802 (1978); Ill. Rev. Stat. ch. 38 § 5-3 (1972); Ind. Code § 35-41-2-4 (1979); La. Rev. Stat. Ann. § 14.24 (West) (1974) (see *State* v. *McAllister,* 366 S. 2d 1340 (1978)); Me. Rev. Stat. Ann., Tit. 17-A § 57; Mich. Comp. Laws § 767.39 (1968) (*People* v. *Smith,* 271 Mich. 553, 260 N. W. 911 (1935)); Mo. Rev. Stat. § 562.046 (1978); Neb. Rev. Stat. § 28-206 (Cum. Supp. 1978) (*State* v. *Rice,* 188 Neb. R. 728, 199 N. W. 2d 480 (1972)); N. H. Rev. Stat. Ann. § 626.8 (1974); N. J. Stat. Ann § 2C: 2-6 (West 1979); N. M. Stat. Ann. § 30-1-13 (1978); Penn. Cons. Stat. 18 § 306 (Cum. Supp. 1979); S. C. Code § 16-1-50 (*State* v. *Massey,* 229 S. E. 2d 332 (1976)); Tex. Code Ann. § 77.03 (1973); Wis. Stat. § 39.05 (1958).

Eleven other states have enacted statutes that modify the common-law rule; these statutes have not been authoritatively construed on whether an accessory can be prosecuted after his principal's acquittal. See Haw. Rev. Stat. § 702-225 (1976); Idaho Code § 19-1431 (1979); Mass. Gen. Laws Ann. ch. 274 § 3 (1970); Minn. Stat. § 609.05 (1964); Nev. Rev. Stat. § 195.040 (1979); Ohio Rev. Code Ann. § 2923.03 (1979); Okla. Stat., Tit. 21 § 172 (1971); Ore. Rev. Stat. § 161.160 (1979); Vt. Stat. Ann., Tit. 13 § 3 (1974); Va. Code § 18.2-21 (1975); W. Va. Code § 61-11-7 (1977); Wyo. Stat. § 6-1-7114 (1977).

Only four states—Maryland, North Carolina, Rhode Island, and Tennessee—clearly retain the common-law bar. See *State* v. *Wood,* 284 Md. 189, 396 A. 2d 1041 (1978); *State* v. *Jones,* 101 N. C. 719, 8 S. E. 147 (1888) (interpreting N. C. Gen. Stat. § 14-15 (1969)); R. I. Gen. Laws § 11-1-3 (1956); *Pierce* v. *State,* 130 Tenn. 24, 168 S. W. 851 (1914).

The Model Penal Code provides that an accomplice may be convicted "though the person claimed to have committed the offense . . . has been acquitted." § 2.06 (7) and see comments Tentative Draft No. 1, May 1953, at 38-39.

[10] The provision is still in effect; it provides that all persons "aiding or abetting the principal offender, shall be charged as principals, not as accessories, the *intent of this section being that as to all accessories before the fact the law heretofore applicable in cases of misdemeanor only shall apply to all crimes. . . .*" Act of March 3, 1901, ch. 854, Section 908, 31 Stat. 1337; D. C. Code § 22-105 (1976) emphasis added).

[11] In 1951 the words "is a principal" were altered to read "is punishable as a principal." That change was designed to eliminate all doubt that in the case of offenses whose prohibition are directed at members of specified classes (*e. g.*, federal employees) a person who is not himself a member of that class may nonetheless be punished as a principal if he induces a person in that class to violate the prohibition. See S. Rep. No. 1020, 82d Cong., 1st Sess., 7-8 (1951). The change was fully consistent with congressional intent to treat accessories before the fact as principals and to abolish the common-law procedural bar. Indeed, by the time of the 1951 re-enactment, the circuit courts that had addressed the question had concluded that § 2 authorizes conviction of an aider and abettor notwithstanding the prior acquittal of the perpetrator of the offense. See *United States* v. *Klass,* 166 F.2d 373, 380 (CA3 1948); *Von Patzoll* v. *United States,* 163 F.2d 216 (CA10 (1946); *Kelly* v. *United States,* 258 F. 392, 402 (CA6 1919); *Rooney* v. *United States,* 203 F. 928, 931-932 (CA 9 1913). Congress manifested no intent to disturb this interpretation. See *Lorillard* v. *Pons,* 434 U.S. 575, 580 (1978).

> offenders, thereby permitting their indictment and conviction for a substantive offense. At common law an accessory can not be tried without his consent before the conviction or outlawry of the principal except where the principal and accessory are tried together; if the principal could not be found or if he had been indicted and refused to plead, had been pardoned or died before conviction, the accessory could not be tried at all. This change of the existing law renders these obstacles to justice impossible." S. Rep. No. 10, 60th Cong., 1st Sess., Pt. 1, at 13 (1908); H. R. Rep. No. 2, 6th Cong., 1st Sess., at 13 (1908).[12]

And on the floor of the House of Representatives, Representative Moon, the chairman of the joint select committee, put the point simply: "[we] have abolished the existing arbitrary distinctions between felonies and misdemeanors." 42 Cong. Rec. 585 (1908).

This history plainly rebuts petitioner's contention that § 2 was not intended to authorize conviction of an aider and abettor after the principal had been acquitted of the offense charged.[13] With the enactment of that section, all participants in conduct violating a federal criminal statute are "principals." As such, they are punishable for their criminal conduct; the fate of other participants is irrelevant.[14]

B

The doctrine of nonmutual collateral estoppel was unknown to the common law and to the Congress when it enacted § 2 in 1909.[15] It emerged in a civil case in 1942, *Bernhard* v. *Bank of America Nat. Trust & Savings Assn.*, 19 Cal. 2d 807, 112 P.2d 892. This Court first applied the doctrine in *Blonder-Tongue* v. *University Foundation*, 402 U.S. 313 (1971). There, we held that a determination of patent invalidity in a prior infringement action was entitled to preclusive effect against the patentee in subsequent litigation against a different defendant. Just this past Term we again applied the doctrine—this time "offensively"—to hold that a defendant who had had a "full and fair" opportunity to litigate issues of fact in a civil proceeding initiated by the Securities and Exchange Commission could be estopped from relitigating those issues in a subsequent action brought by a private plaintiff. *Parklane Hosiery Co.* v. *Shore*, 439 U.S. 322 (1979). In both cases, application of nonmutual estoppel promoted judicial economy and conserved private resources without unfairness to the litigant against whom estoppel was invoked.

Here, petitioner urges us to apply nonmutual estoppel against the government; specifically he argues that the government should be barred from relitigating Niederberger's guilt under § 7214(a)(2) in connection with the vacation trips to Pompano Beach, Miami, and Absecon. That issue, he notes, was an element of his offense which was determined adversely to the government at Niederberger's trial.[16]

This, however, is a criminal case, presenting considerations different from those in *Blonder-Tongue* or *Parkland Hosiery*. First, in a criminal case, the government is often without the kind of "full and fair opportunity to litigate" that is a prerequisite of estoppel. Several aspects of our criminal law make this so: the prosecution's discovery rights in criminal cases are limited, both by rules of court and constitutional privileges; it is prohibited from being granted a directed verdict or from obtaining a judgment notwithstanding the verdict no matter how clear the evidence in support of guilt, compare Fed. Rule Civ. Proc. 50; it can not secure a new trial on the ground that an acquittal was plainly contrary to the weight of the evidence, compare Fed. Rule Civ. Proc. 59; and it can not secure appellate review where a defendant has been acquitted. See *United States* v. *Ball*, 163 U.S. 662, 671 (1896).

The absence of these remedial procedures in criminal cases permits juries to acquit out of compassion or compromise or because of "their assumption of a power which they had no right to exercise, but which they were disposed through lenity." *Dunn* v. *United States*, 284 U.S. 390, 393 (1932). See generally H. Kalven & H. Zeisel, The American Jury 193-347

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[12] Petitioner emphasizes the fact that the committee report fails to mention the common-law rule that the prior acquittal of a principal barred conviction of an accessory, and argues accordingly that Congress did not view that rule as an "obstacle to justice." The Court of Appeals correctly rejected this argument, being unwilling to "apply the canon of statutory interpretation . . . *expressio unius, exclusio alterius* . . . to the language employed in a committee report." 610 F.2d, at 1084 (emphasis added). We agree. Petitioner's argument would permit an omission in the legislative history to nullify the plain meaning of a statute. The language of § 2 abolishes the common-law categories and treats all parties as principals. It is not necessary for Congress in its committee reports to identify all of the "weeds" which are being excised from the garden.

[13] It bears mention that even prior to 1909 petitioner would not have prevailed in his attempt to bar prosecution on the § 7214(a)(2) counts. As the government notes, the version of 26 U. S. C. § 7214 then in effect defined the offense to be a misdemeanor. See R. S. 3169 (1878). Hence, the prior acquittal of his principal would not have barred petitioner's prosecution. And because petitioner accompanied Niederberger on four of five trips and therefore was "present" at the scene of the crime, see Tr. 1018-1020, 1024-1027, 1034-1036, 1096, he could have been convicted at common law for those crimes even if the offense had been designated a felony.

[14] Nothing in *Shuttlesworth* v. *Birmingham*, 373 U. S. 262 (1963), relied on by petitioner, is to the contrary. There, petitioner had been convicted of aiding and abetting others to violate a city trespass ordinance which subsequently was declared constitutionally invalid. See *Gober* v. *Birmingham*, 373 U. S. 374 (1963). Shuttlesworth's case merely applied the rule that "there can be no conviction for aiding and abetting someone do an innocent act." *Id.*, at 265. Here, by contrast, the government proved in petitioner's case that Niederberger had violated § 7214(a)(2) in connection with each of the five trips. See no. 6, *supra*.

[15] In 1912 in *Bigelow* v. *Old Dominion Copper Co.*, 225 U. S. 111, 127, this Court stated that it was "a principle of general elementary law that the estoppel of a judgment must be mutual." See also *Stone* v. *Farmers Bank*, 174 U. S. 409 (1899); *Keokuk & W. R. Co. v. Missouri*, 152 U. S. 301, 317 (1894); *Litchfield* v. *Goodnow*, 123 U. S. 549, 552 (1887).

[16] Petitioner does not contend that the Constitution prevents the government from prosecuting him on the three § 7214(a)(2) counts as to which Niederberger was acquitted. Nothing in the Double Jeopardy Clause or the Due Process Clause forecloses putting petitioner on trial as an aider and abettor simply because another jury has determined that his principal was not guilty of the offenses charged. Compare *Ashe* v. *Swenson*, 397 U.S. 436 (1970).

(1966).[17] It is of course true that verdicts induced by passion and prejudice are not unknown in civil suits. But in civil cases, post-trial motions and appellate review provide an aggrieved litigant a remedy; in a criminal case the government has no similar avenue to correct errors. Under contemporary principles of collateral estoppel, this factor strongly militates against giving an acquittal preclusive effect. See Restatement (Second) of Judgments § 68.1 (Ten. Draft No. 3, May 1976) (denying preclusive effect to an unreviewable judgment).[18]

The application of nonmutual estoppel in criminal cases is also complicated by the existence of rules of evidence and exclusion unique to our criminal law. It is frequently true in criminal cases that evidence inadmissible against one defendant is admissible against another. The Exclusionary Rule, for example, may bar the government from introducing evidence against one defendant because that evidence was obtained in violation of his constitutional rights. And the suppression of that evidence may result in an acquittal. The same evidence, however, may be admissible against other parties to the crime "whose rights were [not] violated." *Alderman* v. *United States,* 394 U.S. 165, 171-172 (1969). Accord, *Rakas* v. *Illinois,* 439 U.S. 128, 134 (1978). In such circumstances, where evidentiary rules prevent the Government from presenting all its proof in the first case, application of nonmutual estoppel would be plainly unwarranted.[19]

It is argued that this concern could be met on a case-by-case basis by conducting a pretrial hearing to determine whether any such evidentiary ruling had deprived the Government of an opportunity to present its case fully the first time around. That process, however, could prove protracted and burdensome. Under such a scheme, the Government presumably would be entitled to seek review of any adverse evidentiary ruling rendered in the first proceeding and of any aspect of the jury charge in that case that worked to its detriment. Nothing short of that would insure that its opportunity to litigate had been "full and fair." If so, the "pre-trial hearing" would fast become a substitute for appellate review, and the very purpose of litigation economy that estoppel is designed to promote would be frustrated.

Finally, this case involves an ingredient not present in either *Blonder-Tongue* or *Parklane Hosiery:* the important federal interest in the enforcement of the criminal law. *Blonder-Tongue* and *Parkland Hosiery* were disputes over private rights between private litigants. In such cases, no significant harm flows from enforcing a rule that affords a litigant only one full and fair opportunity to litigate an issue, and there is no sound reason for burdening the courts with repetitive litigation.

That is not so here. The Court of Appeals opinion put the point well:

> "[T]he purpose of a criminal court is not to provide a forum for the ascertainment of private rights. Rather it is to vindicate the public interest in the enforcement of the criminal law while at the same time safeguarding the rights of the individual defendant. The public interest in the accuracy and justice of criminal results is greater than the concern for judicial economy professed in civil cases and we are thus inclined to reject, at least as a general matter, a rule that would spread the effect of an erroneous acquittal to all those who participated in a particular criminal transaction. To plead crowded dockets as an excuse for not trying criminal defendants is in our view neither in the best interests of the courts, nor the public." 610 F.2d, at 1093.

In short, this criminal case involves "competing policy considerations" that outweigh the economy concerns that undergird the estoppel doctrine. See Restatement (Second) of Judgments § 68.1(e) and comments thereto; cf. *Commissioner* v. *Sunnen,* 333 U.S. 591 (1948) [Ct. D. 1698, 1948-1 C.B. 7].

III

In denying preclusive effect to Niederberger's acquittal, we do not deviate from the sound teaching that "justice must satisfy the appearance of justice." *Offutt* v. *United States,* 348 U.S. 11, 14 (1954). This case does no more than manifest the simple, if discomforting, reality that "different juries [may] reach different results under any criminal statute. That is one of the consequences of our jury system." *Roth* v. *United States,* 354 U.S. 476, 492 (1957). While symmetry of results may be intellectually satisfying, it is not required. See *Hamling* v. *United States,* 418 U.S. 87, 101 (1974).

Here, petitioner received a fair trial at which the Government bore the burden of proving beyond reasonable doubt that Niederberger violated 26 U.S.C. § 7214(a)(2) and that petitioner aided and abetted him in that venture. He was entitled to no less—and to no more.

The judgment of the Court of Appeals is

Affirmed.

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[17] Niederberger's case demonstrates the point. As to the Absecon and Miami vacations, the jury convicted Niederberger of receiving something of value "because of any official act performed . . . by him," 18 U. S. C. § 201(g), but acquitted him of receiving "any fee, compensation, or reward . . . for the performance of any duty," 26 U. S. C. § 7214(a)(2). No explanation has been offered for these seemingly irreconcilable determinations. This inconsistency is reason, in itself, for not giving preclusive effect to the acquittals on the Absecon and Miami counts. See Restatement (Second) Judgments, § 88(4). See also 610 F.2d at 1112 (Gibbons, J., concurring in part and dissenting in part); *Harary* v. *Blumenthal,* 55 F.2d 1113, 1116-1117 (CA2 1977).

[18] This is not to suggest that the availability of appellate review is always an essential predicate of estoppel. See *Johnson Co.* v. *Wharton,* 152 U.S. 252 (1894); see generally 1B Moore's Federal Practice ¶ 0.416 [5]. The estoppel doctrine, however, is premised upon an underlying confidence that the result achieved in the initial litigation was substantially correct. In the absence of appellate review, or of similar procedures, such confidence is often unwarranted.

[19] Indeed, as the Court of Appeals observed, to give the first case preclusive effect would undermine the *Alderman* rule by affording a defendant whose rights were not violated the benefits of suppression. See 610 F.2d, at 1094, n. 51.

Part III. Administrative, Procedural, and Miscellaneous

Delegation Order No. 96 (Rev. 4) (Effective June 4, 1980)

Application of Rulings Without Retroactive Effect

1. Pursuant to authority granted to the Commissioner of Internal Revenue by 26 CFR 301.7805-1(b):

a. the Assistant Commissioner (Technical) and the Deputy Assistant Commissioner (Technical) are hereby authorized to prescribe the extent, if any, to which any ruling issued by or pursuant to authorization from the Assistant Commissioner relating to the internal revenue laws shall be applied without retroactive effect.

b. the Assistant Commissioner (Employee Plans and Exempt Organizations) and the Deputy Assistant Commissioner (Employee Plans and Exempt Organizations) are hereby authorized to prescribe the extent, if any, to which any ruling issued by or pursuant to authorization from the Assistant Commissioner relating to the internal revenue laws shall be applied without retroactive effect.

2. a. Pursuant to authority granted to the Commissioner of Internal Revenue by 26 CFR 301.7805-1(b), there is hereby delegated to the Director, Employee Plans Division and to the Director, Actuarial Division of the National Office, and to the Director of each EP/EO Key District, the authority to limit the retroactive effect of the revocation of any determination letter issued with respect to employee plans if the following conditions are met:

(1) The plan sponsor has received a favorable determination letter under the law in effect prior to the date that the Employee Retirement Income Security Act of 1974 [1974-3 C.B. 1] (ERISA) applied to the plan, but did not receive a favorable post-ERISA determination letter.

(2) The plan sponsor executed the necessary plan amendments to conform to ERISA retroactively to the first plan year that was subject to ERISA and such amendments are executed no later than 91 days after the issuance of a final determination letter or notice of amendments needed to effect compliance (which notice shall be issued at least 91 days period to the final examination report).

(3) Employees' and beneficiaries' rights and/or benefits under the plan are restored to levels they would have had to attain if the plan had never failed to qualify under ERISA.

(4) The requirements of section 2b relating to form are satisfied on June 4, 1980, and the requirements of section 2b relating to operation are met beginning with the ERISA effective date for the minimum participation standards determined with regard to each plan.

b. The requirements of this section are:

(1) The plan satisfies the age and service requirements for participation described in section 410(a) of the Code or fails to satisfy such requirements solely because the plan incorrectly credits service for eligibility purposes;

(2) The plan satisfies the requirements of section 411(a) or fails to satisfy such requirements solely because the plan incorrectly credits service for vesting purposes;

(3) In the case of a plan subject to the joint and survivor requirements of section 401(a)(11) such plan provides a joint and survivor annuity;

(4) The plan has not failed to satisfy the requirements of section 414(1);

(5) The plan has not, in operation, violated the limitations of section 415 (c) by making excess allocations to individuals who are officers, shareholders or highly compensated; and

(6) The plan has not, in operation, been discriminatory in coverage or in contributions or benefits under sections 410(b) and 401(a)(4).

c. In the case of a plan that fails to satisfy section 2a solely as a result of not satisfying one or more of the requirements of section 2b, partial relief will be granted through section 7805 (b). The employer's contributions will not be deductible as contributions to a qualified plan. However, section 7805(b) relief will be applied to the trust and all employees except to the extent described in the next two sentences. In the case of a plan that does not satisfy section 2b(5), the 7805(b) relief described in the previous sentence will not apply to any officer, shareholder, or highly compensated individual who received annual additions that did not satisfy such section. In the case of a plan which does not satisfy section 2b(6), the 7805(b) relief will not apply to any officer, shareholder or highly compensated individual. Thus, any such officer, shareholder or highly compensated individual will not receive the tax treatment applicable with respect to qualified plans. In the case of a plan which fails to satisfy applicable requirements for any other reason relief can only be granted pursuant to section 1b.

d. The section 7805(b) relief detailed in sections 2a, 2c and 3 shall be effective for the period beginning with the ERISA effective date for the minimum participation standards determined with regard to each plan and ending on the date of final compliance which shall be no later than the date defined in section 2a(2) of this order.

e. In determining whether the requirements of this section are satisfied, proposed amendments received by the Service by June 4, 1980, will be taken into account.

3. a. In addition to the authority delegated in section 2 above, there is delegated to the Director of each EP/EO Key District, the Director, Employee Plans Division and the Director, Actuarial Division, the authority to limit the retroactive effect of the revocation, if any, of a favorable post-ERISA determination letter issued for a plan, except issues with respect to which an Alert Guidelines worksheet was completed. If a determination letter was issued erroneously with respect to issues covered by a completed Alert Guidelines worksheet, retroactive relief may only be granted pursuant to section 1b.

b. If a plan described in section 3a is amended in accordance with section 2a(2), restoration will be required and relief will be granted to the extent described below. If the defect did not exist at the time of the prior letter, the sponsor must restore any benefits and relief will be granted in accordance with the principles in section 2c for the period in which the defect existed. If the defect did exist at the time of the prior letter, the related benefits need only be restored for the period during which the plan was, without regard to the defect, not in compliance with Code section 401(a), and full section 7805(b) relief will be granted.

4. The delegation of authority granted pursuant to sections 2 and 3 above does not permit relief to be granted in any case if after September 30, 1982, amendments required for complete compliance have not been executed or a request for a determination letter with proposed ERISA amendments has not been filed. Notwithstanding the above, the Director of each EP/EO Key District is not delegated any section 7805(b) authority in the case of a plan which the Director of each EP/EO Key District determines to have been discriminatory for years before the effective date of section 410 for such plan. Cases described in this section must be referred to the National Office pursuant to procedures governing requests for technical advice.

5. Notwithstanding any of the above, section 7805(b) authority is not delegated to the Director, Employee Plans Division, the Director, Actuarial Division and the Director of each EP/EO Key District in the case of a plan which has been determined to have violated the exclusive benefit rule of section 401(a).

6. The section 7805(b) authority described in sections 2a, 2c or 3 will be exercised except in rare and unusual circumstances. Where rare and unusual circumstances exist, denial of section 7805(b) relief will be applied only if approved by the National Office.

7. The authority delegated in section 1 may not be redelegated.

8. The authority to grant 7805(b) relief in certain employee plan matters herein delegated to the Director, Employee Plans Division and to the Director of each EP/EO Key District may not be redelegated below the level of the Chief, Employee Plans Technical Branch and the Chief, EP/EO Division, respectively. The authority to grant 7805(b) relief delegated to the Director, Actuarial Division may not be redelegated.

9. This delegation order expires with respect to the Director of each EP/EO Key District on December 31, 1982.

10. This delegation order supersedes Delegation Order No. 96 (Rev. 3) [1976-2 C.B. 623] issued July 12, 1976.

JEROME KURTZ,
Commissioner.

(Filed by the Office of the Federal Register on June 5, 1980, 8:45 a.m., and published in the issue of the Federal Register for June 6, 1980, 45 F.R. 38198)

Delegation Order No. 112 (Rev. 6) (Effective June 2, 1980)

Authority to Issue Determination and Revocation Letters, to Grant Extensions of the Remedial Amendment Period and to Issue Examination Reports Relating to Employee Plans

Pursuant to authority vested in the Commissioner of Internal Revenue by Treasury Department Order No. 150-37, authority with respect to issuance of determination and revocation letters, to granting extensions of the remedial amendment period and to issuance of examination reports pertaining to employee plans and related matters is delegated as follows:

1. The District Director of each Employee Plans and Exempt Organizations key district is authorized, subject to paragraph 3, to:

(a) issue determination and revocation letters involving the provisions of sections 401, 403(a), 405, 409A, 501(a), and 4975(e)(7) of the Internal Revenue Code of 1954 with respect to:

(1) qualification of stock bonus, pension, profit sharing, employee stock ownership, annuity, and bond purchase plans, and cash or deferred arrangements;

(2) exemption from federal income tax under section 501(a) of trusts forming a part of such plans, provided that the determination does not involve application of section 502 (feeder organizations) or section 511 (unrelated business income), or the question of whether a proposed transaction will be a prohibited transaction under section 4975(c)(1) or section 503 with respect to plans described in 4975(g)(2) or (3);

(3) compliance with the applicable requirements of foreign situs trusts as to taxability of beneficiaries (section 402(c)) and deductions for employer contributions (section 404(a)(4)); and

(4) amendments, (including those relating to section 414(l) of the Code), partial terminations or terminations of such plans and trusts.

(b) issue examination reports with respect to:

(1) continued qualification under sections 401, 403(a), 405, 409A, and 4975(e)(7) of plans and continued exemption under section 501(a) of the related trust;

(2) imposition of tax under sections 1, 511 through 514, 641 and Chapter 43; and

(3) imposition of penalties under Chapter 68 of the Internal Revenue Code of 1954.

(c) issue determination letters with respect to whether a plan constitutes an employee stock ownership plan that is not intended to qualify under section 401 of the Internal Revenue Code of 1954 for taxable years beginning before January 1, 1979.

(d) issue modification or revocation of determination letters described above in accordance with currently applicable appeal procedures. If the revocation involves collectively-bargained plans, or plans for which the Internal Revenue Service is proposing to issue a revocation letter because certain fiduciary actions subject to Part 4, Subtitle B of Title I of the Employee Retirement Income Security Act (ERISA) [Pub. L. 93-406, 1974-3 C.B. 1, 43] have violated the exclusive benefit rule of section 401(a), the plan must have been submitted for technical advice and the Assistant Commissioner (E) must have concurred with the revocation.

(e) redelegate this authority as follows:

(1) with respect to issuance and modification of favorable determination letters or examination reports, other than a report issued with a pro-

posed revocation letter, not below Internal Revenue Agent and Tax Law Specialist, GS-12, and then only if such individual is a person other than the initiator,

(2) with respect to issuance of proposed and final adverse determination letters or proposed revocation letters and related examination reports, not below Chief, EP/EO Division.

(3) with respect to issuance of final revocation letters, this authority may not be redelegated.

2. In each region, the Regional Director of Appeals, Chiefs and Associate Chiefs, Appeals Office, are authorized to:

(a) issue final determination or final revocation letters on appeals from proposed adverse determination and proposed revocation letters issued by key district offices under this delegation.

(b) issue letters as to the decision on appealed examination reports or statutory notices as provided in Delegation Order No. 77 [(Rev. 14), 1980-19 I.R.B. 15].

(c) This authority may not be redelegated.

3. The Assistant Commissioner (Employee Plans and Exempt Organizations), with concurrence of the Chief Counsel, is authorized to require preissuance review of final adverse determination and final revocation letters covered by section 7476(a) of the Internal Revenue Code of 1954.

4. The District Director of each Employee Plans and Exempt Organizations key district is authorized to:

(a) extend the remedial amendment period described in section 401(b) of the Internal Revenue Code of 1954 in accordance with currently applicable 401(b) procedures for individually designed plans and master and prototype plans not described in (b) below, but not in excess of eight months after the later of:

(1) the due date of the employer's income tax return without extension, for the year in which the remedial amendment period begins, or

(2) the end of the plan year within which the remedial amendment period begins;

(3) however, for a plan maintained by more than one employer, the remedial amendment period may not be extended in excess of two months after the last day of the tenth month after the end of the plan year.

(b) extend the remedial amendment period for a master or prototype plan whose sponsoring organization, after September 2, 1974, and on or before December 31, 1976, filed a request for an opinion letter with respect to the plan's qualification but not in excess of eight months after the later of:

(1) June 30, 1977, or

(2) the last day of the month that is six months after the month in which (i) the opinion or notification letter is issued, (ii) the request for the letter is withdrawn, or (iii) the request is otherwise disposed of by the Service.

(c) redelegate this authority but not below Chief, EP/EO Division.

Delegation Order No. 112 (Rev. 5) [1978-2 C.B. 481] issued October 1, 1978 is hereby superseded.

JEROME KURTZ,
Commissioner

(Filed by the Office of the Federal Register on June 5, 1980, 8:45 a.m., and published in the issue of the Federal Register for June 6, 1980, 45 F.R. 38200)

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, Sections 62, 162, 170, 213, 217, 274, 1016; 1.62-1, 1.162-17, 1.170A-1, 1.213-1, 1.217-2, 1.274-5, 1.1016-3.)

Rev. Proc. 80-32

This revenue procedure modifies Rev. Proc. 80-7, 1980-8 I.R.B. 24, with respect to the optional standard mileage rates for the business use of an automobile and for use in computing deductions for transportation expenses relating to charitable contributions, medical expenses, and moving expenses.

The first paragraph of subsection 1 of section 3.01 of Rev. Proc. 80-7 is amended to read as follows:

Subject to the conditions and limitations set forth below, with respect to transportation expenses paid or incurred after December 31, 1979, deductions will be accepted if computed at a standard mileage rate of (a) 20 cents per mile for the first 15,000 miles of use each year for business purposes, and (b) 11 cents per mile for use for business purposes in excess of 15,000 miles per year. Computation under this method is optional on a yearly basis.

The sixth paragraph of subsection 2 of section 3.01 of Rev. Proc. 80-7 is amended to read as follows:

With respect to automobiles that have been, or are considered to be, fully depreciated under the straight-line method, based upon their use for business purposes, deductions will be accepted if computed at a standard mileage rate of 11 cents per mile for all miles of use of such automobiles attributable to business purposes.

The first paragraph of section 3.02 of Rev. Proc. 80-7 is amended to read as follows:

A taxpayer who incurs costs of operating an automobile for transportation in connection with rendering gratuitous services to a charitable organization under section 170 of the Code, in connection with medical care under section 213, or for moving expenses under section 217 will be permitted to claim as a deduction the standard mileage rate of nine cents per mile, subject to the conditions and limitations set forth in these sections.

These amendments are effective with respect to transportation expenses paid or incurred after December 31, 1979.

EFFECTS ON OTHER DOCUMENTS

Rev. Proc. 80-7 is modified.

Part IV. Items of General Interest

Carryover Basis-Windfall Profit Tax

Announcement 80-91 [1]

The Crude Oili Windfall Profit Tax Act of 1980, Pub. L. 96-223, 1980-3 C.B. 2, 71, repeals the carryover basis provision of section 1023 of the Internal Revenue Code, but also provides that executors or administrators of certain estates may elect carryover basis treatment of assets acquired or passing from decedents.

The irrevocable election, which may be made only for estates of persons dying after December 31, 1976, and before November 7, 1978, must be made by July 31, 1980. Details on making the election are contained in News Release IR-80-46, issued April 7, 1980. Information for filing Form 5970-A, Election of Carryover Basis, which must be used to make the election, is contained in Announcement 80-63, 1980-20 I.R.B. 69.

The carryover basis election can be made in connection with an eligible estate that was closed prior to or after the enactment of the Act if the estate may be reopened under state law. In this case the election must be made by the executor or administrator so appointed.

As an alternative for a closed estate, all beneficiaries and legal representatives of deceased, unborn or unascertained beneficiaries must make the election. The election is made by filing Form 5970-A for the estate with a list of all beneficiaries and signed, notarized statements from each beneficiary or representative indicating that he or she consents to the election. The Form 5970-A together with the list and the statements must be filed with the Internal Revenue Service Center, Philadelphia, PA 19255.

To provide consistent treatment for pecuniary requests, section 1040 of the Code, as contained in the Tax Reform Act of 1976, Pub.L. 94-455, 1976-3 C.B. (Vol. 1) 1, 353, will apply to estates electing carryover basis.

Section 691(c) of the Code, as it existed prior to the 1976 Act, will apply to estates electing carryover basis. This avoids having a separate 691(c) rule applicable only to electing estates.

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[1] Based on News Release IR-80-73, dated June 19, 1980.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
John H. Frazier	Nashville, TN	Certified Public Accountant	Fifteen months effective June 16, 1980
Clifford Y. Pierce	Miami, FL	Certified Public Accountant	Indefinite effective June 13, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 48.4221-3 amended.	Tax treatment of articles previously sold tax free for exportation under section 4221(a)(2).	June 9, 1980	Aug. 8, 1980
26 CFR 48.4042-1 through 48.4042-3 added.	Tax on the use of fuel in commercial waterway transportation.	June 9, 1980	Aug. 8, 1980
26 CFR 1.170A-4, 1.301-1, 1.312-3, 1.341-6, 1.453-9, 1.751-1, 1.1502-14 amended; 1.1254-1 through 1.1254-5 added.	Treatment of gain from the disposition of certain oil, gas, or geothermal property.	June 11, 1980	Aug. 11, 1980
26 CFR 1.411(d)-1 as proposed in the Federal Register for April 9, 1980, 45 F.R. 24201, withdrawn; 1.411(d)-1 amended.	Coordination of vesting and discrimination requirements for qualified pension, etc. plans.	June 12, 1980	Aug. 11, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

Numerical Finding List[1]

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

Finding List of Current Action on Previously Published Rulings[1]

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* Denotes entry since last publication.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27, dated July 7, 1980.

NOTES

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1927–1	$6.90
1927–2	*2.95*
1928–1	6.95
1928–2	9.50
1929–1	12.00
1929–2	*3.15*
1930–1	7.30
1930–2	9.50
1931–1	*3.60*
1931–2	13.00
1932–1	*2.80*
1932–2	8.65
1933–1	*3.35*
1933–2	*3.45*
1934–1	*3.70*
1934–2	14.00
1935–1	6.90
1935–2	*4.00*
1936–1	*3.55*
1936–2	*3.90*
1937–1	*3.75*
1937–2	7.70
1938–1	*4.05*
1938–2	*3.50*
1939–1–1	8.25
1939–1–2	10.90
1939–2	9.40
1940–1	5.55
1940–2	14.00
1941–1	*$6.95*
1941–2	*3.55*
1942–1	7.25
1942–2	*5.55*
1943(*)	*9.55*
1944(*)	*7.85*
1945(*)	9.40
1946–1	*2.55*
1946–2	5.20
1947–1	*1.80*
1947–2	3.40
1948–1	*3.15*
1948–2	7.50
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1949–2	*2.80*
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1950–2	*4.70*
1951–1	*2.65*
1951–2	*5.05*
1952–1	*2.55*
1952–2	7.05
1953–1	*4.25*
1953–2	12.00
1954–1	12.00
1954–2	12.00
1955–1	10.25
1955–2	13.00
1956–1	15.00
1956–2	18.00
1957–1	$10.10
1957–2	13.00
1958–1	9.60
1958–2	13.00
1958–3	15.00
1959–1	15.00
1959–2	9.60
1960–1	9.00
1960–2	11.50
1961–1	14.00
1961–2	10.00
1962–1	14.00
1962–2	13.00
1962–3	20.00
1963–1	9.00
1963–2	10.75
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1965–2	12.25
1966–1	14.00
1966–2	14.05
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1967–2	15.00
1968–1	14.00
1968–2	11.75
1969–1	7.50
1969–2	6.50
1969–3	$12.50
1970–1	11.00
1970–2	14.00
1971–1	10.55
1971–2	8.50
1972–1	13.50
1972–2	13.70
1973–1	16.00
1973–2	8.30
1974–1	11.00
1974–2	9.95
1974–3	*8.20*
1974–3 Supp.	10.00
1975–1	16.00
1975–2	13.00
1976–1	11.00
1976–2	10.25
1976–3–1	9.50
1976–3–2	16.00
1976–3–3	10.00
1977–1	10.75
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The contents of the weekly Bulletin are consolidated semiannually into a permanent, indexed, Cumulative Bulletin. These are sold on a single copy basis and *are not* included as part of the subscription to the Internal Revenue Bulletin. Subscribers to the weekly Bulletin are notified when copies of the Cumulative Bulletin are available. Certain issues of Cumulative Bulletins are out of print and are not available. Persons desiring available Cumulative Bulletins, which are listed on the reverse, may purchase them from the Superintendent of Documents.

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Bulletin No. 1980-30

Internal Revenue bulletin

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Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENT

Announcement 80-93, page 28.
A public hearing will be held on September 9, 1980, concerning proposed regulations relating to the treatment of gain from the disposition of certain oil, gas, or geothermal property.

INCOME TAX

Rev. Rul. 80-194, page 6.
Earned income credit; life insurance salesperson. A self-employed full-time life insurance salesperson, within the meaning of section 3121(d)(3) of the Code, should report the gross commissions received as earned income under section 43(c)(2)(A)(i).

Rev. Rul. 80-195, page 6.
Investment credit; storage facilities; aluminum scrap. A taxpayer built a structure principally to store different grades and forms of aluminum scrap that are not intermingled. This storage of aluminum is not bulk storage of fungible commodities, and the structure does not qualify as section 38 property.

Rev. Rul. 80-196, page 7.
Transfer of stock by controlling shareholders to corporate employees. The tax consequences are set forth for a transfer of a corporation's stock by the corporation's two shareholders to three employees in consideration for past services.

Rev. Rul. 80-197, page 9.
Industrial development bonds; reusable beverage container facilities. Machinery, equipment, and other facilities used by a beverage manufacturer to package beverages in reusable containers because a state law prohibited sale of beverages in nonreturnable containers do not qualify as solid waste disposal facilities under section 103(b)(4)(E) of the Code. The interest on industrial development bonds issued by various cities in the state to finance the facilities will not be excludable from the gross incomes of the bondholders under section 103(a).

Rev. Rul. 80-198, page 10.
Controlled corporations; transfers; accounts payable and accounts receivable. An individual transferred all of the assets and liabilities of a sole proprietorship, which included accounts payable and accounts receivable, to a new corporation in exchange for all of the corporate stock. Both the individual prior to the transfer and the new corporation used the cash method of accounting. There was a valid business purpose for the transfer, and the individual had neither accumulated the accounts receivable nor prepaid any of the accounts payable in anticipation of the incorporation. The transfer is an exchange qualifying under section 351 of the Code.

Rev. Rul. 80-199, page 11.
Reorganizations; liabilities assumed exceeding assets. Accounts payable that were transferred to a corporation in a section 351 exchange prior to the enactment of the Revenue Act of 1978 and

(Continued on page 4)

Finding Lists begin on page 33.
Announcement Relating to Decisions of the Tax Court on page 5.
Announcement of Voluntary Suspensions on page 31.
Announcement of Notice of Proposed Rulemaking on page 32.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Continued

that would have been deductible by the transferor if paid are not liabilities for purposes of sections 357(c) and 358(d) of the Code; Rev. Rul. 69-442 revoked.

Rev. Rul. 80-201, page 14.
Foreign tax credit; limitation; tax treaties. The foreign tax credit per-country limitation provided in United States income tax treaties is superseded for taxable years beginning after 1976 by section 1031 of the Tax Reform Act of 1976, which provides for computation of the limitation using only the overall method.

T.D. 7704, page 15.
Amendments to the regulations under section 954 of the Code relate to the exclusion from subpart F income of certain earnings of insurance companies.

Announcement 80-94, page 28.
Overseas employees of charitable organizations who resided in lesser developed countries while employed by such organizations during any part of their 1979 taxable years will have until October 15, 1980, to file their 1979 income tax returns.

EXEMPT ORGANIZATIONS

Rev. Rul. 80-200, page 13.
Adoption agency; placement of foreign orphans. A nonprofit organization that arranges the placement of orphan children from foreign countries in the homes of adoptive parents in the United States is operated exclusively for charitable purposes.

Announcement 80-95, page 28.
A listing is given of organizations now classified as private foundations.

ESTATE TAX

Rev. Rul. 80-202, page 18.
Installment payments; closely held business; valuation. In computing the limitation on the amount of estate tax that may be paid in installments under section 6166A of the Code, the value of a decedent's interest as a proprietor in a trade or business carried on as a proprietorship is the net amount a willing purchaser would pay for the interest to a willing seller.

GIFT TAX

Rev. Rul. 80-196, page 7.
Transfer of stock by controlling shareholders to corporate employees. The transfer of a corporation's stock by the corporation's two shareholders to three employees for a valid business reason, to retain valuable employees, is made for adequate and full consideration and is not subject to the gift tax.

EMPLOYMENT TAXES

Rev. Proc. 80-31, page 20.
Forms; agent-prepared deposit cards. The procedures are provided under which qualifying agents who perform payroll service may request permission to prepare federal tax deposit cards instead of using the prepunched cards provided by the Treasury Department.

Announcement Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issue or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by Revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the Court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the Tax Court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Focht, Donald D.[1]	7807-73	68	223
Green, Gene P., et ux.[2]	1785-73	66	538
Johnson, Mary Helen[3]	10423-76	72	340

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[1] Acquiescence in the issues relating to (1) whether taxpayer recognised gain when he transferred liabilities, consisting primarily of trade accounts payable, to a corporation in a section 351 transaction which exceeded the adjusted basis of the assets transferred, and (2) whether petitioner failed to include receipts as rental income. See Rev. Rul. 80-199, page 11, this Bulletin.

[2] Acquiescence in the issues relating to (1) whether records of a partnership were adequate to reflect partnership income, (2) whether alleged gambling losses claimed by a partnership were deductible under section 165(d), and (3) whether the petitioners are liable for additions to the tax under section 6653(b).

[3] Acquiescence in the issues relating to (1) whether illegal income obtained by petitioner's husband in a false Federal income tax refund scheme constitutes community property, and (2) whether petitioner is entitled to deduct under section 212 a portion of the legal fees paid to defend her husband as a result of his participation in a false refund scheme.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 43.—Earned Income [Credits Against Tax]

26 CFR 1.43-1: Earned income credit for taxable years beginning in 1975.

Earned income credit; life insurance salesperson. A self-employed full-time life insurance salesperson, within the meaning of section 3121(d)(3) of the Code, should report the gross commissions received as earned income under section 43(c)(2)(A)(i).

Rev. Rul. 80-194

ISSUE

How should the remuneration received by the life insurance salesperson described below be reported for purposes of the earned income credit provided by section 43 of the Internal Revenue Code?

FACTS

A self-employed salesperson, who is a full-time life insurance salesperson, within the meaning of section 3121 (d) (3) of the Federal Insurance Contributions Act (FICA), received remuneration of $6,500 in the form of commissions for the taxable year 1978 and incurred expenses of $3,000 in connection therewith. The salesperson qualifies for the earned income credit as an eligible individual.

LAW AND ANALYSIS

Section 43(a) of the Code allows an eligible individual a credit against the federal income tax for the taxable year equal to ten percent of the individual's earned income for the year as does not exceed $4,000, for taxable years beginning before January 1, 1979 ($5,000 for taxable years beginning after December 31, 1978), subject to the limitation provided by section 43(b). Under section 43(b) the amount of the credit allowable to an eligible individual is reduced (but not below zero) by an amount equal to ten percent of the individual's adjusted gross income (or, if greater, the earned income) as exceeds $4,000 for taxable years beginning before January 1, 1979. For taxable years beginning after December 31, 1978, the amount of the credit allowable is not to exceed the excess, if any, of (1) $500, over (2) 12.5 percent of so much of the adjusted gross income (or, if greater, the earned income) of the taxpayer for the taxable year as exceeds $6,000.

Under section 43(c) (2) (A) of the Code, the term "earned income" means (i) wages, salaries, tips, and other employee compensation, plus (ii) the amount of the taxpayer's net earnings from self-employment for the taxable year (within the meaning of section 1402(a)). Under section 1402(a), the term "net earnings from self-employment" means the gross income derived by an individual from any trade or business carried on by such individual less the deductions allowed that are attributable to such trade or business. Section 1402(c) provides that the term "trade or business" when used with reference to self-employment income or net earnings from self-employment has the same meaning as when used in section 162 (relating to trade or business expenses) except that such term does not include the performance of service by an individual as an employee. Under section 1402(d), the term "employee" has the same meaning as when used in section 3121(d) (3) of the FICA which provides that the term "employee" includes an individual who performs services for remuneration for any person as a full-time life insurance salesperson.

The salesperson in this case had earned income for the year 1978, inasmuch as the salesperson performed services for, or on behalf of, other persons and received remuneration for such services. Thus, the salesperson is entitled to an earned income credit under section 43 of the Code. Since the salesperson is a full-time life insurance salesperson, the salesperson is a statutory employee under section 3121(d) (3) of the FICA. Therefore, under section 1402(c) of the Code, the salesperson is not carrying on a trade or business.

Accordingly, the commissions received by the salesperson are not earnings from self-employment under section 1402(a) of the Code but are commissions received as a statutory employee and includable in the wages category for purposes of the earned income credit.

HOLDING

The salesperson should report the gross commissions ($6,500) as earned income under section 43(c) (2) (A) (i) of the Code. The salesperson's earned income credit, as computed under section 43, is $150.

Section 48.—Definitions; Special Rules

26 CFR 1.48-1: Definition of section 38 property.

Investment credit; storage facilities; aluminum scrap. A taxpayer built a structure principally to store different grades and forms of aluminum scrap that are not intermingled. This storage of aluminum is not bulk storage of fungible commodities, and the structure does not qualify as section 38 property.

Rev. Rul. 80-195

ISSUE

Whether the storage of aluminum scrap in the taxpayer's structure, in the manner described below, is "bulk storage of fungible commodities" for purposes of section 48 of the Internal Revenue Code.

FACTS

A taxpayer is in the business of producing nonferrous metals alloys, primarily alloys of aluminum. All of the melting and refining activities are housed within a single building. Prior to 1978, taxpayer had no shelter for the raw materials used in production. After receipt, the raw materials were sometimes held in the railroad cars and trucks until used or stockpiled outside the building on adjacent land. This manner of storage, however, had often resulted in deterioration of the raw materials through oxidation and also made it difficult to handle the raw materials during or after rain and when snow was on the ground. During 1978, the taxpayer built a corrugated metal structure adjacent to the building housing the melting and refining activities to provide a sheltered storage area. The structure is erected on a single slab of concrete, contains no interior walls or partitions, and is 150 feet long, 60 feet wide and 20 feet high at the peak in the roof. The structure has lights, but no windows, water, toilet facilities, heating or cooling system, or insulation. It is subject to depreciation and has a useful life in excess of 3 years.

The principal materials stored in the taxpayer's structure is aluminum scrap of various grades. These materials are received in the form of ingots, sows (big slabs), and scrap clips. Scrap aluminum cans, for example, may be received in the form of metal clips. To the extent that skimmings from the molten metal operations contain reusable aluminum, they are recovered and stored in the structure. The stored materials are weighed upon receipt and tagged. The information entered on the tax includes: the name of the vendor, the weight of the material and, in some cases, its grade. Materials having similar characteristics are stored together and are not intermingled with other materials. However, there are no separate bins in the structure and no particular area of the floor has been designated for specific materials. A variety of ways of storing the materials are used. Large size units, for example, may simply be stacked one on top of the other in one area of the structure while smaller size units are frequently bundled or baled and stacked on pallets or skids and stored in a separate area of the structure. The taxpayer's employees store and remove the material from the structure using forklift trucks. No processing of material is done within the structure.

LAW AND ANALYSIS

Section 48(a) of the Code provides, to the extent here pertinent, that the term "section 38 property" means tangible personal property or other tangible property (not including a building and its structural components) but only if such property is used as an integral part of manufacturing, production, or other specified activities, or if it constitutes a facility used in connection with manufacturing, production, or other specified activities for the bulk storage of fungible commodities. Section 38 property includes only property with respect to which depreciation (or amortization in lieu of depreciation) is allowable and having a useful life of 3 years or more.

Section 1.48-1(d)(5)(ii) of the Income Tax Regulations provides that in the case of property constructed after August 15, 1971, such property will be a storage facility only if the facility is used principally for the bulk storage of fungible commodities. Bulk storage means the storage of a commodity in a large mass prior to its consumption or utilization. Thus, if a facility is used to store oranges that have been sorted and boxed, it is not used for bulk storage.

Rev. Rul. 74-3, 1974-1 C.B. 10, provides that partitioned enclosures inside a building devoted to the storing of inventoried parts and assembly elements, such as radios and air conditioners that are individually identified, are not facilities used principally for the bulk storage of fungible commodities.

S. Rep. No. 92-437, 92nd Cong., 1st Sess. 29 (1971), 1972-1 C.B. 559, 575, relating to the Revenue Act of 1971, Pub. L. 92-178, 1972-1 C.B. 443, discusses the bulk storage of fungible commodities requirement, which was added to section 48(a)(1)(b) of the Code. This report states that "bulk storage has reference to the keeping of a commodity in a large mass prior to its consumption or utilization. The commodity stored must be fungible in nature; that is, of such a nature that one part may be used in place of another."

The taxpayer's structure is used principally to store different grades of aluminum that are received in various forms such as ingots, sows, and scrap clips with individual units differing significantly in size and weight, with some material stored in bundled groups and others stored unbundled. Each unit or bundled group is tagged and identified as to vendor, weight, and often its grade.

Stored materials that vary in composition, size, and weight are not fungible in nature. One part cannot be used in place of another part and the materials cannot be estimated and replaced by simple reference to weight, measure and number.

Therefore, the storage of the materials in this case cannot be considered to be the bulk storage of fungible commodities.

HOLDING

The storage of the aluminum scrap in the taxpayer's structure in the manner described is not bulk storage of fungible commodities for purposes of section 48 of the Code. Therefore, the structure used to house the materials does not qualify as "section 38 property" for investment credit purposes.

Section 61.—Gross Income Defined

26 CFR 1.61-2: Compensation for services, including fees, commissions, and similar items.
(Also Sections 83, 1012, 2511, 2512; 1.83-1, 1.1012-1, 25.2511-1, 25.2512-8.)

Transfer of stock by controlling shareholders to corporate employees. The transfer of a corporation's stock by the corporation's two shareholders to three employees for a valid business reason, to retain valuable employees, is compensation, is made for adequate and full consideration, and is not subject to the gift tax.

Rev. Rul. 80-196

ISSUE

What are the federal income and gift tax consequences of a transfer of stock under the situation described below?

FACTS

In 1979, *A* and *B*, individual founders of corporation *X*, each owned 50 percent of the 30,000 shares outstanding of the common stock of *X*. *X* employed 200 individuals. On December 31, 1979, *A* and *B* each transferred 100 shares of *X* to *N*, *O*, and *P* as a bonus in consideration of past services to *X*. *N*, *O*, and *P* were key employees of *X*, had provided exceptional duties to *X* for more than 5 years, and were considered valuable to the continued success of *X*. The stock transferred to them was fully transferable and not subject to any restrictions. Neither *A* nor *B* was related to *N, O*, or *P*, nor did any special personal relationship exist with *N, O*, or *P*.

LAW AND ANALYSIS— INCOME TAX

Section 61 of the Internal Revenue Code provides that gross income means all income from whatever source derived, including compensation for services.

Section 83(a) of the Code provides that when property is transferred to a person in connection with the performance of services, the person who performed the services must include in gross income the excess of (1) the fair market value of the property on the first date that the property is transferable or not subject to a substantial risk of forfeiture over (2) the amount, if any, paid for the property. The taxable year of inclusion is generally the first taxable year in which the rights of the person receiving the property are substantially vested (transferable or not subject to a substantial risk of forfeiture).

Section 83(h) of the Code and the Income Tax Regulations thereunder provide that if section 83(a) applies to a transfer of property, the person for whom the services were performed will be allowed a deduction equal to the amount included in gross income by the person who performed the services, but only to the extent such amount meets the requirements of section 162 or 212 and the regulations thereunder. Where property is substantially vested when transferred, the person for whom the services were performed is allowed a deduction in accordance with that person's method of accounting (in conformity with sections 446 and 461).

Section 1.83-6(d) of the regulations provides that if a shareholder of a corporation transfers property to an employee of such corporation or to an independent contractor (or the beneficiary thereof) in consideration of services performed for the corporation, the transaction shall be considered to be a contribution to the capital of the corporation, and immediately thereafter a transfer by the corporation of the property to the employee or independent contractor.

HOLDINGS—INCOME TAX

1. *N, O,* and *P* must include in gross income, for 1979, the fair market value, on the date of transfer, of the stock received. Section 83 of the Code and Rev. Rul. 69-140, 1969-1 C.B. 45.

2. *N, O,* and *P*'s basis in the stock received is the amount included in gross income for 1979. Section 1012 of the Code.

3. *X* will be entitled to a deduction, for its taxable year 1979, of an amount equal to the amounts included in income by *N, O,* and *P,* provided such deduction meets the requirements of section 162 of the Code. Section 83(h) of the Code and section 1.83-6(d) of the regulations.

4. *A* and *B* will not recognize gain or loss as a result of the transfer.

LAW AND ANALYSIS— GIFT TAX

Section 2511 of the Code contains a broad statement as to what transfers constitute taxable gifts. Any voluntary transfer of property or an interest in property, whether direct or indirect, by one to another for less than adequate and full consideration in money or money's worth is subject to the gift tax.

Section 2511(a) of the Code provides that the gift tax shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-1(g)(1) of the Gift Tax Regulations provides that donative intent on the part of a transferor is not an essential element in the application of the gift tax to a transfer. Whether the gift tax is applicable is based upon the objective facts of the transfer and the circumstances under which it is made, rather than on the subjective motives of the donor. The tax, however, is not applicable to transfers for full and adequate consideration in money or money's worth or to ordinary business transactions. Under section 25.2512-8 of the regulations a transfer of property made in the ordinary course of business (a transaction that is bona fide, at arm's length, and free of donative intent) will be considered as made for adequate and full consideration. *Estate of Anderson v. Commissioner*, 8 T.C. 706 (1947); *Bryan v. Commissioner*, 16 T.C. 972 (1951); *Weller v. Commissioner*, 38 T.C. 790 (1962).

In *Weller* the court noted that donative intent is not a requisite for a gift for tax purposes. However, the absence of donative intent is relevant under the regulations in determining whether a transfer is made in the ordinary course of business.

Section 2512(b) of the Code provides that where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift and shall be included in computing the amount of gifts during the calendar quarter. However, under section 25.2512-8 of the regulations, a transfer of property made in the ordinary course of business (a transaction which is bona fide, at arm's length, and free from donative intent) will be considered as made for an adequate and full consideration in money or money's worth.

HOLDINGS—GIFT TAX

The transfer of 100 shares by each of *A* and *B* to each of *N, O,* and *P* were in the ordinary course of business, since they were motivated by a valid business reason, that is, retaining valuable personnel in the employment of *X*. Thus, the transfers are considered as made for adequate and full consideration for gift tax purposes. Therefor, the transfers by *A* and *B* are not subject to the gift tax.

Section 83.—Property Transferred in Connection with Performance of Services

26 CFR 1.83-1: Property transferred in connection with the performance of services.

Treatment of a transfer of corporate stock by controlling shareholders to employees of the corporation. See Rev. Rul. 80-196, page 7.

Section 103.—Interest on Certain Government Obligations

26 CFR 1.103-8: Interest on bonds to finance certain exempt facilities.

Industrial development bonds; reusable beverage container facilities. Machinery, equipment, and other facilities used by a beverage manufacturer to package beverages in reusable containers because a state law prohibited sale of beverages in nonreturnable containers do not qualify as solid waste disposal facilities under section 103(b)(4)(E) of the Code. The interest on industrial development bonds issued by various cities in the state to finance the facilities will not be excludable from the gross incomes of the bondholders under section 103(a).

Rev. Rul. 80-197

ISSUE

Do machinery, equipment, and other facilities acquired by a beverage manufacturer to package beverages in reusable containers qualify as solid waste disposal facilities under section 103(b)(4)(E) of the Internal Revenue Code so that the interest on industrial development bonds issued to finance their acquisition is excludable from the gross incomes of the bondholders under section 103(a)(1) of the Code?

FACTS

The taxpayer, a beverage manufacturer, acquired machinery, equipment, and other facilities necessary to package all its beverages in reusable containers because a new state law prohibited the sale of beverages in "nonreturnable" containers. The purpose of this law was to reduce litter. The law specifies that a nominal deposit be paid upon the purchase of each beverage and that the deposit be refunded upon return of the beverage container. However, the law does not specify what type of beverage container is to be used (that is, reusable vs. nonreusable).

Before the enactment of this nonreturnable container law, the taxpayer's facilities were primarily adapted for providing beverages in disposable nonreusable containers.

The taxpayer has determined that the cost of using reusable containers is less than the cost of providing new containers for each sale cycle.

To package all of its beverages in reusable containers, the taxpayer acquired certain machinery, equipment, and other facilities. The taxpayer is financing the cost of this project with industrial development bonds to be issued by various cities located in state *X*.

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include interest on the obligations of a state, a territory, or a possession of the United States, or any political subdivision of any of the foregoing, or of the District of Columbia.

Section 103(b)(1) of the Code provides that, except as otherwise provided in section 103(b), any industrial development bond shall be treated as an obligation not described in section 103(a)(1).

Section 103(b)(4)(E) of the Code provides that section 103(b)(1) shall not apply to any obligation that is issued as part of an issue substantially all of the proceeds of which are to be used to provide sewage or solid waste disposal facilities.

Section 1.103-8(f)(2)(ii)(a) of the Income Tax Regulations defines the term "solid waste disposal facilities" as any property or portion thereof used for the collection, storage, treatment, utilization, processing, or final disposal of solid waste. Only expenditures for that portion of property that is a solid waste disposal facility qualify as expenditures for solid waste disposal facilities. Whether a collection or storage facility qualifies as a solid waste disposal facility depends upon all of the facts and circumstances.

Section 1.103-8(f)(2)(ii)(b) of the regulations provides that:

> The term "solid waste" shall have the same meaning as in section 203(4) of the Solid Waste Disposal Act (42 U.S.C. Sec. 3252(4)), except that for purposes of this paragraph, material will not qualify as solid waste unless, on the date of issue of the obligations issued to provide the facility to dispose of such waste material, it is property which is useless, unused, unwanted, or discarded solid material which has no market or other value at the place were it is located. . . . The term "solid waste" means garbage, refuse, and other discarded solid materials, including solid-waste materials resulting from industrial, commercial, and agricultural operations, and from community activities, but does not include solids or dissolved material in domestic sewage or other significant pollutants in water resources, such as silt, dissolved or suspended solids in industrial waste water effluents, dissolved materials in irrigation return flows or other common water pollutants.

Section 1.103-8(f)(2)(ii)(C) of the regulations provides that a facility which disposes of solid waste by reconstituting, converting, or otherwise recycling it into material that is not waste shall also qualify as a solid waste disposal facility if "solid waste" constitutes at least 65 percent, by weight or volume, of the total materials introduced into the recycling process.

In the instant case the machinery, equipment, and other facilities acquired by the taxpayer can not qualify as solid waste disposal facilities if the containers processed by such facilities are not considered solid waste. For any material to be solid waste, it must be useless, unwanted, or discarded solid material that has no market or other value at the place where it is located.

The amount of any deposit mandated by the state is only an inducement to the beverage consumers to return the containers and has no relation to the container's value. If the reusable container is not returned, but is discarded, it can potentially become "solid waste" as the term is defined in section 1.103-8(f)(2)(ii) of the regulations. However, once the reusable container is returned to the taxpayer and the deposit is refunded to the retailer, the reusable container is not useless, unwanted, or discarded solid material. Upon its return, the container has been reintroduced into the distribution process and may be reused, barring breakage or damage, numerous times. Every time the beverage container is reused, the taxpayer has eliminated the need to purchase a new container. Therefore, even though a market for used containers does not exist by virtue of the mandatory deposit, the reusable containers do have value to the taxpayer because reuse of these containers is less costly than the purchase of new containers.

HOLDING

The used containers are not "solid waste" within the meaning of section 1.103-8(f)(2)(ii)(b) of the regulations and the facilities acquired by the taxpayer to package beverages in such containers are not solid waste disposal facilities within the meaning of section 103(b)(4)(E) of the Code. The interest on the bonds will not be excludable from the gross incomes of the bondholders under section 103(a).

Section 351.—Transfer to Corporation Controlled by Transferor

26 CFR 1.351-1: Transfer to corporation controlled by transferor.
(Also Section 482; 1.482-1.)

Controlled corporations; transfers; accounts payable and accounts receivable. An individual transferred all of the assets and liabilities of a sole proprietorship, which included accounts payable and accounts receivable, to a new corporation in exchange for all of the corporate stock. Both the individual prior to the transfer and the new corporation used the cash method of accounting. There was a valid business purpose for the transfer, and the individual had neither accumulated the accounts receivable nor prepaid any of the accounts payable in anticipation of the incorporation. The transfer is an exchange qualifying under section 351 of the Code.

Rev. Rul. 80-198

ISSUE

Under the circumstances described below, do the nonrecognition of gain or loss provisions of section 351 of the Internal Revenue Code apply to a transfer of the operating assets of an ongoing sole proprietorship (including unrealized accounts receivable) to a corporation in exchange solely for the common stock of a corporation and the assumption by the corporation of the proprietorship liabilities?

FACTS

Individual *A* conducted a medical practice as a sole proprietorship, the income of which was reported on the cash receipts and disbursements method of accounting. *A* transferred to a newly organized corporation all of the operating assets of the sole proprietorship in exchange for all of the stock of the corporation, plus the assumption by the corporation of all of the liabilities of the sole proprietorship. The purpose of the incorporation was to provide a form of business organization that would be more conducive to the planned expansion of the medical services to be made available by the business enterprise.

The assets transferred were tangible assets having a fair market value of $40,000 and an adjusted basis of $30,000 and unrealized trade accounts receivable having a face amount of $20,000 and an adjusted basis of zero. The liabilities assumed by the corporation consisted of trade accounts payable in the face amount of $10,000. The liabilities assumed by the corporation also included a mortgage liability, related to the tangible property transferred, of $10,000. *A* had neither accumulated the accounts receivable nor prepaid any of the liabilities of the sole proprietorship in a manner inconsistent with normal business practices in anticipation of the incorporation. If *A* had paid the trade accounts payable liabilities, the amounts paid would have been deductible by *A* as ordinary and necessary business expenses under section 162 of the Code. The new corporation continued to utilize the cash receipts and disbursements method of accounting.

LAW AND ANALYSIS

The applicable section of the Code is section 351(a), which provides that no gain or loss shall be recognized when property is transferred to a corporation in exchange solely for stock and securities and the transferor is in control (as defined by section 368(c)) of the transferee corporation immediately after the transfer.

In *Hempt Bros., Inc. v. United States*, 490 F.2d 1172 (3rd Cir. 1974), *cert. denied*, 419 U.S. 826 (1974), the United States Court of Appeals for the Third Circuit held, as the Internal Revenue Service contended, that a cash basis transferee corporation was taxable on the monies it collected on accounts receivable that had been transferred to it by a cash basis partnership in a transaction described in section 351(a) of the Code. The corporate taxpayer contended that it was not obligated to include the accounts receivable in income; rather the transferor partnership should have been taxed on the stock the partnership received under the assignment of income doctrine which is predicated on the well established general principle that income be taxed to the party that earned it.

The court in *Hempt Bros.* solved the conflict between the assignment of income doctrine and the statutory nonrecognition provisions of section 351 of the Code by reasoning that if the cash basis transferor were taxed on the transfer of the accounts receivable, the specific congressional intent reflected in section 351(a) that the incorporation of an ongoing business should be facilitated by making the incorporation tax free would be frustrated.

The facts of the instant case are similar to those in *Hempt Bros.* in that there was a valid business purpose for the transfer of the accounts receivable along with all of the assets and liabilities of *A*'s proprietorship to a corporate transferee that would continue the business of the transferor. Further, *A* had neither accumulated the accounts receivable nor prepaid any of the account payable liabilities of the sole proprietorship in anticipation of the incorporation, which is an indication that, under the facts and circumstances of the case, the transaction was not designed for tax avoidance.

HOLDING

The transfer by *A* of the operating assets of the sole proprietorship (including unrealized accounts receivable) to the corporation in exchange solely for the common stock of the corporation and the assumption by the corporation of the proprietorship liabilities (including accounts payable) is an exchange within the meaning of section 351(a) of the Code. Therefore, no gain or loss is recognized to *A* with respect to the property transferred, including the accounts receivable. For transfers occurring on or after November 6, 1978 (the effective date of the Revenue Act of 1978, Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, 88, with respect to sections 357(c)(3) and 358(d)(2) of the Code) the assumption of the trade accounts payable that would give rise to a deduction if *A* had paid them is not, pursuant to section 357(c)(3), considered as an assumption of a liability for purposes of sections 357(c)(1) and 358(d). See Rev. Rul. 80-199, this page, this Bulletin, for transfers occurring before November 6, 1978, which holds that trade accounts payable transferred to a corporation in a transaction to which section 351(a) applies are not liabilities for the purposes of sections 357(c) and 358(d) if the transferor of the accounts payable could have deducted the amounts paid in satisfaction thereof under section 162 if the transferor had paid these amounts in satisfaction of the payables prior to the exchange. The corporation, under the cash receipts and disbursements method of accounting, will report in its income the account receivables as collected, and will be allowed deductions under section 162 for the payments it makes to satisfy the assumed trade accounts payable when such payments are made.

A's basis in the stock received in the exchange of property for stock under section 358(a)(1) of the Code is $20,000 which is calculated by decreasing *A*'s $30,000 basis in the assets transferred by the $10,000 mortgage liability under sections 358(a)(1)(A)(ii) and 358(d)(1). No adjustment to such basis is made under section 358(a)(1)(A)(ii) because of the assumption by the corporation of the $10,000 in accounts payable inasmuch as the general rule of section 358(d)(1), which requires the basis in the stock received to be decreased by the liabilities assumed, does not apply by reason of section 358(d)(2), which provides that section 358(d)(1) does not apply to the amount of any liabilities defined in section 357(c)(3) such as accounts payable that would have been deductible by *A* as ordinary and necessary business expenses under section 162 in the taxable year paid if *A* had paid these liabilities prior to the exchange. See Rev. Rul. 80-199, with respect to transfers which have occurred before November 6, 1978 (the date of the enactment of the Revenue Act of 1978).

LIMITATIONS

Section 351 of the Code does not apply to a transfer of accounts receivable which constitute an assignment of an income right in a case such as *Brown v. Commissioner*, 40 B.T.A. 565 (1939), *aff'd* 115 F.2d 337 (2d Cir. 1940). In *Brown*, an attorney transferred to a corporation, in which he was the sole owner, a one-half interest in a claim for legal services performed by the attorney and his law partner. In exchange, the attorney received additional stock of the corporation. The claim represented the corporation's only asset. Subsequent to the receipt by the corporation of the proceeds of the claim, the attorney gave all of the stock of the corporation to his wife. The United States Court of Appeals for the Second Circuit found that the transfer of the claim for the fee to the corporation had no purpose other than to avoid taxes and held that in such a case the intervention of the corporation would not prevent the attorney from being liable for the tax on the income which resulted from services under the assignment of income rule of *Lucas v. Earl*, 281 U.S. 111 (1930). Accordingly, in a case of a transfer to a controlled corporation of an account receivable in respect of services rendered where there is a tax avoidance purpose for the transaction (which might be evidenced by the corporation not conducting an ongoing business), the Internal Revenue Service will continue to apply assignment of income principles and require that the transferor of such a receivable include it in income when received by the transferee corporation.

Likewise, it may be appropriate in certain situations to allocate income, deductions, credits, or allowances to the transferor or transferee under section 482 of the Code when the timing of the incorporation improperly separates income from related expenses. See *Rooney v. United States,* 305 F.2d 681 (9th Cir. 1962), where a farming operation was incorporated in a transaction described in section 351(a) after the expenses of the crop had been incurred but before the crop had been sold and income realized. The transferor's tax return contained all of the expenses but none of the farming income to which the expenses related. The United States Court of Appeals for the Ninth Circuit held that the expenses could be allocated under section 482 to the corporation, to be matched with the income to which the expenses related. Similar adjustments may be appropriate where some assets, liabilities, or both, are retained by the transferor and such retention results in the income of the transferor, transferee, or both, not being clearly reflected.

26 CFR 1.351-1: Transfer to corporation controlled by transferor.

Whether in a section 351 incorporation the term "liabilities" as used in sections 357 and 358(d) of the Code prior to amendment by the Revenue Act of 1978 on November 6, 1978, includes accounts payable deductible under section 162 of the Code. See Rev. Rul. 80-199, below.

Section 357.—Assumption of Liability

26 CFR 1.357-2: Liabilities in excess of basis.
(Also Sections 351, 358, 7805; 1.351-1, 1.358-3, 301.7805-1.)

Reorganizations; liabilities assumed exceeding assets. Accounts payable that were transferred to a corporation in a section 351 exchange prior to the enactment of the Revenue Act of 1978 and that would have been deductible by the transferor if paid are not liabilities for purposes of sections 357(c) and 358(d) of the Code; Rev. Rul. 69-442 revoked.

Rev. Rul. 80-199

ISSUE

Whether the term "liabilities" as used in sections 357 and 358(d) of the Internal Revenue Code prior to amendment by the Revenue Act of 1978, Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, 88, on November 6, 1978, includes accounts payable deductible under section 162 of the Code.

FACTS

Individual *A* conducted a small contracting business as a sole proprietorship, the income of which was reported on the cash receipts and disbursements method of accounting. On January 1, 1978, *A* transferred to a newly organized corporation all of the assets of the sole proprietorship in exchange for all of the stock of the corporation, plus the assumption by the corporation of all of the liabilities of the sole proprietorship, in a transaction that met the requirements of section 351(a) of the Code. The transactor did not lack a business purpose. The assets transferred were tangible assets having a fair market value of $20,000 and an adjusted basis of $10,000, and accounts receivable having a fair market value of $30,000 and an adjusted basis of zero dollars. The liabilities assumed by the corporation consisted solely of accounts payable of the sole proprietorship in the face amount of $20,000. The accounts would have been deductible by *A* as ordinary and necessary business expenses under section 162 if *A* had paid them. The new corporation continued to utilize the cash receipts and disbursements method of accounting.

LAW AND ANALYSIS

The applicable sections of the Code are 351, relating to nonrecognition in a transfer to a corporation controlled by the transferor; 357, relating to assumption of liability; 358, relating to basis to distributees; and 362, relating to basis to corporations.

Section 357(a) provides, in part, as a general rule that the assumption of liabilities on the part of a corporate transferee in connection with a section 351 exchange, or the acquisition by the transferee of property subject to a liability in such an exchange, shall not be treated as a receipt of money or other property by the transferor.

Section 357(c)(1) prior to amendment by the Revenue Act of 1978 provides, in part, that in the case of an exchange to which section 351 applies if the sum of the amount of the liabilities assumed, plus the amount of the liabilities to which the property is subject, exceeds the total of the adjusted basis of the property transferred pursuant to such exchange, then such excess shall be considered as a gain from the sale or exchange of a capital asset or of property which is not a capital asset, as the case may be.

Section 358(a)(1) of the Code provides, in part, that in the case of an exchange to which section 351 applies the basis of the property permitted to be received under section 351 without the recognition of gain or loss shall be the same as that of the property exchanged (A) decreased by (i) the fair market value of any other property (except money) received by the taxpayer, (ii) the amount of money received by the taxpayer, and (iii) the amount of loss to the taxpayer which was recognized on such exchange, and (B) increased by (i) the amount which was treated as a dividend, and (ii) the amount of gain to the taxpayer which was recognized on such exchange (not including any portion of such gain which was treated as a dividend).

Section 358(d) of the Code prior to the amendment by the Revenue Act of 1978 provides that if as part of the consideration to the taxpayer, another party to the exchange, assumed a liability of the taxpayer, or acquired from the taxpayer property subject to a liability, such assumption or acquisition (in the amount of the liability) shall, for purposes of this section, be treated as money received by the taxpayer on the exchange.

Since the adjusted basis of the assets transferred by *A* to the corporation was $10,000 and the accounts payable assumed by the corporation was $20,000, the primary question for consideration is whether the transfer of the assets and liabilities of *A*'s sole proprietorship to the corporation results in gain under section 357(c) of the Code. In ***Raich v. Commissioner,*** 46 T.C. 604 (1966), the Tax Court of the United States directed its attention to such a question in a case where the taxpayer transferred assets of a business conducted as a sole proprietorship, the income from which was reported on the cash receipts and disbursements method of accounting, to a newly formed corporation in exchange for all of the stock of the corporation plus the assumption by the corporation of all of the liabilities of the sole proprietorship (trade accounts payable and notes payable) in a transaction meeting the requirements of section 351(a). The court held that the trade accounts receivable had a zero basis, and that since the total liabilities, consisting primarily of trade accounts payable, assumed by the corporation were in excess of the adjusted basis of all of the assets transferred, the taxpayer (transferor) incurred a gain under section 357(c) (as it existed prior to the amendment by the Revenue Act of 1978). In Rev. Rul. 69-442, 1969-2 C.B. 53, the Service indicated that it would follow the decision in ***Raich v. Commissioner*** and apply section 357(c) to other situations involving similar facts.

In *Focht v. Commissioner,* 68 T.C. 223 (1977), *acq.*, page 5, this Bulletin, the taxpayer, in 1970, transferred to a newly-formed corporation all of the assets of a business conducted as a sole proprietorship, the income of which was reported on the cash receipts and disbursements method of accounting, in exchange for all of the stock of the corporation plus an assumption by the corporation of all of the liabilities of the sole proprietorship in a transaction meeting the requirements of section 351(a) of the Code. These liabilities consisted of the liabilities actually assumed by the corporation as well as liabilities to which certain of the property transferred was subject. The liabilities assumed by the corporation consisted primarily of trade accounts payable. The Internal Revenue Service treated all of the liability obligations including the accounts payable as liabilities within the meaning of section 357(c), and determined that the taxpayer incurred a gain, by reason of section 357(c), in the amount by which the liabilities assumed by the corporation exceeded the adjusted basis of the assets transferred. The Tax Court of the United States held that an obligation should not be treated as a liability, under sections 357 and 358(d), to the extent that its payment would have been deductible (under section 162) if made by the transferor. The court held that section 357(c) did not apply to the account payable liabilities for this reason and overruled its prior decision in *Raich* on this point.

The Service will follow the decision in *Focht*.

HOLDING

No gain is realized by *A* on the exchange of property for stock by reason of section 357(c) of the Code because the accounts payable assumed by the corporation would have been deductible by *A* as ordinary and necessary business expenses under section 162 in the taxable year paid if *A* had paid these liabilities prior to the exchange. *A*'s basis in the stock received in the exchange of property for stock under section 358(a)(1) is the $10,000 basis that *A* had in the property transferred to the corporation. No adjustment to such basis is made under section 358(a)(1)(A)(ii) because of the assumption by the corporation of the $20,000 in accounts payable inasmuch as section 358(d) does not apply to the accounts payable. Likewise, no adjustment to such basis is made under section 358(a)(1)(B)(ii) because section 357(c) does not apply to the accounts payable.

Transactions which occur on or after November 6, 1978 will be govrened by sections 357(c and 358(d) as amended by the Revenue Act of 1978.

COURT DECISIONS THAT THE INTERNAL REVENUE SERVICE WILL NOT FOLLOW

The Service will not follow the rationale of the decision of the United States Court of Appeals for the Ninth Circuit in *Thatcher v. Commissioner*, 533 F.2d 1114 (9th Cir. 1976) which involved a transaction similar to the facts of this revenue ruling. The court agreed with the Service that the transferors must recognize gain under section 357(c) of the Code on the incorporation transfer, but the court also concluded that the transferor should receive a deduction for trade accounts payable discharged by the transferee corporation to the extent of the accounts receivable or the gain recognized under section 357(c), whichever is less.

The Service also will not follow the rationale of the decision of the United States Court of Appeals for the Second Circuit in *Bongiovanni v. Commissioner*, 470 F.2d 921 (2d Cir. 1972), involving a similar transaction and which held that the term "liabilities," as used in section 357(c) of the Code, did not include all liabilities which are included for accounting purposes, but was meant to apply only to what might be called "tax" liabilities, that is, liens in excess of tax costs, particularly mortgages encumbering property transferred in an exchange within the meaning of section 351. The above mentioned language offers no clear guidance as to the meaning of the terms "accounting" liabilities and "tax" liabilities or to making a distinction between them. For example, to the extent that the *Bongiovanni* decision could be interpreted as suggested by Footnote 6 in *Thatcher* as holding that "liabilities" for the purpose of section 357(c) means only "the excess of *secured* debts over the transferor's adjusted basis in the assets transferred" (italics supplied), the Service would view such an interpretation as being unduly restrictive of the term "liabilities."

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 69-442 is revoked.

Further, this revenue ruling is not to be relied upon for an interpretation of the term "liability" for any provision of the Code or Income Tax Regulations thereunder, other than sections 357 or 358(d), because in *Focht* the Tax Court properly limited its interpretation of the term to those sections.

SECTION 7805(b) OF THE CODE

Pursuant to the authority contained in section 7805(b) of the Code, this revenue ruling will not be applied to a transferee corporation that, pursuant to section 362(a)(1) of the Code, increased the basis of the property acquired in a transaction to which section 351 applied by the amount of the gain recognized by the transferor on such transfer under section 357(c) and Rev. Rul. 69-442. Thus, a transferee corporation will not be required to reduce the basis in the property received by the amount of such gain recognized by the transferor unless a claim for refund or credit relating to the gain is filed by the transferor because of the revocation of Rev. Rul. 69-442.

Section 358.—Basis to Distributees

26 CFR 1.358-1: Basis to distributees.

Whether section 358(d) of the Code applies to accounts payable liabilities which could have been deducted under section 162 if paid by a transferor in a section 351 exchange who had utilized the cash receipts and disbursements method of accounting. See Rev. Rul. 80-199, page 11.

Section 482.—Allocation of Income and Deductions Among Taxpayers

26 CFR 1.482-1: Allocation of income and deductions among taxpayers.

Whether the timing of an incorporation transaction under section 351 of the Code may improperly separate income from related expenses such that the Internal Revenue Service can make an allocation between taxpayers so as to match income with expenses. See Rev. Rul. 80-198, page 10.

Section 501.—Exemption from Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Adoption agency; placement of foreign orphans. A nonprofit organization that arranges the placement of orphan children from foreign countries in the homes of adoptive parents in the United States is operated exclusively for charitable purposes.

Rev. Rul. 80-200

ISSUE

Is the nonprofit organization that provides for the placement of orphan children from foreign countries in the manner described below operated exclusively for charitable purposes within the meaning of section 501(c)(3) of the Internal Revenue Code?

FACTS

A nonprofit organization, which otherwise qualifies for exemption under section 501(c)(3) of the Code, was formed for the purpose of arranging for the placement of orphan children living in foreign countries with adoptive parents living in the United States. It receives applications from residents of the United States who desire to adopt a foreign-born orphan child, and conducts an investigation to determine whether the applicants are qualified as adoptive parents. It also locates, by means of its contacts with agencies and institutions in foreign countries, orphan children who are available for adoption in the United States.

The organization makes all the necessary arrangements for and pays the expenses of the child's departure and travel to the United States. It also handles all required administrative and legal proceedings, and it assumes financial responsibility for each child until the adoption proceedings have been completed. Its primary sources of support are fees paid by the adoptive parents and contributions from the general public.

LAW AND ANALYSIS

Section 501(c)(3) of the Code provides for exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense.

The term "charitable," in its generally accepted legal sense, includes the care of orphans.

By arranging for the placement and adoption of orphans the organization is engaged in charitable activities.

HOLDING

An organization that arranges for the placement of orphan children from foreign countries in homes of adoptive parents living in the United States, in the manner described above, is operated exclusively for charitable purposes and is exempt from federal income tax under section 501(c)(3) of the Code.

APPLICATION INSTRUCTIONS

Even though an organization considers itself within the scope of this revenue ruling, it must file an application on Form 1023, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. See sections 1.501(a)-1 and 1.508-1(a) of the regulations. In accordance with the instructions to Form 1023, the application should be filed with the District Director of Internal Revenue for the key district indicated therein.

Section 894.—Income Affected by Treaty

26 CFR 1.894-1: Income affected by treaty.

Whether section 1031 of the Tax Reform Act of 1976, which amended section 904(a) of the Code to provide that the limitation on the foreign tax credit provided in section 901 shall be computed using only the overall method, supersedes the per-country limitation on the foreign tax credit provided in United States income tax treaties. See Rev. Rul. 80-201, below.

Section 901.—Taxes of Foreign Countries and of Possessions of United States

26 CFR 1.901-1: Allowance of credit for taxes.

Whether section 1031 of the Tax Reform Act of 1976, which amended section 904(a) of the Code to provide that the limitation on the foreign tax credit provided in section 901 shall be computed using only the overall method, supersedes the per-country limitation on the foreign tax credit provided in United States income tax treaties. See Rev. Rul. 80-201, below.

Section 904.—Limitation on Credit [Foreign Tax Credit]

26 CFR 1.904-1: Limitation on credit for foreign taxes.
(Also Sections 894, 901, 7852; 1.894-1, 1.901-1.)

Foreign tax credit; limitation; tax treaties. The foreign tax credit per-country limitation provided in United States income tax treaties is superseded for taxable years beginning after 1976 by section 1031 of the Tax Reform Act of 1976, which provides for computation of the limitation using only the overall method.

Rev. Rul. 80-201

ISSUE

Does section 1031 of the Tax Reform Act of 1976, Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 96, which amended section 904(a) of the Internal Revenue Code to provide that the limitation on the foreign tax credit shall be computed using only the overall method, supersede the foreign tax credit per-country limitation provided in United States income tax treaties?

LAW AND ANALYSIS

Subject to certain limitations provided in section 904 of the Code, section 901(b) authorizes qualifying United States taxpayers to claim a foreign tax credit for the amount of any income tax paid or accrued to any foreign country or to any possession of the United States.

Prior to its amendment by the 1976 Act, section 904 of the Code provided for both a per-country and an overall limitation in computing the total amount of allowable foreign tax credit. However, section 1031 of the 1976 Act amended section 904 by repealing the per-country limitation.

The present section 904 is inconsistent with treaties that provide for the per-country limitation by incorporating the foreign tax credit provisions of the Code in force as of dates specified in such treaties and at such time the Code provided for the per-country limitation. *See* Article XV of United States-Republic of Austria Income Tax Convention, 1957-2 C.B. 985, 990.

The present section 904 is not inconsistent with other treaties, such as those treaties that incorporate the foreign tax credit provisions of the Code as it may be amended from time to time or any treaty that provides for a per-country limitation but specifically indicates that changes in United States domestic law which do not eliminate the general principle of the foreign tax credit are not inconsistent with the treaty. *See* Article 20 of the United States-Poland Income Tax Convention, 1977-1 C.B. 416, 423.

Section 7852(d) of the Code provides that no provision of the Code shall apply in any case where its application would be contrary to any treaty obligation in effect on the date of enactment of the 1954 Code. This section indicates, in effect, that a mere inconsistency, without more, between a provision in a tax treaty and an amendment to the Code is not enough by itself to repeal the treaty provision. However, the general provision of section 7852(d) does not prevent Congress from passing legislation that, in effect, overrides a treaty provision.

Article VI, Clause 2 of the United States Constitution provides that both laws of the United States and treaties shall be the supreme law of the land.

Because treaties and acts of Congress are given equal weight by the Constitution as domestic law, Congress has the authority to overrule the effect of a treaty by subsequent legislation. When an act of Congress and a treaty relate to the same subject, the courts will endeavor to construe them so as to give effect to both, if this can be done without violating the language of either. The courts do not favor repudiation of an earlier treaty by implication and require clear indications that Congress, in enacting subsequent inconsistent legislation, meant to supersede the earlier treaty. *Head Money Cases,* 112 U.S. 580, 597-99 (1884); *United States v. Payne,* 264 U.S. 446, 448 (1924); *Menominee Tribe of Indians v. United States,* 391 U.S. 404, 413 (1967). An example of such a clear indication is the presence of subsequent inconsistent legislation together with a committee report indicating that Congress intended such legislation to supersede the earlier treaty. In *Cook v. United States,* 288 U.S. 102 (1933), subsequent inconsistent legislation was held not to supersede an earlier treaty provision because neither the committee reports nor the debates on the subsequent legislation mentioned the earlier treaty.

Not only is section 904, as amended by section 1031 of the 1976 Act, inconsistent wtih the aforementioned treaty provisions, but also the committee reports accompanying section 1031 express congressional intent to supersede those treaty provisions. For example, S. Rep. No. 94-938, 94th Cong., 2d Sess. 237 (1976), 1976-3 C.B. (Vol. 3) 49, 275, in discussing the elimination of the per-country limitation, states:

> It is the committee's intent that all existing treaties are to be applied consistently with this amendment by using the overall limitation in computing the allowable foreign tax credit.[19]

Footnote 19 adds the following:

> The committee further intends that . . . the amendments made by the committee's bill are to be used in computing the credit allowed all treaties.

This same language appears in H.R. Rep. No. 94-658, 94th Cong., 1st Sess. 226 (1976), 1976-3 C.B. (Vol. 2) 918.

These passages indicate a clear Congressional intent to have this amendment in the Act supersede any conflicting foreign tax credit provisions in the treaties. In addition, the reference to "all treaties" in S. Rep. No. 94-938 indicates that Congress intended the repeal of the per-country limitation to be applicable to treaty obligations in effect on the enactment date of the 1954 Code, and thus subject to section 7852(d), as well as to subsequently adopted treaty obligations.

HOLDING

Section 1031 of the 1976 Act supersedes, for taxable years beginning after December 31, 1976, the foreign tax credit per-country limitation provided in United States income tax treaties.

Section 954.—Foreign Base Company Income

26 CFR 1.954-2: Foreign personal holding company income.

T.D. 7704

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Exclusion from subpart F income of certain earnings of insurance companies

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final Income Tax Regulations under section 954(c)(3)(B) and (C) of the Internal Revenue Code of 1954, which provides an exclusion from subpart F income of certain earnings of insurance companies. Changes to the applicable tax law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1]. This document also makes certain related, clarifying changes to the regulations. These regulations provide necessary guidance to the public for compliance with the law and affect under subpart F of the Code each United States shareholder owning the stock of a controlled foreign corporation that is an insurance company.

EFFECTIVE DATE: The regulations are, where indicated, effective for taxable years of controlled foreign corporations beginning after December 31, 1975, and April 23, 1979, and for taxable years of United States shareholders whose taxable years end with or within those taxable years of the controlled foreign corporations.

FOR FURTHER INFORMATION CONTACT: Donald K. Duffy, of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3458.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On April 23, 1979, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 954(c)(3) of the Internal Revenue Code of 1954 (44 FR 23883). The amendments were proposed to conform the regulations to section 1023 of the Tax Reform Act of 1976 (Pub. L. 94-455, 90 Stat. 1620) and to clarify existing regulations under section 954(c)(3)(B). A public hearing was not held since none was requested. After consideration of all relevant matters presented by interested persons regarding the proposed amendments, this Treasury decision adopts the amendments to the Income Tax Regulations set forth in this document.

DESCRIPTION OF REGULATIONS

Section 954(c)(3)(B) provides, in pertinent part, that foreign personal holding company income under subpart F does not include certain dividends, interest, and gains derived from investments made by a controlled foreign corporation which is an insurance company of its unearned premiums or reserves which are ordinary and necessary for the proper conduct of its insurance business. Income eligible for this exclusion must be received from a person other than a related person. Existing regulations under § 1.954-2(d)(3) fail to establish a rule for computation of the amount of the exclusion. Section 1.954-2(d)(3) as amended by this document corrects this omission and in effect provides that the maximum amount excludable is limited to a portion of eligible income derived from investment of that proportionate amount of a controlled foreign corporation's assets which is equal to its unearned premiums and reserves. The amendment defines eligible income as dividends, interest, and the excess of gains over losses from sales or exchanges of stock or securities, other than amounts taxed to United States shareholders under section 952(a)(1), relating to income derived from the insurance of United States risks, and other than amounts received from related persons.

Section 1.954-2(d)(4) of the amendments with respect to section 954(c)(3)(C) reflects the enactment of section 1023 of the Tax Reform Act of 1976, which added an exclusion from foreign personal holding company income. This added exclusion parallels in many respects the exclusion under section 954(c)(3)(B) and § 1.954-2(d)(3). However, the maximum amount excludable is limited in effect to a portion of eligible income derived from investment of that proportionate amount of a controlled foreign corporation's assets which is equal to one-third of premiums earned on casualty insurance contracts which are not directly or indirectly attributable to the insurance or reinsurance of risks of related persons. Section 1.954-2(d)(4) of the proposed amendments defined eligible income as it was defined in proposed § 1.954-2(d)(3) reduced, however, by the income excluded under section 954(c)(3)(B) and § 1.954-2(d)(3).

COMMENTS FROM THE PUBLIC

Comments from the public questioned the methods for computing the exclusions under § 1.954-2(d)(3) and (4). Suggestions were made that if eligible income is defined in a way which does not take into account certain dividends, interest, and the excess of gains over losses from the sale or exchange of stock or securities, then a portion of the assets attributable to ineligible income should likewise not be taken into account in any exclusion formula. This suggestion fails to recognize that a portion of the unearned premiums or reserves under paragraph (d)(3) of § 1.954-2 and a portion of the one-third of earned premiums under paragraph (d)(4) of § 1.954-2, as the case may be, would also not be taken into account in any exclusion formula. The final regulations adopted by this document reflect the fact that a portion of a foreign insurance company's assets equal to its unearned premiums or reserves under section 954(c)(3)(B), or its earned premiums under section 954(c)(3)(C), is invested in assets which give rise to income which is either taken into account as subpart F income under other provisions (and hence is not taken into account under section 954(c)) or is not eligible for the exclusion from foreign personal holding company income under section 954(3)(B) or (C).

Some comments also suggested that the assets used in the exclusion formula under § 1.954-2(d)(3) and (4) should include only those assets which actually produce income. The final regulations adopt this suggestion.

The definition of the term "eligible income" under § 1.954-2(d)(4)(ii) of the proposed amendments is revised in response to comments. The final regulations define this term as it is defined in § 1.954-2(d)(3)(iv).

In response to other comments, the determination of the amount of the exclusion under § 1.954-2(d)(3) applies only for taxable years of controlled foreign corporations beginning after April 23, 1979. For taxable years beginning before that date, any reasonable method will be recognized.

Evaluation of the effectiveness of these regulations after issuance will be based upon comments received from the public and from offices within the Department of the Treasury and the Internal Revenue Service.

DRAFTING INFORMATION

The principal author of these regulations is Donald K. Duffy, of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

After consideration of all relevant matters presented by interested persons regarding the proposed amendments to the regulations under section 954(c)(3), the following amendments to the regulations are hereby adopted:

Section 1.954-2 is amended by revising paragraph (d)(3)(i), by adding new subdivisions (iii), (iv), and (v) to paragraph (d)(3), and by adding a new subparagraph (4) to paragraph (d). These revised and added provisions read as set forth below:

§ 1.954-2 Foreign personal holding company income.

* * * * *

(d) *Certain income received from unrelated persons in the active conduct of a trade or business.* * * *

(3) *Dividends, interest, and gains on securities derived by insurance companies from investments of unearned premiums or reserves*—(i) *In general.* Foreign personal holding company income of a controlled foreign corpora-

tion which is an insurance company does not include certain income, determined under subdivision (iii) of this paragraph (d)(3), derived from investments made by the company of its unearned premiums or reserves which are ordinary and necessary for the proper conduct of its insurance business. Although the name, charter powers and subjection to the insurance laws of a foreign country are significant in determining the business which a controlled foreign corporation is authorized and intends to carry on, the character of the business actually done in the taxable year determines whether it is an insurance company for purposes of section 954(c)(3)(B). The term "unearned premium," as used in this paragraph (d)(3), means the amount which will cover the cost of carrying the insurance risk for the period for which the premium has been paid in advance.

* * * * *

(iii) *Amount of exclusion.* The maximum amount eligible for the exclusion under section 954(c)(3)(B) and subdivision (i) of this paragraph (d)(3) is an amount equal to the eligible income (as defined in subdivision (iv) of this paragraph (d)(3)) of a controlled foreign corporation which is an insurance company multiplied by a fraction. The numerator of the fraction is the mean of the corporation's unearned premiums or reserves described in subdivision (ii) of this paragraph (d)(3) at the beginning and end of its taxable year. The denominator of the fraction is the mean of the reserve assets held by the corporation at the beginning and end of its taxable year. Reserve assets are assets which may give rise to foreign personal holding company income described in section 954(c)(1) (without regard to modifications and adjustments under section 954(c)(3) and (4)). The amount of reserve assets attributable to real property and stock is determined on the basis of their fair market value. Any other reserve assets are taken into account on the basis of their adjusted basis for purposes of determining gain on their sale, exchange, or other disposition.

(iv) *Eligible income.* Eligible income equals the total amount of the dividends, interest, and the excess of gains over losses from sales or exchanges of stock or securities, reduced by the following amounts:

(A) The dividends, interest, and the excess of gains over losses described in this paragraph (d)(3)(iv) which are taxed under section 952(a)(1). See section 953 and § 1.953-1(a). This reduction is apportioned ratably between dividends and interest received from, and the excess of gains over losses from sales or exchanges to or with, related and unrelated persons (as defined in § 1.954-1(e)); and

(B) The dividends, interest, and the excess of gains over losses described in this paragraph (d)(3)(iv) which are received from, or derived from sales or exchanges to or with, related persons (as defined in § 1.954-1(e)(1)). The amount of the income described in this paragraph (d)(3)(iv)(B) which is received or derived from related persons does not include income described in subdivision (iv)(A) of this paragraph (d)(3) which is considered to be received or derived from related persons.

(v) *Effective date.* Subdivisions (iii) and (iv) of this paragraph (d)(3) apply to taxable years of controlled foreign corporations beginning after April 23, 1979, and for taxable years of United States shareholders whose taxable years end with or within those taxable years of the controlled foreign corporations. For taxable years of a controlled foreign corporation beginning before April 24, 1979, the amount of the exclusion under this paragraph (d)(3) may be determined under any reasonable method.

(4) *Dividends, interest, and gains on securities derived by insurance companies from investments of earned premiums*—(i) *In general.* Foreign personal holding company income of a controlled foreign corporation which is an insurance company does not include certain income, determined under subdivision (ii) of this paragraph (d)(4), derived from investments made by the corporation of an amount of its assets equal to one-third of certain of its earned premiums. For purposes of determining whether a controlled foreign corporation is an insurance company, see paragraph (d)(3)(i) of this section. This paragraph (d)(4) applies to taxable years of controlled foreign corporations beginning after December 31, 1975, and for taxable years of United States shareholders whose taxable years end with or within those taxable years of the controlled foreign corporations.

(ii) *Amount of exclusion.* The maximum amount eligible for the exclusion under section 954(c)(3)(C) and subdivision (i) of this paragraph (d)(4) is determined in the same manner, and with respect to the same amounts, as described in paragraph (d)(3)(iii) of this section with the following exception. The numerator of the fraction described in paragraph (d)(3)(iii) of this section is an amount equal to one-third of earned premiums. Subdivision (iii) of this paragraph (d)(4) defines the term "earned premiums."

(iii) *Earned premiums.* Earned premiums are premiums earned on insurance contracts (other than life insurance and annuity contracts) during the taxable year and which are described in section 832(b)(4), other than premiums which are directly or indirectly attributable to the insurance or reinsurance of risks of related persons (as defined in § 1.954-1(e)(1)). In determining whether premiums are directly or indirectly so attributable, see subdivision (iv) of this paragraph (d)(4).

(iv) *Insurance or reinsurance of risks of related persons.* A premium is directly or indirectly attributable to the insurance or reinsurance of a risk of a related person if the premium is derived by an insurance company from the assumption or sharing of the risk of a related person upon an insurance or reinsurance policy issued to or by the related person or from an arrangement by which all or part of the policy risk of a related person is in effect transferred directly or indirectly through an unrelated person to the insurance company. If an insurance company participates in an insurance or reinsurance pool, whether there is joint liability on the risk with a related person is not determinative of whether the insurance company insured or reinsured the risk of a related person. If a premium is attributable in part to the insurance or reinsurance of a risk of a related person, and in part to other risks, the amount of the premium is apportioned on a reasonable basis.

* * * * *

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved June 4, 1980.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on June 24, 1980, 8:45 a.m., and published in the issue of the Federal Register for June 25, 1980, 45 F.R. 42606)

Section 1012.—Basis of Property —Cost

26 CFR 1.1012-1: Basis of property.

Treatment of a transfer of corporate stock by controlling shareholders to employees of the corporation. See Rev. Rul. 80-196, page 7.

Section 2031.—Definition of Gross Estate

26 CFR 20.2031-1: Definition of gross estate; valuation of property.

The valuation of closely held business. See Rev. Rul. 80-202, this page.

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26 CFR 20.2031-3: Valuation of interests in businesses.

Whether the value of a closely held business is the value of its assets or the net amount a willing purchaser would pay to a willing seller for the business. See Rev. Rul. 80-202, this page.

Section 2511.—Transfers in General

26 CFR 25.2511-1: Transfers in general.

The gift tax consequences of transfers of stock of a corporation to employees of the corporation by controlling shareholders. See Rev. Rul. 80-196, page 7.

Section 2512.—Valuation of Gifts

26 CFR 25.2512-8: Transfers for insufficient consideration.

The gift tax consequences of transfers of stock of a corporation to employees of the corporation by controlling shareholders. See Rev. Rul. 80-196, page 7.

Section 6166.—Alternate Extension of Time for Payment of Estate Tax Where Estate Consists Largely of Interest in Closely Held Business

The value of a decedent's interest as a proprietor in a trade or business carried on as a proprietorship. See Rev. Rul. 80-202, below.

Section 6166A.—Extension of Time for Payment of Estate Tax Where Estate Consists Largely of Interest in Closely Held Business

26 CFR 20.6166-1: Extension of time for payment of estate tax where estate consists largely of interest in closely held business. (Also Sections 2031, 6166; 20.2031-1, 20.2031-3.)

Installment payments; closely held business; valuation. In computing the limitation on the amount of estate tax that may be paid in installments under section 6166A of the Code, the value of a decedent's interest as a proprietor in a trade or business carried on as a proprietorship is the net amount a willing purchaser would pay for the interest to a willing seller.

Rev. Rul. 80-202

ISSUE

How should the value of a decedent's interest as a proprietor in a trade or business carried on as a proprietorship be computed for purposes of determining the limitation on the amount of estate tax that may be paid in installments under section 6166A of the Internal Revenue Code?

LAW AND ANALYSIS

Section 6166A(a) of the Code provides for the payment of estate tax in installments if the value of an interest in a closely held business that is included in determining the gross estate exceeds either (1) 35 percent of the value of the gross estate, or (2) 50 percent of the taxable estate. This provision specifies that value for purposes of applying section 6166A shall be value determined for federal estate tax purposes.

Section 6166A(b) of the Code provides that the amount of tax that may be paid in installments shall be an amount that bears the same ratio to the estate tax imposed by section 2001 (reduced by credits against such tax) as the value of the interest in a closely held business that qualifies for the election to pay the tax in installments bears to the value of the gross estate.

Section 6166A(c)(1) of the Code provides that the term "interest in a closely held business" includes an interest as a proprietor in a trade or business carried on as a proprietorship.

Section 20.2031-1(b) of the Estate Tax Regulations provides that the value of every item of property includible in a decedent's gross estate is its fair market value at the time of the decedent's death.

Section 20.2031-3 of the regulations provides that the fair market value of any interest of a decedent in a proprietorship is the net amount a willing purchaser would pay for the interest to a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of the relevant facts.

For estate tax purposes, the fair market value of a decedent's interest as a proprietor in a trade or business carried on as a proprietorship is the net amount a purchaser would pay for the interest to a seller. The value of the gross estate includes only such net amount and not the total value of the assets of the proprietorship.

HOLDING

In computing the limitation on the amount of estate tax that may be paid in installments under section 6166A of the Code, the value of a decedent's interest as a proprietor in a trade or business carried on as a proprietorship is the net amount a willing purchaser would pay for the interest to a willing seller.

The above conclusion also applies to section 6166 of the Code.

Section 6302.—Mode or Time of Collection

26 CFR 31.6302(c)-1: Use of government depositaries in connection with taxes under Federal Insurance Contributions Act and income tax withheld.

Procedures under which qualifying agents may request permission to prepare federal tax deposit cards instead of using the pre-punched cards provided by the Treasury Department. See Rev. Proc. 80-31, page 20.

26 CFR 31.6302(c)-3: Use of government depositaries in connection with tax under the Federal Unemployment Tax Act.

Procedures under which qualifying agents may request permission to prepare federal tax deposit cards instead of using the pre-punched cards provided by the Treasury Department. See Rev. Proc. 80-31, page 20.

Section 7805.—Rules and Regulations

26 CFR 301.7805-1: Rules and regulations.

Whether the revocation of Rev. Rul. 69-442, relating to the application of sections 357(c) and 358(d) of the Code to deductible accounts payable liabilities should be applied retroactively or prospectively only. See Rev. Rul. 80-199, page 11.

Section 7852.—Other Applicable Rules

Whether section 1031 of the Tax Reform Act of 1976, which amended section 904(a) of the Code to provide that the limitation on the foreign tax credit provided in section 901 shall be computed using only the overall method, supersedes the per-country limitation on the foreign tax credit provided in United States income tax treaties. See Rev. Rul. 80-201, page 14.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.602: Forms and instructions. (Also Part I, Section 6302; 31.6302(c)-1, 31.6302(c)-3.)

Rev. Proc. 80-31

Section 1. Purpose

.01 The purpose of this revenue procedure is to outline the requirements and instructions for reporting agents who perform a payroll service and who, in connection with this service, submit employment federal tax deposit payments for their clients. These payments are described in the Employment Tax Regulations (26 CFR Part 31) under section 6302 of the Internal Revenue Code. All federal tax deposit payments are required to be deposited through a qualified federal tax depositary, as defined in 31 CFR Part 203. Each payment must be accompanied by the appropriate federal tax deposit card.

.02 Under the provisions of this revenue procedure, qualifying agents may request permission to prepare federal tax deposit cards instead of using the prepunched cards provided by the Treasury Department. These agent-prepared federal tax deposit cards must accompany the payments of clients who have been approved under this program. Authorization will extend only to those agents who have a minimum of 500 clients and who satisfy all the requirements of this revenue procedure.

Sec. 2. Background

.01 The Treasury Department furnishes federal tax deposit cards to those taxpayers who can reasonably be expected to make tax deposits. These cards are prepunched and preprinted with essential identifying information for processing the payment data to the appropriate tax account. Many payroll and tax preparation businesses have not had the prepunched deposit cards for making the required tax deposits, and, in most instances, this occurred because the agent had not requested that the client forward the deposit cards furnished by the Treasury Department. Some of these reporting agents have mailed deposits directly to an Internal Revenue Service office when the deposit cards were not available to them. This practice is not in conformity with the Employment Tax Regulations.

.02 Authorization for preparing Form FTD 501, Federal Tax Deposit, Withheld Income and FICA Taxes (FTDs), first appeared in Rev. Proc. 75-12, 1975-1 C.B. 653. The authority to prepare federal tax deposit cards is no longer dependent on the authority to file Form 941, Employer's Quarterly Federal Tax Return, on magnetic tape.

Sec. 3. FTD Payments Submitted by Reporting Agents

.01 All federal tax deposit cards prepared by an authorized agent must be submitted with payment to a qualified federal tax depositary. The only acceptable agent-prepared deposit cards are those relating to Forms 941, 940, and 943. Form 501 is used to report a deposit for withheld income and FICA taxes (Form 941). Deposit Form 508 is used to report a deposit for unemployment taxes (Form 940). Deposit Form 511 is used to report a deposit for agricultural FICA taxes and voluntarily withheld income tax (Form 943).

.02 Authorized agents will be furnished a supply of blank FTD cards. The same type of card is used for all three taxes. The agent will identify the type of tax by a tax class code punched in column 19 of the card.

.03 Deposits for other taxes and for clients who have not been accepted under this program must be made to a depositary by means of the prepunched cards provided by the Treasury Department. Reporting agents authorized under this program who mail payments directly to an Internal Revenue Service office will have their remittances returned to them under instructions that they obtain the appropriate deposit cards from their client and that they submit the same through a qualified federal tax depositary, as required. Taxpayers whose payments are returned to their reporting agent may be subject to appropriate penalty and interest charges. Unless the client delivers the prepunched cards to them, reporting agents should not assume the responsibility of making tax deposits on behalf of a client as to any deposit that may become due before the client is actually under this program.

.04 Agent-prepared FTD cards must be submitted to a qualified depositary separate from the prepunched deposit cards which were mailed to the taxpayer by the Treasury Department.

Sec. 4. Application to Prepare FTD Cards

.01 Agents who wish to prepare federal tax deposit cards must first file a letter of application with the Director of the Internal Revenue Service Center where the deposits will be processed. In most cases this will be the same service center that processes the related tax forms. See Exhibit 1 for a list of service centers and their respective addresses.

The letter of application should include all the following information:

1 The full name, address, and employer identification number of the firm making the application. If the reporting agent will prepare deposit cards at more than one branch or location, each location must be identified in the letter of application, or each location must submit an individual letter of application.

2 The name, title, and telephone number of a person the Service can contact regarding the application. In most cases, any problem with the letter of application can be resolved by telephone and this will expedite processing by the service center.

3 The name, address, employer identification number, Federal Reserve Bank code, bank identification number/check digit code, and the branch code of the federal tax depositary which will forward the agent-prepared deposit cards to the Service. Prior to submitting the letter of application, the reporting agent must have an agreement with a depositary that the depositary will accept the agent-prepared FTDs and will submit them under a

transmittal separate from Treasury Deprtment prepunched FTDs.

4 A listing of the taxpayers who will have their federal tax deposit cards prepared by the reporting agent. See Section 5 for the information required on this listing. See Exhibit 2 for an example of a list of clients.

5 A power of attorney for each taxpayer on the listing. See Section 6 for information concerning the power of attorney. See Exhibit 3 for an example of a properly prepared power of attorney.

6 A statement of the approximate number of deposit cards the agent expects to prepare during the first six months after approval. The Service will issue a six-month supply of blank deposit cards with the authorization letter.

.02 Applications containing a listing of less than 500 clients will be denied. If an agent has previously been preparing federal tax deposit cards under the provisions of Rev. Proc. 75-12 before supercession by Rev. Proc. 79-15, 1979-1 C.B. 498, the agent is exempt from this qualification.

Sec. 5. Listing of Clients

.01 Each letter of application must include a listing of the taxpayers who will have their federal tax deposits prepared by the reporting agent. The listing must include each taxpayer's complete business name, address (including ZIP code), employer identification number, and an account number not exceeding five digits assigned to the client by the agent. For each client, the listing must specify the types of taxes for which deposit cards will be prepared.

.02 The listing must be double spaced to allow room for notations by the service center. The clients must be listed in account number sequence. A duplicate listing must be submitted so that the Service can maintain a file of taxpayers accepted under this program. See Section 8 for updates to the initial listing of clients. See Exhibit 2 for an example of the way the listing should be submitted.

Sec. 6. Power of Attorney

.01 A power of attorney must be submitted for each client on the listing. The power of attorney may be submitted on Form 2848, Power of Attorney, which is available on request. A sample power of attorney is set forth in Exhibit 3. If this form is not used, the power of attorney must clearly state that the reporting agent is granted the authority to prepare and submit federal tax deposits for the applicable tax forms. The power of attorney must be signed by the taxpayer and the reporting agent.

.02 If a power of attorney is already on file for full tax reporting, it is not necessary to execute a new agreement. If a power of attorney is already on file for magnetic tape filing of Form 941, it does not need to be revoked. However, a new power of attorney must be submitted to cover any federal tax deposits not already covered.

.03 The power of attorney for agent-prepared FTDs will be a limited power of attorney. Notices, refunds, tax forms, and other output will be mailed to the taxpayer. Requests from a reporting agent for information or adjustments on an account will be honored by the service center only to the extent covered by the power of attorney.

.04 Requests for taxpayer name and address changes may not be made by a reporting agent with a limited power of attorney. The only requests that will be honored will be those originating from the taxpayer or an attorney-in-fact if the attorney has a full power of attorney for all tax matters concerning a taxpayer and has filed a copy of the full power of attorney with the Internal Revenue Service Center.

.05 The reporting agent must keep copies of the power of attorney on file at the agent's principal place of business for examination by the Internal Revenue Service upon request. If the power of attorney includes the authority to sign and file tax returns, it must be retained until the statute of limitations for the last return filed under its authority expires.

.06 The power of attorney will remain in effect until such time as it is revoked by the taxpayer, terminated by written notification by the reporting agent, or expires under its own terms.

.07 The power of attorney is automatically revoked when the reporting agent notifies the Service that the taxpayer will no longer have FTDs submitted by the agent. It is also automatically revoked when the Service notifies the reporting agent that the requirements of this revenue procedure have not been adhered to and the Service will no longer accept the agent-prepared FTDs from that agent.

.08 Any time a power of attorney has been terminated or revoked, a new power of attorney will be required if a client re-enters this program. The new power of attorney must be signed and dated subsequent to the revocation.

Sec. 7. Acceptance of Agent's Application

.01 The Service will process each letter of application within thirty days of receipt. The authorization letter will include a three-digit identifying number which the Service will assign to the reporting agent. If the reporting agent will prepare deposit cards at more than one location or branch, each location or branch will be assigned a separate identifying number. After an agent has been assigned an identifying number, all communication regarding the preparation of federal tax deposit cards should include this number. Updates to the agent's listing of clients must always contain the identifying number of the location or branch handling the particular client's records. The agent-identifying number must be punched in card columns 72-74 of the agent-prepared deposit cards.

.02 One copy of the listing of the reporting agent's clients will be returned with the authorization letter. The Service will verify each client's employer identification number and will provide the client's name control which must be punched in card columns 13-16 of the deposit cards. An Internal Revenue Service district office code will be written in for each taxpayer and must be punched in card columns 17 and 18. If there is a discrepancy, the Service will also provide the business name as it is maintained on record with the Service. Corrections will be indicated by a line through the agent's information with the corrected information written above.

.03 Reporting agents must not change the validated employer identification number, name control, or district office code except when notified to do so by the Internal Revenue Service.

.04 All discrepancies in taxpayer filing requirements will be resolved by telephone if a contact is established in the letter of application. If, for any reason, a particular taxpayer whose name is recited on the agent's list is not accepted by the Service under this program, the name of the taxpayer will be circled out and the reason for non-acceptance will be stated in the acceptance letter.

.05 Based on the request by the reporting agent in the letter of application, the Service will issue a six-month supply of blank deposit cards with the acceptance letter. Orders of additional blank cards should be made by the reporting agent to the FTD Coordinator at the appropriate service center. Requests for more cards should be made at least thirty days before the expected depletion of the stock each agent has on hand. Reporting agents are cautioned that blank federal tax deposit cards are intended only for clients accepted under this program. Misuse of this privilege will be cause for disqualification of the agent.

SEC. 8. UPDATES TO THE AGENT'S LIST OF CLIENTS

.01 After acceptance of the reporting agent's initial list of clients, all additions and deletions must be reported to the service center immediately. New clients may not be included in the preparation of federal tax deposits by a reporting agent until they are accepted and the entity information (EIN, name control, district office code, and filing requirements) is validated and provided by the Service. If the reporting agent chooses to make federal tax deposits for a new client prior to being accepted, the agent must use the Treasury Department prepunched deposit cards and deposit the payment with a qualified depositary separate from the agent-prepared deposit cards.

.02 The Internal Revenue Service will process the agent's update listing within two weeks of receipt. The update listing should be in the same format as the initial listing, with the additions preceding and on a separate page from the deletions. Two copies of this listing should be submitted to enable the Service to maintain a file copy. The service center will process the additions on an expedite basis and in the same manner as the initial listing. Deletions will be acknowledged to the reporting agent.

.03 Once a client has been deleted under this program, the reporting agent may not request to re-enter that client until the next quarter. For example, if a client is deleted in the first quarter of the year (Jan., Feb., Mar.), the client may not be added back onto the accepted list of clients until the second quarter of the year (Apr., May, June). A new power of attorney must be submitted when the request to reenter the program is sent to the Service.

.04 Once each six months, the reporting agent must send a consolidated listing of their clients currently accepted by the Service. The consolidated listing is for information only and will not be returned to the agent. If no clients have been added or deleted during a six-month period, it is not necessary to submit this listing.

SEC. 9. PREPARATION OF THE DEPOSIT CARDS

.01 Keypunch instructions for agent-prepared federal tax deposits are included in this revenue procedure as Exhibit 4. The deposit cards must be interpreted across the top of the card. If the agent uses card columns 1-3 for internal control, interpretation of these three card columns should be suppressed, if possible. All other fields may be interpreted immediately above the punches, or each field may be separated by a single space. An uninterpreted card should never be included in the agent's shipment of deposit cards.

.02 The employer identification number, name control, and district office code fields must be punched with the information provided and verified by the Service. No change should be made to this information for a particular client unless the Service notifies the reporting agent to do so.

.03 The tax class field must be either a "1" for a Form 501 deposit (Form 941), a "6" for a Form 511 deposit (Form 943), or an "8" for a Form 508 deposit (Form 940).

.04 The tax period ending field must always contain the month in card column 20 and the year in card column 21. The month will be either a "3" for March, a "6" for June, a "9" for September, or a "12 (&) punch" for December. If the deposit is a Form 501 deposit (Form 941), the month will be either a "3", "6", "9", or "12" (&) punch". If the deposit is a Form 511 deposit (Form 943) or a Form 508 deposit (Form 940), the month will always be a "12 (&) punch". The year will always be the last position of the tax period year (8 = 1978, 9 = 1979, 0 = 1980, etc.).

.05 The payment date must always be punched in card columns 26-29. Punch the month (01-12) in card columns 26-27 and the day (01-31) in card columns 28-29. It is essential that the payment date punched in this field be the same date the depositary receives payment for the deposit and date stamps the deposit card.

.06 The payment amount must be punched unedited and right-justified in card columns 30-38. If the amount exceeds 9 digits or if the payment amount is changed prior to submission, the corrected money amount should be punched unedited and right-justified in card columns 39-50. If not, leave card columns 39-50 blank.

.07 The three-digit agent-identifying number must be punched in card columns 72-74. The agent's account number assigned to the client must be punched in card columns 76-80.

SEC. 10. SUBMISSION OF AGENT-PREPARED FEDERAL TAX DEPOSITS

.01 After all applicable deposit cards are punched and interpreted, the cards should be grouped and delivered with the appropriate payment to the qualified depositary specified in the agent's letter of application. It is required that the reporting agent deliver the deposit cards early in the day so that the depositary can date stamp each card and prepare transmittals on the same day as the payment date punched in card columns 26-29 of the deposit cards. The deposit cards should be in groups of 100 cards with a machine listing of each deposit amount and a total for each group. The depositary will prepare the transmittals and ship the deposit cards to the appropriate service center.

.02 If the reporting agent is a bank business service and is authorized by the bank to prepare the transmittals (Form 2284, Advice of Credit), the agent-prepared federal tax deposits must be boxed separately from the prepunched cards. The group of agent-prepared FTDs must be diagonally red-striped with a felt pen across the tops of the cards and the boxes must clearly indicate that the FTDs are prepunched agent-prepared FTDs. The boxes must be marked for the attention of the FTD Inter-agency Coordinator at the appropriate service center. See Exhibit 1 for the service center addresses.

SEC. 11. TERMINATION OF THIS AUTHORIZATION

The Service reserves the right to terminate this agreement with reporting agents because of possible systemic changes which may preclude the use of punched cards. If the reporting agent cannot modify processing to accommodate these changes, the agreement may be terminated with sixty days notice.

EXHIBIT 1

Requests for additional copies of this Revenue Procedure, applications to prepare Federal tax deposits, update listings of authorized clients, and requests for additional blank cards should be addressed to the Director, Internal Revenue Service Center, Attn: FTD Coordinator, at one of the following addresses:

1. NORTH-ATLANTIC REGION

(a) Andover Service Center
P.O. Box 311
Andover, MA 01810

(b) Brookhaevn Service Center
P.O. Box 400
Holtsville, NY 11742

2. MID-ATLANTIC REGION

Philadelphia Service Center
P.O. Box 245
Cornwells Heights, PA 19020

3. CENTRAL REGION

Cincinnati Service Center
P.O. Box 267
Covington, KY 41012

4. SOUTHEAST REGION

(a) Atlanta Service Center
P.O. Box 47421
Doraville, GA 30340

(b) Memphis Service Center
P.O. Box 30309
Airport Mail Facility
Memphis, TN 38130

5. MIDWEST REGION

Kansas City Service Center
P.O. Box 5321
Kansas City, MO 64131

6. SOUTHWEST REGION

Austin Service Center
P.O. Box 934
Austin, TX 78767

7. WESTERN REGION

(a) Ogden Service Center
P.O. Box 9941
Ogden, UT 84409

(b) Fresno Service Center
P.O. Box 12866
Fresno, CA 93779

Shipments of agent-prepared Federal tax deposit cards should be addressed to the Director, Internal Revenue Service Center, Attn: Interagency Coordinator, at one of the following addresses:

1. NORTH-ATLANTIC REGION

(a) Andover Service Center
P.O. Box 540
Andover, MA 01810

(b) Brookhaven Service Center
P.O. Box 950
Holtsville, NY 11742

2. MID-ATLANTIC REGION

Philadelphia Service Center
P.O. Box 6075
Philadelphia, PA 19114

3. CENTRAL REGION

Cincinnati Service Center
P.O. Box 1488
Cincinnati, OH 45201

4. SOUTHWEST REGION

(a) Atlanta Service Center
P.O. Box 47272
Doraville, GA 30362

(b) Memphis Service Center
P.O. Box 2500
Memphis, TN 38101

5. MIDWEST REGION

Kansas City Service Center
P.O. Box 337
Kansas City, MO 64141

6. SOUTHWEST REGION

Austin Service Center
P.O. Box 443
Austin, TX 78767

7. WESTERN REGION

(a) Ogden Service Center
1160 W. 1200 Street
Ogden, UT 84201

(b) Fresno Service Center
P.O. Box 12147
Fresno, CA 93776

EXHIBIT 2

Agent Identifying Number: (assigned by IRS)
Agent EIN:
Type of List: (additions, deletions, consolidations)

DATE OF LIST:
Name of Reporting Agent:
Address of Reporting Agent:

Client Account #	EIN	Name Control	D.O. Code	Client Business Name and Address	Type of Tax		
					941	940	943
01234	11-1111111			Blossom Corp. 16 Tulip Blvd. Flower, CA 91111	X	X	
01235	99-9999999			Animal Farm Rural Rt. 1 Orwell, CA 93333			X

1. Heading data may be positioned differently but should contain ALL requested information.
2. Sort by account number assigned to client by agent.
3. Leave Name Control and D.O. Fields blank—these will be entered by IRS.
4. Double-space between entries of clients.
5. Indicate the type of tax in the appropriate column.

EXHIBIT 3

Form **2848**
(Rev. July 1976)
Department of the Treasury
Internal Revenue Service

Power of Attorney

(See the separate Instructions for Forms 2848 and 2848–D.)

Name, identifying number, and address including ZIP code of taxpayer(s)

Client's name and address

hereby appoints (Name, address including ZIP code, and telephone number of appointee(s)) (See Treasury Department Circular No. 230 as amended (31 C.F.R. Part 10), Regulations Governing the Practice of Attorneys, Certified Public Accountants, and Enrolled Agents before the Internal Revenue Service, for persons recognized to practice before the Internal Revenue Service.)

Reporting agent's name and address

as attorney(s)-in-fact to represent the taxpayer(s) before any office of the Internal Revenue Service for the following Internal Revenue tax matters (specify the type(s) of tax and year(s) or period(s) (date of death if estate tax)):

The preparation and submission of federal tax deposit Forms 501, 508, and/or 511 (specify applicable form numbers) and the remittance of federal tax deposit payments to accompany such forms.

The attorney(s)-in-fact (or either of them) are authorized, subject to revocation, to receive confidential information and to perform on behalf of the taxpayer(s) the following acts for the above tax matters:

(Strike through any of the following which are not granted.)

~~To receive, but not to endorse and collect, checks in payment of any refund of Internal Revenue taxes, penalties, or interest. (See "Refund checks" on page 2 of the separate instructions.)~~

~~To execute waivers (including offers of waivers) of restrictions on assessment or collection of deficiencies in tax and waivers of notice of disallowance of a claim for credit or refund.~~

~~To execute consents extending the statutory period for assessment or collection of taxes.~~

~~To execute closing agreements under section 7121 of the Internal Revenue Code.~~

~~To delegate authority or to substitute another represantative.~~

Other acts (specify) to receive information concerning Forms 941, 940 and/or 943 acct.

Send copies of notices and other written communications addressed to the taxpayer(s) in proceedings involving the above matters to (Name, address including ZIP code, and telephone number):

and

This power of attorney revokes all earlier powers of attorney and tax information authorizations on file with the same Internal Revenue Service office for the same matters and years or periods covered by this form, except the following:

(Specify to whom granted, date, and address including ZIP code, or refer to attached copies of earlier powers and authorizations.)

Signature of or for taxpayer(s)

If signed by a corporate officer, partner, or fiduciary on behalf of the taxpayer, I certify that I have the authority to execute this power of attorney on behalf of the taxpayer.

(Signature) (Title, if applicable) (Date)

(Signature) (Title, if applicable) (Date)

(The applicable portion of the back page must also be completed.)

Form **2848** (Rev. 7–76)

EXHIBIT 4

KEYPUNCH INSTRUCTIONS FOR AGENT-PREPARED FEDERAL TAX DEPOSITS

Card Column	Description
1–3	Blank (may be used by agent for internal control)
4–12	Employer Identification Number—9 numerics (verified by IRS)
13–16	Name control (provided by IRS)
17–18	District office code—2 numerics (provided by IRS)
19	Tax class—1 numeric 1 = 941 (Withheld Income and FICA taxes) 8 = 940 (Unemployment taxes) 6 = 943 (Agricultural FICA and Voluntarily Withheld Income taxes)
20–21	Tax Period Ending (MY) M = month = 3, 6, 9, or & (12 punch) Y = year = units position of year NOTE: If the tax class is "1", the month must be a 3, 6, 9, or & (12 punch) If the tax class is "6" or "8", the month must be a & (12 punch) EXAMPLES: 38 = March 1978 68 = June 1978 98 = September 1978 &8 = December 1978
22–25	Blank (not available for agent use)
26–29	Payment date (MMDD)—4 numerics MM = month = 01–12 DD = day = 01–31
30–38	Payment amount field—9 numerics (do not edit—right justify)
39–50	Alternate amount field—12 numerics or blank (Do not use unless amount exceeds 9 digits or amount in cc 30–38 is being corrected. Do not edit—right justify)
51–71	Blank (not available for agent use)
72–74	Agent identifying number assigned by IRS
75	Blank
76–80	Account number assigned to taxpayer by agent—left justify

Part IV. Items of General Interest

Treatment of Gain from Disposition of Certain Oil, Gas, or Geothermal Property—Public Hearing

Announcement 80-93 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to the tax treatment of gain from the disposition of certain oil, gas, or geothermal property.

DATES: The public hearing will be held on September 9, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by August 11, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-276-76), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under sections 170, 301, 312, 341, 453, 751, 1254, and 1502 of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Wednesday, June 11, 1980, at page 39512 (45 FR 39512).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of the comments to be presented at the hearing and the time they wish to devote to each subject by August 11, 1980. Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive appearing in the Federal Register for Wednesday, November 8, 1978.

By direction of the Commissioner of Internal Revenue.

Overseas Employees of Charitable Organizations

Announcement 80-94 [1]

Overseas employees of charitable organizations, as defined in section 501(c)(3) of the Internal Revenue Code, who resided in a lesser developed country while employed by such organizations during any part of their 1979 taxable years will have until October 15, 1980, to file their 1979 income tax returns. This extension is granted to those taxpayers who, under legislation reported by the Senate Finance Committee, would be allowed to elect an income exclusion of up to $20,000 under section 911 in lieu of the deduction provided for excess foreign living costs under section 913.

In order to qualify for this extension, taxpayers must qualify for the exclusion election, and either be residing or traveling outside the United States and Puerto Rico on April 15, 1980, or if in the United States or Puerto Rico on April 15, have applied for and received an extension of time to file until June 15, 1980. If the legislation is enacted, any necessary revised tax forms will be issued.

Lesser developed counries are countries not on the following list:

- Australia
- Austria
- Canada
- Czechoslovakia
- European Economic Community member states
  - Belgium
  - Britain
  - Denmark
  - France
  - Ireland
  - Italy
  - Luxemburg
  - Netherlands
  - West Germany
- Finland
- Germany (East)
- Hungary
- Iceland
- Japan
- Liechtenstein
- Monaco
- New Zealand
- Norway
- Poland
- Republic of South Africa
- San Marino
- Spain
- Sweden
- Switzerland
- Union of Soviet Socialist Republics

Any foreign country within the Sino-Soviet bloc as defined in Section 2 of E.O. 11071, 1963-1 C.B. 137.

Taxpayers eligible for the exclusion who were outside the U.S. and Puerto Rico on April 15 will not be penalized for failure to pay any tax due on the return if they file their returns and pay the amount due by October 15, 1980. Taxpayers eligible for the exclusion who originally applied for and received an extension until June 15, 1980, will not be assessed penalties for failure to pay if they paid the required amount of tax with the application for the original extension and they file and pay the remainder by October 15, 1980. In any case, interest will be due on any unpaid taxes from April 15, 1980, to the date of payment.

The due dates for estimated tax payments for the 1981 tax year are not changed by this extension.

Foundation Status of Certain Organizations

Announcement 80-95

The following organizations have failed to establish or have been unable to maintain their status as public char-

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[1] Filed by the Office of the Federal Register on June 24, 1980, and published in the issue of the Federal Register for June 25, 1980, 45 F.R. 42688.

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[1] Based on News Release IR-80-69, dated June 10, 1980.

ities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3) of the Code, eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Accord American Citizens Committee Opposed to Reverse Discrimination, Inc., San Antonio, TX
Alder Boosters Club, Inc., Jonathan, Plain City, OH
American Friends of Yeshiva Knesset Hezekiah of Kefar Hasidim, Inc., Far Rockaway, NY
Anderson Hills Recreation Foundation, Cincinnati, OH
Annapolis Volunteer Fire Brigade, Annapolis, CA
Antioch Baptist Missions, Inc., Indianapolis, IN
Association for the Development of Latin Americans in Technical Endeavors, Inc., Brooklyn, NY
Beckley World Mission, Beckley, WV
Big Brothers & Big Sisters of Howard County, Inc., Kokomo, IN
Blevins Scholarship Fund, Inc., James T., Brownstown, IN
Boguechitto Community Day Care Center, Browns, AL
Boston Foundation, John A., M.D., Abilene, TX
Bremen Community Hospital Auxiliary of German Township, Inc., Bremen, IN
Brentwood Youth Development Corp., Brentwood, NY
Bridge City Texas Little League, Bridge City, TX
Brookings Foundation, Brookings, SD
Capital Expo, Inc., Frankfort, KY
Cathedral Child Development Center, Inc., Covington, KY
Cavehill Productions, Inc., Smiths Grove, KY
Cedar Lake Historical Association, Inc., Cedar Lake, IN
Central Ohio Citizens for Better Care, Inc., Columbus, OH
Central Ohio Nursing Home Training Advisory Council, Columbus, OH
Charter Oak Terrace Health Center, Inc., Hartford, CT
Chattanooga Big Wheels, Inc., Chickamauga, GA
Christ is the Answer of Bremen, Indiana, Inc., Bremen, IN
Citizens for Indiana Boys School Carillon, Inc., Plainfield, IN
Classic Theatre Museum, The, Dayton, OH
Columbus Architecture Foundation, Columbus, OH
Connecticut Caucus on the Black Aged, Inc., Hartford, CT
Continuing Education Institute, Inc., Brighton, MA
Davenport Ridge School Parent-Teacher Organization, Stanford, CT
Dayton Child Development Corp., Dayton, OH
Dayton Street Neighborhood Association, Cincinnati, OH
Domicilia, Inc., Boston, MA
Douglas Swim Club, Douglas, WY
Dunham Civil Preparedness Charitable Trust, The George W., Albuquerque, NM
Earth Center, Inc., Jacksonville, FL
East of the River Neighborhood Investment Association, Inc., Washington, DC
East Walnut Hills Assembly, Inc., Cincinnati, OH
Eastland Vikings Alumni Association, Columbus, OH
Energy City Opportunities, Inc., Gillette, WY
Epilepsy Foundation of Indiana, Inc., Indianapolis, IN
Ervin House, Inc., Louisville, KY
Ethiopian Community Association of Pennsylvania & Surrounding States, Philadelphia, PA
Evangelism and Tract Promotion, Inc., Indianapolis, IN
Evangelistic Association of the Americas, Inc., The, Covington, KY
Fairfield County Bicentennial Commission, Inc., Lancaster, OH
Fourth International Conference, Inc., Lakewood, CO
Friends of Children and Books and Mary Harbage, Dayton, OH
Friends of Tchaikovsky Society Library and Research Foundation, San Francisco, CA
Friends of the Library of Mason, Ohio, Inc., Mason, OH
Gateway Housing Corp., Owingsville, KY
Genesis Foundation, Inc., The, Longmeadow, MA
Gilmores Community Day Care Center, New Orleans, LA
Greater Bridgeport Area Council on Alcoholism, Inc., Bridgeport, CT
Greene County Youth Activity Fund, Inc., Xenia, OH
Harris County Search and Rescue, Inc., Houston, TX
Hemophilia Association of South Texas, Harlingen, TX
Hild and Nelson Family Association, The, Auburn, WY
Hill Investments—Two, Inc., Hartford, CT
Hingham Girls Athletic Leagues, Inc., Hingham, MA
His Place Ministries, Inc., Harlan, KY
Home Help Resources, Inc., Austin, TX
Indiana Children's Theatre Workshop, Inc., Bloomington, IN
Indiana Council for Effective Law Enforcement, Inc., Indianapolis, IN
Indiana Transactional Analysis, Inc., Richmond, IN
Indianapolis Free Wheelers, Inc., Indianapolis, IN
Inspiration, Inc., Jeffersonville, IN
Institute for International and Intercultural Studies, Cincinnati, OH
Italian Village Society Housing and Development Corp., Columbus, OH
Jefferson County Historical Society, Inc., Madison, IN
Jomoco Research, Arvada, CO
Kaleidoscope Dance Center, Inc., Ithaca, NY
Kenosha Partners, Inc., Kenosha, WI
Kentucky Junior Golf Foundation, Inc., Louisville, KY
Kentucky River-Camp Nelson Historical Restoration Society, Inc., Lexington, KY
King School Site Project, Akron, OH
LAMP, Inc., Louisville, KY
Laughlin Officers' Wives' Club, Scholarship and Charitable Association, Laughlin AFB, TX

Life Center, Inc., The, Boston, MA
Literary Preservation Society for the Development of American Writers and Artists, Inc., Indianapolis, IN
Lowell Opera Co., Lowell, MA
Lupus Association of Rhode Island, Inc., East Providence, RI
Madisonville Juvenile Delinquency Prevention Program, Cincinnati, OH
Mainstage Productions, Inc., Montpelier, VT
Malden Northern Little League, Inc., Malden, MA
Mental Health Volunteers of Ohio, Inc., Cincinnati, OH
Mid-East Films Corp., Westport, CT
Milligan Family Organization of America, Bountiful, UT
Minnesota Information Services for Creative Alternatives, St. Paul, MI
Missionary Tract Fund Limited, Inc., Indianapolis, IN
National Association for Sickle Cell Disease/Indianapolis Sickle Cell Anemia Parent Club, Inc., Indianapolis, IN
National Medical Association of Northwest Indiana, Inc., Gary, IN
National Youth Hall of Fame Foundation, Kerrville, TX
Neighborhood Education Center, Inc., Brentwood, MD
New Earth Evangelistic Association, Inc., Roxbury, MA
New Resources Group, Inc., Barnstable MA
Northeast Kingdom Youth Dance Company, Inc., Lyndonville, VT
Ohio Hunger Network, Columbus, OH
Orgonon, Inc., The, Columbus, OH
Owens Evangelistic Association, The Charles, Goose Creek, SC
Oxford Community Association, Inc., Fort Wayne, IN
Phone-A-Career, San Francisco, CA
Physicians Recuitment Foundation of Pekin, Inc., Pekin, IL
Prayer & Praise Fellowship, Inc., Slayton, MI
Project "PRIDE", Inc., Rhinelander, WI
Provincetown Dance Group, Inc., Provincetown, MA
PTVS, Inc., Indianapolis, IN
Rapid City Bicentennial Charitable Trust, Rapid City, SD
Research and Evaluation, Inc., Worthington, OH
Rhode Island Science and Engineering Society, Inc., Bristol, RI
Rio Grande Valley Kidney Association, McAllen, TX
Rippy Child Foundation, Inc., Wilson C., Tampa, FL
Rocky Mountain Middlebury Alumni Association, Denver, CO
Rosslyn Foundation, The, Arlington, VA
Rowell Ranch Rodeo, Inc., Hayward, CA
S. F. J. Ministries, Inc., Loveland, CO
St. Johns Ridgewood Community Service Center, Inc., Ridgewood, NY
St. Joseph's Community Services, Inc., Nashua, NY
Sayville Bayport Youth Development, Inc., Sayville, NY
Singing Hills Bible Camp, Inc., Corbin, KY
Society for Commercial Archeology, Inc., Burlington, VT
Southside Community Ministries, Columbus, OH
Spencer Heart Fund, Inc., Jericho, NY
Teatro Cuatro, Pueblo, CO
Texas Gamma Chapter of Pi Beta Phi Educational Foundation, Lubbock, TX
Theater North Association, Berlin, NH
Three Rivers Auxiliary, Cincinnati, OH
Tomato Patch Foundation, Inc., The, Hobart, IN
Twin Cities Center for Urban Policy, Inc., Minneapolis, MN
United Day Foundation Funds, Laredo, TX
Upstreet, Inc., Windsor, VT
Valley Sponsoring Committee, Canton, NY
Vermont State Association of Youth Services Bureaus, Inc., Montpelier, VT
Video Resources, Inc., New Haven, CO
Vista Pines, Inc., Richmond, IN
Warfield Scholarship Fund, Inc., William, New York, NY
Washington County 76'ers, Marietta, OH
West African Welfare Foundation, Inc., Murray, KY
Western Slope Action Coalition, Inc., Fruita, CO
Westerville Area City Spirit, Inc., Westerville, OH
Womankind, Inc., Concord, NH
York County Denture Delivery Clinic, Inc., Sanford, ME
Young Evangelistic Association-Global Ministries, Inc., Don, Owensville, OH
Youth Volunteers, Inc., LaPorte, IN
350 Years of Yarmouth Mass, Inc., Yarmouth, MA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
John H. Frazier	Nashville, TN	Certified Public Accountant	Fifteen months effective June 16, 1980
Clifford Y. Pierce	Miami, FL	Certified Public Accountant	Indefinite effective June 13, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 48.4221-3 amended.	Tax treatment of articles previously sold tax free for exportation under section 4221(a)(2).	June 9, 1980	Aug. 8, 1980
26 CFR 48.4042-1 through 48.4042-3 added.	Tax on the use of fuel in commercial waterway transportation.	June 9, 1980	Aug. 8, 1980
26 CFR 1.170A-4, 1.301-1, 1.312-3, 1.341-6, 1.453-9, 1.751-1, 1.1502-14 amended; 1.1254-1 through 1.1254-5 added.	Treatment of gain from the disposition of certain oil, gas, or geothermal property.	June 11, 1980	Aug. 11, 1980
26 CFR 1.411(d)-1 as proposed in the Federal Register for April 9, 1980, 45 F.R. 24201, withdrawn; 1.411(d)-1 amended.	Coordination of vesting and discrimination requirements for qualified pension, etc. plans.	June 12, 1980	Aug. 11, 1980

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27, dated July 7, 1980.

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______	1937–2	7.70
______	*1938–1*	*4.05*
______	*1938–2*	*3.50*
______	1939–1–1	8.25
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______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*2.65*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$10.10
______	1957–2	13.00
______	1958–1	9.60
______	1958–2	13.00
______	1958–3	15.00
______	1959–1	15.00
______	1959–2	9.60
______	1960–1	9.00
______	1960–2	11.50
______	1961–1	14.00
______	1961–2	10.00
______	1962–1	14.00
______	1962–2	13.00
______	1962–3	20.00
______	1963–1	9.00
______	1963–2	10.75
______	1964–1–1	10.00
______	1964–1–2	11.00
______	1964–2	9.80
______	1965–1	10.70
______	1965–2	12.25
______	1966–1	14.00
______	1966–2	14.05
______	1967–1	10.00
______	1967–2	15.00
______	1968–1	14.00
______	1968–2	11.75
______	1969–1	7.50
______	1969–2	6.50
______	1969–3	$12.50
______	1970–1	11.00
______	1970–2	14.00
______	1971–1	10.55
______	1971–2	8.50
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August 4, 1980
Bulletin No. 1980-31

9258

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-188, page 7.
Arbitrage bonds; advance refunding issue; acquired obligations; matured Treasury bonds. The yield on matured Treasury bonds purchased in an escrow restructuring transaction with part of the proceeds of an issue of advance refunding bonds may not be taken into account in computing the yield on the major portion investments of the issue for the purpose of determining compliance with the arbitrage yield restrictions of section 103(c)(2) of the Code.

Rev. Rul. 80-204, page 9.
Arbitrage bonds; temporary investment of proceeds. A political subdivision of a city issued bonds to finance construction of a water distribution facility more than two years before construction of the facility was to begin and invested a major portion of the proceeds in higher-yielding certificates of deposit to generate cash income from the large spread between interest rates on taxable and tax-exempt obligations. Because the political subdivision did not act with due diligence, the bond proceeds do not qualify for investment at a materially higher yield for a temporary period. Therefore, the bonds are arbitrage bonds, and the interest received by the bondholders is not excludable from their gross incomes.

Rev. Rul. 80-208, page 12.
Taiwan Relations Act. The tax implications of the Taiwan Relations Act are discussed.

T.D. 7705, page 5.
Amendments to the regulations under section 85 and 6050B of the Code relate to the taxation of unemployment compensation.

Del. Order No. 183, page 16.
Extension of time for making certain elections. Designated Service officials are authorized to grant reasonable extensions of time for making certain elections.

Announcement 80-96, page 17.
A public meeting will be held on August 19, 1980, to solicit views on issues being considered in the negotiation of a new income tax treaty with the British Virgin Islands.

EXEMPT ORGANIZATIONS

Rev. Rul. 80-205, page 10.
Recreation facility; restricted use. The Service will not follow the *Eden Hall Farm* decision, which held that an organization providing recreational facilities for employees of selected corporations qualifies as a social welfare organization under section 501(c)(4) of the Code.

Rev. Rul. 80-206, page 11.
Tenants' rights. A nonprofit organization that promotes the legal rights of tenants in a particular community and occasionally initiates litigation to contest the validity of legislation adversely affecting tenants may qualify for exemption under

(Continued on page 4)

Finding Lists begin on page 21.
Announcement of Voluntary Suspensions on page 19.
Announcement of Proposed Rulemaking on page 20.
Monthly Index for July begins on page 23.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

EXEMPT ORGANIZATIONS—Cont'd

section 501(c)(4) of the Code as a social welfare organization; Rev. Rul. 73-306 distinguished.

Rev. Rul. 80-207, page 11.
Private foundations; supporting organization; control of board by disqualified person. An organization that is exempt under section 501(c)(3) of the Code makes distributions to a university. The organization is controlled by a four member board of directors, one of whom is a substantial contributor to the organization and a disqualified person. Two other directors are employees of a corporation, also a disqualified person, in which more than 35 percent of the voting power is owned by the substantial contributor. The remaining director is chosen by the university. None of the directors has a veto power. The organization is not a supporting organization within the meaning of section 509(a)(3).

ESTATE TAX

Rev. Rul. 80-209, page 13.
Domicile; illegal alien. An illegal alien who lived in the U.S. for 19 years with the alien's family, purchased a residence, and established strong community ties was domiciled in the U.S. at the date of death and the taxable estate is subject to the tax imposed by section 2001 of the Code.

Rev. Rul. 80-210, page 14.
Credits against tax; prior transfers; marital deduction. In determining the credit for tax on prior transfers under the "second limitation" of section 2013(c)(1) of the Code, for purposes of computing the tax on the reduced adjusted gross estate of a decedent who died after 1976, the applicable marital deduction is the value of the property actually passing to the surviving spouse, but not to exceed the greater of $250,000 or one-half of the reduced adjusted gross estate; Rev. Rul. 60-161 amplified.

EMPLOYMENT TAXES

Rev. Rul. 80-208, page 12.
Taiwan Relations Act. The tax implications of the Taiwan Relations Act are discussed.

SELF-EMPLOYMENT TAX

Announcement 80-97, page 17.
Form 4361, Application for Exemption from Self-Employment Tax for Use by Ministers, Members of Religious Orders and Christian Science Practitioners, has been revised and is available in Service offices.

ADMINISTRATIVE

Announcement 80-98, page 17.
Public service organizations interested in sponsoring Tax Counseling for the Elderly programs must submit applications by August 15, 1980.

Announcement 80-99, page 17.
Effective August 1, 1980, Forms 5970 and 5970-A are obsolete because of the repeal of the carryover basis rules of section 1023 of the Code by the Crude Oil Windfall Profit Tax Act of 1980.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-7: Interest.

Whether interest on obligations of a political subdivision will be exempt from tax. See Rev. Rul. 80-188, page 7.

26 CFR 1.61-7: Interest.

Whether interest on obligations of a political subdivision will be exempt from tax. See Rev. Rul. 80-204, page 9.

Section 85.—Unemployment Compensation

26 CFR 1.85-1: Unemployment compensation.
(Also Section 6050B; 1.6050B-1.)

T.D. 7705 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Unemployment compensation

AGENCY: Internal Revenue Service, Treasury

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the taxation of unemployment compensation. Changes to the applicable law were made by the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1] and the Technical Amendments Act of 1979 [Technical Corrections Act of 1979, Pub. L. 96-222, 1980-20 C.B. 5]. The regulations would provide the public with the guidance needed to comply with those Acts and would affect all taxpayers who receive unemployment compensation under a governmental unemployment compensation plan.

DATE: The regulations are effective for taxable years beginning after December 31, 1978.

FOR FURTHER INFORMATION CONTACT: John G. Schmalz of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3432, not a toll-free call.

SUPPLEMENTARY INFORMATION

BACKGROUND

On December 19, 1979, the Federal Register published proposed amendments to the Income Tax Regulations [26 CFR Part 1] under section 85 of the Internal Revenue Code of 1954 [44 FR 75183]. The amendments were proposed to prescribe rules and regulations for the taxation of unemployment compensation received by certain taxpayers under certain governmental unemployment compensation plans. Although no public hearing was requested, one written comment was received which related to the proposed rules. Several other comments were received which questioned certain public policy decisions made by Congress when it enacted section 85. After consideration of the comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision. The preamble to the notice of proposed rulemaking summarizes and explains the proposed amendments.

FRAUDULENTLY RECEIVED UNEMPLOYMENT COMPENSATION

One comment was received concerning the taxation of fraudulently received unemployment compensation. The commentator suggested that the regulations under section 85 of the Internal Revenue Code make it clear that no amount of unemployment compensation received as a result of a claimant's fraud will be exempt from taxation. Since this suggestion is consistent with the Service's position, a provision has been added to the proposed regulations stating that all amounts of fraudulently received unemployment compensation are taxable without regard to any limitation in section 85 of the Internal Revenue Code.

OTHER COMMENTS

Other comments were not adopted as they suggested changes that conflicted with express statutory provisions.

ADDITIONAL INFORMATION

These regulations are needed to guide the public and government employees responsible for the administration of section 85.

The preceding parts of the preamble evidence Service consideration of the public comments and respond to the issues raised by these comments. Evaluation of the effectiveness of the regulations after issuance will be based on comments received from offices within the Internal Revenue Service and the Treasury Department, other governmental agencies, State and local governments, and the public.

To a certain extent, section 6050B of the Internal Revenue Code of 1954 will require additional reporting and recordkeeping by payers of unemployment compensation, *i.e.*, certain payers will be required to report to the Service the amount of their payment along with other information and will also be required to provide the recipient with a Form 1099 UC.

DRAFTING INFORMATION

The principal author of this regulation was John G. Schmalz of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly the following amendments to 26 CFR Part 1 are hereby adopted:

Paragraph 1. Immediately after § 1.83-8, there is added the following new section:

---

[1] This publication of the Treasury Decision contains the complete text of the amendments to the regulations. The instructions for modifying the notice of proposed rulemaking have been omitted.

§ 1.85-1 Unemployment compensation.

(a) *Introduction.* Section 85 prescribes rules relating to the inclusion in gross income of unemployment compensation (as defined in paragraph (b)(1) of this section) paid in taxable years beginning after December 31, 1978 pursuant to governmental programs. In general, these rules provide that unemployment compensation paid pursuant to governmental programs is includible in the gross income of a taxpayer if the taxpayer's modified adjusted gross income (as defined in paragraph (b)(2) of this section) exceeds a statutory base amount (as defined in paragraph (b)(3) of this section). If there is such an excess, however, the amount included in gross income is limited under paragraph (c)(1) of this section to the lesser of one-half of such excess or the amount of the unemployment compensation. If such taxpayer's modified adjusted gross income does not exceed the applicable statutory base amount, none of the unemployment compensation is included in the taxpayer's gross income.

(b) *Definitions* — (1) *Unemployment compensation*— (i) *General rule.* Except as provided in paragraph (b)(1)(iii) of this section, the term "unemployment compensation" means any amount received under a law of the United States, or of a State, which is in the nature of unemployment compensation. Thus, section 85 applies only to unemployment compensation paid pursuant to governmental programs and does not apply to amounts paid pursuant to private nongovernmental unemployment compensation plans (which are includible in income without regard to section 85). Generally, unemployment compensation programs are those designed to protect taxpayers against the loss of income caused by involuntary layoff. Ordinarily, unemployment compensation is paid in cash and on a periodic basis. The amount of the payments is usually computed in accordance with a formula based on the taxpayer's length of prior employment and wages. Such payments, however, may be made in a lump sum or other than in cash or on some other basis.

(ii) *Disability and worker's compensation payments.* Amounts in the nature of unemployment compensation also include cash disability payments made pursuant to a governmental program as a substitute for cash unemployment payments to an unemployed taxpayer who is ineligible for such payments solely because of the disability. Usually these disability payments are paid in the same weekly amount and for the same period as the unemployment compensation benefits to which the unemployed taxpayer otherwise would have been entitled. Amounts received under workmen's compensation acts as compensation for personal injuries or sickness are not amounts in the nature of unemployment compensation. See section 104(a)(1) relating to the exclusion from gross income of such amounts.

(iii) *Employee contributions to a governmental plan.* If a governmental unemployment compensation program is funded in part by an employee's contribution which is not deductible by the employee, an amount paid to such employee under the program is not to be considered unemployment compensation until an amount equal to the total nondeductible contributions paid by the employee to such program has been paid to such employee.

(iv) *Examples of governmental unemployment compensation programs.* Governmental unemployment compensation programs include (but are not limited to) programs established under:

(A) A State law approved by the Secretary of Labor pursuant to section 3304 of the Internal Revenue Code of 1954.

(B) Chapter 85 of Title 5, United States Code, relating to unemployment compensation for Federal employees generally and for ex-servicemen.

(C) Trade Act of 1974, sections 231 and 232 (19 U.S.C. 2291 and 2292) [Pub. L. 93-618, 1975-1 C.B. 501].

(D) Disaster Relief Act of 1974, section 407 (42 U.S.C. 5177).

(E) The Airline Deregulation Act of 1978 (49 U.S.C. 1552(b)).

(F) The Railroad Unemployment Insurance Act, section 2 (45 U.S.C. 352).

(2) *Modified adjusted gross income.* The term "modified adjusted gross income" means the sum of the following amounts:

(i) Adjusted gross income (as defined in section 62);

(ii) All disability payments of the type that are eligible for exclusion from gross income under section 105(d); and

(iii) All amounts of unemployment compensation (as defined in paragraph (b)(1) of this section).

(3) *Base amount.* The term "base amount" means—

(i) $25,000 in the case of a joint return under section 6013.

(ii) Zero in the case of a taxpayer who—

(A) Is married (within the meaning of section 143) at the close of the taxable year,

(B) Does not file a joint return for such taxable year, and

(C) Does not live apart (as defined in paragraph (b)(4) of this section) from his or her spouse at all times during the taxable year.

(iii) $20,000 in the case of all other taxpayers.

(4) *Living apart.* A taxpayer does not "live apart" from his or her spouse at all times during a taxable year if for any period during the taxable year the taxpayer is a member of the same household as such taxpayer's spouse. A taxpayer is a member of a household for any period, including temporary absences due to special circumstances, during which the household is the taxpayer's place of abode. A temporary absence due to special circumstances includes a nonpermanent absence caused by illness, education, business, vacation, or military service.

(c) *Limitations*—(1) *General rule.* If for a taxable year, a taxpayer's modified adjusted gross income does not exceed the applicable statutory base amount, no amount of unemployment compensation is included in gross income for the taxable year. If there is such an excess, the taxpayer includes in gross income for the taxable year the lesser of the following:

(i) One-half of the excess of the taxpayer's modified adjusted gross income over such taxpayer's base amount, or

(ii) The amount of unemployment compensation.

(2) *Exception for fraudulently received unemployment compensation.* If a taxpayer fraudulently receives unemployment compensation under any governmental unemployment compensation program, then the entire amount of such fraudulently received unemployment compensation must be included in the taxpayer's gross income for the taxable year in which the benefits were received. Thus, the limitation in section 85 and in paragraph (c)(1) of this section, does not apply to such amounts.

(3) *Examples.* The application of this paragraph may be illustrated by the following examples:

Example (1). H and W are married taxpayers who for calendar year 1979 file a joint income tax return. During 1979 H receives $4,500 of disability income that is eligible for an exclusion under section 105(d). W works for part of 1979 and receives $20,000 as compensation and also receives $5,000 of unemployment compensation in 1979. Assume that H and W's adjusted gross income is $20,000. The modified adjusted gross income of H and W is $29,500 ($4,500 + $20,000 + $5,000). Since their modified adjusted gross income ($29,500) is greater than their base amount ($25,000), some of the unemployment compensation received by W must be included in their gross income on their 1979 joint income tax return. Under paragraph (c)(1) of this section, of the $5,000 which is unemployment compensation, the lesser of $2,250 (($29,500 − 25,000) ÷ 2) or $5,000 must be included in their gross income. Thus, $2,250 of the $5,000 received by W in 1979 is included in the gross income of H and W on their joint income tax return for 1979.

Example (2). Assume the same facts in example (1) except H receives $5,000 of disability income that is eligible for an exclusion under section 105(d) and W receives $28,000 as compensation, and $4,000 which is unemployment compensation. Assume that H and W's adjusted gross income is $28,000. The modified adjusted gross income of H and W is $37,000 ($4,000 + $28,000 + $5,000). Since their modified adjusted gross income ($37,000) is greater than their base amount ($25,000), all of the unemployment compensation received by W must be included in their gross income on their 1979 joint income tax return. Under paragraph (c)(1) of this section, of the $4,000 which is unemployment compensation, the lesser of $6,000 (($37,000 − $25,000) ÷ 2) or $4,000 must be included in their gross income. Thus, all of the $4,000 unemployment compensation received by W is included in the gross income of H and W on their joint income tax return for 1979.

(d) *Cross reference.* See section 6050B, relating to the requirement that every person who makes payments of unemployment compensation aggregating $10 or more to any individual during any calendar year file an information return with the Internal Revenue Service.

Par. 2. Immediately after § 1.6050-1, there is added the following new section:

§ 1.6050B-1 Information returns by person making unemployment compensation payments.

For taxable years beginning after December 31, 1978, every person who makes payments of unemployment compensation (as defined in section 85(c)) aggregating $10 or more to any individual during any calendar year shall file a Form 1099UC in accordance with the instructions to such form.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of Internal Revenue.

Approved June 25, 1980.

DONALD C. LUBICK,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 8, 1980, 8:45 a.m., and published in the issue of the Federal Register for July 9, 1980, 45 F.R. 46069)

Section 103.—Interest on Certain Governmental Obligations

26 CFR 1.103-13: Arbitrage bonds.
(Also Section 61; 1.61-7.)

Arbitrage bonds; advance refunding issue; acquired obligations; matured Treasury bonds. The yield on matured Treasury bonds purchased in an escrow restructuring transaction with part of the proceeds of an issue of advance refunding bonds may not be taken into account in computing the yield on the major portion investments of the issue for the purpose of determining compliance with the arbitrage yield restrictions of section 103(c)(2) of the Code.

Rev. Rul. 80-188

ISSUE

Will bonds that have been issued by an authority that is a political subdivision of a state be arbitrage bonds within the meaning of section 103(c)(2) of the Internal Revenue Code under the circumstances described below?

FACTS

Authority *M* is a hospital district that is a political subdivision of the state of *O*. On January 2, 1976, *M* issued its advance refunding bonds to refund construction bonds that were issued by *M* in 1975. The refunding bonds have a yield of 8 percent.

A major portion of the proceeds of the advance refunding bonds were immediately invested in United States Treasury obligations—State and Local Government Series (SLGS) at a restricted yield of 8 percent. Amounts representing a minor portion of the proceeds of the advance refunding bonds were immediately invested in SLGS at an unrestricted yield of 9 percent.

On February 4, 1980, *M* redeemed the SLGS that it had purchased in 1976 and used the proceeds to purchase United States Treasury bonds. *M* invested a minor portion of the proceeds of the redemption in United States Treasury bonds at an unrestricted yield. *M* invested part of the major portion of the proceeds of the redemption in United States Treasury bonds at a yield of 13 percent. *M* invested the remainder of the major portion of the proceeds of the redemption in United States Treasury bonds with a maturity date of February 1, 1980. *M* purchased all of the Treasury bonds at fair market value from *A*, an unrelated third person.

M directed the trustee for the advance refunding bonds not to redeem the Treasury bonds that matured on February 1, 1980, until five years had elapsed from the purchase of such bonds. In computing the yield on its major portion investments, *M* took into account the yield on the matured Treasury bonds as of the date the bonds would be presented for payment. As computed by *M*, the yield on all the Treasury bonds allocated to the major portion of the advance refunding bonds is 8 percent.

M allocated all of the costs of the purchase of the Treasury bonds to the minor portion of the escrow for the advance refunding bonds. At the time of the issuance of the advance refunding bonds *M* executed a no-arbitrage certification in accordance with the provisions of section 1.103-13(a)(2)(ii) of the proposed Income Tax Regulations published in the Federal Register of May 3, 1973 (38 F.R. 10944).

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include interest on the obligations of a state or a political subdivision of a state.

Section 103(c)(1) of the Code provides that, with certain minor exceptions, the interest on any arbitrage bond will not be excludable from gross income.

Section 103(c)(2) of the Code provides that the term "arbitrage bond" means any obligation that is issued as part of an issue all or a major portion (more than 15 percent) of the proceeds of which are reasonably expected to be used directly or indirectly (A) to acquire securities or obligations that may be reasonably expected at the time of issuance of such issue, to produce a yield over the term of the issue that is materially higher than the yield on obligations of such issue, or (B) to replace funds that were used directly or indirectly to acquire securities or obligations described in section 103(c)(2)(A).

T.D. 7627 (44 F.R. 32657), 1979-2 C.B. 45, which adopted the final arbitrage bond regulations, provides that, for governmental obligations issued on or before the effective date of the final regulations (May 31, 1979), the proposed income tax regulations, as amended, under section 103(c) of the Code shall apply.

Section 1.103-13(a)(2)(i) of the proposed regulations published in the Federal Register of May 3, 1973 (38 F.R. 10944), provides, in part, that under section 103(c)(2) of the Code the determination whether an obligation is an arbitrage bond depends upon the issuer's reasonable expectations, as of the date of issue, regarding the amount and use of the proceeds of the issue. The reasonable expectations regarding the amount and use of the proceeds of a governmental obligation may be established by the certification described in section 1.103-13(a)(2)(ii).

Example (1) of section 1.103-13(a)(2)(v) of the final regulations illustrates the effect of a no-arbitrage certification. In this example, city *A* issues bonds to construct a water treatment facility and in the certification *A* includes a statement that 85 percent of the receipts from the sale of the bonds will be used for construction costs within three years of the date of issue of the bonds. Subsequently, construction of the water treatment facility was determined by the Environmental Protection Agency to have certain adverse effects. As a result, 85 percent of the receipts from the sale of the bonds will not be expended for project costs within three years of the date of issue of the bonds. The example concludes that the certification is conclusive as to the issuer's reasonable expectations that 85 percent of the receipts will be expended for construction costs within three years of the date of issue of the bonds.

Section 1.103-13(b)(4)(i) of the proposed regulations published in the Federal Register of May 3, 1973 (38 F.R. 10944), provides that the term "acquired obligations" means securities and obligations allocated to the proceeds of an issue of governmental obligations during the period of time such issue is outstanding.

Section 1.103-13(b)(4)(iii) of the proposed regulations published in the Federal Register of May 3, 1973 (38 F.R. 10944), provides that the term "obligation" means any evidence of indebtedness that is not described in section 103(a)(1) of the Code. An amendment to section 1.103-13(b)(4)(iii), published in the Federal Register of October 29, 1976 (41 F.R. 47680), provides that cash is not an acquired obligation. For example, cash held or received by a trustee is not taken into account as a zero-yield obligation for the period that it is held before being invested in an acquired obligation or for the period that it is held after repayment of an obligation and before being reinvested in an acquired obligation.

Section 1.103-13(b)(5) of the proposed regulations published in the Federal Register of December 3, 1975 (40 F.R. 56448), provides, in part, that in the case of a refunding issue the yield produced by acquired obligations allocated to the proceeds (other than transferred proceeds) of the refunding issue is materially higher than the yield produced by such issue if the yield of such acquired obligations exceeds the yield of such issue.

The only reason *M* directed the trustee not to redeem the matured Treasury bonds at their face amount on the date they were purchased was to reduce the yield on the major portion of the bond proceeds. Therefore, for purposes of section 1.103-13(b)(4)(iii) of the proposed and final regulations the matured Treasury bonds purchased by *M* are considered paid and are the equivalent of cash. Accordingly, the yield on the matured Treasury bonds purchased by *M* may not be taken into account in computing the yield on the major portion investments for its advance refunding bonds. As a result, the yield on the major portion investments for *M*'s advance refunding bonds is 13 percent.

The "reasonable expectations" test contained in section 103(c) of the Code and the certification procedure contained in section 1.103-13(a)(2) of the proposed and the final regulations both provide a high degree of certainty by generally assuring that the bonds will not be arbitrage bonds in the event of occurrences that are beyond the control of the issuer. Compare example (1) of section 1.103-13(a)(2)(v) of the final regulations which concerns the reasonable expectations of an issuer with respect to a matter it did not reasonably expect to occur and was beyond its control. However, neither the reasonable expectations test nor the certification procedure provides protection in this particular case where the issuer has taken deliberate and intentional actions to produce arbitrage.

HOLDING

M has failed to comply with the arbitrage yield restrictions of section 1.103-13(b)(5) of the proposed regulations. The no-arbitrage certification made by *M* will not prevent the advance refunding bonds from being arbitrage bonds. Thus, the advance refunding bonds issued by *M* are arbitrage bonds within the meaning of section 103(c)(2) of the Code and the interest on the bonds is not excludable from the gross income of the bondholders under section 103(a)(1).

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26 CFR 1.103-13: Arbitrage bonds.
(Also Section 61; 1.61-7.)

Arbitrage bonds; temporary investment of proceeds. A political subdivision of a city issued bonds to finance construction of a water distribution facility more than two years before construction of the facility was to begin and invested a major portion of the proceeds in higher-yielding certificates of deposit to generate cash income from the large spread between interest rates on taxable and tax-exempt obligations. Because the political subdivision did not act with due diligence, the bond proceeds do not qualify for investment at a materially higher yield for a temporary period. Therefore, the bonds are arbitrage bonds, and the interest received by the bondholders is not excludable from their gross incomes.

Rev. Rul. 80-204

ISSUE

Are the bonds issued by an authority that is a political subdivision of a city subject to the arbitrage yield restrictions of section 103(c) of the Internal Revenue Code with respect to the investment of the bond proceeds under the circumstances described below?

FACTS

On January 1, 1979, Authority *M* was created as a political subdivision of City *O* in order to consolidate under one administration the various utilities within *O*. The first major project that *M* will undertake is construction of a water distribution facility. Because *M* has no revenues with which to pay for the construction, M planned to issue bonds for this purpose. Such bonds would not be "industrial development bonds" within the meaning of section 103(b)(2) of the Code.

On September 1, 1979, *M* incurred a binding obligation to corporation X involving the expenditure of $500,000 for planning and engineering services in connection with the water distribution facility. Because of the nature of the services, *X* will be unable to complete the planning process before October 1, 1981. It is estimated that construction of the facility will begin in February 1982, and will be completed before August 31, 1982.

In accordance with ordinary financial practice, *M* would not issue bonds to pay for construction of the facility until the planning process was substantially completed. However, *M* issued $10,000,000 of 6 percent general obligation bonds on January 2, 1980. From the available bond proceeds of $9,400,000 (face amount minus costs of issuance and a portion of the $500,000 fee for planning and engineering), $8,400,000 was invested in a one-year certificate of deposit at a 12.5 percent interest rate, $500,000 was invested in a six-month certificate at 13 percent, and $500,000 was invested in a nine-month certificate at 12.5 percent.

The stated purpose of the abnormally early issuance is to take advantage of the large interest spread between taxable and tax-exempt obligations in order to generate cash income. The income will be used primarily to pay for the initial administrative costs of establishing *M*.

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include interest on obligations of a state or a political subdivision of a state.

Section 103(c)(1) of the Code provides that, with certain minor exceptions, the interest on any arbitrage bond will not be excludable from gross income.

Section 103(c)(2) of the Code provides that the term "arbitrage bond" means any obligation that is issued as part of an issue all or a major portion (more than 15 percent) of the proceeds of which are reasonably expected to be used directly or indirectly (A) to acquire securities or obligations that may be reasonably expected at the time of issuance of such issue, to produce a yield over the term of the issue that is materially higher than the yield on obligations of such issue, or (B) to replace funds that were used directly or indirectly to acquire securities or obligations described in section 103(c)(2)(A).

Section 103(c)(4)(A) of the Code provides that an obligation shall not be treated as an arbitrage bond solely by reason of the fact that the proceeds of the issue of which such obligation is a part may be invested for a temporary period in securities or other obligations until such proceeds are needed for the purpose for which such issue was issued.

Section 1.103-14(b) of the Income Tax Regulations provides in general that original proceeds and investment proceeds of an issue of governmental obligations that are invested in acquired obligations during a 3-year period beginning on the date of issue are invested for a temporary period if the expenditure test of paragraph (b)(2), the time test of paragraph (b)(3), and the due diligence test of paragraph (b)(4) are satisfied. The time test requires that the issuer must incur a substantial binding obligation to commence the project within 6 months after the date of issue. The due diligence test provides that after the substantial binding obligation is incurred, work on the facility must proceed with due diligence to completion. The expenditure test provides that at least 85 percent of spendable proceeds (as defined in paragraph (b)(2)(iii)) must be spent within the temporary period.

When bonds are issued to finance a public project, the due diligence test is ordinarily satisfied whenever the issuer endeavors to spend the bond proceeds on the project with reasonable dispatch. In determining whether due diligence has been exercised, any legal, financial, engineering, or other obstacle to engaging in work on the project will ordinarily be taken into account.

In this case, however, actual construction of the water facility will not begin until more than two years after the date of issue. Moreover, *M*'s purpose in proceeding with the bond issue prematurely was to secure an opportunity to invest the bond proceeds in higher yielding taxable obligations. Thus, *M* has deliberately acted to prolong the period between issuance of the bonds and expenditure of the proceeds, and has done so for the purpose of earning arbitrage. A deliberate act of this nature is inconsistent with the requirement of due diligence.

In these circumstances, *M* does not saitsfy the due diligence test of section 1.103-14(b)(4) of the regulations. However, this case is distinguishable from one where the date of issuance is determined solely with regard to bona fide financial or other nonarbitrage reasons (for example, where financing for one project is combined with financing for several others solely for economies of scale and other bond marketing advantages).

HOLDING

The bond proceeds do not qualify for investment at a materially higher yield during a temporary period described in section 1.103-14(b) of the regulations. Further, the bonds are arbitrage bonds, and the interest received by the bondholders is not excludable from their gross incomes under section 103(a)(1) of the Code.

Section 501.—Exemption from Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(c)(4)-1: Civic organizations and local associations of employees.

Recreational facility; restricted use. The Service will not follow the *Eden Hall Farm* decision, which held that an organization providing recreational facilities for employees of selected corporations qualifies as a social welfare organization under section 501(c)(4) of the Code.

Rev. Rul. 80-205

ISSUE

Will the Internal Revenue Service follow the decision in *Eden Hall Farm v. United States,* 389 F. Supp. 858 (W.D. Pa. 1975), which held that an organization providing recreational facilities to the employees of selected corporations qualifies for exemption from federal income tax as a social welfare organization described in section 501(c)(4) of the Internal Revenue Code?

FACTS

The organization was formed to carry out the provisions of the will of a former employee of the *X* corporation. Management of the organization was vested in a board of three trustees, all of whom were required to be employees of the *X* corporation. The organization's activities have consisted of maintaining and operating guest and recreational facilities on a farm near the community in which the *X* corporation is located.

In its initial years of operation, the organization's facilities were made available only to employees of the *X* corporation. In subsequent years, the facilities were opened to guests of *X* corporation's employees, employees of other selected corporations, and guests of these other employees. During the years considered by the district court, the facilities were used predominantly by employees of *X* corporation.

The district court found that the organization's provision of recreational facilities served a recognized community need and that the organization qualified as a social welfare organization under section 501(c)(4) of the Code. With respect to the organization's restrictions on the use of its facility, the court found that the restrictions were consistent with the capacity of the facilities and provided a means of limiting use of the facilities to those who met the organization's requirements. Thus, the court concluded that the organization was not operated for the benefit of *X* corporation or its employees.

LAW AND ANALYSIS

Section 501(c)(4) of the Code provides for the exemption from federal income tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(a)(2)(i) of the Income Tax Regulations provides that an organization is operated for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community.

The regulations clearly require, and prior revenue rulings have recognized, that an organization claiming exemption under section 501(c)(4) of the Code must operate for the benefit of the community as a whole rather than for the benefit of a limited group. Compare Rev. Rul. 78-69, 1978-1 C.B. 156, which holds that an organization providing rush hour commuter bus service to all residents of a community qualifies for exemption under section 501(c)(4), with Rev. Rul. 55-311, 1955-1 C.B. 72, which holds that a local association of employees operating a bus primarily for the convenience of its members does not so qualify. Also compare Rev. Rul. 62-167, 1962-2 C.B. 142, which holds that an organization retransmitting television signals for the benefit of an entire community qualifies for exemption under section 501(c)(4), with Rev. Rul. 54-394, 1954-2 C.B. 131, which holds that an organization providing television on a cooperative basis does not qualify.

There is no requirement that a section 501(c)(4) organization provide equal benefits to every member of the community. The organization described in Rev. Rul. 78-69 that provides rush hour commuter bus service benefits only those individuals who have a need for that service. Similarly, an organization providing a particular type of recreational facility benefits only those who enjoy that type of recreation. Such limitations are inherent in the activities that are undertaken to promote the social welfare.

In the instant case, however, the organization imposed limitations on the use of its facility other than those that were inherent in the nature of the facility. By restricting use of the facility to employees of selected corporations and their guests, the organization is primarily benefiting a private group rather than primarily benefiting the common good and general welfare of the community.

It is the position of the Internal Revenue Service that organizations restricting their benefits in this way do not qualify for exemption as organizations described in section 501(c)(4) of the Code. Organizations of this type primarily benefit the individuals or private groups that are allowed to use the facility and any benefit to the community or promotion of the social welfare of the community is purely incidental.

HOLDING

The Internal Revenue Service will not follow the decision in *Eden Hall Farm v. United States.* It is the position of the Service that an organization providing recreational facilities to the employees of selected corporations does not qualify for exemption from federal income tax as a social welfare organization under section 501(c)(4) of the Code.

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26 CFR 1.501(c)(4)-1: Civic organizations and local associations of employees.

Tenants' rights. A nonprofit organization that promotes the legal rights of tenants in a particular community and occasionally initiates litigation to contest the validity of legislation adversely affecting tenants may qualify for exemption under section 501(c)(4) of the Code as a social welfare organization; Rev. Rul. 73-306 distinguished.

Rev. Rul. 80-206

ISSUE

May an organization formed to promote the legal rights of all tenants in a particular community and occasionally to initiate litigation to contest the validity of legislation that adversely affects tenants qualify for exemption from federal income tax under section 501(c)(4) of the Internal Revenue Code as a social welfare organization?

FACTS

The organization was formed to promote the legal rights of tenants in a particular community. To accomplish this objective, it publishes a newsletter and conducts public meetings dealing with matters of concern to tenants. It also operates an information center that provides tenants with answers concerning their rights and obligations under lease agreements with their landlords. In order to present the views of tenants with respect to laws and regulations that affect them, the organization regularly testifies before administrative and legislative bodies. Occasionally, the organization initiates litigation to contest the validity of legislation it feels will adversely affect tenants in the county.

LAW AND ANALYSIS

Section 501(c)(4) of the Code provides for the exemption from federal income tax of civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare.

Section 1.501(c)(4)-1(a)(2)(i) of the Income Tax Regulations provides that an organization is operated exclusively for the promotion of social welfare if it is primarily engaged in promoting in some way the common good and general welfare of the people of the community. An organization embraced within this section is one which is operated primarily for the purpose of bringing about civic betterments and social improvements.

Rev. Rul. 73-306, 1973-2 C.B. 179, holds that a nonprofit organization formed to represent member-tenants of an apartment complex in negotiations with landlords, in litigation, and before local and federal regulatory agencies with respect to matters of mutual concern to the tenants does not qualify for exemption under section 501(c)(4) of the Code.

Rev. Rul. 73-306 is distinguishable because in that revenue ruling the organization's activities are directed primarily toward benefitting its member-tenants rather than, as in the instant case, all tenants in the community.

By promoting the legal rights of tenants in a particular community under the circumstances described above, the organization is promoting the common good and general welfare of the people of the community.

HOLDING

A nonprofit organization that promotes the legal rights of all tenants in a particular community and occasionally initiates litigation to contest the validity of legislation adversely affecting tenants may qualify for exemption under section 501(c)(4) of the Code as a social welfare organization.

APPLICATION INSTRUCTIONS

Even though an organization considers itself within the scope of this revenue ruling, it must file an application on Form 1024, Application for Recognition of Exemption Under Section 501(a) or for Determination Under Section 120, in order to be recognized by the Service as exempt under section 501(c)(4) of the Code. See section 1.501(a)-1 of the regulations. In accordance with the instructions to Form 1024, the application should be filed with the District Director of Internal Revenue for the key district indicated therein.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 73-306 is distinguished.

Section 509.—Private Foundation Defined

26 CFR 1.509(a)-4: Supporting organizations.

Private foundations; supporting organization; control of board by disqualified person. An organization that is exempt under section 501(c)(3) of the Code makes distributions to a university. The organization is controlled by a four member board of directors, one of whom is a

substantial contributor to the organization and a disqualified person. Two other directors are employees of a corporation, also a disqualified person, in which more than 35 percent of the voting power is owned by the substantial contributor. The remaining director is chosen by the university. None of the directors has a veto power. The organization is not a supporting organization within the meaning of section 509 (a)(3).

Rev. Rul. 80-207

ISSUE

Is an organization which makes distributions to a university, under the circumstances described below, a supporting organization within the meaning of section 509(a)(3) of the Internal Revenue Code if it is controlled by a disqualified person and the employees of a disqualified person?

FACTS

The organization is exempt from federal income tax under section 501(c)(3) of the Code. Its purpose is to make distributions to a university described in section 509(a)(1) and section 170(b)(1)(A)(ii).

The organization is controlled by a four member board of directors. One of these directors is a substantial contributor to the organization. Two other directors are employees of a business corporation of which more than 35 percent of the voting power is owned by the substantial contributor. The remaining director is chosen by the university. None of the directors has a veto power over the organization's actions.

LAW AND ANALYSIS

Section 509(a)(3)(C) of the Code provides that in order to qualify as other than a private foundation under section 509(a)(3), an organization may not be controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations described in section 509(a)(1) or (2).

Section 4946 provides that the term "disqualified person" includes a substantial contributor to an organization, and a corporation of which a substantial contributor owns more than 35 percent of the total combined voting power.

Section 1.509(a)-4(j) of the Income Tax Regulations provides that a supporting organization will be considered to be controlled directly or indirectly by one or more disqualified persons if the voting power of such persons is 50 percent or more of the total voting power of the organization's governing body or if one or more of such persons has the right to exercise veto power over the actions of the organization. However, all pertinent facts and circumstances will be taken into consideration in determining whether a disqualified person does in fact indirectly control an organization.

Because only one of the organization's directors is a disqualified person and neither the disqualified person nor any other director has a veto power over the organization's actions, the organization is not directly controlled by a disqualified person under section 1.509(a)-4(j) of the regulations. However, in determining whether an organization is indirectly controlled by one or more disqualified persons, one circumstance to be considered is whether a disqualified person is in a position to influence the decisions of members of the organization's governing body who are not themselves disqualified persons. Thus, employees of a disqualified person will be considered in determining whether one or more disqualified persons controls 50 percent or more of the voting power of an organization's governing body.

Two of the organization's four directors are also employees of a corporation that is itself a disqualified person because more than 35 percent of its voting power is owned by a disqualified person. Because a majority of its board of directors consists of a disqualified person and employees of a disqualified person, the organization is indirectly controlled by disqualified persons within the meaning of section 509(a)(3)(C) of the Code.

HOLDING

Since the organization is controlled by a disqualified person and the employees of a disqualified person, under the circumstances described above, it is not a supporting organization within the meaning of section 509(a)(3) of the Code.

Section 892.—Income of Foreign Governments and of International Organizations

26 CFR 1.892-1: Income of foreign governments and international organizations. (Also Sections 911, 912, 913, 3121; 5b.-911-1, 1.912-1, 5b.913-2, 31.3121(a)-1.)

Taiwan Relations Act. The tax implications of the Taiwan Relations Act are discussed.

Rev. Rul. 80-208

ISSUES

(1) Are the Internal Revenue Code provisions that are applicable to foreign governments applicable to Taiwan?

(2) Is the American Institute in Taiwan (the Institute) exempt from United States taxation?

(3) How are employees of the Institute treated for federal income tax purposes?

LAW AND HOLDINGS

(1) Section 4(a) of the Taiwan Relations Act (the Act), Pub. L. No. 96-8, 1979-1 C.B. 459, provides that the laws of the United States shall apply with respect to Taiwan in the manner that the laws of the United States applied with respect to Taiwan prior to January 1, 1979.

Section 4(c) of the Act provides that for all purposes the Congress approves the continuation in force of all treaties and all other international agreements, including multilateral conventions, entered into by the United States and the governing authorities on Taiwan, which were in force between them on December 31, 1978, unless and until terminated in accordance with law.

Thus, all laws, including the Internal Revenue Code, treaties, international agreements, and conventions between the United States and Taiwan that were in force on December 31, 1978, are continued in force unless and until terminated by law.

(2) Section 8 of the Act provides that the Institute, its property, and its income are exempt from all taxation imposed by the United States or any state or local taxing authority of the United States, except to the extent provided for in section 11(a)(3) of the Act relating to the Federal Insurance Contributions Act (FICA), which may apply to certain employees of the Institute. The FICA provisions will apply for Institute employees, who before becoming Institute employees were employees of any agency of the United States covered by FICA and upon termination of their Institute employment are entitled to reemployment or reinstatement with such agency, since section 11(a)(3) of the Act requires that such employees have their benefits (including FICA benefits) continued during their Institute employment.

(3) Section 11(d)(1) of the Act provides that for purposes of sections 911 and 913 of the Code amounts paid by the Institute to its employees shall not be treated as earned income. Also, amounts received by employees of the Institute shall not be included in gross income, and shall be exempt from taxation, to the extent that they are equivalent to amounts received by civilian officers and employees of the Government of the United States as allowances and benefits that are exempt from taxation under section 912.

Section 911.—Income Earned by Individuals in Certain Camps

26 CFR 5b.911-1: Individuals qualifying for the exclusion.

Whether employees of the American Institute in Taiwan have earned income for purposes of this section. See Rev. Rul. 80-208, page 12.

Section 912.—Exemption for Certain Allowances

26 CFR 1.912-1: Exclusion of certain cost-of-living allowances.

Whether employees of the American Institute in Taiwan are exempt from taxation to the extent provided for in this section. See Rev. Rul. 80-208, page 12.

Section 913.—Deduction for Certain Expenses of Living Abroad

26 CFR 5b.913-2: Taxpayers qualifying for the deduction.

Whether employees of the American Institute in Taiwan have earned income for purposes of this section. See Rev. Rul. 80-208, page 12.

Section 2001.—Imposition and Rate of Tax

26 CFR 20.0-1: Introduction.
(Also Section 2101; 20.2101-1.)

Domicile; illegal alien. An illegal alien who lived in the U.S. for 19 years with the alien's family, purchased a residence, and established strong community ties was domiciled in the U.S. at the date of death and the taxable estate is subject to the tax imposed by section 2001 of the Code.

Rev. Rul. 80-209

ISSUE

For purposes of the federal estate tax imposed by section 2001 of the Internal Revenue Code, was a person who entered the United States illegally and who continued to live in the United States until death a resident of the United States at the date of death?

FACTS

The decedent entered the United States illegally in 1959. Two years later, the decedent's spouse also entered the United States illegally. Up to the date of death in 1978, the decedent continued to remain in the United States. The decedent never secured a visa from the Government, nor did the decedent ever apply for and receive official permission to reside in the United States. Therefore, the decedent was at all times after entering the United States subject to the laws regarding deportation of aliens.

In 1963, the decedent purchased a home in the United States and resided there until death. The decedent was, during the fifteen years prior to death, a member of several local clubs and an active participant in community affairs.

In 1964 and in 1972, the decedent purchased real property in the decedent's native country through the services of an agent. After the purchases, the properties were leased to a succession of tenants.

The representatives of the decedent's estate have argued that the decedent was not a resident of the United States and that the real property located in the decedent's native country is not includible in the federal gross estate.

LAW AND ANALYSIS

Section 2001(a) of the Code imposes a tax on the transfer of the taxable estate of "every decedent who is a citizen or resident of the United States." The tax imposed by section 2001(a) applies, in general, to property owned by a resident of the United States regardless of where the property is located.

Section 2101 of the Code imposes a separate tax on the transfer of the taxable estate of "every decedent nonresident not a citizen of the United States." Under section 2103, the gross estate of a nonresident who is not a United States citizen includes, for purposes of the tax imposed by section 2101, only property situated in the United States.

Section 20.0-1(b)(1) of the Estate Tax Regulations defines the term "resident" as follows:

> A "resident" decedent is a decedent who, at the time of his death, had his domicile in the United States. . . . A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later removing therefrom. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile, nor will intention to change domicile effect such a change unless accompanied by actual removal.

The question of whether the taxable estate of a decedent who is not a United States citizen is subject to the federal estate tax under section 2001 of the Code depends upon where the decedent was domiciled at the date of death.

The requirements for acquiring a domicile are (1) legal capacity to do so; (2) physical presence; and (3) a current intention to make a home in the place. Restatement (Second) of Conflict of Laws § 15, Comment a (1971).

Legal capacity to acquire a domicile of choice has been found to exist even when people are subject to transfer to another domicile at the direction of others. *See, e.g., Stifel v. Hopkins*, 477 F.2d 1116, 1120 (6th Cir. 1973). Therefore, the fact that the decedent was subject to deportation does not render the decedent legally incapable of acquiring a domicile.

Because the decedent was physically present in this country at the date of death, the decedent would have been domiciled in the United States if the decedent had a current intention to make the United States a home. However, once a person has established a domicile in one place, it is presumed to continue in that place until it is shown to have been changed. *Mitchell v. United States*, 88 U.S. (21 Wall.) 350 (1874). The presumption can be rebutted upon facts showing an intention to remain in the United States for an indefinite period or on a permanent basis. See generally, Restatement (Second) of Conflict of Laws § 18, comment d (1971). Some of the factors used in determining such requisite intention are home ownership, local community ties and living with one's family in the claimed domicile. *See Farmer's Loan & Trust Co. v. United States*, 60 F.2d 618 (S.D.N.Y. 1932).

In the present case, the fact that the decedent lived in the United States for a long time with the decedent's family and that the decedent established strong community ties indicates an absence of any fixed intention of returning to the native country.

The purchase of property located in a person's native country is not sufficient to conclude that the decedent was not domiciled in the United States, especially since the location of an investment is not indicative of domicile. *See Rodiek v. Commissioner*, 33 B.T.A. 1020, 1034 (1936), affirmed, 87 F.2d 328 (2nd Cir. 1937), Ct. D. 1229, 1937-1 C.B. 290. The facts in the present case thus indicate that the decedent intended to remain in the United States indefinitely.

HOLDING

The decedent was domiciled in the United States at the date of death. Therefore, the taxable estate of the decedent is subject to the federal estate tax imposed by section 2001 of the Code. Further, the same conclusion would result, under the facts presented, if the decedent had entered the United States legally in 1959 as a nonimmigrant holding a visa and had remained in the United States after the visa expired. Even though such a decedent, at the time of entry, may not have had the intent to remain in the United States, nevertheless, that decedent may subsequently form the intent to remain in the United States indefinitely and establish domicile in the United States.

Section 2013.—Credit for Tax on Prior Transfers

26 CFR 20.2013-3: "Second limitation."
(Also Section 2056; 20.2056(c)-1.)

Credits against tax; prior transfers; marital deduction. In determining the credit for tax on prior transfers under the "second limitation" of section 2013(c)(1) of the Code, for purposes of computing the tax on the reduced adjusted gross estate of a decedent who died after 1976, the applicable marital deduction is the value of the property actually passing to the surviving spouse, but not to exceed the greater of $250,000 or one-half of the reduced adjusted gross estate; Rev. Rul. 60-161 amplified.

Rev. Rul. 80-210

ISSUE

In determining the "second limitation" on the credit for tax on prior transfers under section 2013(c)(1) of the Internal Revenue Code, what is the applicable marital deduction used in computing the estate tax on the reduced gross estate, under the circumstances described below?

FACTS

D died in May 1979, leaving a surviving spouse, *S*. *D* had made no gifts after December 31, 1976. The value of the gross estate included on the federal estate tax return was $600,000, and debts and expenses in the amount of $40,000 were claimed as deductions. *D* bequeathed to *S* an amount equal to one-half of the federal adjusted gross estate. Thus, *S* received $280,000 ($\frac{1}{2} \times$ $560,000), and a marital deduction was claimed for that amount. A tax on prior transfer credit was claimed under section 2013 of the Code based on a transfer of $100,000 that *D* received from the estate of *D*'s parent, who died in November 1977.

LAW AND ANALYSIS

Section 2013 of the Code provides, in general, that a transferee's estate is allowed a credit for the estate tax paid on property transferred to the transferee from a transferor who died within ten years before, or within two years after, the transferee's death. The amount of the credit is the lesser of two limitations.

The "second limitation", as prescribed in section 2013(c)(1) of the Code and section 20.2013-3 of the Estate Tax Regulations, provides that the amount of the credit shall not exceed the amount by which (A) the transferee's estate tax, computed after the allowance of all credits except the credit for tax on prior transfers, exceeds (B) such tax computed by excluding from the transferee's gross estate the value of the transferred property.

Section 2056 of the Code provides, with certain limitations, a deduction from the value of the gross estate for the value of the property that passes from the decedent to the surviving spouse. For estates of decedents dying before January 1, 1977, section 2056(c) provided that the amount of the marital deduction was limited to one-half of the value of the adjusted gross estate. The Tax Reform Act of 1976, Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, amended section 2056(c) for estates of decedents dying after December 31, 1976, to provide generally that the marital deduction shall not exceed the greater of $250,000 or one-half of the adjusted gross estate.

Rev. Rul. 60-161, 1960-1 C.B. 367, provides that if a marital deduction under section 2056 of the Code is allowable in the transferee's estate, then, in computing the estate tax on the reduced gross estate (the gross estate less the value of the transferred property) under section 2013(c)(1)(B), the applicable marital deduction is the value of the property passing to the surviving spouse, but not to exceed one-half of the reduced adjusted gross estate (the adjusted gross estate less the value of the transferred property).

In computing the estate tax on the reduced gross estate in accordance with section 2013(c)(1)(B) of the Code, for estates of transferees dying after December 31, 1976, the applicable marital deduction is the value of the property passing to the surviving spouse, but not to exceed, generally, the greater of $250,000 or one-half of the reduced adjusted gross estate.

In this case the value of the property passing to the surviving spouse is $280,000 and the reduced adjusted gross estate equals $460,000 ($600,000 gross estate less $100,000 transferred property less $40,000 debts and expenses). The maximum marital deduction allowable in computing the estate tax on the reduced estate is therefore $250,000; the value of the property passing to the surviving spouse ($280,000), but not to exceed the greater of $250,000 or one-half of the reduced adjusted gross estate ($230,000).

HOLDING

In determining the "second limitation" on the credit for tax on prior transfers under section 2013(c)(1) of the Code, the applicable marital deduction in this case is $250,000.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 60-161 is amplified.

Section 2056.—Bequests, Etc., to Surviving Spouse

26 CFR 20.2056(c)-1: Marital deduction; limitation on aggregate of deductions; in general.

Determination of marital deduction for purpose of computing tax on the reduced gross estate of a decedent dying after 1976. See Rev. Rul. 80-210, page 14

Section 2101.—Tax Imposed

26 CFR 20.2101-1: Estates of nonresidents not citizens; tax imposed.

Whether an alien who entered the U.S. illegally and continued to live in the U.S. until death was domiciled in the U.S. at the date of death. See Rev. Rul. 80-209, page 13.

Section 3121.—Definitions [Federal Insurance Contributions Act]

26 CFR 31.3121(a)-1: Wages.

Whether employees of the American Institute in Taiwan are subject to FICA. See Rev. Rul. 80-208, page 12.

Section 6050B.—Returns Relating to Unemployment Compensation

26 CFR 1.6050B-1: Information returns by person making unemployment compensation payments.

Requirement for persons making unemployment compensation payments to file information returns. See T.D. 7705, page 5.

Part III. Administrative, Procedural, and Miscellaneous

Delegation Order No. 183 (Effective June 23, 1980)

Extension of Time for Making Certain Elections

I. Pursuant to authority granted to the Commissioner of Internal Revenue by 26 CFR 1.9100-1, the Assistant Commissioner (Technical) and the Assistant Commissioner (Employee Plans and Exempt Organizations) are authorized to grant a reasonable extension of time fixed by regulations for making an election or application for relief in respect of tax under Subtitle A of the Code, subject to the requirements of 26 CFR 1.9100-1.

II. This authority may be redelegated to Division Directors and Branch Chiefs. In the case of granting extensions of time for filing applications for change in accounting method and accounting period not involving precedent issues this authority may be redelegated to the Chief of Ruling Section 1, Corporation Tax Branch.

JEROME KURTZ,
Commissioner.

(Filed by the Office of the Federal Register on July 3, 1980, 8:45 a.m., and published in the issue of the Federal Register for July 7, 1980, 45 F.R. 45751)

Part IV. Items of General Interest

U.S.-British Virgin Islands Income Tax Treaty—Public Meeting

Announcement 80-96 [1]

The Treasury Department will hold a public meeting on August 19, 1980, to solicit the views of interested persons on issues being considered in the negotiation of a new income tax treaty to replace the treaty currently in force between the United States and the British Virgin Islands [1947-1 C.B. 209].

The public meeting will be held at the Treasury Department, at 2:00 p.m., in room 4121. Persons interested in attending are requested to give notice in writing by August 8, 1980, of their intention to attend. Notices should be addressed to H. David Rosenbloom, International Tax Counsel, Department of the Treasury, Washington, D.C. 20220.

The present treaty is a 1958 extension to the British Virgin Islands of the then current income tax treaty between the United States and the United Kingdom. The need to revise the treaty has arisen out of two principal considerations: the fact that many of the provisions of the present treaty are either outdated or not relevant to the economic relationships between the United States and the British Virgin Islands and the fact that certain persons may receive benefits of the treaty in ways which were not intended at the time the treaty was extended to the British Virgin Islands.

The announcement of the public meeting follows the recent conclusion of a series of discussions between representatives of the United States and the British Virgin Islands. On the basis of these discussions, it is agreed that the general form of the new treaty will be patterned after the U.S. Model treaty and a new U.S.-U.K. treaty [1980-21 I.R.B. 5]. It is also agreed, however, that the new treaty with the British Virgin Islands will provide for rates of withholding tax at source on dividends, interest, and royalties of at least 15 percent. The new treaty will also include an article patterned after Article 16 of the U.S. Model treaty, designed to deny benefits of reduced U.S. withholding rates on dividends, interest, and royalties paid to a British Virgin Islands corporation in certain circumstances. Transitional rules for certain transactions entered into prior to July 1, 1980, are contemplated.

The Treasury seeks the views of interested persons in regard to this agreement, as well as other matters relevant to an income tax treaty between the United States and the British Virgin Islands. The August 19 public meeting is being held to provide an opportunity for an exchange of views, as well as for the purpose of discussing the United States position in regard to the issues presented in the negotiations.

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[1] Filed by the Office of the Federal Register on June 26, 1980, and published in the issue of the Federal Register for June 27, 1980, 45 F.R. 43516.

Form 4361, Application for Exemption from Self-Employment Tax for Use by Ministers, Members of Religious Orders, and Christian Science Practitioners, Revised

Announcement 80-97

Form 4361, which relates to applications for exemption from self-employment tax, has been revised to further clarify and modify the instructions.

Form 4361 (Revised May 1980) has also been revised to:

1) Provide that the exemption from self-employment tax, if received, may not be revoked.

2) Reflect three recently issued revenue rulings.

3) Require that an applicant attach to Form 4361 a letter from the governing body of the church or religious order establishing the applicant's status if he or she did not receive a certificate.

Existing supplies of Form 4361 (Revised Mar. 1978) should not be used. The revised form will be available at Internal Revenue Services offices in July 1980.

Sponsors for Tax Counseling for the Elderly

Announcement 80-98 [1]

Public service organizations interested in sponsoring local or nationwide Tax Counseling for the Elderly (TCE) programs must submit their applications by August 15, 1980, the Service has announced.

Tax Counseling for the Elderly is a Service-administered program through which volunteers from sponsoring organizations provide free tax assistance and information to individuals age 60 and over. Organizations that sponsor programs may be reimbursed by the Service for expenses incurred.

Any private or public non-profit organization or agency with experience in volunteer activities may apply for TCE sponsorship. Selections will be made in October. TCE programs will take place during next year's federal tax filing season from January 1 through April 15, 1981.

The TCE application package contains program guidelines, rules and requirements for sponsorship, and an application form.

Organizations can obtain the application package by writing or calling the Service at:

Tax Counseling for the Elderly Program
Taxpayer Service Division TX:T:I
Internal Revenue Service
1111 Constitution Ave., N.W.
Washington, D.C. 20224
(202) 566-4904

Carryover Basis Forms Obsoleted

Announcement 80-99

Effective August 1, 1980, Form 5970, Information Notice to IRS as Required by IRC Section 6039A(a), and Form 5970-A, Election of Carryover Basis, are obsolete.

The Crude Oil Windfall Profit Tax Act of 1980, Pub. L. 96-223, 1980-3 C.B. 2, 71, repealed the carryover basis rules of section 1023 of the Internal Revenue Code. However, a provision of this law allowed the personal representatives of the estates of decedents who died after December 31, 1976, and before November 7, 1978, to elect carryover basis rules during a 120 day period after enactment of the law. The period for the election ended on July 31, 1980.

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[1] Based on News Release IR-80-80, dated July 17, 1980.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
John H. Frazier	Nashville, TN	Certified Public Accountant	Fifteen months effective June 16, 1980
Clifford Y. Pierce	Miami, FL	Certified Public Accountant	Indefinite effective June 13, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 48.4221-3 amended.	Tax treatment of articles previously sold tax free for exportation under section 4221(a)(2).	June 9, 1980	Aug. 8, 1980
26 CFR 48.4042-1 through 48.4042-3 added.	Tax on the use of fuel in commercial waterway transportation.	June 9, 1980	Aug. 8, 1980
26 CFR 1.170A-4, 1.301-1, 1.312-3, 1.341-6, 1.453-9, 1.751-1, 1.1502-14 amended; 1.1254-1 through 1.1254-5 added.	Treatment of gain from the disposition of certain oil, gas, or geothermal property.	June 11, 1980	Aug. 11, 1980
26 CFR 1.411(d)-1 as proposed in the Federal Register for April 9, 1980, 45 F.R. 24201, withdrawn; 1.411(d)-1 amended.	Coordination of vesting and discrimination requirements for qualified pension, etc. plans.	June 12, 1980	Aug. 11, 1980
26 CFR 48.4221-2 amended.	Tax-free sales of articles to be used for, or resold for, further manufacture.	July 2, 1980	Aug. 31, 1980

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27, dated July 7, 1980.

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Key to Abbreviations:

RR	Revenue Ruling
RP	Revenue Procedure
TD	Treasury Decision
CD	Court Decision
PL	Public Law
EO	Executive Order
DO	Delegation Order
TDO	Treasury Department Order
TC	Tax Convention
SPR	Statement of Procedural Rules
PTE	Prohibited Transaction Exemption

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August 11, 1980
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Internal Revenue
bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENT

Announcement 80-107, page 19.
A public hearing will be held on September 4, 1980, on proposed regulations relating to qualified group legal services plans.

INCOME TAX

Rev. Rul. 80-211, page 5.
Business expenses; punitive damages. Amounts paid by a corporation as punitive damages that arose as a result of a civil lawsuit against the corporation for breach of contract and fraud in connection with the ordinary conduct of its business activities are deductible as ordinary and necessary business expenses.

Rev. Rul. 80-212, page 5.
Per diem allowance; away from home. An employee who participated in a 12-month executive training program at various offices throughout the country pending reassignment in a new location was away from home and could exclude from gross income a per diem allowance paid by the employer. The per diem allowance was not wages subject to income tax withholding.

Rev. Rul. 80-213, page 7.
"Stapled," "paired," or "back-to-back" stock; valuation. Factors are set forth that should be considered, in addition to those in Rev. Rul. 59-60, in valuing the stock of a subsidiary corporation that is distributed to the shareholders of the former parent and that can be sold only with the stock of the distributing corporation; Rev. Rul. 59-60 amplified.

Rev. Rul. 80-214, page 8.
LIFO; price indexes; department stores. The January 1980 Bureau of Labor Statistics price indexes are acceptable for use by department stores employing the retail inventory and last-in, first-out inventory methods of valuing inventories for taxable years of 12 months ended December 31, 1979, and January 31, 1980.

Rev. Rul. 80-216, page 10.
Condominium conversions; capital gain v. ordinary income. Section 1237 of the Code does not apply to the conversion of rental units in an apartment building into condominiums and the sale of the condominiums to the general public.

Announcement 80-100, page 17.
Various areas of the States of Nebraska and Pennsylvania have been declared disaster areas in which losses qualify for the special tax treatment under section 165(h) of the Code.

Announcement 80-105, page 18.
Various areas of the States of Florida and New York have been declared disaster areas in which losses qualify for the special tax treatment under section 165(h) of the Code.

EXEMPT ORGANIZATIONS

Rev. Rul. 80-215, page 9.
Promoting sports for children. An otherwise quali-

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Announcement of Voluntary Suspension on page 20.
Announcement of Notice of Proposed Rulemaking on page 21.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

EXEMPT ORGANIZATIONS—Cont'd

fying organization that is formed to develop, promote, and regulate a sport for individuals under 18 years of age by organizing local and statewide competitions, promulgating rules, organizing officials, presenting seminars, distributing a newsletter, and otherwise encouraging growth of the sport qualifies for exemption under section 501 (c)(3) of the Code; Rev. Rul. 70-4 distinguished.

Announcement 80-101, page 17.
A listing is given of organizations now classified as private foundations and an organization that is not a private operating foundation.

EMPLOYMENT TAXES

Rev. Rul. 80-212, page 5.
Per diem allowance; away from home. An employee who participated in a 12-month executive training program at various offices throughout the country pending reassignment in a new location was away from home and could exclude from gross income a per diem allowance paid by the employer. The per diem allowance was not wages subject to income tax withholding.

EXCISE TAXES

Rev. Rul. 80-217, page 11.
Windfall profit tax; severance tax adjustment. A state privilege tax imposed on the removal of oil, when taken together with the related income tax credit or refund, that is not determined on the basis of the gross value of the extracted oil but is determined by reference to the windfall profit portion of such value does not meet the requirements for the severance tax adjustment that may be taken into account in determining the windfall profit.

Announcement 80-102, page 18.
A correction is made to Rev. Proc. 80-19, which relates to the method by which tire manufacturers, producers, and importers may determine tire and tube weights on an average weight basis for purposes of section 4071(a) of the Code.

ADMINISTRATIVE

Rev. Rul. 80-218, page 12.
Timely filing of returns; taxpayer in foreign country. Tax returns mailed by taxpayers in foreign countries will be accepted as timely filed if they bear an official postmark dated on or before midnight of the last date prescribed for filing, including any extensions.

Ct. D. 2001, page 13.
Evidence; documents illegally seized from third party. Evidence that was discovered as a result of an illegal seizure of documents from a third party, who was not before the court, may not be suppressed in a criminal trial as a Fourth Amendment violation, nor does the supervisory power of the federal courts extend to suppress such evidence. *Payner*, Supreme Court of the United States.

Announcement 80-103, page 18.
Corrections are made to Rev. Proc. 80-22, which relates to areas in which advance rulings and determination letters will not be issued.

Announcement 80-104, page 18.
Publication 79, Statistics of Income—1977, Individual Income Tax Returns, may be purchased from the Superintendent of Documents, Washington, D.C.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 162.—Trade or Business Expenses

26 CFR 1.162-1: Business expenses.

Business expenses; punitive damages. Amounts paid by a corporation as punitive damages that arose as a result of a civil lawsuit against the corporation for breach of contract and fraud in connection with the ordinary conduct of its business activities are deductible as ordinary and necessary business expenses.

Rev. Rul. 80-211

ISSUE

Are amounts paid as punitive damages that are incurred in the ordinary conduct of the taxpayer's business operations deductible as an ordinary and necessary business expense under section 162 of the Internal Revenue Code?

FACTS

X, a domestic corporation, deducted a payment identified as punitive damages as an ordinary and necessary business expense. *X*'s obligation to make such payment arose as a result of a civil lawsuit in which *X* was sued by *Y*, another domestic corporation, for breach of contract and fraud in connection with the ordinary conduct of its business activities. Judgment was rendered against *X* by the court.

LAW AND ANALYSIS

Section 162 of the Code provides that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 162(c) of the Code provides that no deduction shall be allowed under section 162(a) for any illegal payment, bribe, kickback, or rebate when made under any of the circumstances or to or by any of the persons described in section 162(c).

Section 1.162-1(a) of the Income Tax Regulations provides that business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business.

In applying these provisions, the courts and the Service have recognized that payments made in settlement of lawsuits are deductible if the acts which gave rise to the litigation were performed in the ordinary conduct of the taxpayer's business. *See, for example,* Rev. Rul. 78-210, 1978-1 C.B. 39; Rev. Rul. 69-491, 1969-2 C.B. 22; *Kornhauser v. United States,* 276 U.S. 145, T.D. 4222, VII-2 C.B. 267 (1928); *Mulgrew Blacktop, Inc. v. United States,* 311 F. Supp. 570 (S.D. Iowa 1969); and *Cochrane v. Commissioner,* 23 B.T.A. 202 (1931), *acq.* X-2 C.B. 14 (1931).

The Senate Finance Committee in S. Rept. 91-522, 91st Cong., 1st Sess. (1969), 1969-3 C.B. 423, 597, stated that the additions to section 162 of the Code made in section 902 of the Tax Reform Act of 1969, 1969-3 C.B. 10, 147, denying deductions for the following expenditures were intended to be *all inclusive* (Emphasis added): fines or similar penalties paid to a government for violation of any law, a portion of treble damage payments under the antitrust laws, bribes to public officials, and other unlawful bribes or "kickbacks".

In the present situation *X* was sued by another corporation for fraudulent acts and contractual violations perpetuated in the ordinary conduct of its business activities. Therefore, payment of the judgment by *X*, including amounts identified as punitive damages, is an ordinary and necessary cost of doing business. Further, the action against *X* is not based upon any of the prohibited activities described in section 162(c) of the Code.

HOLDING

Amounts paid as punitive damages incurred by the taxpayer in the ordinary conduct of its business operations are deductible as an ordinary and necessary business expense under section 162 of the Code.

26 CFR 1.162-1: Business expenses.
(Also Sections 274, 3401; 1.274-5, 31.3401 (a)-1.)

Per diem allowance; away from home. An employee who participated in a 12-month executive training program at various offices throughout the country pending reassignment in a new location was away from home and could exclude from gross income a per diem allowance paid by the employer. The per diem allowance was not wages subject to income tax withholding.

Rev. Rul. 80-212

ISSUE

Under the circumstances described below, is a taxpayer who participates in a training program of the taxpayer's employer considered "away from home" within the meaning of section 162(a)(2) of the Internal Revenue Code?

FACTS

X, a corporation, conducts a training program whereby potential and current executives are given extensive classroom and on-the-job training at various offices of *X* throughout the United States. The participants in the training program are relieved of their job responsibilities immediately after selection for the program, their positions are filled by others, and they are assigned to 12 months of training. The purpose of the program is to provide *X* with a continuing supply of administrators to cope with the management problems of a complex organization. After satisfactorily completing the 12 months of training, the participants are to be given a permanent appointment to fill an executive vacancy in one of *X*'s offices. It is a virtual certainty that this permanent appointment will be at a location different from where the participant worked when selected by *X* for the program.

A, an unmarried individual who uses the cash receipts and disbursements method of accounting and files returns on a calendar year basis, was assigned to the program described above effective September 1, 1978. *A* had been employed regularly by *X* in city *M* since January 1973, and had been renting an apartment in *M* for 35*x* dollars a month. After *A*'s assignment to the program, *A* did not perform any duties for *X* in the vicinity of *M*, *A*'s position in *M* was filled by another individual, and *A* had no reasonable expectation of returning to *M* to work. However, *A*'s various administrative records continued to be kept in *M* and *X* continued to designate *M* as *A*'s official assignment office.

On August 31, 1979, *A* satisfactorily completed the 12-month training program of *X*. During that time *A* traveled to numerous offices of *X* throughout the country for short temporary periods to observe the various functions in those offices. *A* lived in motels and ate all meals in restaurants. *A* continued to maintain the apartment in city *M*. During this 12-month period, *A* returned to *M* at various times totalling 30 days. *A* stayed in the apartment, visited friends, attended to personal business matters, and generally maintained community contacts. *A* continued to maintain a post office box and bank account in *M* as well as a driver's license and voter registration for the state in which *M* is located. *A* also purchased insurance and filed tax returns in the state in which *M* is located during the 12-month period. *A* received a permanent assignment on September 1, 1979, to a new place of business.

During the training period while *A* was away from city *M*, *X* paid *A* a per diem amount based on the cost of living in the area where *A* was physically located at the particular time. *A* was required to and did provide an adequate accounting to *X* for all expenditures, and such expenditures were reasonable in amount. The per diem amounts were not in excess of such expenditures. *A* did not report the per diem amounts received during the training period in gross income.

LAW AND ANALYSIS

Section 274 of the Code and the regulations thereunder provide rules for reporting and substantiation of certain expenses paid or incurred by taxpayers in connection with the performance of services as employees.

Section 1.274-5(e)(2) of the Income Tax Regulations provides that, for purposes of computing tax liability, an employee need not report on the employee's tax return "business expenses" for travel, transportation, entertainment, gifts and similar purposes, paid or incurred solely for the benefit of the employer for which the employee is required to, and does, make an adequate accounting to the employer and which are charged directly or indirectly to the employer or for which the employee is paid through advances, reimbursements, or otherwise, provided that the total amount of such advances, reimbursements, and charges is equal to such expenses. Therefore, provided these requirements are met, the employee need not report such reimbursements in gross income.

Section 1.274-5(e)(1) of the regulations provides generally that the term "business expenses" means ordinary and necessary expenses for travel, entertainment, or gifts which are deductible under section 162 of the Code, and the regulations thereunder. Thus, the term "business expenses" does not include personal, living or family expenses disallowed by section 262, and advances, reimbursements, or allowances for such expenditures must be reported as income by the employee.

Section 162(a)(2) of the Code provides that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on a trade or business, including traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business.

In this case *A* made an adequate accounting to *X* for all the expenses incurred. The per diem amounts were not in excess of such expenses, and the expenses were not lavish or extravagant. Therefore, whether *A* must report the per diem amounts received from *X* in gross income depends on whether *A*'s travel expenses were paid or incurred while "away from home" within the meaning of section 162(a)(2) of the Code.

Rev. Rul. 73-529, 1973-2 C.B. 37, provides that generally a taxpayer's "home" for purposes of section 162(a)(2) of the Code is considered to be located at (1) the taxpayer's regular or principal (if more than one regular) place of business, or (2) if the taxpayer has no regular or principal place of business because of the nature of the trade or business, then at the taxpayer's regular place of abode in a real and substantial sense. If the taxpayer comes within neither category (1) nor category (2), the taxpayer is considered to be an itinerant who has a "home" wherever the taxpayer happens to work, and thus is not "away from home" for traveling expense deduction purposes. The revenue ruling further provides that there are three objective factors that may be used to determine, with respect to the taxable year in question, the bona fide nature of an assertion that the taxpayer's claimed abode is the taxpayer's "regular place of abode in a real and substantial sense." They are:

(1) Whether the taxpayer performs a portion of the taxpayer's business in the vicinity of the claimed abode and uses such abode (for purposes of lodging) while performing such business there;

(2) Whether the taxpayer's living expenses incurred at the claimed abode are duplicated because the taxpayer's business requires travel away therefrom; and

(3) Whether the taxpayer—

(a) has not abandoned the vicinity in which the historical place of lodging and claimed abode are both located,

(b) has a member or members of the taxpayer's family (marital or lineal only) currently residing at the claimed abode, or

(c) uses the claimed abode frequently for purposes of lodging.

The Service will recognize that a taxpayer has a "home" for traveling expense deduction purposes if the taxpayer claims an abode and, under bona fide circumstances, satisfies all three objective factors set forth above. If a taxpayer, under bona fide circumstances, satisfies only two of the three objective factors set forth above, then all the facts and circumstances of the case will be subjected to close scrutiny to determine whether the taxpayer has a "home" for traveling expense deduction purposes in the form of a regular place of abode in a real and substantial sense. If a taxpayer fails to satisfy at least two of the three objective factors set forth above, the taxpayer will be regarded as having a "home" wherever the taxpayer happens to work, and thus cannot be "away from home" for purposes of section 162(a)(2) of the Code.

After *A* was assigned to the program on September 1, 1978, *A* did not have a regular or principal place of business in city *M* because *A* was released from all job responsibility in *M* and had no reasonable expectation of returning there to work. The fact that *A*'s administrative records continued to be kept at *M* and that *A*'s assignments were issued from *M* does not change this conclusion. Nor did *A* have a regular or principal place of business in any other location because *A*'s training assignments were temporary pending permanent assignment on September 1, 1979. Therefore, whether *A* was away from home depends on a determination of where *A*'s regular place of abode was in a real and substantial sense while *A* was a participant in the training program.

Applying the three objective factors listed above to *A*'s situation during the time period September 1, 1978, to August 31, 1979, *A* did not satisfy factor (1) because *A* did not perform any business in the vicinity of city *M*. However, *A* did satisfy factor (2) because *A* did duplicate living expenses incurred in *M* in that *A* continued to rent the apartment. *A* also satisfied factor (3) because *A* had not abandoned the vicinity in which *A*'s historical place of lodging and claimed abode were located in that *A* maintained the apartment in *M* and also returned to *M* to generally maintain community contacts there. In addition, *A* did use the claimed abode frequently for purposes of lodging.

Based on all the facts and circumstances of this case, including the satisfaction of factors (2) and (3) and the additional contacts with city *M* that *A* maintained (such as maintaining a post office box and bank account in *M*, maintaining a driver's license and voter registration for the state in which *M* is located, and purchasing insurance and filing tax returns in the state in which *M* is located during the 12-month period), *A* is considered to have had a home in *M* in the form of a regular place of abode in a real and substantial sense during the period from September 1, 1978, to August 31, 1979.

HOLDING

Because *A*'s home in the form of a regular place of abode in a real and substantial sense remained in city *M* during the training period which lasted through August 31, 1979, *A* was "away from home" during the 12-month training period. Therefore, during that time, *A* need not report any per diem allowance received from *X* in gross income. In addition, the per diem allowance is not considered "wages" subject to income tax withholding pursuant to section 31.3401(a)-1(b)(2) of the Employment Tax Regulations.

Section 274.—Disallowance of Certain Entertainment, Etc., Expenses

26 CFR 1.274-5: Substantiation requirements.

Whether a taxpayer who participates in a training program of the taxpayer's employer is considered "away from home" and may accordingly exclude per diem amounts from gross income. See Rev. Rul. 80-212, page 5.

Section 301.—Distributions of Property

26 CFR 1.301-1: Rules applicable with respect to distribution of money and other property.

"Stapled," "paired," or "back-to-back" stock; valuation. Factors are set forth that should be considered, in addition to those in Rev. Rul. 59-60, in valuing the stock of a subsidiary corporation that is distributed to the shareholders of the former parent and that can be sold only with the stock of the distributing corporation; Rev. Rul. 59-60 amplified.

Rev. Rul. 80-213

SECTION 1. PURPOSE

The purpose of this revenue ruling is to provide information and guidance to taxpayers, Internal Revenue Service personnel, and others concerned with the valuation for federal tax purposes, of stock of a subsidiary corporation that is distributed to the shareholders of the former parent and can be sold only with the stock of the distributing corporation. Such stock is referred to as "stapled," "paired" or "back-to-back" stock.

SEC. 2. BACKGROUND

There are variations in the methods by which stapling arrangements are created, but they generally have the following features in common: (a) An existing domestic corporation organizes a new foreign affiliate to conduct business in a foreign country. The affiliate is usually organized in a country with lower tax rates than the United States or that offers other tax advantages. (b) The affiliate issues the same number of shares as the parent company has outstanding. (c) The shares of the affiliate are distributed ratably to the shareholders of the domestic corporation. (d) The shares of the two companies are stapled or paired so that they can be transferred only as a unit. (e) There is generally a close association in the operations of the two companies.

The distribution by the parent of the subsidiary stock to the parent's shareholders under these circumstances is a distribution of property to the shareholders within the meaning of section 301(a) of the Internal Revenue Code and will be includable in the gross incomes of the parent's shareholders as a dividend distribution to the extent provided in section 301(c) and section 316. Rev. Rul. 54-140, 1954-1 C.B. 116. Also, see *Wilkinson v. Commissioner*, 29 T.C. 421 (1957), *nonacq.*, 1960-2 C.B. 8.

SEC. 3. NATURE OF THE PROBLEM

In many instances the stock of the distributing company is publicly traded on one of the organized exchanges or in the over-the-counter market. Therefore, market quotations are available for the stock of the distributing company prior to the distribution and for the stapled stock after the distribution. There are no market transactions solely in the stock of the distributed corporation. Consequently, some other measure of its value must be used.

Rev. Rul. 59-60, 1959-1 C.B. 237, outlines and reviews in general, the approach, methods and factors to be considered in valuing shares of capital stock of closely held corporations. The methods discussed therein also apply to the valuation of corporate stocks in which market quotations are either unavailable or are so infrequent that they do not reflect fair market value. Rev. Rul. 68-609, 1968-2 C.B. 327, points out that the general approach, methods, and factors outlined in Rev. Rul. 59-60, as modified, are equally applicable to valuations of corporate stocks for income and other tax purposes as well as for estate and gift tax purposes and apply in determining the fair market value of business interests.

Although Rev. Rul. 59-60 does not provide specific rules for stapled stock, it does provide general guidelines for valuing such stock of the distributed corporation. There are factors surrounding the formation of the distributed corporation, the distribution of its shares, its continued operation, and the sale of its stock that are not encountered in valuing the stock of a typical closely held corporation. A proper analysis of fair market value of stapled stock requires the consideration of all relevant facts and circumstances.

SEC. 4. VALUATION CONSIDERATIONS

The following factors, in addition to those mentioned in Rev. Rul. 59-60, should be considered in valuing stapled stock.

.01 Valuation of securities is, in essence, a prophecy as to the future and must be based on facts available and the prospective economic conditions as of the valuation date. Because the future of the distributed and distributing corporation will be closely associated by the stapling of the stock of the two corporations, the history and experience of the distributing corporation in conducting the same or similar business of the distributed corporation should be considered.

.02 In reviewing the prior earnings of the distributed company in operating the business either as a division or a subsidiary, adjustments must be made to the earnings to account for changes that will result because of the change in status. The distributed company may not be subject to United States laws in general and may no longer be subject to federal income taxes.

.03 When the subsidiary is a foreign corporation, consideration should be given to the corporation laws of the host country, the political stability of the host country and the countries in which the company operates, the possibility of changes in the rate of exchange, and restrictions on the transfer of funds. Consideration should also be given to the fact that the management of the distributing company weighed these factors along with other advantages and disadvantages in arriving at the decision to conduct business under this form of organization.

.04 The quality, experience, and reputation of the company are important factors in the valuation of a business. Where the distributed company proposes to carry on a business on much the same basis as had existed prior to the distribution, consideration should be given to the good will and going concern value developed by the distributing company and also whether the management of the distributed company will be composed of largely the same persons as had existed prior to the realignment. Consideration should also be given to the possibility of the distributed company being able to call upon personnel of the distributing company for specialized areas of expertise.

.05 Any financial assistance in the form of direct loans, surety arrangements, or performance guarantees from the distributing company would tend to place the distributed company in a more favorable position than if it were to exist as an operationally independent entity.

.06 Whether the distributed company is to assume any existing contracts or is to be assigned contracts from any particular customers or in any particular geographical area should be noted.

.07 If the distributed company meets stock exchange listing requirements only by virtue of the stapling arrangement, this enhanced marketability is a valuation factor to be considered.

.08 In most instances, the best measure of the value of closely held stock is found in the prices at which the stock of companies engaged in the same or a similar line of business are selling in a free and open exchange. When stock is valued by this approach it is generally necessary to adjust the preliminary value in recognition that the shares of the comparative companies are publicly traded while the shares to be valued are not.

Where the stock of the distributing corporation is registered prior to the distribution, the stapled shares can be publicly traded after the distribution with the stock of the distributing corporation. Therefore, no discount for lack of marketability is appropriate in that instance.

SEC. 5. EFFECT ON OTHER DOCUMENTS

Rev. Rul. 59-60, as modified by Rev. Ruls. 65-193, 1965-2 C.B. 370, and 68-609, 1968-2 C.B. 327, and as amplified by Rev. Rul. 77-287, 1977-2 C.B. 319, is further amplified.

Section 472.—Last-In, First-Out Inventories

26 CFR 1.472-1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The January 1980 Bureau of Labor Statistics price indexes are acceptable for use by department stores employing the retail inventory and last-in, first-out inventory methods of valuing inventories for taxable years of 12 months ended December 31, 1979, and January 31, 1980.

Rev. Rul. 80-214

The following price indexes for January 1980 published by the Bureau of Labor Statistics on March 4, 1980, for use by department stores employing the retail inventory and last-in, first-out inventory methods are accepted by the Internal Revenue Service pursuant to section 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 72-21, 1972-1 C.B. 745, for appropriate application to inventories for taxable years of 12 months ended December 31, 1979, and January 31, 1980.

Indexes are given on a national basis for the store total, for 20 major groups of departments, and for two special combinations—soft and durable goods. The store total index covers all departments, including some not listed separately, with the following exceptions: candy, foods, liquor, tobacco, paints, and wallpaper, as well as contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS
(January 1941 = 100)

	Department group	January 1979	January 1980	Percentage Change from January 1979 to January 1980[1]
I	Piece Goods	316.0	335.0	6.0
II	Domestics and Draperies	388.3	406.0	4.6
III	Women's and Children's Shoes	454.3	486.5	7.1
IV	Men's and Boys' Shoes	543.9	599.3	10.2
V	Infants' Wear	358.0	378.8	5.8
VI	Women's Underwear	297.5	317.7	6.8
VII	Women's and Girls' Hosiery	185.3	193.8	4.6
VIII	Women's and Girls' Accessories	356.8	374.7	5.0
IX	Women's Outerwear and Girls' Wear	322.3	326.4	1.3
X	Men's Clothing	408.6	406.8	—.4
XI	Men's Furnishings	349.4	374.6	7.2
XII	Boys' Clothing and Furnishings	345.0	365.1	5.8
XIII	Jewelry	495.2	605.4	22.3
XIV	Notions	368.1	393.2	6.8
XV	Toilet Articles and Drugs	412.5	442.5	7.3
XVI	Furniture and Bedding	411.8	441.4	7.2
XVII	Floor Covering	330.1	348.9	5.7
XVIII	Housewares	537.4	590.3	9.8
XIX	Major Appliances	192.4	203.1	5.6
XX	Radio and Television	113.5	115.1	1.4
	Groups I—XV: Soft Goods	370.6	390.1	5.3
	Groups XVI—XX: Durable Goods	350.2	375.6	7.3
	Store Total	364.4	385.4	5.8

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[1] Absence of a minus sign before percentage change in this column signifies price increase.

Section 501.—Exemption from Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Promoting sports for children. An otherwise qualifying organization that is formed to develop, promote, and regulate a sport for individuals under 18 years of age by organizing local and statewide competitions, promulgating rules, organizing officials, presenting seminars, distributing a newsletter, and otherwise encouraging growth of the sport qualifies for exemption under section 501(c)(3) of the Code; Rev. Rul. 70-4 distinguished.

Rev. Rul. 80-215

ISSUE

Does a nonprofit organization that develops, promotes, and governs a sport for individuals under 18 years of age in a particular state, under the circumstances described below, qualify for exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code?

FACTS

The organization, which otherwise qualifies for exemption under section 501(c)(3) of the Code, was formed to develop, promote, and regulate a sport for junior players, and to promote sportsmanlike competition for junior players in a particular state. The organization is comprised of affiliated individual associations, clubs, leagues, and teams. Each club may be comprised of any number of teams. Each team, represented by one coach, votes to elect one person from its club to be a member of the organization for two years.

The organization organizes local and state-wide competition for individuals under 18 years of age; promulgates rules; organizes officials; and presents seminars for players, coaches, and referees. The organization provides a framework for protests, appeals, and procedures. It also distributes a newsletter, and otherwise encourages the growth of the sport throughout the state.

LAW AND ANALYSIS

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense and includes the advancement of education and the promotion of social welfare by organizations designed to combat juvenile delinquency.

Trusts created for the purpose of promoting sports for children have been upheld as charitable on the basis of either combatting juvenile delinquency or advancing education. *Restatement (Second) Trusts* (1959), section 374(n); IV *Scott on Trusts* (3d ed. 1967), section 374-6A; Bogert, *Trusts and Trustees* (2d ed. 1964), section 379.

By developing, promoting, and regulating a sport for individuals under 18 years of age, under the circumstances described above, the organization combats juvenile delinquency by providing a recreational outlet for the young people. See Rev. Rul. 65-2, 1965-1 C.B. 227, which provides, in part, that an organization that is organized and operated for the purpose of teaching a particular sport to children by holding clinics conducted by qualified instructors and by providing free instruction, equipment, and facilities is combatting juvenile delinquency within the meaning of section 501(c)(3) of the Code.

Additionally, the organization promotes the education of the children by providing a format for educational activities. Thus, its activities are charitable in its generally accepted legal sense.

Rev. Rul. 70-4, 1970-1 C.B. 126, which holds that an organization engaged in promoting and regulating a sport for amateurs is not exempt under section 501(c)(3) of the Code, but is exempt under section 501(c)(4), is distinguishable because that organization directed its activities to all members of the general public without regard to age. The subject organization limits its activities to individuals under 18 years of age.

HOLDING

An organization that develops, promotes, and governs a sport for individuals under 18 years of age, under the circumstances described above, qualifies for exemption from federal income tax under section 501(c)(3) of the Code.

APPLICATION INSTRUCTIONS

Even though an organization considers itself within the scope of this revenue ruling, it must file an application on Form 1023, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. See sections 1.501(a)-1 and 1.508-1(a) of the regulations. In accordance with the instructions to Form 1023, the application should be filed with the District Director of Internal Revenue for the key district indicated therein.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 70-4 is distinguished.

Section 1237.—Real Property Subdivided for Sale

26 CFR 1.1237-1: Real property subdivided for sale.

Condominium conversions; capital gain v. ordinary income. Section 1237 of the Code does not apply to the conversion of rental units in an apartment building into condominiums and the sale of condominiums to the general public.

Rev. Rul. 80-216

ISSUE

Do the provisions of section 1237 of the Internal Revenue Code apply to the conversion of rental units in an apartment building into condominiums and the proposed sale of such units?

FACTS

In 1974, an individual taxpayer purchased land and a multi-unit apartment building situated on the land from an unrelated party. The apartments were rented and managed by the taxpayer until 1980, when they were converted to condominiums under applicable state law. No substantial improvements have been made to the land or the building. The taxpayer proposes to sell the condominium units to the general public.

The purchaser of a condominium unit will receive legal title in fee simple to a one-family unit in the multi-unit building coupled with ownership of an undivided interest in the land and all other parts of the building held in common with the other owners of the individual units.

The taxpayer has not previously held the apartment building for sale and does not currently hold any other real property for sale.

LAW AND ANALYSIS

Section 1237(a) of the Code provides that any lot or parcel that is part of a tract of real property in the hands of a taxpayer other than a corporation shall not be deemed to be held primarily for sale to customers in the ordinary course of trade or business at the time of sale solely because of the taxpayer having subdivided such tract for purposes of sale or because of any activity incident to such subdivision or sale if (1) such tract, or any lot or parcel thereof, had not previously been held by such taxpayer primarily for sale to customers in the ordinary course of trade or business and, in the same taxable year in which the sale occurs, such taxpayer does not so hold any other real property, (2) no substantial improvement that substantially enhances the value of the lot or parcel sold is made by the taxpayer on such tract while held by the taxpayer or is made pursuant to a contract of sale entered into between the taxpayer and the buyer, and (3) such lot or parcel, except in the case of real property acquired by inheritance or devise, is held by the taxpayer for a period of five years.

Section 1237(c) of the Code provides that the term "tract of real property" means a single piece of real property, except that two or more pieces of real property shall be considered a tract if at any time they were contiguous in the hands of the taxpayer or if they would be contiguous except for the interposition of a road, street, railroad, stream, or similar property.

The terms lot or parcel that is part of a tract of real property contained in section 1237(a) of the Code refer only to land. Although section 1237 does permit certain improvements to a tract of real property without denying the application of its provisions to the subdivision and sale of lots and parcels from such tract, the provisions of section 1237 do not apply to the subdivision and sale of improvements. *See H.R. Rep. No. 1337,* 83d Cong., 2d Sess. A285 (1954).

HOLDING

The benefits of section 1237 of the Code do not apply to the conversion of the rental units in the apartment building into condominiums and the proposed sale of such condominium units to the general public.

Section 3401.—Definitions [Collection of Income Tax at Source on Wages]

26 CFR 31.3401(a)-1: Wages.

Whether a taxpayer who participates in a training program of the taxpayer's employer is considered "away from home" and accordingly may exclude per diem amounts from gross income. See Rev. Rul. 80-212, page 5.

Section 4986.—Imposition of Tax [Windfall Profit Tax on Domestic Crude Oil]

Whether a state privilege tax imposed on the removal of oil, and a related income tax credit, when taken together, qualify for the severance tax adjustment allowed in computing liability for the crude oil windfall profit tax. See Rev. Rul. 80-217, this page.

Section 4988.—Windfall Profit; Removal Price

26 CFR 150.4988-1: Windfall profit; removal price.

Whether a state privilege tax imposed on the removal of oil, and a related income tax credit, when taken together qualify for the severance tax adjustment allowed in computing liability for the crude oil windfall profit tax. See Rev. Rul. 80-217, below.

Section 4996.—Other Definitions and Special Rules [Windfall Profit Tax on Domestic Crude Oil]

26 CFR 150.4996-2: Severance tax adjustment.
(Also Sections 4986, 4988; 150.4986-1, 150.4988-1.)

Windfall profit tax; severance tax adjustment. A state privilege tax imposed on the removal of oil, when taken together with the related income tax credit or refund, that is not determined on the basis of the gross value of the extracted oil but is determined by reference to the windfall profit portion of such value does not meet the requirements for the severance tax adjustment that may be taken into account in determining the windfall profit.

Rev. Rul. 80-217

ISSUE

Whether a state tax imposed on the removal of oil, and a related income tax credit, when taken together, constitute a severance tax for purposes of the crude oil windfall profit tax adjustment allowed by section 4988(a)(2) of the Internal Revenue Code.

FACTS

State *X* imposes a privilege tax on the removal of oil from the ground at the rate of 15 percent of the gross value of the oil at the wellhead. In addition the state's imposing statute provides the taxpayer with a state income tax credit in an amount equal to the total amount of the privilege tax imposed less the difference between (1) the federal windfall profit tax computed with a state severance tax adjustment (were the state tax in question to qualify for the severance tax adjustment), and (2) the federal windfall profit tax computed without the same state severance tax adjustment. Under the state statute, if the amount of such tax credit exceeds the taxpayer's state income tax liability for the taxable year, the excess amount is refundable to the taxpayer.

LAW AND ANALYSIS

Section 4986 of the Code imposes a tax on the windfall profit from taxable crude oil removed from the premises during each taxable period. The tax is to be paid by the producer of the crude oil.

Under section 4988 of the Code the term "windfall profit" means the excess of the removal price of the barrel of crude oil over the sum of (1) the adjusted base price of such barrel, and (2) the amount of the severance tax adjustment with respect to such barrel provided by section 4996(c).

Section 4996(c) of the Code provides that the severance tax adjustment with respect to any barrel of crude oil shall be the amount by which (A) any severance tax imposed with respect to such barrel, exceeds (B) the severance tax that would have been imposed if the barrel had been valued at its adjusted base price. For purposes of the severance tax adjustment, the term "severance tax" is defined as a tax (A) imposed by a state with respect to the extraction of oil, and (B) determined on the basis of the gross value of the extracted oil. Under section 4996(c)(3), a severance tax is not taken into account to the extent that the rate thereof exceeds 15 percent.

Section 150.4996-2(b) of the Temporary Excise Tax Regulations Under the Crude Oil Windfall Profit Tax Act of 1980 provides that the term "severance tax" does not include a tax levied on the value of reserves in the ground or a tax levied on the basis of net proceeds from production. That section further provides that a tax on the removal of crude oil from the ground levied at a fixed fee per barrel is not a severance tax because the amount of that tax is not determined by reference to the gross value of the extracted oil.

In this case, although the privilege tax imposed by state *X* is ostensibly on the gross value of the oil, only a portion of the amount of tax paid by the taxpayer is retained by the state. The following example illustrates the above:

A, located in state *X*, extracts oil from the ground that has a removal value of $40.00 per barrel. The adjusted base price of the oil is $16.00 per barrel. The oil is of the type that is subject to the federal windfall profit tax at the 50 percent rate. The computations are as follows:

State *X* Privilege Tax Imposed ($40.00 × 15 percent)		$ 6.00
Less: Privilege Tax on Adjusted Base Price ($16.00 × 15 percent)		$ 2.40
Severance Tax Adjustment (if allowed)		$ 3.60
Federal Windfall Profit Tax (WPT) Computation:		
Removal value of oil		$40.00
Less: Adjusted base price		$16.00
Windfall profit before severance tax adjustment		$24.00
Less: Severance Tax Adjustment		3.60
Windfall profit with severance tax adjustment		$20.40
WPT with severance tax adjustment ($20.40 × 50 percent)		$10.20
WPT without severance tax adjustment ($24.00 × 50 percent)		$12.00
State *X* Income Tax Credit:		
Privilege Tax Paid by *A*		$ 6.00
WPT without severance tax adjustment	$12.00	
WPT with severance tax adjustment	$10.20	
Difference		$ 1.80
Amount of privilege tax refunded to *A*		$ 4.20
Amount of privilege tax retained by state *X*		$ 1.80

The example indicates that although the state *X* tax (15 percent) is ostensibly determined on the basis of the gross value of the oil, and *A* initially pays $6.00 tax to the state, *A* receives a credit or refund of $4.20 from the state resulting in a net tax paid of $1.80. This net tax ($1.80) equals the rate of state *X*'s tax (15 percent) multiplied by the amount of *A*'s federal windfall profit tax liability computed without a severance tax adjustment ($12.00).

Thus, the state privilege tax, when taken together with the related income tax credit or refund, is not determined on the basis of the gross value of the extracted oil but is determined by reference to the windfall profit portion of such value.

HOLDING

The privilege tax imposed by state *X* does not meet the requirements for the severance tax adjustment and thus may not be taken into account in determining the windfall profit for purposes of computing the crude oil windfall profit tax imposed by section 4986 of the Code.

Section 7502.—Timely Mailing Treated as Timely Filing and Paying

26 CFR 301.7502-1: Timely mailing treated as timely filing.

Timely filing of returns; taxpayer in foreign country. Tax returns mailed by taxpayers in foreign countries will be accepted as timely filed if they bear an official postmark dated on or before midnight of the last date prescribed for filing, including any extensions.

Rev. Rul. 80-218

United States federal tax returns mailed by taxpayers in foreign countries will be accepted as timely filed if they bear an official postmark dated on or before midnight of the last date prescribed for filing, including any extension of time for such filing. If the last date for filing falls on a Saturday or Sunday, returns will be considered timely if postmarked on or before midnight of the following Monday.

This revenue ruling does not extend to claims, statements, or other documents.

Part III. Administrative, Procedural, and Miscellaneous

Ct. D. 2001

SUPREME COURT OF THE
UNITED STATES
NO. 78-1729

United States v. Payner
[447 U.S.]

On writ of certiorari to the
United States Court of Appeals for
the Sixth Circuit

[June 23, 1980]

Syllabus

At respondent's nonjury trial for falsifying a federal income tax return by denying that he maintained a foreign bank account, respondent moved to suppress a loan guarantee agreement in which he pledged the funds in the bank account as security. The District Court found respondent guilty on the basis of all the evidence, but then (1) found that the Government had discovered the guarantee agreement as the result of a flagrantly illegal search of a bank officer's briefcase, (2) suppressed all the Goverment's evidence except for respondent's tax return and related testimony, and (3) set aside the conviction for failure to demonstrate knowing falsification. The court held, *inter alia*, that, although the illegal search did not violate respondent's Fourth Amendment rights, the inherent supervisory power of the federal courts required it to exclude evidence tainted by the illegal search. The Court of Appeals affirmed.

Held:

1. Respondent lacks standing under the Fourth Amendment to suppress the documents illegally seized from the bank officer. A defendant's Fourth Amendment rights are violated only when the challenged conduct invaded *his* legitimate expectation of privacy rather than that of a third party, and respondent possessed no privacy interest in the documents seized in this case. Cf. *Rakas* v. *Illinois,* 439 U.S. 128; *United States* v. *Miller,* 425 U.S. 435 [Ct. D. 1978, 1976-1 C.B. 535].

2. The supervisory power of the federal courts does not authorize a court to suppress otherwise admissible evidence on the ground that it was seized unlawfully from a third party not before the court. Under the Fourth Amendment, the interest in deterring illegal searches does not justify the exclusion of tainted evidence at the instance of a party who was not the victim of the challenged practices. And the values assigned to the competing interests of deterring illegal searches and of furnishing the trier of fact with all relevant evidence do not change because a court has elected to analyze the question under the supervisory power instead of the Fourth Amendment. Such power does not extend so far as to confer on the judiciary discretionary power to disregard the considered limitations of the law it is charged with enforcing.

590 F. 2d 206, reversed.

Powell, J., delivered the opinion of the Court, in which Burger, C. J., and Stewart, White, Rehnquist, and Stevens, JJ., joined. Burger, C. J., filed a concurring opinion. Marshall, J., filed a dissenting opinion, in which Brennan and Blackmun, JJ., joined.

Mr. Justice Powell delivered the opinion of the Court.

The question is whether the District Court properly suppressed the fruits of an unlawful search that did not invade the respondent's Fourth Amendment rights.

I

Respondent Jack Payner was indicted in September 1976 on a charge of falsifying his 1972 federal income tax return in violation of 18 U.S.C. § 1001.[1] The indictment alleged that respondent denied maintaining a foreign bank account at a time when he knew that he had such an account at the Castle Bank and Trust Company of Nassau, Bahama Islands. The Government's case rested heavily on a loan guarantee agreement dated April 28, 1972, in which respondent pledged the funds in his Castle Bank account as security for a $100,000 loan.

Respondent waived his right to jury trial and moved to suppress the guarantee agreement. With the consent of the parties, the United States District Court for the Northern District of Ohio took evidence on the motion at a hearing consolidated with the trial on the merits. The court found respondent guilty as charged on the basis of all the evidence. The court also found, however, that the Government discovered the guarantee agreement by exploiting a flagrantly illegal search that occurred on January 15, 1973. The court therefore suppressed "all evidence introduced in the case by the Government with the exception of Jack Payner's 1972 tax return . . . and the related testimony." *United States* v. *Payner,* 434 F. Supp. 113, 136 (1977). As the tax return alone was insufficient to demonstrate knowing falsification, the District Court set aside respondent's conviction.[2]

The events leading up to the 1973 search are not in dispute. In 1965, the Internal Revenue Service launched an investigation into the financial activities of American citizens in the Bahamas. The project, known as "Operation Trade Winds," was headquartered in Jacksonville, Fla. Suspicion focused on the Castle Bank in 1972, when investigators learned that a suspected narcotics trafficker had an account there. Special Agent Richard Jaffe of the Jacksonville office asked Norman Casper, a private investigator and occasional informant, to learn what he could about the Castle Bank and its depositors. To that end, Casper cultivated his friendship with Castle Bank vice-president Michael Wolstencroft. Casper introduced Wolstencroft to Sybol Kennedy, a private investigator and former employee. When Casper discovered that the banker intended to spend a few days in Miami in January of 1973, he devised a scheme to gain access to the bank records he knew Wolstencroft would be carrying in his briefcase. Agent Jaffe approved the basic outline of the plan.

Wolstencroft arrived in Miami on January 15 and went directly to Kennedy's apartment. At about 7:30 p.m., the two left for dinner at a Key Biscayne restaurant. Shortly thereafter, Casper entered the apartment using a key supplied by Kennedy. He removed the briefcase and delivered it to Jaffe. While the agent supervised the copying of approximately 400 documents taken from the briefcase, a "lookout" observed Kennedy and Wolstencroft at dinner. The observer notified Casper when the pair left the restaurant, and the briefcase was replaced. The documents photographed that evening included papers evidencing a close working relationship between the Castle Bank and the Bank of Perrine, Fla. Subpoenas issued to the Bank of Perrine ultimately uncovered the loan guarantee agreement at issue in this case.

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[1] 18 U. S. C. § 1001 provides in relevant part:
"Whoever, in any matter within the jurisdiction of any department or agency of the United States knowingly and willfully . . . makes any false, fictitious or fraudulent statements or representations, . . . shall be fined not more than $10,000 or imprisoned not more than five years, or both."

[2] The unusual sequence of rulings was a byproduct of the consolidated hearing conducted by the District Court. The court initially failed to enter judgment on the merits. At the close of the evidence, it simply granted respondent's motion to suppress. After the Court of Appeals for the Sixth Circuit dismissed the government's appeal for want of jurisdiction, the District Court vacated the order granting the motion to suppress and entered a verdict of guilty. The court then reinstated its suppression order and set aside the verdict. Respondent does not challenge these procedures.

The District Court found that the United States, acting through Jaffe, "knowingly and willfully participated in the unlawful seizure of Michael Wolstencroft's briefcase. . . ." 434 F. Supp, at 120. According to that court, "the Government affirmatively counsels its agents that the Fourth Amendment standing limitation permits them to purposefully conduct an unconstitutional search and seizure of one individual in order to obtain evidence against third parties. . . ." *Id.*, at 132-133. The District Court also found that the documents seized from Wolstencroft provided the leads that ultimately led to the discovery of the critical loan guarantee agreement. *Id.*, at 123.[3] Although the search did not impinge upon the respondent's Fourth Amendment rights, the District Court believed that the Due Process Clause of the Fifth Amendment and the inherent supervisory power of the federal courts required it to exclude evidence tainted by the Government's "knowing and purposeful *bad faith hostility* to any person's fundamental constitutional rights." *Id.*, at 129; see *id.*, at 133, 134-135.

The Court of Appeals for the Sixth Circuit affirmed in a brief order endorsing the District Court's use of its supervisory power. *United States* v. *Payner*, 590 F. 2d 206 (1979) (*per curiam*). The Court of Appeals did not decide the due process question. We granted certiorari—U.S.—(1979), and we now reverse.

II

This Court discussed the doctrine of "standing to invoke the [Fourth Amendment] exclusionary rule" in some detail last term. *Rakas* v. *Illinois*, 439 U.S. 128, 138 (1978). We reaffirmed the established rule that a court may not exclude evidence under the Fourth Amendment unless it finds that an unlawful search or seizure violated the defendant's own constitutional rights. *Id.*, at 133-140. See, *e.g.*, *Brown* v. *United States*, 411 U.S. 223, 229-230 (1973); *Alderman* v. *United States*, 394 U.S. 165, 171-172 (1969); *Simmons* v. *United States*, 390 U.S. 377, 389 (1968). And the defendant's Fourth Amendment rights are violated only when the challenged conduct invaded *his* legitimate expectation of privacy rather than that of a third party. *Rakas* v. *Illinois*, *supra*, at 143; *id.*, at 149-152 (POWELL, J., concurring); *Combs* v. *United States*, 408 U.S. 224, 227 (1972); *Mancusi* v. *DeForte*, 392 U.S. 364, 368 (1968).

The foregoing authorities establish, as the District Court recognized, that respondent lacks standing under the Fourth Amendment to suppress the documents illegally seized from Wolstencroft. 434 F. Supp., at 126. The Court of Appeals did not disturb the District Court's conclusion that "Jack Payner possessed no privacy interest in the Castle Bank documents that were seized from Wolstencroft." 434 F. Supp., at 126; see 590 F. 2d, at 207. Nor do we. *United States* v. *Miller*, 425 U.S. 435 (1976), established that a depositor has no expectation of privacy and thus no "protectable Fourth Amendment interest" in copies of checks and deposit slips retained by his bank. *Id.*, at 437; see *id.*, at 442. Nothing in the record supports a contrary conclusion in this case.[4]

The District Court and the Court of Appeals believed, however, that a federal court should use its supervisory power to suppress evidence tainted by gross illegalities that did not infringe the defendant's constitutional rights. The United States contends that this approach—as applied in this case—upsets the careful balance of interests embodied in the Fourth Amendment decisions of this Court. In the Government's view, such an extension of the supervisory power would enable federal courts to exercise a standardless discretion in their application of the exclusionary rule to enforce the Fourth Amendment. We agree with the Government.

III

We certainly can understand the District Court's commendable desire to deter deliberate intrusions into the privacy of persons who are unlikely to become defendants in a criminal prosecution. See 434 F. Supp., at 135. No court should condone the unconstitutional and possibly criminal behavior of those who planned and executed this "briefcase caper."[5] Indeed, the decisions of this Court are replete with denunciations of willfully lawless activities undertaken in the name of law enforcement. *E.g., Jackson* v. *Denno,* 378 U.S. 368, 386 (1964); see *Olmstead* v. *United States,* 277 U.S. 438, 485 (1928) (Brandeis, J., dissenting). But our cases also show that these unexceptional principles do not command the exclusion of evidence in every case of illegality. Instead, they must be weighed against the considerable harm that would flow from indiscriminate application of an exclusionary rule.

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[3] The United States argued in the District Court and the Court of Appeals that the guarantee agreement was discovered through an independent investigation untainted by the briefcase search. The Government also denied that its agents willfully encouraged Casper's illegal behavior. For purposes of this opinion, we need not question the District Court's contrary findings on either point.

[4] We are not persuaded by respondent's suggestion that the Bahamian law of bank secrecy creates an expectation of privacy not present in *United States* v. *Miller*, 425 U. S. 435 (1976). At the outset, it is not clear that secret information regarding this respondent's account played any role in the investigation that led to the discovery of the critical loan guarantee agreement. Even if the causal link were established, however, respondent's claim lacks merit. He cites a provision, Ch. 96.9 of the Statute Law of the Bahama Islands (1909), that is no longer in effect. Bank secrecy is now safeguarded by § 19 of the Banks Act, I Bah. Rev. Stat. ch. 96 (1965), as amended, 1965 Bah. Acts No. 65, which provides in relevant part:

> "Except for the purpose of the performance of his duties or the exercise of his functions under this Act or when lawfully required to do so by any court of competent jurisdiction within the Colony or under the provisions of any law of the Colony, no person shall disclose any information relating to . . . the affairs of . . . any customer of a [bank] licensee which he has acquired in the performance of his duties or the exercise of his functions under this Act."

See also the Banks and Trust Companies Regulation Act, 1965 Bah. Acts No. 64, § 10, as amended, 1968 Bah. Acts No. 33, 1969 Bah. Acts No. 20, 1971 Bah. Acts No. 15. The statute is hardly a blanket guarantee of privacy. Its application is limited; it is hedged with exceptions; and we have been directed to no authority construing its terms. Moreover, American depositors know that their own country requires them to report relationships with foreign financial institutions. 31 U. S. C. § 1121; 31 CFR § 103.24. See generally *California Bankers Assn.* v. *Shultz*, 416 U. S. 21, 59-63, 71-76 (1974) [Ct. D. 1960, 1974-1 C.B. 393]. We conclude that respondent lacked a reasonable expectation of privacy in the Castle Bank records that documented his account.

Thus, the exclusionary rule "has been restricted to those areas where its remedial objectives are most efficaciously served." *United States* v. *Calandra,* 414 U.S. 338, 348 (1974). The Court has acknowledged that the suppression of probative but tainted evidence exacts a costly toll upon the ability of courts to ascertain the truth in a criminal case. *E.g., Rakas* v. *Illinois, supra,* at 137-138; *United States* v. *Ceccolini,* 435 U.S. 268, 275-279 (1978); *Stone* v. *Powell,* 428 U.S. 464, 489-491 (1976); see *Michigan* v. *Tucker,* 417 U.S. 433, 450-451 (1974).[6] Our cases have consistently recognized that unbending application of the exclusionary sanction to enforce ideals of governmental rectitude would impede unacceptably the truth-finding functions of judge and jury. *E.g., Stone* v. *Powell, supra,* at 485-489; *United States* v. *Calandra, supra,* at 348. After all, it is the defendant, and not the constable, who stands trial.

The same societal interests are at risk when a criminal defendant invokes the supervisory power to suppress evidence seized in violation of a third party's constitutional rights. The supervisory power is applied with some caution even when the defendant asserts a violation of his own rights.[7] In *United States* v. *Caceres,* 440 U.S. 741, 754-757 (1979) [Ct. D. 1998, 1979-1 C.B. 465], we refused to exclude all evidence tainted by violations of an executive department's rules. And in *Elkins* v. *United States,* 364 U.S. 206, 216 (1960), the Court called for a restrained application of the supervisory power.

> "[A]ny apparent limitation upon the process of discovering truth in a federal trial ought to be imposed only upon the basis of considerations which outweigh the general need for untrammeled disclosure of competent and relevant evidence in a court of justice." 364 U.S., at 216.

See also *Nardone* v. *United States,* 308 U.S. 338, 340 (1939).

We conclude that the supervisory power does not authorize a federal court to suppress otherwise admissible evidence on the ground that it was seized unlawfully from a third party not before the court. Our Fourth Amendment decisions have established beyond any doubt that the interest in deterring illegal searches does not justify the exclusion of tainted evidence at the instance of a party who was not the victim of the challenged practices. *Rakas* v. *Illinois, supra,* at 137; *Alderman* v. *United States, supra,* at 174-175.[8] The values assigned to the competing interests do not change because a court has elected to analyze the question under the supervisory power instead of the

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[5] "The security of persons and property remains a fundamental value which law enforcement officers must respect. Nor should those who flout the rules escape unscathed." *Alderman* v. *United States,* 394 U. S. 165, 175 (1969). We note that in 1976 Congress investigated the improprieties revealed in this record. See Oversight Hearings into the Operations of the IRS before a Subcommittee of the House Committee on Government Operations (Operation Tradewinds, Project Haven, and Narcotics Traffickers Tax Program), 94th Cong., 1st Sess. As a result, the Commissioner of Internal Revenue "called off" Operation Trade Winds. Tr. of Oral Arg. 35. The Commissioner also adopted guidelines that require agents to instruct informants on the requirements of the law and to report known illegalities to a supervisory officer, who is in turn directed to notify appropriate state authorities. IRS Manual Supp. 9-21, §§ 9373.3(3), 9373.4 (Dec. 27, 1977). Although these measures appear on their face to be less positive than one might expect from an agency charged with upholding the law, they do indicate disapproval of the practices found to have been implemented in this case. We cannot assume that similar lawless conduct, if brought to the attention of responsible officials, would not be dealt with appropriately. To require in addition the suppression of highly probative evidence in a trial against a third party would penalize society unnecessarily.

[6] See also *Kaufman* v. *United States,* 394 U. S. 217, 237-238 (1969) (Black, J., dissenting); Oaks, Studying the Exclusionary Rule in Search and Seizure, 37 U. Chi. L. Rev. 665, 736-746, 755-756 (1970).

[7] Federal courts may use their supervisory power in some circumstances to exclude evidence taken from the *defendant* by "willful disobedience of law." *McNabb* v. *United States,* 318 U. S. 332, 345 (1943); see *Elkins* v. *United States,* 364 U. S. 206, 223 (1960); *Rea* v. *United States,* 350 U. S. 214, 216-217 (1956); cf. *Hampton* v. *United States,* 425 U. S. 484, 495 (POWELL, J., concurring in the judgment). This Court has never held, however, that the supervisory power authorizes suppression of evidence obtained from third parties in violation of Constitution, statute or rule. The supervisory power merely permits federal courts to supervise "the administration of criminal justice" among the parties before the bar. *McNabb* v. *United States, supra,* at 340.

[8] "The deterrent values of preventing the incrimination of those whose rights the police have violated have been considered sufficient to justify the suppression of probative evidence even though the case against the defendant is weakened or destroyed. We adhere to that judgment. But we are not convinced that the additional benefits of extending the exclusionary rule to other defendants would justify further encroachment upon the public interest in prosecuting those accused of crime and having them acquitted or convicted on the basis of all the evidence which exposes the truth." *Alderman* v. *United States, supra,* at 174-175. See also *Stone* v. *Powell,* 428 U. S. 464, 488-489 (1976); *United States* v. *Calandra,* 414 U. S. 338, 348 (1974).

The dissent urges that the balance of interests under the supervisory power differs from that considered in *Alderman* and like cases, because the supervisory power focuses upon the "need to protect the integrity of the federal courts." Although the District Court in this case relied upon a deterrent rationale, we agree that the supervisory power serves the "two-fold" purpose of deterring illegality and protecting judicial integrity. As the dissent recognizes, however, the Fourth Amendment exclusionary rule serves precisely the same purposes. *Ibid.,* citing, *inter alia, Dunaway* v. *New York,* 442 U. S. 200, 218 (1979), and *Mapp* v. *Ohio,* 367 U. S. 643, 659-660 (1961). Thus, the Fourth Amendment exclusionary rule, like the supervisory power, is applied in part "to protect the integrity of the *court* rather than to vindicate the constitutional rights of the defendant. . . ."; see generally *Stone* v. *Powell,* 428 U. S. 465, 486 (1976); *United States* v. *Calandra, supra,* at 486.

In this case, where the illegal conduct did not violate the respondent's rights, the interest in preserving judicial integrity and in deterring such conduct is outweighed by the societal interest in presenting probative evidence to the trier of fact. See *supra;* see also, *e.g., Stone* v. *Powell, supra,* at 485-486. None of the cases cited by the dissent supports a contrary view, since none of those cases involved criminal defendants who were not themselves the victims of the challenged practices. Thus, our decision today does not limit the traditional scope of the supervisory power in any way; nor des it render that power "superfluous." We merely reject its use as a substitute for established Fourth Amendment doctrine.

Fourth Amendment. In either case, the need to deter the underlying conduct and the detrimental impact of excluding the evidence remain precisely the same.

The District Court erred, therefore, when it concluded that "society's interest in deterring [bad faith] conduct by exclusion outweigh[s] society's interest in furnishing the trier of fact with all relevant evidence." 434 F. Supp., at 135. This reasoning, which the Court of Appeals affirmed, amounts to a substitution of individual judgment for the controlling decisions of this Court.[9] Were we to accept this use of the supervisory power, we would confer on the judiciary discretionary power to disregard the considered limitations of the law it is charged with enforcing. We hold that the supervisory power does not extend so far.

The judgment of the Court of Appeals is *Reversed.*

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[9] The same difficulty attends respondent's claim to the protections of the Due Process Clause of the Fifth Amendment. The Court of Appeals expressly declined to consider the Due Process Clause. But even if we assume that the unlawful briefcase search was so outrageous as to offend fundamental " 'canons of decency and fairness,' " *Rochin* v. *California*, 342 U. S. 165, 169 (1952), quoting *Malinski* v. *New York*, 324 U. S. 401, 417 (1945) (opinion of Frankfurter, J.), the fact remains that "[t]he limitations of the Due Process Clause . . . come into play only when the Government activity in question violates some protected right of the *defendant*," *Hampton* v. *United States*, *supra*, at 490 (plurality opinion).

Part IV. Items of General Interest

Disaster Areas

Announcement 80-100

The President of the United States has determined that the areas listed below were adversely affected by disasters of sufficient severity and magnitude to warrant federal disaster assistance.

Taxpayers who suffered losses in these areas as a result of these disasters may elect the special tax treatment provided under section 165(h) of the Internal Revenue Code. Section 1.165-11 of the Income Tax Regulations sets forth the procedure for making this election. Losses not incurred with respect to a trade or business or any transaction entered into for profit will not qualify for treatment under section 165(h) unless such losses qualify as casualty loses.

State: Pennsylvania

Counties affected: Allegheny, Armstrong, Indiana, Westmoreland

Type of disaster: Severe storms and tornadoes

Begun on or about: June 3, 1980

Foundation Status of Certain Organizations

Announcement 80-101

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3) of the Code, eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Alcoholism Services of Knoxville, Inc., Knoxville, TN
Augusta Center for Biblical Study, Inc., Augusta, GA
B.O.L.D., Inc. of Minnesota, Minneapolis, MN
Berlin Arts Association, Inc., Berlin, NH
Bethlehem Community Center, Inc., The, Augusta, GA
Bitterford Art Gallery, Inc., Aberdeen, SD
Bridgeport Day Care Inc., Bridgeport, CT
C & M Lifeline, Inc., Decatur, GA
Canaan Day Care Center, Inc., Milwaukee, WI
Chattanooga Hamilton County Epilepsy Foundation, Inc., Chattanooga, TN
Children's Oncology Services of Georgia, Inc., Atlanta, GA
Christian Medical Foundation of the Carolinas, Inc., Charlotte, NC
Church Renewal Crusades, Inc., College Park, GA
Circle of Light, Inc., Atlanta, GA
Citizens Council to Reduce Handgun Violence, Nashville, TN
Coalicion De Organizaciones Hispanas, Inc., Providence, RI
Columbus Sesquicentennial, Inc., Columbus, GA
Community Alternatives, Inc., Deerwood, MN
Consultants for Human Change, Minneapolis, MN
Cool Spring Little League, Inc., Forest City, NC
Crossroads Inc., "Where Families are Cheated", Edina MN
DHS Alumni Association, Inc., Dupree, SD
Door-Kewaunee Nutrition & Elderly Services Projects Inc., Sturgeon Bay, WI
Durham Rotary Community Fund, Inc., Durham, NC
Emergency Help Program of Lincoln County, Georgia, Inc., Lincolnton, GA
Eternal Investments Foundation, Inc., Forest Park, GA
Farmers Union Green Thumb, Inc., Jamestown, ND
Forest Acres Park, Inc., Lumberton, NC
Freedom Fair, Inc., Avon, MN
Gavilan Student Accident Trust Fund, Gilroy, GA
God's Warehouse for the People, Yes, Minneapolis, MN
Gospel Odyssey Evangelistic Association Inc., Goodrich, ND
Hadley Family Association, Inc., John Hipwell, Ogden, UT
Halfway House Inc., Grand Forks, ND
Handicap-Abilities, Inc., Luxemberg, WI
Haven Ministries, Inc., Hastings, MN
Hayvanu Shalom Ahlaihem, Inc., Milwaukee, WI
Indo-American Cultural Society, Greensboro, NC
Institute for Crime and Justice Research, St. Paul, MN
Jackson-Butts County Child Development Foundation, Inc., Jackson, GA
Jesus is Lord Prayer Community, Eagan, MN
Learn and Play, Inc., Delavin, WI
Lebanon Relief Fund, Greenville, SC
Loving Faith Foundation, Inc., Decatur, GA
Lue Foundation, Marvin Charlie, Atlanta, GA
MAC Crime Prevention & Education Program, Inc., Milwaukee, WI
Mayville Rotary Scholarship Foundation, Inc., Mayville, WI
Milwaukee Hispanic Arts Council, Inc., Milwaukee, WI
Minnesota Horse Show Charities, Inc., St. Paul, MN
Minnesota Womens Education Council, St. Paul, MN
Mooring Stock Farm, Sturgeon Lake, MN
Mountain Park Athletic Association, Inc., Lilburn, GA
Multi-Cultural and Women's Training Coalition, Minneapolis, MN
Necedah Area Community Health, Inc., Necedah, WI
Network 13 Coordinating Council for End-Stage Renal Disease, Inc., Wauwatosa, WI
New Prague Community Theatre, Inc., New Prague, MN

Noah's Ark Day Care Center, Beloit, WI

Northern Plains Humane Society, Inc., Williston, ND

Old Rosetownship Historical Society, Inc., St. Paul, MN

Pamko, Inc., St. Paul, MN

Parent Advocate Consortium, Inc., Burlingame, CA

Paris Research Institute, San Leandro, CA

Park Circus Pranksters, Inc., Green Bay, WI

Racine Kenosha Plumbers & Steamfitters Education Fund, Racine, WI

Rapid Inspiration Pulling Stars, Inc., The, Atlanta, GA

Red Wing Video Commonwealth, Red Wing, MN

Richland County Swim Association, Columbia, SC

Sandhill Fellowship Hall, Inc., Hamlet, NC

Serenity House, Inc., Waycross, GA

Services for Women in Crisis, Inc., Nashville, TN

Shrine Bowl of Minnesota, Inc., Minneapolis, MN

Skilled Jobs for Women, Inc., Madison, WI

South Carolina Chief Justice Portrait Committee, Spartanburg, SC

Sunshine Home Mission Center, Inc., Knoxville, TN

Thoracic Surgery Directors Association, Chapel Hill, NC

Trinity Lutheran Foundation of Green Bay, Inc., Green Bay, WI

The following organization, which has been treated as a private operating foundation described in section 4942 (j)(3) of the Code, has now been classified as an organization that is not a private operating foundation. Grantors and contributors may no longer rely upon rulings or determinations that this organization is a private operating foundation. The organization is:

Son Life Ministries, Inc., Winter Haven, FL

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Correction of Rev. Proc. 80-19

Announcement 80-102

Rev. Proc. 80-19, 1980-25 I.R.B. 45, page 47, column 3, paragraph 2, last sentence, is corrected to read as follows:

By the 10th of the second succeeding month after the tires in such category are first placed in production, a random sample average actual weight of each of the tires (by specification weight) in that category will be submitted to the industry group.

This correction will be reflected in Rev. Proc. 80-19 when it is republished in 1980-1 C.B.

Correction of Rev. Proc. 80-22

Announcement 80-103

Rev. Proc. 80-22, 1979-26 I.R.B. 26, contains some incorrect references in section 1, Purpose and Nature of Changes.

Sections 1.028, 1.029, and 1.0211-1.0214 should read as follows:

8 New section 3.0127 refers to section 2031 of the Code.

9 New section 3.0128 refers to section 2512 of the Code.

11 New section 3.025 refers to the tax consequences of proposed legislation.

12 New section 3.026 refers to determination of reasonable cause under subtitle F (Procedure and Administration) of the Code.

13 New section 3.027 refers to the applicability of criminal penalties to proposed transactions.

14 New sections 4.0110 and 4.0111 refer to section 7701 of the Code.

Furthermore, the second sentence of paragraph 4 under section 2.01 should read as follows:

Changes will be published as they occur throughout the year and will be incorporated annually in a new revenue procedure published in the first quarter of the next calendar year.

These corrections will be reflected in Rev. Proc. 80-22 when it is reprinted in 1980-1 C.B.

Publication 79, Statistics of Income—1977, Individual Income Tax Returns

Announcement 80-104 [1]

Publication 79, Statistics of Income—1977, Individual Income Tax Returns, is now available and may be purchased for $7.00 from the Superintendent of Documents, Washington, D.C. 20402.

Disaster Areas

Announcement 80-105

The President of the United States has determined that the areas listed below were adversely affected by disasters of sufficient severity and magnitude to warrant federal disaster assistance.

Taxpayers who suffered losses in these areas as a result of these disasters may elect the special tax treatment provided under section 165(h) of the Internal Revenue Code. Section 1.165-11 of the Income Tax Regulations sets forth the procedure for making this election. Losses not incurred with respect to a trade or business or any transaction entered into for profit will not qualify for treatment under section 165(h) unless such losses qualify as casualty losses.

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[1] Based on News Release IR-80-77, dated July 3, 1980.

State: Florida

Counties affected: Broward, Dade, Monroe, Palm Beach

Type of disaster: Arrival of large numbers of undocumented aliens

Begun on or about: April 13, 1980

State: New York

Area affected: Love Canal area of Niagara County

Type of disaster: Adverse impact of chemical wastes in Love Canal waste landfill in City of Niagara Falls

Begun on or about: May 5, 1980

No determination has been made by the Internal Revenue Service that such losses will, in fact, qualify as casualty losses deductible under section 165 of the Code.

Qualified Group Legal Services Plans—Public Hearing

Announcement 80-107 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to qualified group legal services plans.

DATES: The public hearing will be held on September 4, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by August 22, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (EE-5-78), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION

The subject of the public hearing is proposed regulations under sections 120 and 501(c)(20) of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Tuesday, April 29, 1980 (45 FR 28360).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of oral comments to be presented at the hearing and the time they wish to devote to each subject by August 22, 1980.

Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restriction, attendance cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive on improving government regulations appearing in the Federal Register for Wednesday, November 8, 1978.

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[1] Filed by the Office of the Federal Register on July 24, 1980, and published in the issue of the Federal Register for July 25, 1980, 45 F.R. 49596.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
John H. Frazier	Nashville, TN	Certified Public Accountant	Fifteen months effective June 16, 1980
Clifford Y. Pierce	Miami, FL	Certified Public Accountant	Indefinite effective June 13, 1980
Robert L. Hamersley	Boise, ID	Certified Public Accountant	Indefinite from July 7, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 48.4221-2 amended.	Tax-free sales of articles to be used for, or resold for, further manufacture.	July 2, 1980	Aug. 31, 1980
26 CFR 1.1441-4(d) revoked.	Exemption from withholding of tax under chapter 3 with respect to Virgin Islands inhabitants.	July 8, 1980	Sept. 8, 1980
26 CFR 301.6059-1, 301.6692-1 added.	Requirement that the plan administrator of a defined benefit plan periodically file an actuarial report for the plan.	July 8, 1980	Sept. 8, 1980
26 CFR 1.46-1, 1.46-2 amended.	FIFO and other ordering rules for the investment credit.	July 10, 1980	Sept. 8, 1980
26 CFR 1.501(c)(9)-1 as proposed in the Federal Register for January 23, 1969, 34 F.R. 1028, withdrawn; 1.501(c)(9)-1 through 1.501(c)(9)-8 added.	Voluntary employees' beneficiary associations.	July 17, 1980	Sept. 15, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.– Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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______ *1937–1*	*3.75*	______ 1952–2	7.05	______ 1965–2	12.25	______ 1977–1	10.75
______ 1937–2	7.70	______ *1953–1*	*4.25*	______ 1966–1	14.00	______ 1977–2	11.75
______ *1938–1*	*4.05*	______ 1953–2	12.00	______ 1966–2	14.05	______ 1978–1	11.75
______ *1938–2*	*3.50*	______ 1954–1	12.00	______ 1967–1	10.00	______ 1978–2	13.00
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______ 1939–1–2	10.90	______ 1955–1	10.25	______ 1968–1	14.00	______ 1978–3–2	9.00
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August 18, 1980
Bulletin No. 1980-33

Internal Revenue bulletin

contin

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Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-219, page 5.
Recapture of investment credit; sale of undivided interest in facility to tax exempt cooperative. The investment credit recapture implications of the sale by a public utility company of an undivided interest in its electric generating facility to a tax exempt cooperative are discussed.

Rev. Rul. 80-220, page 6.
Employees' group-term life insurance; coverage brackets. Life insurance covering fewer than ten full-time employees that would meet the qualifications of section 1.79-1(c) of the regulations only if all three of its coverage brackets were taken into account is not group-term life insurance for purposes of section 79 of the Code if no employee has ever been covered under the middle bracket.

Rev. Rul. 80-221, page 6.
Redemption of stock; appreciated property; plan of sale. A corporation issued preferred stock for cash with the intent of later redeeming the stock for appreciated property. The transaction was merely a prearranged plan to avoid the tax on the sale of the property, and the nonrecognition of gain provisions of section 311(a) of the Code did not apply.

Rev. Rul. 80-222, page 10.
Foreign insurance company; no U.S. agent; reinsurance of U.S. risks. A foreign insurance company, which is not engaged in the conduct of trade or business in the U.S., reinsures risks that were initially assumed by other insurance companies and that are located in the U.S. The policies are neither signed nor countersigned in the U.S. by any officer or agent of the foreign insurance company. The premiums paid on such policies are subject to the excise tax imposed by section 4371(3) of the Code. The premiums received are not subject to either taxation under section 881 or withholding under section 1442. I.T. 1359 and I.T. 3061 amplified and superseded.

Rev. Rul. 80-223, page 12.
Foreign tax credit; inconsistent provisions of treaties. The enactment of sections 901(f) and 907 of the Code by the Tax Reduction Act of 1975 supersedes inconsistent provisions of all income tax treaties.

Rev. Proc. 80-33, page 21.
CLADR system; effective dates. The effective dates of Rev. Procs. 79-26 and 79-35, both of which prescribed certain changes to the CLADR system, are revised.

Pub. L. 96-272, page 16.
Amendments to section 50B(i) of the Code relate to the employer's WIN credit with respect to part-time child day care workers and those child day care workers whose wages are reimbursed by grants made to the employer under section 2007 of the Social Security Act.

(Continued on page 4)

Finding Lists begin on page 25.
Announcement of Voluntary Suspensions on page 23.
Announcement of Notice of Proposed Rulemaking on page 24.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

Announcement 80-110, page 22.
A public meeting will be held on August 27, 1980, to solicit views on issues being considered in the revisions of the existing income tax treaty between the United States and Trinidad and Tobago.

EMPLOYEE PLANS

T.D. 706, page 7.
Amendments to the regulations under section 412 of the Code relate to an exception from the minimum funding standards for certain pension plans funded exclusively by insurance contracts.

GIFT TAX

Rev. Rul. 80-224, page 13.
Split gifts; consent of spouse after due date of return. Spouses may not elect under section 2513 of the Code to split gifts made by one spouse after the donor spouse has filed a gift tax return reporting the gifts and the due date for filing the return has passed.

EXCISE TAXES

Rev. Rul. 80-225, page 14.
Foreign insurance company; U.S. agent; surplus lines insurance. A foreign insurance company, which is not licensed in a particular state, conducts a surplus lines insurance business in that state through a licensed broker that acts as the company's agent, regularly signs and countersigns policies, and settles losses arising from such policies. The excise tax imposed by section 4371 of the Code does not apply to premiums paid to the foreign insurance company on such policies.

TAX CONVENTIONS

Rev. Rul. 80-223, page 12.
Foreign tax credit; inconsistent provisions of treaties. The enactment of sections 901(f) and 907 of the Code by the Tax Reduction Act of 1975 supersedes inconsistent provisions of all income tax treaties.

ADMINISTRATIVE

Del. Order No. 4 (Rev. 11), page 19.
Summonses. Authority to serve summonses issued by certain Service employees, certify the method and manner of service and the method and manner of giving notice, is delegated to GS-5 and above Revenue Representatives; Del. Order 4 (Rev. 10) superseded.

Del. Order No. 11 (Rev. 12), page 20.
Offers in compromise. The Director, Collection Division, Office of International Operations, is authorized to accept certain offers in compromise, and authority to accept offers in compromise submitted under section 3469 of the Revised Statutes, as amended, is revoked; Del. Order 11 (Rev. 11) superseded.

Announcement 80-106, page 22.
Form 6458, Certification and Election Form, for making certifications, elections, and transmissions of certain information under the Crude Oil Windfall Profit Tax Act of 1980 is available at Service district offices.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 38.—Investment in Certain Depreciable Property

26 CFR 1.38-1: Investment in certain depreciable property.

Whether the sale of an undivided interest in its "section 38 property" by a utility company to a tax exempt cooperative disqualifies the utility company's retained interest as section 38 property. See Rev. Rul. 80-219, below.

Section 47.—Certain Dispositions, Etc., of Section 38 Property

26 CFR 1.47-2: "Disposition" and "cessation."
(Also Sections 38, 761; 1.38-1, 1.761-2.)

Recapture of investment credit; sale of undivided interest in facility to tax exempt cooperative. The investment credit recapture implications of the sale by a public utility company of an undivided interest in its electric generating facility to a tax exempt cooperative are discussed.

Rev. Rul. 80-219

ISSUES

(1) When a utility company sells an undivided interest in its "section 38 property" to a tax exempt cooperative, creating a partnership for federal tax purposes, does ownership of the undivided interest by the cooperative disqualify the utility company's retained interest in the property as section 38 property, thereby causing the recapture provisions of section 47(a) of the Internal Revenue Code to apply? Also, does the contribution by the utility company of its retained interest to the partnership constitute a disposition of section 38 property for purposes of section 47(a)?

(2) Will the federal income tax treatment be different if the partners elect under section 761 of the Code to be excluded from the application of subchapter K, chapter 1, of the Code?

FACTS

Situation 1.

M is an investor-owned electric utility company. *M* owned the entire interest in and operates facilities for the generation, transmission, and distribution of electricity. All of the facilities were acquired by *M* for use in its business and qualified as section 38 property. In 1978 *M* sold an undivided interest in certain generating facilities to *T*, a cooperative exempt from federal income tax pursuant to the provisions of section 501(c)(12) of the Code. The facilities are owned by *M* and *T* as a tenancy in common under a joint operating agreement classified as a partnership and each is considered to have contributed its interest in the facilities to the partnership for federal income tax purposes. The *M* and *T* partnership is subject to the provisions of subchapter K, chapter 1, of the Code.

Situation 2.

The facts are the same as Situation 1 except that the partners elected pursuant to the provisions of section 1.761-2(b) of the Income Tax Regulations to be excluded from the application of subchapter K, chapter 1, of the Code. Thus, *M* and *T* were excluded from partnership status.

LAW AND ANALYSIS

Section 38 of the Code allows an investment credit with respect to qualified investment in certain depreciable property.

Section 47(a)(1) of the Code provides that if during the taxable year any property is disposed of, or otherwise ceases to be section 38 property with respect to the taxpayer, before the close of the useful life that was taken into account in computing the credit under section 38, then the tax under chapter 1 of the Code for such taxable year shall be increased by an amount equal to the aggregate decrease in the credits allowed under section 38 for all prior taxable years that would have resulted solely from substituting, in determining qualified investment, for such useful life the period beginning with the time such property was placed in service by the taxpayer and ending with the time such property ceased to be section 38 property.

Section 47(b) of the Code provides that property shall not be treated as ceasing to be section 38 property with respect to the taxpayer by reason of a mere change in the form of conducting the trade or business so long as the property is retained in such trade or business as section 38 property and the taxpayer retains a substantial interest in such trade or business.

Section 1.47-3(f) of the regulations provides that no disposition of section 38 property will occur by reason of a mere change in form of conducting a trade or business if the following conditions are met. The conditions are: (1) the property is retained as section 38 property in the same trade or business, (2) the transferor retains a substantial interest in such trade or business, (3) substantially all the assets necessary to operate such trade or business are transferred, and (4) the basis of the property to the transferee is determined by reference to the basis in the hands of the transferor.

Section 721 of the Code provides that no gain or loss shall be recognized to a partnership or to any of its partners in the case of a contribution of property to the partnership in exchange for an interest in the partnership.

Section 723 of the Code provides that the basis of property contributed to a partnership by a partner shall be the adjusted basis of such property to the contributing partner at the time of the contribution increased by the amount (if any) of gain recognized to the contributing partner at such time.

Rev. Rul. 78-268, 1978-2 C.B. 10, holds that when an electric generating facility is owned as a tenancy in common under an arrangement classified as a partnership, the disallowance of the investment credit in respect of the interest of the cooperative and the city (two of the four partners) does not render the investment in the facilities by investor-owned utilities (the other two partners) ineligible for the investment credit.

HOLDING

Situation 1.

The sale by *M* of an undivided interest in its generating facilities to *T* will be treated as a disposition of property within the meaning of section 47(a) of the Code. Thus, there is a recapture of the investment credit taken on such property. The interest retained by *M* is not disqualified as section 38 property; thus, there is no disposition of property under section 47(a) that would result in a recapture of investment credit with respect to the interest retained by *M*.

The contribution of *M*'s retained interest in the facilities to the partnership is not a disposition of property within the meaning of section 47(a) because the conditions specified in section 1.47-3(f) of the regulations have been met.

Situation 2.

The election by *M* and *T* to be excluded from the provisions of subchapter K, chapter 1, of the Code does not alter the tax treatment set forth in Situation 1 above.

Section 79.—Group-Term Life Insurance Purchased for Employees

26 CFR 1.79-1: Group-term life insurance —general rules.

Employees' group-term life insurance; coverage brackets. Life insurance covering fewer than ten full-time employees that would meet the qualifications of section 1.79-1(c) of the regulations only if all three of its coverage brackets were taken into account is not group-term life insurance for purposes of section 79 of the Code if no employee has ever been covered under the middle bracket.

Rev. Rul. 80-220

ISSUE

Does the life insurance described below qualify as group-term life insurance for purposes of section 79 of the Internal Revenue Code?

FACTS

In 1979 *X* corporation established a plan to provide life insurance for its four full-time employees. The amount of protection for the employees was computed on the basis of coverage brackets (established by the insurer) as follows:

Bracket	*Description*	*Amount of Coverage*
1	officer/shareholder	$50,000
2	junior professional	$25,000
3	bookkeeper/secretary	$10,000

Of the four full-time employees, three were eligible for coverage under bracket 1 and the remaining employee was covered under bracket 3. Although additional employees have been hired by *X* since inception of the plan, no employee has ever been covered under bracket 2.

LAW AND ANALYSIS

Section 79(a) of the Code provides that the yearly cost of group-term life insurance provided by an employer on the life of any employee will be includible in the gross income of the employee to the extent that such cost exceeds the sum of the cost of $50,000 of such insurance and the amount (if any) paid by the employee toward the purchase of such insurance.

Section 1.79-1(c) of the Income Tax Regulations provides that, as a general rule, life insurance provided to a group of employees cannot qualify as group-term life insurance unless, at some time during the calendar year, it is provided to at least ten full-time employees who are members of the group of employees. However, the general rule does not apply if, among other conditions, the amount of insurance provided is computed either as a uniform percentage of compensation or on the basis of coverage brackets established by the insurer. In general, the amount of insurance provided employees in a coverage bracket may not exceed 2½ times the coverage of the next lower bracket and the coverage of the lowest bracket must be at least 10 percent of the coverage of the highest bracket.

In the present case, the employees of *X* (a group including less than ten full-time employees) are entitled to amounts of insurance computed on the basis of three coverage brackets. However, since inception of the plan, no employee of *X* has ever been covered under bracket 2. Thus, for all practical purposes, there are only two brackets, 1 and 3, and the coverage of bracket 1 exceeds 2½ times the coverage of bracket 3. Therefore, the requirements of section 1.79-1(c) of the regulations have not been satisfied.

HOLDING

The life insurance provided to employees of *X* is not group-term life insurance for purposes of section 79 of the Code and the employees of *X* may not exclude from gross income any portion of the cost of such insurance.

Section 167.—Depreciation

26 CFR 1.167(a)-11: Depreciation based on class life asset depreciation ranges for property placed in service after December 31, 1970.

Revision of effective dates for Rev. Proc. 79-26, 1979-1 C.B. 566, and Rev. Proc. 79-35, 1979-2 C.B. 498, both of which prescribed certain changes to Rev. Proc. 77-10, 1977-1 C.B. 548, regarding the Class Life Asset Depreciation Range system. See Rev. Proc. 80-33, page 21.

Section 311.—Taxability of Corporation on Distribution

26 CFR 1.311-1: General.
(Also Section 1001; 1.1001-1.)

Redemption of stock; appreciated property; plan of sale. A corporation issued preferred stock for cash with the intent of later redeeming the stock for appreciated property. The transaction was merely a prearranged plan to avoid the tax on the sale of the property, and the nonrecognition of gain provisions of section 311(a) of the Code did not apply.

Rev. Rul. 80-221

ISSUE

Whether the nonrecognition of gain provisions of section 311(a) of the Internal Revenue Code apply where a corporation issues its "preferred stock" for cash for the purpose of redeeming the "stock" from the purchaser with appreciated property owned by the corporation.

FACTS

Corporation *X* is engaged in a manufacturing business and owned a piece of vacant land which it originally acquired for use in its manufacturing business. *X* abandoned its plans for the use of the land in its business. The land had an adjusted basis of 100*x* dollars and a fair market value of 10,000*x* dollars. *Y*, an unrelated corporation, offered to purchase the land at its fair market value of 10,000*x* dollars. However, *X*, in order to avoid the recognition of gain on the sale of the land, entered into the following transaction with *Y*. On March 31, 1979, *Y* purchased for 10,000*x* dollars one share of 10,000*x*-dollar-par-value nonvoting "preferred stock" of *X*. This share of "stock" called for payment of a quarterly cumulative dividend of 300*x* dollars. The "stock" was redeemable at the option of the shareholder 13 months after issuance solely by the transfer of legal title and possession of the land to the shareholder. However, if an event occurred that would excuse *X* from transferring title to *Y* (such as a condemnation of the land by the state), *X* would be required to redeem the "stock" with a payment of 10,000*x* dollars in cash. The "stock" was also callable by *X* under the same terms 14 months after issuance.

X was entitled to full use and possession of the land while the "stock" was outstanding, but could not waste, sell, or otherwise dispose of the land. *X* was liable for the real estate taxes on the property during the period the "stock" was outstanding. The real estate taxes on the land were nominal. On March 31, 1979, *Y* gave 10,000*x* dollars to *X* in exchange for this one share of *X* "preferred stock." The fair market value of the land on that date was 10,000*x* dollars.

On May 1, 1980, 13 months after the issuance of the "preferred stock", *Y*, who had received no dividends on the "preferred stock," demanded redemption of the share of "preferred stock." *Y* received a deed transferring legal title to the land to *Y*. *Y* also received 1,200*x* dollars in cash for the accrued quarterly dividends on the stock. The value of the "stock" during the 12-month period immediately prior to the distribution in redemption thereof represented at least 10 percent in value of all the outstanding stock of *X* during that period. *Y* had no other interest in *X*.

LAW AND ANALYSIS

Section 61(a)(3) of the Code states that gross income includes gains derived from dealings in property. Section 1001(a) provides, in part, that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in section 1011 for determining gain. Section 311(a) provides, in part, that except as provided in subsection (d), no gain or loss shall be recognized to a corporation on a distribution, with respect to its stock or property. Section 311(d)(1) provides that a corporation shall recognize gain if it distributes appreciated property in redemption of its stock. However, section 311(d)(2)(A) provides that the exception of section 311(d)(1) to the general rule of nonrecognition of section 311(a) will not apply if the redemption is (1) a distribution in complete redemption of all of the stock of a shareholder, who (2) for the 12-month period immediately prior to the distribution (3) holds at least 10 percent in value of the outstanding stock of the distributing corporation.

The form of the transaction in this case (a purchase of *X* stock by *Y* followed by a redemption of this stock with *X* distributing the vacant land to *Y* in full payment in exchange therefor) was chosen solely for the purpose of attempting by the application of section 311(a) of the Code, to avoid the tax on the gain that otherwise would have been recognized to *X*. *Y* had no interest in acquiring "stock" ownership in *X*, and *Y* did so only to accommodate the tax avoidance motives of *X*. *Y*'s objectives were solely to purchase the land from *X*, and *X*'s objectives were to sell the land to *Y*. *Y*'s "stock" ownership in *X* was transitory and was not intended to represent a normal shareholder interest. Rather, the "stock" represented *Y*'s right to receive the land at a specified time and to receive payment for giving *X* the purchase price of the land prior to *Y* receiving title to the land.

The two steps of the transaction of the purchase of the "stock" and its "redemption" for the land were part of a prearranged integrated plan and may not be considered independently of each other for federal income tax purposes. See Rev. Rul. 70-140, 1970-1 C.B. 73, which concluded that the transfer by an individual of assets of proprietorship, pursuant to an integrated plan, followed by the corporation's acquisition by an unrelated corporation did not qualify under the nonrecognition provisions of section 351 and that gain or loss was recognized under section 1001. Compare *Idol v. Commissioner*, 38 T.C. 444, *aff'd*, 319 F.2d 647 (6th Cir 1963), in which section 311(a) of the Code was held not to apply to a redemption of stock that had been acquired solely for the purpose of having it redeemed by the distribution of appreciated assets. In *Bush Brothers and Co. v. Commissioner*, 73 T.C. No. 37 (1979), the United States Tax Court stated that the nonrecognition provisions of section 311(a) of the Code were not intended to apply to transactions that are motivated primarily by tax avoidance and without any substantial business purpose.

HOLDING

Section 311(a) of the Code is not applicable to the subject transaction, and gain is recognized to *X* on the sale of the land to *Y* under section 1001.

Section 412.—Minimum Funding Standards

26 CFR 1.412(i)-1: Certain insurance contract plans.

T.D. 7706 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Exception for certain insurance contract plans from minimum funding standards.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

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[1] This publication of the Treasury Decision contains the complete text of the amendments to the regulations. The instructions for modifying the notice of proposed rulemaking have been omitted.

SUMMARY: This document provides final regulations relating to an exception for certain pension plans funded exclusively by insurance contracts from the minimum funding standards. Changes in the applicable tax law were made by the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1]. These regulations provide necessary guidance to the public for compliance with the law and affect employees covered by those plans.

DATE: For plans in existence on January 1, 1974, the regulations are effective for plan years beginning after December 31, 1975. For plans not in existence on January 1, 1974, the regulations are effective for plan years beginning after September 2, 1974.

FOR FURTHER INFORMATION CONTACT: Richard J. Wickersham of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3250) (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On February 6, 1975, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 412(i) of the Internal Revenue Code of 1954 (40 F.R. 5535). The amendments were proposed in order to conform the regulations to section 1013(a) of the Employee Retirement Income Security Act of 1974 (88 Stat. 914) and section 301(b) of such Act (88 Stat. 869). A public hearing was neither requested nor held on these proposed regulations. After consideration of all comments regarding the proposed amendments those amendments are adopted as revised by this Treasury decision.

INSURANCE CONTRACT PLANS

Section 412 of the Code prescribes minimum funding standards which are generally applicable to defined benefit plans. Under section 412(h)(2) of the Code, any insurance contract plan described in section 412(i) of the Code for a plan year is not subject to the minimum funding requirements of section 412 for that plan year. Section 412(i) of the Code sets forth certain specified requirements which such a plan must meet to qualify for this exception from the minimum funding requirements. Section 412(i) provides further that a plan funded exclusively by the purchase of group insurance contracts which is determined under regulations to have the same characteristics as an individual insurance contract plan will be treated as a plan described in section 412(i).

PAYMENT OF LOAD FACTORS

Section 412(i) of the Code and § 1.412(i)-1(b)(2)(i) and (c)(2)(i) of the regulations, as proposed, require that an insurance contract plan be funded exclusively by the purchase of insurance contracts. The final regulations make it clear that this requirement is not violated by payments which are made in order to satisfy certain minimum vesting requirements with respect to accrued benefits derived from employee contributions. Thus, for example, it will be permissible for an employer to pay the "load factor" on insurance contracts in order for the plan to meet the requirement (set forth in section 411 of the Code) that an employee must be 100 percent vested in the accrued benefit derived from his own contributions.

PREMIUM PAYMENTS

Section 412(i) states that the insurance contract plan must provide for level annual premium payments. The final regulations clarify this requirement. Employees who cease their participation in the plan may pay premiums on their own behalf if the contracts are distributed to them upon their termination of employment. The level annual payment applies only to the premiums on the insurance contracts. Consequently, it is permissible for the insurance company to apply such items as experience gains and dividends against premiums due on the contracts without violating this requirement.

LAPSES AND LOANS

The final regulations have expanded on the requirements necessary for a plan to be reinstated after a lapse in premium payments. Reinstatement must occur prior to the time any participant's benefits would be reduced because of the lapse.

Another requirement in the proposed regulations is the prohibition of policy loans on the insurance contracts issued under the plan. The final regulations provide that an application of funds by the issuer to pay premiums due on the contracts will not be considered policy loans for purposes of this prohibition if certain conditions are satisfied.

OTHER CHANGES

The final regulations make it clear that an insurance contract plan may be funded by a combination of individual and group contracts if certain requirements are satisfied. A clarifying change was made to the final regulations to make it clear that the group contracts are being compared to individual contracts which have been approved for sale in the relevant state.

DRAFTING INFORMATION

The principal author of these proposed regulations was Richard J. Wickersham of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to 26 CFR Part 1 are hereby adopted:

§ 1.412(i)-1 Certain insurance contract plans.

(a) *In general.* Under section 412 (h)(2) of the Internal Revenue Code of 1954, as added by section 1013(a) of the Employee Retirement Income Security Act of 1974 (88 Stat. 914) (hereinafter referred to as "the Act"), an insurance contract plan described in section 412(i) for a plan year is not subject to the minimum funding requirements of section 412 for that plan year. Consequently, if an individual or group insurance contract plan satisfies all of the requirements of paragraph (b)(2) or (c)(2) of this section, whichever are applicable, for the plan year, the plan is not subject to the requirements of section 412 for that plan year. The effective date for section 412 of the Code is determined under section 1017 of the Act. In general, in the case of a plan which was not in existence on January 1, 1974, this section applies for plan years beginning after September 2, 1974, and in the case of a plan in existence on January 1, 1974, to plan years beginning after December 31, 1975.

(b) *Individual insurance contract plans.* (1) An individual insurance contract plan is described in section 412(i) during a plan year if the plan satisfies the requirements of paragraph (b)(2) of this section for the plan year.

(2) The requirements of this subparagraph are:

(i) The plan must be funded exclusively by the purchase from an insurance company or companies (licensed under the law of a State or the District of Columbia to do business with the plan) of individual annuity or individual insurance contracts, or a combination thereof. The purchase may be made either directly by the employer or through the use of a custodial account or trust. A plan shall not be considered to be funded otherwise than exclusively by the purchase of individual annuity or individual insurance contracts merely because the employer makes a payment necessary to comply with the provisions of section 411(c)(2) (relating to accrued benefit from employee contributions).

(ii) The individual annuity or individual insurance contracts issued under the plan must provide for level annual, or more frequent, premium payments to be paid under the plan for the period commencing with the date each individual participating in the plan became a participant and ending not later than the normal retirement age for that individual or, if earlier, the date the individual ceases his participation in the plan. Premium payments may be considered to be level even though items such as experience gains and dividends are applied against premiums. In the case of an increase in benefits, the contracts must provide for level annual payments with respect to such increase to be paid for the period commencing at the time the increase becomes effective. If payment commences on the first payment date under the contract occurring after the date an individual becomes a participant or after the effective date of an increase in benefits, the requirements of this subdivision will be satisfied even though payment does not commence on the date on which the individual's participation commenced or on the effective date of the benefit increase, whichever is applicable. If an individual accrues benefits after his normal retirement age, the requirements of this subdivision are satisfied if payment is made at the time such benefits accrue. If the provisions required by this subdivision are set forth in a separate agreement with the issuer of the individual contracts, they need not be included in the individual contracts.

(iii) The benefits provided by the plan for each individual participant must be equal to the benefits provided under his individual contracts at his normal retirement age under the plan provisions.

(iv) The benefits provided by the plan for each individual participant must be guaranteed by the life insurance company, described in paragraph (b)(2)(i) of this section, issuing the individual contracts to the extent premiums have been paid.

(v) Except as provided in the following sentence, all premiums payable for the plan year, and for all prior plan years, under the insurance or annuity contracts must have been paid before lapse. If the lapse has occurred during the plan year, the requirements of this subdivision will be considered to have been met if reinstatement of the insurance policy, under which the individual insurance contracts are issued, occurs during the year of the lapse and before distribution is made or benefits commence to any participant whose benefits are reduced because of the lapse.

(vi) No rights under the individual contracts may have been subject to a security interest at any time during the plan year. This subdivision shall not apply to contracts which have been distributed to participants if the security interest is created after the date of distribution.

(vii) No policy loans, including loans to individual participants, on any of the individual contracts may be outstanding at any time during the plan year. This subdivision shall not apply to contracts which have been distributed to participants if the loan is made after the date of distribution. An application of funds by the issuer to pay premiums due under the contracts shall be deemed not to be a policy loan if the amount of the funds so applied, and interest thereon, is repaid during the plan year in which the funds are applied and before distribution is made or benefits commence to any participant whose benefits are reduced because of such application.

(c) *Group insurance contract plans.* (1) A group insurance contract plan is described in section 412(i) during a plan year if the plan satisfies the requirements of subparagraph (2) for the plan year.

(2) The requirements of this subparagraph are:

(i) The plan must be funded exclusively by the purchase from an insurance company or companies, described in paragraph (b)(2)(i) of this section, of group annuity or group insurance contracts, or a combination thereof. The purchase may be made either directly by the employer or through the use of a custodial account or trust. A plan shall not be considered to be funded otherwise than exclusively by the purchase of group annuity or group insurance contracts merely because the employer makes a payment necessary to comply with the provisions of section 411(c)(2) (relating to accrued benefit derived from employee contributions).

(ii) In the case of a plan funded by a group insurance contract or a group annuity contract the requirements of paragraph (b)(2)(ii) of this section must be satisfied by the group contract issued under the plan. Thus, for example, each individual participant's benefits under the group contract must be provided for by level annual, or more frequent, payments equivalent to the payments required to satisfy such paragraph. The requirements of this subdivision will not be satisfied if benefits for any individual are not provided for by level payments made on his behalf under the group contract.

(iii) The group annual or group insurance contract must satisfy the requirements of clauses (iii), (iv), (v), (vi), and (vii) of paragraph (b)(2). Thus, for example, each participant's benefits provided by the plan must be equal to his benefits provided under the group contract at his normal retirement age.

(iv)(A) If the plan is funded by a group annuity contract, the value of the benefits guaranteed by the insurance company issuing the contract under the plan with respect to each participant under the contract must not be less than the value of such benefits which the cash surrender value would provide for that participant under any individual annuity contract plan satisfying the requirements of paragraph (b) and approved for sale in the State where the principal office of the plan is located.

(B) If the plan is funded by a group insurance contract, the value of the benefits guaranteed by the insurance company issuing the contract under the plan with respect to each participant under the contract must not be less than the value of such benefits which the cash surrender value would provide for that participant under any individual insurance contract plan satisfying the requirements of paragraph (b) and approved for sale in the State where the principal office of the plan is located.

(v) Under the group annuity or group insurance contract, premiums or other consideration received by the insurance company (and, if a custodial account or trust is used, the custodian or trustee thereof) must be allocated to purchase individual benefits for participants under the plan. A plan which maintains unallocated funds in an auxiliary trust fund or which provides that an insurance company will maintain unallocated funds in a separate account, such as a group deposit administration contract, does not satisfy the requirements of this subdivision.

(d) *Combination of plans.* A plan which is funded by a combination of individual contracts and a group contract shall be treated as a plan described in section 412(i) for the plan year if the combination, in the aggregate, satisfies the requirements of this section for the plan year.

Sec. 412(i), 7805 of the Internal Revenue Code of 1954 (88 Stat. 919 and 68A Stat. 917, (26 U.S.C. 412(i) and 7805)).

JEROME KURTZ,
Commissioner of Internal Revenue.

Approved June 24, 1980.

DONALD C. LUBICK,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 15, 1980, 8:45 a.m., and published in the issue of the Federal Register for July 16, 1980, 45 F.R. 47675)

Section 761.—Terms Defined [Partners and Partnerships]

26 CFR 1.761-2: Exclusion of certain unincorporated organizations from the application of all or part of subchapter K of Chapter 1 of the Code.

Whether the election to be excluded from the application of subchapter K, Chapter 1, of the Code will cause the recapture provisions of section 47(a) to be triggered where a partnership was created by the acquisition of a utility company's undivided interest in section 38 property by a tax exempt cooperative. See Rev. Rul. 80-219, page 5.

Section 881.—Tax on Income of Foreign Corporations Not Connected with United States Business

26 CFR 1.881-1: Taxation of foreign corporations not engaged in U.S. business. (Also Sections 1441, 1442, 4371; 1.1441-2, 1.1442-1, 46.4371-2.)

Foreign insurance company; no U.S. agent; reinsurance of U.S. risks. A foreign insurance company, which is not engaged in the conduct of trade or business in the U.S., reinsures risks that were initially assumed by other insurance companies and that are located in the U.S. The policies are neither signed nor countersigned in the U.S. by any officer or agent of the foreign insurance company. The premiums paid on such policies are subject to the excise tax imposed by section 4371(3) of the Code. The premiums received are not subject to either taxation under section 881 or withholding under section 1442. I.T. 1359 and I.T. 3061 amplified and superseded.

Rev. Rul. 80-222

ISSUE

Are the insurance premiums received by *M* under the circumstances described below subject to taxation under section 881 of the Internal Revenue Code, in light of the position stated in I.T. 1359, I-1 C.B. 292 (1922), with respect to the taxability of certain insurance premiums?

FACTS

M is a foreign casualty insurance company organized under the laws of country *X*. Its principal business is the reinsurance of risks initially assumed by other insurance companies, some of which are risks located in the United States and are, therefore, United States risks within the meaning of section 861(a)(7) of the Code. The policies issued by *M* for the reinsurance of these risks are neither signed nor countersigned in the United States by any officer or agent of *M*. *M* is not otherwise engaged in the conduct of any insurance business in the United States within the meaning of section 842 or the conduct of any trade or business in the United States within the meaning of section 864(b). The policies of reinsurance referred to above are subject to the excise tax imposed by section 4371(3).

LAW AND ANALYSIS

Section 881(a) of the Code imposes a tax of 30 percent of the amount received by foreign corporations from sources within the United States as premiums and other fixed or determinable annual or periodical income to the extent such amount is not effectively connected with the conduct of a trade or business within the United States.

Section 1442 of the Code provides for the withholding from foreign corporations of a 30-percent tax in the same manner and on the same items of income as is provided in section 1441.

Section 1441(a) of the Code requires all persons paying any of the items of income listed in subsection (b) to any nonresident alien individual that constitutes gross income from sources within the United States to deduct and withhold a tax of 30 percent from such items. Subsection (b) includes in the list of these income items "premiums" and "other fixed or determinable annual or periodical income."

Section 4371 of the Code imposes a tax of a specified percentage of the premiums paid on each policy of insurance or reinsurance issued by a foreign insurer or reinsurer covering a United States risk. However, such policies that are signed or countersigned by an insurer's officer or agent in a state or the District of Columbia, within which the insurer is authorized to do business, are specifically excepted by section 4373(1) from the imposition of this excise tax.

I.T. 1359 concludes that insurance premiums received from insuring United States risks by foreign insurance companies not engaged in the conduct of any trade or business in the United States are not fixed or determinable and, thus, are not subject to withholding under the predecessor of section 1442 of the Code. See also I.T. 3061, 1937-1 C.B. 114. I.T. 1359 gives two reasons for this conclusion: (1) Congress, in enacting the withholding provisions, intended to require withholding on only those kinds of gross income items having a high content of net income, but insurance premiums do not have this high content of net income and often yield a loss; and (2) the impracticability of collecting an income tax on premiums from which little net income, if any, is derived was one reason Congress retained the stamp tax (Revenue Act of 1918, Title *XI*, Schedule A, paragraph 15, the predecessor of the section 4371 excise tax) on premiums received by insurance companies not engaged in a trade or business in the United States.

The legislative history of the stamp tax supports the result reached in I.T. 1359. Its history demonstrates that Congress did not believe that any income tax, including a withholding tax, was applicable to insurance premiums paid to foreign insurance companies not engaged in a trade or business in the United States. Thus, in order to eliminate the competitive imbalance created by the fact that such foreign insurance companies, unlike their domestic competitors, were not subject to any United States income tax, Congress imposed the stamp tax on premiums received by such foreign insurance companies. *See* 61 Cong. Rec. 7180-81 (1921); Hearings on H.R. 7378 Before the Senate Finance Comm. (Vol. 1), 77th Cong., 1st Sess. 121-22 (1942); H.R. Rep. No. 2333, 77th Cong., 1st Sess. 61 (1942), 1942-2 C.B. 372, 420.

Subsequent to the publication of I.T. 1359, Congress has taken legislative action with respect to the taxation of insurance premiums received by foreign insurance companies that is consistent with the conclusion reached in I.T. 1359. Congress, aware of I.T. 1359's holding for many years, has consistently reenacted both the insurance and withholding tax provisions without altering the result in I.T. 1359. *See,* e.g., Message From the President of the United States (Exhibit VIII), Doc. No. 140, 87th Cong., 1st Sess. 289-290 (1961), which restates the rationale of I.T. 1359 and notes that a 30-percent withholding tax on the premiums "would destroy a normal and essential channel of insurance business, which is important to the American economy where only a foreign company is equipped to handle the risk."

In the Revenue Act of 1962, Pub. L. 87-834, 1962-3 C.B. 111, Congress added section 952 to the Code, which treats income not effectively connected with the conduct of a trade or business in the United States and derived from the insurance of United States risks by a controlled foreign corporation as "subpart F income" that is taxable currently to certain United States shareholders of such corporations. This section was added on the assumption that the 30-percent withholding tax did not apply to such insurance premium income. This treatment was considered necessary in order to prevent tax avoidance schemes that would not have been possible if such premiums were subject to the 30-percent tax imposed by section 881(a). *See* H.R. Rep. No. 1447, 87th Cong., 2d Sess. 60 (1962), 1962-3 C.B. 405, 464; 108 Cong. Rec. 5305 (1962).

These actions taken by Congress without any attempt to reverse the longstanding position stated in I.T. 1359 indicate that I.T. 1359 correctly states the tax law applicable to the premiums under consideration. *See United States v. Correll,* 389 U.S. 299, 305-06 (1967), 1968-1 C.B. 64.

HOLDING

The insurance premiums received by *M* under the circumstances described above are not subject to taxation under section 881 of the Code and, therefore, are not subject to the withholding of tax under section 1442.

EFFECT ON OTHER DOCUMENTS

I.T. 1359 and I.T. 3061 are amplified and superseded since the position stated therein is restated under current law in this revenue ruling.

Section 842.—Foreign Corporations Carrying on Insurance Business

Whether the federal income tax or federal excise tax applies to premiums paid to a foreign insurance company conducting a surplus lines insurance business in the United States. See Rev. Rul. 80-225, page 14.

Section 864.—Definitions [Determination of Sources of Income]

26 CFR 1.864-2: Trade or business within the United States.

Whether the Federal income tax or Federal excise tax applies to premiums paid to a foreign insurance company conduct-

ing a surplus lines insurance business in the United States. See Rev. Rul. 80-225, page 14.

Section 894.—Income Affected by Treaty

26 CFR 1.894-1: Income affected by treaty.

Whether the enactment of sections 901 (f) and 907 of the Code by section 601 of the Tax Reduction Act of 1975 supersedes inconsistent provisions of income tax treaties with foreign countries entered into prior to the enactment of these sections. See Rev. Rul. 80-223, below.

Section 901.—Taxes of Foreign Countries and of Possessions of United States

26 CFR 1.901-1: Allowance of credit for taxes.
(Also Sections 894, 907, 7852; 1.894-1.)

Foreign tax credit; inconsistent provisions of treaties. The enactment of sections 901(f) and 907 of the Code by the Tax Reduction Act of 1975 supersedes inconsistent provisions of all income tax treaties.

Rev. Rul. 80-223

ISSUE

Does the enactment of sections 901 (f) and 907 of the Internal Revenue Code by the Tax Reduction Act of 1975, Pub. L. 94-12, 1975-1 C.B. 545, 561 (the "1975 Act") supersede inconsistent provisions of income tax treaties with foreign countries entered into prior to the enactment of these sections?

LAW AND ANALYSIS

Section 901(f) of the Code provides that the foreign tax credit is not allowable for certain payments made to foreign countries with respect to oil or gas in which the taxpayer has no economic interest and which is purchased or sold at a price that differs from the fair market value for such oil or gas.

Section 907 of the Code provides for a reduction of the amount of foreign income taxes paid or accrued with respect to foreign oil and gas extraction income and for the separate application of the credit limitation of section 904 to foreign oil related income and to other taxable income.

Section 7852(d) of the Code provides that no provision of the Code shall apply in any case in which its application would be contrary to any provision of a treaty in effect on the date of the enactment of the 1954 Code. This section indicates, in effect, that a mere inconsistency, without more, between a provision in a tax treaty and an amendment to the Code is not enough by itself to override the treaty provision. However, the general provision of section 7852(d) does not prevent Congress from passing legislation that, in effect, overrides a treaty provision.

Article *VI*, Clause 2 of the United States Constitution provides that both the laws of the United States and treaties shall be the supreme law of the land.

Sections 901(f) and 907 of the Code are not inconsistent with treaties that incorporate the foreign tax credit provisions of the Code as it may be amended from time to time or any treaty that provides for a per-country limitation but specifically indicates that changes in United States domestic law which do not eliminate the general principle of the foreign tax credit are not inconsistent with the treaty. *See* Article 20 of the United States-Poland Income Tax Convention, 1977-1 C.B. 416, 423. However, sections 901(f) and 907 of the Code are inconsistent with treaties that provide for foreign tax credits determined pursuant to the foreign tax credit provisions of the Code in effect as of dates specified in such treaties. *See* Article XV of the United States-Republic of Austria Income Tax Convention, 1957-2 C.B. 985, 990. Subsequent legislation amending the foreign tax credit provisions of the Code will normally not affect these treaties unless Congress clearly manifests an intention to do so.

Because treaties and acts of Congress are given equal weight by the Constitution as domestic law, Congress has the authority to overrule the effect of a treaty by subsequent legislation. When an act of Congress and a treaty relate to the same subject, the courts will endeavor to construe them so as to give effect to both, if this can be done without violating the language of either. The courts do not favor repudiation of an earlier treaty by implication and require clear indications that Congress, in enacting subsequent inconsistent legislation, meant to supersede the earlier treaty. *Head Money Cases,* 112 U.S. 580, 597-99 (1884); *United States v. Payne,* 264 U.S. 446, 448 (1924); *Menominee Tribe of Indians v. United States,* 391 U.S. 404, 413 (1967). An example of such a clear indication is the presence of subsequent inconsistent legislation together with a committee report indicating that Congress intended such legislation to supersede the earlier treaty. In *Cook v. United States,* 288 U.S. 102 (1933), subsequent inconsistent legislation was held not to supersede an earlier treaty provision because neither the committee reports nor the debates on the subsequent legislation mentioned the earlier treaty. It is, therefore, necessary to examine the legislative history underlying the enactment of sections 901(f) and 907 of the Code for a clear indication from Congress as to whether it intended these sections to supersede any provision of treaties entered into prior to the enactment of these sections.

Sections 901(f) and 907 of the Code were enacted by Congress in section 601 of the 1975 Act. Neither the 1975 Act nor the committee reports and congressional debates accompanying the Act contain any language or discussion dealing with the effect of these sections on tax treaties. These provisions had previously been proposed as part of the Oil and Gas Energy Act of 1974 and again as part of the Energy Tax and Individual Relief Act of 1974. The committee reports on these provisions, as proposed, also do not discuss their effect on treaties. Thus, the effect of these sections was not considered in any of the legislative history leading up to the actual enactment of sections 901 (f) and 907 by the 1975 Act. Therefore, at the time of their enactment, Congress left no clear indication as to its intention with respect to the application of the new sections to treaties that do not incorporate the foreign tax credit provisions of the Code as amended from time to time.

Section 1031 of the Tax Reform Act of 1976, Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 96 (the "1976 Act") amended section 904 of the Code by repealing the per-country limitation.

This amendment was inconsistent with treaties that provide for the per-country limitation by incorporating the foreign tax credit provisions of the Code in force as of dates specified in such treaties. However, the committee reports on this amendment express the clear intention of Congress to supersede these treaty provisions. See Rev. Rul. 80-201, 1980-30 I.R.B. 14.

In discussing the elimination of the per-country limitation the committee reports state that it is intended that all existing treaties are to be applied consistently with the amendment of section 904 by the 1976 Act. See *S. Rep. No. 94-938*, 94th Cong., 2d Sess. 237 (1976), 1976-3 C.B. (Vol. 3) 49, 275. In a footnote to this report (footnote 19) the committee states:

> The committee further intends that, *as in the case with other recent legislation modifying the foreign tax credit*, the amendments made by the committee's bill are to be used in computing the credit allowed under all treaties (emphasis added).

This same footnote also appears in *H.R. Rep. No. 94-658*, 94th Cong., 1d Sess. 226 (1976), 1976-3 C.B. (Vol. 2) 701, 918. This reference to "other recent legislation" indicates that when Congress passed sections 901(f) and 907 of the Code it intended to supersede any inconsistent treaty provisions. No other significant legislation affecting the foreign tax credit was passed by the 94th Congress.

Statutes are normally construed with reference to circumstances existing at the time of the passage of the statutes. Therefore, comments made by a *subsequent* Congress on the meaning of an *earlier* Congress are not considered part of the legislative history of the earlier act. *United States v. Wise*, 370 U.S. 405 (1962). They are entitled to consideration as a secondarily authoritative expression of expert opinion. *Waterman Steamship Corp. v. United States*, 381 U.S. 252 (1965), 1965-2 C.B. 465; *Pennsylvania Mutual Co. v. Ledever*, 252 U.S. 523 (1920).

However, in this case, it was the *same* Congress (the 94th Congress) that enacted sections 901(f) and 907 of the Code in the 1975 Act and then that commented on this enactment in its reports on the 1976 Act while amending sections 904 and 907. The closer in time that a later legislative comment is to the original enactment and the greater the continuity of the Congress, the more persuasive the comment may be considered to be. *Sioux Tribe of Indians v. United States*, 316 U.S. 317 (1942); *Tri-Lakes S. S. Co. v. Commissioner*, 146 F.2d 970 (6th Cir. 1945); *Associated Telephone & Telegraph Co. v. United States*, 306 F.2d 824 (2d Cir. 1962), *cert. denied*, 371 U.S. 950 (1962). In this case, the comments made in 1976 by the House Ways and Means Committee and the Senate Finance Committee were made by the *same* committees of the *same* Congress that passed the original versions of sections 901(f) and 907 in 1975.

If subsequent comments in committee reports of Congress about what it meant years earlier in enacting a law are made in conjunction with legislation amending the earlier law, and the amendatory legislation assumes the correctness of such comments, the comments are entitled to great weight in statutory construction. *Mount Sinai Hospital of Greater Miami, Inc. v. Weinberger*, 517 F.2d 329 (5th Cir. 1975). Although no amendments were made to section 901(f) of the Code by the 1976 Act, several amendments were made to section 907. Congress made these amendments on the assumption that section 907 supersedes all inconsistent treaty provisions. Moreover, since much of section 907 was amended or enacted by the 1976 Act, the statement in the committee reports that the amendments are to be used in computing the credit allowed under all treaties applies specifically to the amendments of section 907. There is no reason why Congress would intend part of section 907 to apply to all treaties but not the rest of section 907 or the integrally related section 901(f).

HOLDING

The enactment of sections 901(f) and 907 of the Code by the 1975 Act supersede inconsistent provisions of all income tax treaties, those in effect on the date of the enactment of the 1954 Code as well as those in effect after this date.

Section 907.—Special Rules in Case of Foreign Oil and Gas Income

Whether the enactment of sections 901(f) and 907 of the Code by section 601 of the Tax Reduction Act of 1975 supersedes inconsistent provisions of income tax treaties with foreign countries entered into prior to the enactment of these sections. See Rev. Rul. 80-223, page 12.

Section 1001.—Determination of Amount of and Recognition of Gain or Loss

26 CFR 1.1001-1: Computation of gain or loss.

Whether a corporation intent on selling its appreciated property can avoid recognition of gain under section 1001 of the Code by issuing its preferred stock to the prospective purchaser of the property and later effecting a redemption which, in form, was structured under the nonrecognition provisions of section 311(a). See Rev. Rul. 80-221, page 6.

Section 1441. Withholding of Tax on Nonresident Aliens

26 CFR 1.1441-2: Income subject to withholding.

Whether insurance premiums received by foreign corporations, which are not engaged in the conduct of a trade or business in the United States, on policies of reinsurance of United States risks, which were initially assumed by other insurance companies, that are subject to the excise tax imposed by section 4371(3) of the Code are subject to the income tax imposed by section 881 and to the withholding provisions of section 1442. See Rev. Rul. 80-222, page 10.

Section 1442.—Withholding of Tax on Foreign Corporations

26 CFR 1.1442-1: Withholding of tax on foreign corporations.

Whether insurance premiums received by foreign corporations, which are not engaged in the conduct of a trade or business in the United States, on policies of reinsurance of United States risk, which were initially assumed by other insurance companies, that are subject to the excise tax imposed by section 4371(3) of the Code are subject to the income tax imposed by section 881 and to the withholding provisions of section 1442. See Rev. Rul. 80-222, page 10.

Section 2513.—Gift by Husband or Wife to Third Party

26 CFR 25.2513-2: Manner and time of signifying consent.

Split gifts; consent of spouse after due date of return. Spouses may not elect under section 2513 of the Code to split gifts made by one spouse after the donor spouse has filed a gift tax return reporting the gifts and the due date for filing the return has passed.

Rev. Rul. 80-224

ISSUE

Under section 2513 of the Internal Revenue Code, can spouses elect to split gifts made by one spouse, after the donor spouse has filed a gift tax return reporting the gifts and the due date for filing the return has passed?

FACTS

A gift tax return reporting gifts made by *G* during the fourth quarter of 1978 was filed on February 15, 1979, the due date for such a return. There was no indication on the return that *G*'s spouse, *S*, consented to have *G*'s gifts to third parties considered as made one-half by each spouse. In May 1979 *S* filed a gift tax return and *G* filed an amended gift tax return. Both returns were for the fourth quarter of 1978 and indicated the consent of both spouses to split the gifts that were made by *G* and that were reported on the previously filed return.

LAW AND ANALYSIS

Section 2513(a) of the Code provides that a gift made by a donor to any person other than a spouse shall be considered as made one-half by the donor and one-half by the donor's spouse, if both spouses have signified their consent to split all such gifts made during the calendar quarter, as provided in section 2513(b).

Section 2513(b)(2) of the Code provides that such consent may be signified at any time after the close of the calendar quarter in which the gift was made, subject to certain limitations. One of those limitations is that the consent may not be signified after the due date of the gift tax return unless before the due date of the return neither spouse has filed a return for that calendar quarter. If, by the due date, neither spouse has filed a gift tax return for the calendar quarter, the consent may not be signified after a return for such quarter has been filed by either spouse.

The consent to split gifts may not be made after one spouse has filed a return with respect to the gifts and the due date for filing the return has passed. A failure to comply with a statutory condition for making an election in the first return filed precludes the taxpayer from subsequently attempting to make such election, even through the failure may be due to an oversight, an error in judgment or a lack of knowledge of the law. See *McLean v. United States,* Civil No. 78-1186 (N.D. Cal., March 28, 1979), *Thorrez v. Commissioner,* 31 T.C. 655 (1958), *aff'd per curiam,* 272 F.2d 945 (6th Cir. 1959).

HOLDING

Spouses may not elect to have gifts considered as made one-half by each spouse under section 2513 of the Code after one spouse has filed a gift tax return reporting the gifts and the due date for filing the return has passed.

Section 4371.—Imposition of Tax

26 CFR 46.4371-2: Imposition of tax on policies issued by foreign insurers; scope of tax.

Whether insurance premiums received by foreign corporations, which are not engaged in the conduct of a trade or business in the United States, on policies of reinsurance of United States risks, which were initially assumed by other insurance companies, that are subject to the excise tax imposed by section 4371(3) of the Code not subject to the income tax imposed by section 881 and to the withholding provisions of section 1442. See Rev. Rul. 80-222, page 10.

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26 CFR 46.4371-3: Rate and computation of tax.
(Also Sections 842, 864, 4373; 1.864-2.)

Foreign insurance company; U.S. agent; surplus lines insurance. A foreign insurance company, which is not licensed in a particular state, conducts a surplus lines insurance business in that state through a licensed broker that acts as the company's agent, regularly signs and countersigns policies, and settles losses arising from such policies. The excise tax imposed by section 4371 of the Code does not apply to premiums paid to the foreign insurance company on such policies.

Rev. Rul. 80-225

ISSUE

Does the federal excise tax imposed by section 4371 of the Internal Revenue Code on foreign insurance policies apply to insurance premiums paid to a foreign insurance company under the facts described below?

FACTS

Company *X* is a foreign casualty insurance company, conducting a surplus lines insurance business. Surplus lines insurance involves insuring risks which licensed insurers (those licensed to conduct an insurance business in the state) are unwilling to accept.

X has not obtained a license to conduct any insurance business under the laws of State *A*. However, in determining that no licensed market for a risk exists, a person licensed by State *A* as a surplus lines broker is permitted by the laws of State *A* to place the risk with an eligible surplus lines insurer, such as *X*, that is not licensed to conduct insurance business in State *A*. Thus, the laws of State *A* allow *X* to conduct a surplus lines insurance business in State *A* to the extent of signing or countersigning surplus lines insurance policies in the state covering the above risks and settling claims arising thereunder.

Company *Y* is licensed by State *A* as a surplus lines broker. *Y* regularly signs and countersigns surplus lines insurance policies in State *A* as agent for *X* with respect to surplus insurance risks, wholly or partly, within the State *A* and settles losses arising thereunder in *X*'s name.

LAW AND ANALYSIS

Section 4371 of the Code imposes a tax on each policy of insurance or reinsurance issued by any foreign insurer or reinsurer.

Under section 4373 of the Code, the tax does not apply to any policy signed or countersigned by an officer or agent of the insurer in a state, or in the District of Columbia, within which such insurer is authorized to do business.

Congress adopted section 4371 because it did not believe that any United States income tax (including withholding tax) was applicable to insurance premiums paid to foreign insurance companies not engaged in trade or business in the United States. See generally Rev. Rul. 80-222, page 10 of this Bulletin.

As a result of *Y*'s regularly signing and countersigning policies in State *A* as agent for *X*, *X* is engaged in a trade or business in the United States under sections 842 and 864 of the Code and is thus subject to income tax under section 831 on its underwriting income derived from the premiums received on the policies described above. *See, e.g., Amodio v. Commissioner,* 34 T.C. 894, 906 (1960), holding a nonresident alien taxpayer to be engaged in a trade or business in the United States as a result of activities performed on its behalf by an independent agent of the taxpayer in the United States.

Although *X* is not licensed to conduct an insurance business in State *A*, the laws of State *A* permit *X* to engage in certain surplus lines insurance activities in State *A* (the signing or countersigning of policies) without obtaining a license, and as a result of regularly performing these activities, *X* is engaged in a trade or business in the United States. Thus, with respect to the policies described above, *X* is authorized to do a surplus lines insurance business in State *A* within the meaning of section 4373(1) of the Code.

HOLDING

The excise tax imposed by section 4371 of the Code does not apply to the premiums on those policies paid to *X*, provided *X* is engaged in a U.S. trade or business with respect to the underwriting income derived by *X* from those premiums.

Compare Rev. Rul. 80-222, which relates to a situation where a foreign insurer is not engaged in business in the United States and is not subject to U.S. income tax, but is subject to the excise tax imposed by sections 4371 of the Code.

Section 4373.—Exemptions [Policies Issued by Foreign Insurers]

Whether the excise tax on foreign insurance policies applies to premiums paid to a foreign insurance company that is also subject to United States income tax. See Rev. Rul. 80-225, page 14.

Section 6402.—Authority to Make Credits or Refunds

26 CFR 301.6402-3: Special rules applicable to income tax.

Claims for refund based on changes of effective rates for depreciation as a result of revising the effective dates of Rev. Proc. 79-26, 1979-1 C.B. 566, and Rev. Proc. 79-35, 1979-2 C.B. 498, both of which prescribed certain changes to Rev. Proc. 77-10, 1977-1 C.B. 548, regarding the Class Life Asset Depreciation Range system. See Rev. Proc. 80-33, page 21.

Section 7852.—Other Applicable Rules

Whether the enactment of sections 901 (f) and 907 of the Code by section 601 of the Tax Reduction Act of 1975 supersedes inconsistent provisions of income tax treaties with foreign countries entered into prior to the enactment of these sections. See Rev. Rul. 80-223, page 12.

Subpart B.—Legislation and Related Committee Reports

Public Law 96-272
96th Congress, H.R. 3434 [1]
June 17, 1980

An Act

To establish a program of adoption assistance, to strengthen the program of foster care assistance for needy and dependent children, to improve the child welfare, social services, and aid to families with dependent children programs, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

Section 1. This Act, with the following table of contents, may be cited as the "Adoption Assistance and Child Welfare Act of 1980".

* * * * *

PERMANENT EXTENSION OF PROVISIONS RELATING TO CHILD DAY CARE SERVICES AND WIN TAX CREDIT

Sec. 208. * * *

(b) (1) Section 50B(i) of the Internal Revenue Code of 1954 (relating to special rules with respect to employment of day care workers) is amended to read as follows:

"(i) Special Rules With Respect to Employment of Day Care Workers.—

"(1) Eligible employee.—An individual who would be an 'eligible employee' (as that term is defined for purposes of this section) except for the fact that such individual's employment is not on a substantially full-time basis, shall be deemed to be an eligible employee as so defined, if such employee's employment is related to the provision of child day care services and is performed on either a full-time or part-time basis.

"(2) Alternative computation with respect to child day care services eligible employees paid from funds made available under title XX of the Social Security Act.—The amount of the credit allowed a taxpayer under section 40, as determined under section 50A and the preceding provisions of this section, with respect to work incentive program expenses paid or incurred by him with respect to an eligible employee whose services are performed in connection with a child day care services program conducted by the taxpayer, and with respect to whom the taxpayer is reimbursed (in whole or in part) from funds made available pursuant to section 2007 of the Social Security Act, at the option of the taxpayer shall be equal to 100 percent of the unreimbursed wages paid or incurred by the taxpayer with respect to such employee, but not more than the amount of the limitation in paragraph (4).

"(3) Unreimbursed wages.—For purposes of this subsection, the term 'unreimbursed wages' means work incentive program expenses for which the taxpayer was not reimbursed under section 2007 of the Social Security Act or under any other grant or program.

"(4) Limitation.—The amount of the credit, as determined under paragraph (2), with respect to any employee shall not exceed the lesser of—

"(A) an amount equal to $6,000 minus the amount of the funds reimbursed to the taxpayer with respect to such employee from funds made available pursuant to section 2007 of the Social Security Act; or

"(B) with respect to work incentive program expenses attributable to service rendered—

"(i) during the one-year period which begins on the day such employee begins work for the taxpayer, an amount equal to the lesser of—

"(I) $3,000, or

"(II) 50 percent of the sum of the amount of the unreimbursed wages of such employee and the amount reimbursed to the taxpayer with respect to such employee from funds made available pursuant to section 2007 of the Social Security Act; or

"(ii) during the one-year period which begins on the day after the last day of the one-year period described in clause (i), an amount equal to the lesser of—

"(I) $1,500, or

"(II) 25 percent of the sum of the amount of the unreimbursed wages of such employee and the amount reimbursed to the taxpayer with respect to such employee from funds made available pursuant to section 2007 of the Social Security Act."

(2) Section 50B(h) (1) (B) of such Code is amended by inserting "(except as provided in subsection (i))" after "full-time basis".

(3) (A) The amendments made by paragraphs (1) and (2) shall be effective with respect to taxable years beginning after December 31, 1979.

(B) The redesignation of subsection (i) of section 50B of the Internal Revenue Code of 1954 as subsection (j) by section 3(a) (1) of Public Law 96-178 [1980-6 I.R.B. 12] shall remain in effect with respect to taxable years beginning after December 31, 1979.

* * * * *

Approved June 17, 1980.

Senate Report No. 96-336
1st Session

[Bracketed numerals indicate official report page numbers]

ADOPTION ASSISTANCE AND CHILD WELFARE ACT OF 1979

October 2 (legislative day June 21), 1979.

Mr. Long, from the Committee on Finance, submitted the following report together with additional views to accompany H.R. 3431.[1]

* * * * *

General Discussion of the Bill

* * * * *

[84] CHANGES TO COORDINATE TAX CREDIT AND SOCIAL SERVICES PROVISIONS

Present law.—The amount of wages eligible to be paid for through the social services program was limited to

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[1] This publication of the law, Senate Report No. 96-936, this page, and Conference Report No. 96-900, page 17, is restricted to excerpts involving tax matters. House Report No. 96-136 and House Report No. 96-136, Part 2, are not published.

[1] Public Law 96-272, this page.

$4,000 in the case of proprietary employers on the presumption that they would claim the 20 percent tax credit and thus receive full reimbursement for the first $5,000 of wages paid. The tax credit, however, is computed only on the net wages actually paid by the employer after deducting any reimbursement he receives from other sources. Thus, if an employer pays wages of $5,000 and receives a social services grant to meet $4,000 of that total, his tax credit would have been computed only on the remaining $1,000. Under the former tax credit provisions this would have provided a tax credit of $200 (20 percent of $1,000). H.R. 12973 as reported by the Finance Committee last year would have permitted any wages reimbursed under the social services provisions to be included in computing the tax credit. However, because the tax credit percentage has now been increased to 50 percent for the first year wages and 25 percent for the second year wages, this change could result in a total reimbursement exceeding 100 percent of costs. H.R. 12973 included an overall limit of $1,000 on the credit to avoid such situations. Even with such a limit, however, there could still be instances of more than 100 percent reimbursement.

Committee bill.—The committee amendment would permit employers who hire welfare recipients in child care jobs to include any costs reimbursed under the title XX grant program in computing their tax credit. The amount of the credit would, however, be reduced to whatever extent necessary so that the combination of title XX grant and tax credit would never exceed 100 percent of the first $6,000 of wages paid to the employee. The amendment is effective for taxable years beginning after December 31, 1978.

CREDIT MADE APPLICABLE TO PART-TIME EMPLOYMENT

Present law.—H.R. 12973, as reported last year by the Committee, also modified the tax credit as applicable to child care jobs so that the tax credit and the related reimbursement under the social services provisions could be used for part-time as well as full-time employment. The tax credit is restricted to employees who have been employed for at least 30 days on a substantially full-time basis. The purpose of this change was to make the credit and payment provisions available in cases where the child care facility might hire, for example, two welfare recipients on a half-time basis for $4,000 per year each to perform a job for which they might otherwise hire a single full-time employee at a salary of $8,000 per year.

[85] *Committee bill.*—Effective for taxable years beginning after December 31, 1978, the Committee amendment would permit the tax credit and related title XX grant provisions to be applied to part-time as well as full-time employment by welfare recipients in child care jobs.

CHANGES RELATED TO PUBLIC LAW 95-600 [1978-3 C.B. (VOL. 1) 1]

Present law.—The 1978 tax reduction act (Public Law 95-600) made several significant changes in the tax credit provisions for hiring welfare recipients. Under prior law, the tax credit for hiring welfare recipients in child care jobs was limited to 20 percent of the first $5,000 of wages and was available only through September 30, 1978. Effective January 1, 1979, the new law treats child care jobs in the same manner as other employment for purposes of the tax credit. The credit is made permanent and applies to the first $6,000 of wages (at a 50 percent rate in the first year and a 25 percent rate in the second year).

Committee bill.—The committee amendment contains several provisions related to the changes made by Public Law 95-600:

1. The title XX grant provisions would be conformed to the $6,000 maximum wages creditable for the tax provision. (That is, grants up to $5,000 per eligible employee could be made for profit-making child care facilities and up to $6,000 for public and nonprofit facilities.)

2. The former tax credit provisions for child care jobs are reinstated for the period October 1, 1978 to December 31, 1978. (After that date, the new provisions of Public Law 95-600 are effective under existing law.)

3. A number of technical amendments are made to perfect the transition provisions in Public Law 95-600 and to rectify certain clerical errors in that statute.

* * * * *

Conference Report No. 96-900
2d Session

[Bracketed numerals indicate official report page numbers]

ADOPTION ASSISTANCE, CHILD WELFARE, AND SOCIAL SERVICES

April 23, 1980.

Mr. Ullman, from the committee of conference, submitted the following conference report to accompany H.R. 3431.[1]

* * * * *

Joint Explanatory Statement of the Committee of Conference

* * * * *

Permanent Extension of Provisions Relating to Child Day Care Services and WIN Tax Credit
(Sec. 208)

Present law.—Employers of AFDC recipients who are placed in jobs under the WIN program, or who have received AFDC for at least 90 days, are eligible for a tax credit equal to 50% of up to $6,000 of wages per employee for the first year of employment and 25% of such wages for the second year.

House bill.—Present law.

Senate bill.—The Senate bill would permit employers who receive Title XX grants for purposes of hiring welfare recipients in child care jobs to elect to include such grants in wages eligible for the tax credit. For taxpayers who so elect, the credit amount would be limited so that the total amount of the credit plus the grant could not exceed the lesser of $6,000 or 100% of total wages paid to the employee. In addition, the bill would allow the tax credit for persons employed on a part-time basis in child care jobs and would make certain technical amendments to correct errors in the Revenue Act of 1978 [1978-3 C.B. (Vol. 1) 1].

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[1] Public Law 96-272, page 16.

Conference agreement.—The conference agreement maintains the current law provision which provides that the credit is not allowed for wages reimbursed by a grant. The conference agreement provides, however, for a special 100-percent credit with respect to unreimbursed wages paid to workers whose wages are reimbursed in whole or in part by funds made available under section 2007 (grants to hire welfare recipients as child care workers) of the Social Security Act. If the taxpayer elects to compute the credit using this rate, the credit with respect to any employee is limited to the least of: (1) $6,000 minus the reimbursement with respect to this employee under section 2007, (2) $3,000 (for the first year of employment) or $1,500 (for the second year of employment), or (3) 50 percent (for the first year of employment) or 25 percent (for the second year of employment) of the sum of unreimbursed wages and the reimbursement under section 2007.

The conference agreement includes the Senate provision with regard to the eligibility of part-time child care workers for the credit. Regulations should define a minimum standard for part-time employment, such as 8 hours per week for the first 4 weeks of employment, to ensure that employees are eligible only if they have established a regular employment relationship with the employer.

* * * * *

Part III. Administrative, Procedural, and Miscellaneous

Delegation Order No. 4 (Rev. 11) (Effective July 11, 1980)

Authority to Issue Summonses, to Administer Oaths and Certify, and to Perform Other Functions

1(a). The authorities granted to the Commissioner of Internal Revenue by 26 CFR 301.7602-1(b), 301.7603-1, 301.7604-1 and 301.7605-1(a) and the authorities contained in Section 7609 of the Internal Revenue Code of 1954 and vested in the Commissioner of Internal Revenue Service by Treasury Department Order No. 150-37, dated March 17, 1955, to issue summonses; to set the time and place for appearance; to serve summonses; to take testimony under oath of the person summoned; to receive and examine books, papers, records or other data produced in compliance with the summons; to enforce summonses; to apply for court orders approving the service of John Doe Summonses issued under Section 7609 (f) of the Internal Revenue Code; and to apply for court orders suspending the notice requirements in the case of summonses issued under Section 7609(g) of the Internal Revenue Code, are delegated to the officers and employees of the Internal Revenue Service specified in paragraphs 1(b), 1(c), and 1(d) of this Order and subject to the limitations stated in paragraphs 1(b), 1(c), 1(d), and 6 of this Order

(b) The authorities to issue summonses and to perform the other functions related thereto specified in paragraph 1(a) of this Order, are delegated to all District Directors, the Director of International Operations, and the following officers and employees, provided that the authority to issue a summons in which the proper name or names of the taxpayer or taxpayers is not identified because unknown or unidentifiable (hereinafter called a "John Doe" summons) may be exercised only by said officers and employees and by them only after obtaining preissuance legal review by Regional Counsel, Deputy Regional Counsel (General Litigation) or District Counsel, or the Director, General Litigation Division in the case of Inspection.

(1) Inspection: Assistant Commissioner and Director, Internal Security Division.

(2) District Criminal Investigation: Chief of Division, except this authority in streamlined districts is limited to the District Director.

(3) International Operations: Chiefs of Divisions.

(4) District Collection Activity: Chief of Division, except this authority in streamlined districts is limited to the District Director.

(5) District Examination: Chief of Division, except this authority in streamlined districts is limited to the District Director.

(6) District Employee Plans and Exempt Organizations: Chief of Division.

(c) The authorities to issue summonses except "John Doe" summonses, and to perform other functions related thereto specified in paragraph 1(a) of this Order, are delegated to the following officers and employees:

(1) Inspection: Regional Inspectors and Assistant Regional Inspectors (Internal Security) and Chief, Investigations Branch.

(2) District Criminal Investigation: Assistant Chief of Division; Chiefs of Branches; and Group Managers.

(3) International Operations: Assistant Director; Chiefs of Branches; Case Managers; and Group Managers.

(4) District Collection Activity: Assistant Chief of Division; Chiefs of Collection Section; Chiefs of Field Branches and Office Branches; Chiefs, Special Procedures Staffs; Chiefs of Technical and Office Compliance Branches and Groups and Group Managers.

(5) District Examination: Chiefs of Branches, Case Managers, Group Managers and, in streamlined districts Chiefs, Examination Section.

(6) District Employee Plans and Exempt Organizations: Group Managers.

(d) The authority to issue summonses except "John Doe" summonses and to perform the other functions related thereto specified in paragraph 1(a) of this Order is delegated to the following officers and employees except that in the instance of a summons to a third party witness, the issuing officer's case manager, group manager, or supervisory official above that level, has in advance personally authorized the issuance of the summons. Such authorization shall be the original and all copies of the summons or by a statement on the face of the original and all copies of the summons, signed by the issuing officer, that he/she had prior authorization to issue said summons and stating the name and title of the authorizing official and the date of authorization.

(1) International Operations: Internal Revenue Agents; Attorneys, Estate Tax; Estate Tax Examiners; Special Agents; Revenue Service and Assistant Revenue Service Representatives; Tax Auditors; and Revenue Officers, GS-9 and above.

(2) District Criminal Investigation: Special Agents.

(3) District Collection: Revenue Officers, GS-9 and above.

(4) District Examination: Internal Revenue Agents; Tax Auditors; Attorneys, Estate Tax; and Estate Tax Examiners.

(5) District Employee Plans and Exempt Organizations: Internal Revenue Agents; Tax Law Specialists; and Tax Auditors.

(e) Each of the officers and employees referred to in paragraphs 1(b), 1(c) and 1(d) of this Order may serve a summons whether it is issued by him/her or another official.

(f) Revenue Representatives, GS-5 and above, and Revenue Officers, who are assigned to the District Collection Activity and to International Operations may serve any summons issued by the officers and employees referred to in paragraphs 1(b), 1(c) and 1(d) of this Order.

2. Each of the officers and employees referred to in paragraphs 1(b), 1(c), and 1(d) of this Order authorized to issue summonses, is delegated the authority under 26 CFR 301.7602-1(b) to designate any other officer or employee of the Internal Revenue Service referred to in paragraph 4(b) of this Order, as the individual before whom a person summoned pursuant to Section 7602 of the Internal Revenue Code shall appear. Any such other officer or employee of the Internal Revenue Service when so designated in a summons is authorized to take testimony under oath of the person summoned and to receive and examine books, papers, records or other data produced in compliance with the summons.

3. Internal Security Inspectors are delegated the authority under 26 CFR 301.7603-1 to serve summonses issued in accordance with this Order by any of the officers and employees of the Inspection Service referred to in paragraphs 1(b)(1) and 1(c)(1) of this Order even though Internal Security Inspectors do not have the authority to issue summonses.

4(a). The authorities granted to the Commissioner of Internal Revenue by 26 CFR 301.7602-1(a), and 301.7605-1(a) to examine books, papers, records or other data, to take testimony under oath and to set the time and place of examination are delegated to the officers and employees of the Internal Revenue Service specified in paragraphs 4(b), 4(c), and 4(d) of this Order and subject to the limitations stated in paragraphs 4(c) and 6 of this Order.

(b) General Designations

(1) Inspection: Assistant Commissioner; Director, Internal Security Division; Director, Internal Audit Division; Regional Inspectors; Internal Auditors; and Internal Security Inspectors.

(2) District Criminal Investigation: Chief and Assistant Chief of Division; Chiefs of Branches; Group Managers; and Special Agents.

(3) International Operations: Director, Assistant Director; Chief of Divisions and Branches; Special Agents; Case Managers; Group Managers, Internal Revenue Agents; Attorneys, Estate Tax; Estate Tax Examiners; Revenue Service and Assistant Revenue Service Representatives; Tax Auditors; and Revenue Officers.

(4) District Collection Activity: Chiefs and Assistant Chiefs of Division; Chiefs of Field Branches and Office Branches; Chiefs, Special Procedures Staffs; Chiefs, Technical and Office Compliance Branches; Chiefs, Collection Section; Chiefs, Technical and Office Compliance Branches and Groups; Group Managers and Revenue Officers.

(5) District Examination: Chiefs of Division; Chiefs of Examination Sections; Chiefs of Examination Branches; Case Managers; Group Managers; Internal Revenue Agents; Tax Auditors; Attorneys, Estate Tax; and Estate Tax Examiners.

(6) District Employee Plans and Exempt Organization: Chief of Division; Chief, Examination Branch; Chief, Technical Staff; Group Managers; Internal Revenue Agents; Tax Law Specialists; and Tax Auditors.

(7) Service Center: Chief, Compliance Division; Chief, Examination Branch; Chief, Collection Branch; Chief, Criminal Investigation Branch; Revenue Agents; Tax Auditors; Tax Examiners in the correspondence examination functions; and Special Agents.

(c) District Directors, Service Center Directors, Regional Inspectors, the Chief of Investigation Branch, and the Director of International Operations may redelegate the authority under 4(a) of this Order to Law Clerks (Estate Tax), aides or trainees, respectively, for the positions of Revenue Agent, Tax Auditor, Tax Examiner in the Service Center Correspondence and Processing function, Tax Law Specialists, Revenue Officer, Internal Auditor, Internal Security Inspector, Attorney (Estate Tax) and Special Agent, provided that each such Law Clerk (Estate Tax), aide or trainee shall exercise said authority only under the direct supervision, respectively, as applicable of a Revenue Agent, Tax Auditor, Tax Examiner in the Service Center Correspondence and Processing function, Tax Law Specialist, Revenue Officer, Social Agent, Internal Auditor or Internal Security Inspector or Attorney (Estate Tax).

(d) District Directors may redelegate the authority under 4(a) of this Order to Revenue Representatives and Office Collection Representatives.

5. Under the authority granted to the Commissioner of Internal Revenue by 26 CFR 301.7622-1, the officers and employees of the Internal Revenue Service referred to in paragraphs 1(b), 1(c), 1(d), and 4(b) and 4(c) of this Order are designated to administer oaths and affirmations and to certify to such papers as may be necessary under the internal revenue laws and regulations *except* that the authority to certify shall not be construed as applying to those papers or documents the certification of which is authorized by separate order or directive. Revenue Representatives and Office Collection Representatives referred to in paragraph 4(d) of this Order are not designated to administer oaths or to perform the other functions mentioned in this paragraph, except that Revenue Representatives, GS-5 and above, are authorized to certify the method and manner of service, and the method and manner of giving notice, when performing the functions and duties contained in paragraph 1(f) of this order.

6. The authority delegated herein may not be redelegated except as provided in paragraphs 4(c) and 4(d).

7. This Order supersedes Delegation Order No. 4 (Rev. 10) [1980-10 I.R.B. 13], issued February 1, 1980.

JEROME KURTZ,
Commissioner.

(Filed by the Office of the Federal Register on July 15, 1980, 8:45 a.m., and published in the issue of the Federal Register for July 16, 1980, 45 F.R. 47778)

Delegation Order No. 11 (Rev. 12) (Effective July 7, 1980)

Authority to Accept or Reject Offers in Compromise

The authority vested in the Commissioner of Internal Revenue by Treasury Department Order Nos. 150-

25 and 150-36, 26 CFR 301.7122-1 and 26 CFR 301.7701-9, and Treasury Department Order No. 150-60, is hereby delegated as follows:

1. Regional Commissioners of Internal Revenue are delegated authority, under Section 7122 of the Internal Revenue Code, to accept offers in compromise in cases in which the unpaid liability (including any interest, penalty, additional amount or addition to tax) is $100,000 or more. This authority does not pertain to offers in compromise of liabilities arising under laws relating to alcohol, tobacco and firearms taxes. This authority may not be redelegated.

2. For the Office of International Operations, the Assistant Commissioner (Compliance) is delegated authority, under Section 7122 of the Internal Revenue Code, to accept offers in compromise of tax, based solely on doubt as to liability, in cases in which the unpaid liability (including any interest, penalty, additional amount or addition to tax) is $100,000 or more. This authority does not pertain to offers in compromise of liabilities arising under laws relating to alcohol, tobacco, and firearms taxes. This authority may not be redelegated.

3. For the Office of International Operations, the Director, Collection Division is delegated authority, under Section 7122 of the Internal Revenue Code, to accept offers in compromise based on doubt as to collectibility and those based on doubt as to both collectibility and liability in cases in which the unpaid liability (including any interest, penalty, additional amount or addition to tax) is $100,000 or more. This authority does not pertain to offers in compromise of liabilities arising under laws relating to alcohol, tobacco, and firearms taxes. This authority may not be redelegated.

4. District Directors, Assistant District Directors, the Director of International Operations and the Assistant Director of International Operations, Regional Directors of Appeals, Chiefs and Associate Chiefs, Appeals Offices, are delegated authority, under Section 7122 of the Internal Revenue Code, to accept offers in compromise in cases in which the liability sought to be compromised (including any interest, penalty, additional amount or addition to tax) is less than $100,000, to accept offers involving specific penalties, and to reject offers in compromise regardless of the amount of the liability sought to be compromised. This authority does not pertain to offers in compromise of liabilities arising under laws relating to alcohol, tobacco, and firearms taxes. The authority delegated to District Directors, Assistant District Directors and the Director of International Operations may not be redelegated, except that the authority to reject offers in compromise may be redelegated, but not lower than to Division Chief. The District Director in a streamlined district may not redelegate this authority. The Regional Director of Appeals, Chiefs and Associate Chiefs, Appeals Offices, may not redelegate this authority.

5. Service Center Directors and Assistant Service Center Directors are delegated authority, under Section 7122 of the Internal Revenue Code, to accept offers in compromise, limited to penalties based solely on doubt as to liability, in cases in which the unpaid liability is less than $100,000, and to reject offers in compromise, limited to penalties, regardless of the amount of the liability sought to be compromised. This authority does not pertain to offers in compromise of liabilities arising under laws relating to alcohol, tobacco, and firearms taxes. This authority may be redelegated, but not lower than to Division Chief.

6. This Order supersedes Delegation Order No. 11 (Rev. 11) [1979-2 C.B. 481] issued August 23, 1979.

William E. Williams,
Acting Commissioner.

(Filed by the Office of the Federal Register on July 10, 1980, 8:45 a.m., and published in the issue of the Federal Register for July 11, 1980, 45 F.R. 46956)

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26 CFR 601.105: Examinations of returns and claims for refund credit or abatement; determination of correct tax liability.
(Also Part I, Sections 167, 6402; 1.167(a)-11, 301.6402-3.)

Rev. Proc. 80-33

In this revenue procedure, the Assistant Secretary (Tax Policy) of the Treasury prescribes revised effective dates for Rev. Proc. 79-26, 1979-1 C.B. 566 and Rev. Proc. 79-35, 1979-2 C.B. 498, both of which prescribed certain changes to Rev. Proc. 77-10, 1977-1 C.B. 548, regarding the Class Life Asset Depreciation Range system.

The effective date of Rev. Proc. 79-26, concerning waste reduction and resource recovery plants, central steam utility production and distribution, electric utility steam production plants, gas utility manufactured gas production plants, and industrial steam and electric generation and/or distribution systems, is revised to be April 30, 1979. The effective date of Rev. Proc. 79-35, concerning the manufacture of chemicals and allied products and the manufacture of professional, scientific, and controlling instruments, is revised to be July 16, 1979. These new effective dates are the dates of publication in the Internal Revenue Bulletin and are to be applied in accordance with section 1.167(a)-11(b)(4) of the Income Tax Regulations. That is, the asset guideline classes, periods, and ranges determined for such periods in effect as of the last day of a taxable year of election shall apply to all vintage accounts of such taxable year, except that neither the asset guideline period nor the lower limit of the asset depreciation range for any such account shall be longer than the asset guideline period or lower limit of the asset depreciation range, as the case may be, for such account in effect as of the first day of the taxable year.

Also, under the provisions of section 1.167(a)-11(b)(4) of the regulations this revenue procedure expressly provides that taxpayers, who were precluded from depreciating assets by application of Rev. Proc. 79-26 and Rev. Proc. 79-35 because of the prior effective dates, may, if tax returns have been filed for the taxable year beginning prior to January 1, 1979, at their option, utilize the asset depreciation ranges or periods described therein by filing an amended return in accordance with section 301.6402-3 of the regulations, provided section 1.167(a)-11(b)(4), as stated above, is applicable.

Rev. Procs. 79-26 and 79-35 modified.

Part IV. Items of General Interest

Form 6458, Certification and Election Form

Announcement 80-106 [1]

A new form for making certifications and elections under the Crude Oil Windfall Profit Tax Act of 1980, Pub. L. 96-223, 1980-3 C.B. 1, is now available at Service district offices.

Eligible producers may use Form 6458, Certification and Election Form, to certify exemption from the windfall profit tax. Independent producers may use the form to certify that they are entitled to a lower windfall profit tax withholding rate. Both exempt and independent producers should use it to revoke any previous certification.

Purchasers and qualified operators may use Form 6458 to make or terminate a joint election for the operator to do the administrative duties normally done by the purchaser. Operators also may use the form to submit to the Service documents certifying that a project qualifies as an incremental tertiary production project or documents notifying the Service that a project no longer qualifies.

The instructions for Form 6458 have been revised to indicate that it is not necessary to file the form with the Service when Part II, Independent Producer Certificates, is completed.

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[1] Based on News Release IR-80-79, dated July 17, 1980.

U.S.—Trinidad and Tobago Income Tax Treaty—Public Meeting

Announcement 80-110 [1]

The Treasury Department today announced that it will hold a public meeting on August 27, 1980, to solicit the views of interested persons on issues being considered in the revisions of the existing income tax treaty between the United States and Trinidad and Tobago.

The public meeting will be held at the Treasury Department at 2:00 p.m. in room 4121. Persons interested in attending are requested to give notice in writing by August 22, 1980, of their intention to attend. Notices should be sent to Joel Rabinovitz, Deputy International Tax Counsel, Department of the Treasury, Room 4013, Washington D.C. 20220.

The present treaty, which has been in force since December 30, 1970, is being renegotiated at the initiative of Trinidad and Tobago. Among the issues on which the Treasury would welcome comments are the tax treatment of technical, management, and consulting services, equipment leasing, and offshore oil drilling. It would be useful to know how these activities are conducted in Trinidad and Tobago and any attendant tax problems. Comments on other provisions of the existing treaty are also welcome. Persons unable to attend the meeting are invited to submit written comments.

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[1] Filed by the Office of the Federal Register on July 31, 1980, and published in the issue of the Federal Register for August 1, 1980, 45 F.R. 51330.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individual has been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Robert L. Hamersley	Boise, ID	Certified Public Accountant	Indefinite from July 7, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 48.4221-2 amended.	Tax-free sales of articles to be used for, or resold for, further manufacture.	July 2, 1980	Aug. 31, 1980
26 CFR 1.1441-4(d) revoked.	Exemption from withholding of tax under chapter 3 with respect to Virgin Islands inhabitants.	July 8, 1980	Sept. 8, 1980
26 CFR 301.6059-1, 301.6692-1 added.	Requirement that the plan administrator of a defined benefit plan periodically file an actuarial report for the plan.	July 8, 1980	Sept. 8, 1980
26 CFR 1.46-1, 1.46-2 amended.	FIFO and other ordering rules for the investment credit.	July 10, 1980	Sept. 8, 1980
26 CFR 1.501(c)(9)-1 as proposed in the Federal Register for January 23, 1969, 34 F.R. 1028, withdrawn; 1.501(c)(9)-1 through 1.501(c)(9)-8 added.	Voluntary employees' beneficiary associations.	July 17, 1980	Sept. 15, 1980
26 CFR 1.72-4, 1.72-15, 1.104-1, 1.105-1, 1.105-2, 1.105-4, 1.106-1, amended; 1.105-7 through 1.105-10, added; 7.105-1, 7.105-2, deleted.	Exclusion of certain disability payments from gross income.	July 9, 1980	Sept. 8, 1980
26 CFR 1.166-1, 1.166-4, 1.381(c)(4)-1, amended; 1.166-10, added.	Reserve for certain guaranteed debt obligations.	July 11, 1980	Sept. 9, 1980

Numerical Finding List[1]

Bulletins 1980-27 through 1980-32

Announcements:

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

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______	*1948–1*	*3.15*
______	1948–2	7.50
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______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
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______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
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______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$10.10
______	1957–2	13.00
______	1958–1	9.60
______	1958–2	13.00
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______	1959–1	15.00
______	1959–2	9.60
______	1960–1	9.00
______	1960–2	11.50
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______	1961–2	10.00
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______	1967–1	10.00
______	1967–2	15.00
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August 25, 1980
Bulletin No. 1980-34

Internal Revenue bulletin

9258

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-226, page 5.

Minimum tax; tax benefit; preference deductions. Section 58(h) of the Code limits the application of the minimum tax to preference deductions that provide a tax benefit to the taxpayer. Steps to be followed in computing the minimum tax when a taxpayer has preference deductions that do not yield a tax benefit are provided.

Rev. Rul. 80-227, page 6.

Industrial development bonds; exempt facility; resolution. The governing body of a political subdivision adopted a resolution, prior to the commencement of construction of an exempt facility, that evidenced its intent to issue industrial development bonds to provide financing for the facility. Before the bonds can be issued they must be approved by a state official, who has the complete power to approve or disapprove the issue. The adoption of the resolution satisfies the requirement of section 1.103-8(a)(5)(iii) of the regulations that "some other similar official action" must be taken prior to commencement of construction, and the bonds will qualify for the exception provisions of section 103(b)(4) of the Code. Rev. Rul. 78-260 distinguished and Rev. Rul. 79-320 clarified.

Rev. Rul. 80-228, page 7.

Controlled corporations; transfers; intracompany account payable. A corporation that operated its business in two separate divisions transferred all of the assets of one division to a new corporation in exchange for all of the new corporation's stock. There were valid business reasons for the transfer, and at the time of the transfer there was an intracompany account payable due from the division whose assets were transferred. The original corporation received "other property" within the meaning of section 351(b) of the Code and must recognize gain in the amount of the account payable.

Rev. Rul. 80-230, page 10.

Bank; Comptroller of the Currency's semiannual assessment. A calendar year, accrual method bank may not accrue on December 31 the semiannual assessment that the bank is required to pay to the Comptroller of the Currency on or before January 31 for the 6-month period beginning January 1.

Rev. Rul. 80-231, page 14.

Foreign tax credit; allocation of income to domestic parent; tax deemed paid. The effect of a reduction in the amount of foreign income tax paid by a foreign subsidiary following an allocation of income under section 482 of the Code on the computation of its domestic parent corporation's deemed paid foreign tax credit under section 902 is discussed; Rev. Rul. 76-508 amplified.

T.D. 7707, page 11.

Amendments to the regulations under section 892 of the Code relate to the taxation of foreign governments on their income from commercial activities within the U.S.

(Continued on page 4)

Finding Lists begin on page 25.
Announcement of Voluntary Suspension on page 22.
Announcement of Notice of Proposed Rulemaking on page 23.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

Announcement 80-108, page 20.
Form 6177, General Assistance Program Determination, has been revised to include the General Assistance Program of the State of New Jersey on its list of qualified general assistance programs.

EMPLOYEE PLANS

Rev Rul. 80-229, page 8.
Termination; asset allocation; discrimination; defined benefit plan. Guidelines and examples are provided for determining if an asset allocation is discriminatory under section 401(a)(4) of the Code upon the termination of a defined benefit plan; Rev. Ruls. 55-60, 59-241, and 65-294 superseded.

EXEMPT ORGANIZATIONS

Announcement 80-109, page 20.
A listing is given of organizations now classified as private foundations.

EXCISE TAXES

Rev Rul. 80-232, page 17.
Truck trailers; sales price; discounts. In determining the lowest price at which a distributor, a member of the same affiliated group of corporations as the manufacturer, sells truck trailers to independent dealers, certain discounts and allowances may be taken into account, but only if regularly given and not merely offered.

Pub. L. 96-298, page 18.
The aviation excise taxes that were scheduled to expire or be reduced on July 1, 1980, have been extended for a 3-month period.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 56.—Imposition of Tax

26 CFR 1.56-1: Imposition of tax.

Application of minimum tax to preference deductions that do not provide a tax benefit. See Rev. Rul. 80-226, below.

Section 57.—Items of Tax Preference

26 CFR 1.57-1: Items of tax preference defined.
(Also Section 56, 58; 1.56-1.)

Minimum tax; tax benefit; preference deductions. Section 58(h) of the Code limits the application of the minimum tax to preference deductions that provide a tax benefit to the taxpayer. Steps to be followed in computing the minimum tax when a taxpayer has preference deductions that do not yield a tax benefit are provided.

Rev. Rul. 80-226

ISSUE

Does section 58(h) of the Internal Revenue Code limit the application of the minimum tax preference deductions that provide a tax benefit to the taxpayer?

FACTS

The taxpayer and the taxpayer's spouse filed a joint federal income tax return (Form 1040) for the year ended December 31, 1978, and elected to itemize deductions.

The taxpayers' combined gross income for 1978 was 260*x* dollars consisting of wages and capital gains. The taxpayers' deductions from gross income, in computing adjusted gross income, consisted of a section 1202 deduction for capital gains of 30*x* dollars and nonpreference deductions of 130*x* dollars, resulting in an adjusted gross income of 100*x* dollars from which to subtract their itemized deductions.

In itemizing their deductions the taxpayers claimed a medical expense deduction of 10*x* dollars and other itemized deductions of 155*x* dollars. The taxpayers also claimed personal exemptions totalling 5*x* dollars.

The taxpayers listed their adjusted itemized deductions on Form 4625 (Computation of Minimum Tax—Individuals), as 40*x* dollars (itemized deductions not in excess of adjusted gross income of 100*x* dollars or 100*x* dollars, less 60 percent of adjusted gross income or 60*x* dollars). The taxpayers also listed 30*x* dollars of capital gains preference.

LAW AND ANALYSIS

Section 56(a) of the Code provides that in addition to the other taxes imposed by Chapter 1 of the Code, there is imposed for each taxable year, with respect to the income of every person, a tax equal to 15 percent of the amount by which the sum of the items of tax preference exceeds the greater of (1) $10,000 or (2) the regular tax deduction for the taxable year as determined under section 56(c).

Section 57(a) of the Code provides, for taxable years beginning before January 1, 1979, that adjusted itemized deductions for the taxable year of taxpayers other than corporations are items of tax preference subject to the 15 percent minimum tax. For taxable years beginning after December 31, 1978, adjusted itemized deductions are subject to an alternative minimum tax under section 55.

Section 57(b) of the Code defined "adjusted itemized deductions" for the taxable years beginning in or after 1977, but before January 1, 1979, as the amount by which the sum of the deductions for the taxable year other than (A) deductions allowable in arriving at adjusted gross income, (B) the deduction for personal exemptions, (C) the deduction for medical, dental, etc. expenses, (D) the deduction for casualty losses described in section 165(c)(3), and (E) the deduction allowable under section 691(c), exceeds 60 percent (but does not exceed 100 percent) of the taxpayer's adjusted gross income for the taxable year.

Section 58(h) of the Code provides that items of tax preference are to be properly adjusted when the tax treatment giving rise to such items does not result in a reduction of the taxpayer's tax under subchapter A of Chapter 1 of the Code.

The intent of Congress in enacting section 58(h) of the Code was that tax preference items that are of no tax benefit to a taxpayer are not to be included in the computation of the minimum tax on tax preferences. See S. Rep. No. 94-938, 94th Cong., 2d Sess. 113 (1976), 1976-3 C.B. (Vol. 3) 151.

To the extent itemized deductions (other than medical expenses and casualty losses) exceed adjusted gross income they are not considered in the computations under section 57(b) for taxable years beginning before January 1, 1979. If itemized deductions do not otherwise provide a tax benefit, they are not subject to the minimum tax under section 58(h).

In determining the extent to which a taxpayer's tax preference items of deduction reduce the taxpayer's gross income and thereby provide a tax benefit, a taxpayer will be treated as using all nonpreference deductions first (other than those itemized deductions that exceed 100 percent of adjusted gross income computed without regard to preference deductions), followed by preference items of deduction to the extent necessary to reduce taxable income to zero. This approach will limit a taxpayer's items of tax preference to the excess of (1) taxable income computed without regard to preference items, over (2) taxable income computed with regard to preference items. This excess represents the actual tax benefit received by a taxpayer from preference items.

The amount of preference items yielding a tax benefit equals gross income minus the taxpayer's "preference exclusion." In the case of a taxpayer with an adjusted itemized deductions preference, the "preference exclusion" is computed by totalling (1) nonpreference deductions allowable in arriving at adjusted gross income, (2) medical deductions and casualty losses, (3) itemized deductions to the extent of 60 percent of adjusted gross income computed without regard to deductions which are preference items, and (4) the deductions for personal exemptions.

The preference exclusion in the

present case, of 223*x* dollars, includes the 130*x* dollars of nonpreference deductions used in arriving at adjusted gross income, the medical expense deduction of 10*x* dollars, itemized deductions to the extent of 60 percent of adjusted gross income computed without regard to deductions which are preference items, 78*x* dollars, and personal exemptions of 5*x* dollars. These nonpreference items are subtracted from gross income to determine the amount of preference deductions from which the taxpayers have received a tax benefit. Thus, 223*x* dollars is subtracted from the taxpayers' gross income of 260*x* dollars yielding 37*x* dollars. The taxpayers have 70*x* dollars in preference items (30*x* dollars of capital gains preference plus adjusted itemized deductions equal to 40 percent of adjusted gross income, 40*x* dollars). Therefore, the taxpayers received a tax benefit from preference items to the extent of 37*x* dollars. The remaining 33*x* dollars of preference items did not yield the taxpayers any tax benefit and are not taken into account in computing their minimum tax liability.

HOLDING

The taxpayers' minimum tax for 1978 is computed by subtracting $10,000 from the 37*x* dollars for which they received a tax benefit and then taking 15 percent of that amount.

Section 58.—Rules for Application of This Part

Application of minimum tax to preference deductions that do not provide a tax benefit. See Rev. Rul. 80-226, page 25.

Section 103.—Interest on Certain Governmental Obligations

26 CFR 1.103-8: Interest on bonds to finance certain exempt facilities.

Industrial development bonds; exempt facility; resolution. The governing body of a political subdivision adopted a resolution, prior to the commencement of construction of an exempt facility, that evidenced its intent to issue industrial development bonds to provide financing for the facility. Before the bonds can be issued they must be approved by a state official, who has the complete power to approve or disapprove the issue. The adoption of the resolution satisfies the requirement of section 1.103-8(a)(5)(iii) of the regulations that "some other similar official action" must be taken prior to commencement of construction, and the bonds will qualify for the exception provisions of section 103(b)(4) of the Code. Rev. Rul. 78-260 distinguished and Rev. Rul. 79-320 clarified.

Rev. Rul. 80-227

ISSUE

Will the adoption of a resolution to issue bonds by the issuer before commencement of construction satisfy the requirements of section 1.103-8(a)(5)(iii) of the Income Tax Regulations when final approval of the bond issuance must subsequently be made by a specified state official under the circumstances described below?

FACTS AND LAW

Authority *M* is a political subdivision of state *O* that was formed under the Industrial Development Authority Act of *O*. On January 2, 1980, the governing body of *M* adopted a resolution evidencing the intent of *M* to issue industrial development bonds to finance the construction of a facility described in section 103(b)(4) of the Internal Revenue Code. The land on which the facility will be constructed is presently owned by *M*. The facility will be leased on a long-term basis to corporation *X*, a nonexempt person. On April 2, 1980, *X* obtained temporary financing and commenced construction of the facility on *M*'s land. It is estimated that *X* will complete the facility and place it in use by March 1981.

M proposes to issue the bonds on January 2, 1981, and will use bond proceeds to reimburse *X* for the costs of construction. The Industrial Development Authority Act of *O* provides that before *M* may issue the bonds a specified official of *O*, after a public hearing, must determine that the facility will serve a public purpose, and that the financing of the facility is within the purview of the policy and authority of the Industrial Development Authority Act. Although the official's determination is to be based on the recommendation of *M*, the official has the complete discretion to approve or disapprove the bond issue. Neither *M* nor *X* may appeal the official's decision.

Section 1.103-8(a)(5)(iii) of the regulations provides that if the original use of a facility commences (or acquisition of a facility occurs) on or after the date of issue of obligations issued to provide such facility, a bond resolution with respect to such obligations must have been adopted by, or some other similar official action toward the issuance of such obligations must have been taken by, the issuer prior to the commencement of construction or acquisition of such facility in order for the facility to qualify as an exempt facility under section 103(b)(4) of the Code.

HOLDING

The adoption of the resolution by the governing body of *M* satisfies the requirement set forth in section 1.103-8(a)(5)(iii) of the regulations that "some other similar official action" must be taken prior to commencement of construction of the facility being financed by the bond issue.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 79-320, 1979-2 C.B. 35, concludes that the adoption by a governing body of a political subdivision of a resolution evidencing a present intent to have the political subdivision issue obligations to finance a specific exempt facility will satisfy the requirement of section 1.103-8(a)(5)(iii) of the regulations provided such governing body is authorized to have such obligations issued. Rev. Rul. 79-320 also concludes that the governing body of a political subdivision that adopts a resolution to have the political subdivision issue obligations that is subject to voter approval has not evidenced a present intent to issue obligations that satisfies the requirement of section 1.103-8(a)(5)(iii) on the date the resolution is adopted because the governing body lacks the necessary authority to have the obligations issued without prior voter approval. To the extent that these conclusions may imply that the authority of a governing body to cause the political subdivision to issue bonds must not be subject to any conditions on the date a resolution is adopted in order for such resolution to satisfy the requirement of section 1.103-8(a)(5)(iii), Rev. Rul. 79-320 is clarified. If, however, the conditions on the authority of the governing body result in the governing body not having the ability to express the present intent of the political subdivision to issue the obligations, a resolution adopted by the governing body will not satisfy the requirement of section 1.103-8(a)(5)(iii).

The situation in this revenue ruling is distinguishable from the situation described in Rev. Rul. 78-260, 1978-2 C.B. 99, as clarified by Rev. Rul. 79-320, 1979-42 I.R.B. 7, which holds that the adoption by the governing body of a political subdivision of a resolution to issue bonds subject to the approval of the voters of the political subdivision does not satisfy the requirements of section 1.103-8(a)(5)(iii) of the regualtions. The resolution described in Rev. Rul. 78-260 fails to qualify as "some other similar official action" of the issuer because only the voters could express the present intent of the issuer to issue bonds. Thus, in Rev. Rul. 78-260 the governing body of the issuer could not express the present intent of the issuer to issue the obligations without voter approval. In this revenue ruling, however, because the issuer acts only through its governing body the resolution of the governing body approving the issuance of the bonds does express the present intent of the issuer to issue the obligations in question so that the resolution qualifies as "some other similar official action" within the meaning of section 1.103-8(a)(5)(iii).

Section 351.—Transfer to Corporation Controlled by Transferor

26 CFR 1.351-1: Transfer to corporation controlled by transferor.

Controlled corporations; transfers; intracompany account payable. A corporation that operated its business in two separate divisions transferred all of the assets of one division to a new corporation in exchange for all of the new corporation's stock. There were valid business reasons for the transfer, and at the time of the transfer there was an intracompany account payable due from the division whose assets were transferred. The original corporation received "other property" within the meaning of section 351(b) of the Code and must recognize gain in the amount of the account payable.

Rev. Rul. 80-228

ISSUE

In the facts described below, did *X* corporation receive "other property" from *Y* corporation within the meaning of section 351(b) of the Internal Revenue Code?

FACTS

X corporation operated its business in two entirely separate divisions ("Division 1" and "Division 2"), keeping a separate bank account and a separate set of books for each division. Each division also maintained an intracompany account in their respective books of account and transactions between the two divisions were recorded therein. For valid business reasons *X* organized a new corporation, *Y*. All the assets of Division 2 were transferred by *X* to *Y* at net book value in exchange for all of the stock of *Y*. At the time of the transfer, the intracompany account payable due to Division 1 from Division 2 was 100*x* dollars. On its opening balance sheet *Y* listed an account payable to *X* of 100*x* dollars and *X*, conversely, listed an account receivable from *Y* of 100*x* dollars. Within one year after the transfer the account payable of *Y* was paid in full to *X*.

LAW AND ANALYSIS

The nonrecognition provisions of 351(a) of the Code provide that where property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control of the corporation, no gain or loss is recognized in the transaction. If, however, in addition to stock or securities, "other property" is received by the transferor, the transferor must recognize gain on the exchange but not in excess of the fair market value of the "other property" received pursuant to section 351(b).

It is a well established principle of tax law that short-term notes and other evidences of indebtedness received in a reorganization constitute "other property." See *Cortland Specialty Co. v. Commissioner,* 60 F.2d 937 (2nd Cir. 1932), XII-1 C.B. 164 and *Pinellas Ice & Cold Storage Co. v. Commissioner,* 287 U.S. 462 (1933), XII-1 C.B. 161.

When *Y* was organized as a separate corporation, and an account payable from *Y* to *X* was established (and, correlatively, an account receivable was reflected by *X* on its books), a real liability on the part of *Y* (and a real asset on the part of *X*) came into being. The intracompany account payable (and the intracompany account receivable) did not simply "carry over" to the books of *Y*. Instead, *X* received something other than merely the stock of *Y*.

In the instant case the account receivable to *X* from *Y* was a note or other evidence of indebtedness received by *X* in a section 351 transaction and it constituted "other property" for purposes of section 351(b) of the Code. This is due to the fact that the preincorporation intracompany accounts could not have given rise to a debtor-creditor relationship between *X* and *Y* because *X* could not, prior to incorporation of *Y*, have been liable for a debt to itself. The intracompany accounts were mere bookkeeping entries by *X*, a single corporation, to show the activities of separate divisions for internal accounting purposes.

In *Wham Construction Company, Inc. v. United States,* Civil No. 72-689 (D.S.C., Feb. 16, 1976), *aff'd* Civil No. 76-2047 (4th Cir. 1979), on facts similar to those set forth above, the District Court, in holding for the taxpayer, determined that the account receivable represented a mere loan to the new subsidiary from the transferor for which the transferor received only a return of capital. In its affirmance of the District Court's decision in *Wham*, the Court of Appeals reasoned that where there was but one transferor and where the transferee corporation had no assets other than those derived from the transferor, it found it difficult to conceive of a concept wherein the transferor, as a result of the transaction, received anything which it did not have prior to the incorporation. However, the facts indicate that there was indisputably no borrowing from a bank by the new subsidiary, nor was there any loan from the transferor to the new subsidiary subsequent to the incorporation of the new subsidiary. The Court of Appeals also ignored the fact that prior to the incorporation of the new subsidiary there was no debt owned by it to the transferor.

Consequently, the Internal Revenue Service will not follow the decision of the United States Court of Appeals for the Fourth Circuit in *Wham.*

HOLDING

X did receive "other property" in the form of the 100*x* dollar account receivable and, pursuant to section 351(b) of the Code, must recognize gain in that amount.

Section 401.—Qualified Pension, Profit-Sharing and Stock Bonus Plans

26 CFR 1.401-4: Discrimination as to contributions or benefits.
(Also Section 411; 1.411(d)-2.)

Termination; asset allocation; discrimination; defined benefit plan. **Guidelines and examples are provided for determining if an asset allocation is discriminatory under section 401(a)(4) of the Code upon the termination of a defined benefit plan; Rev. Ruls. 55-60, 59-241, and 65-294 superseded.**

Rev. Rul. 80-229

SECTION 1. PURPOSE

The revenue ruling provides guidelines for determining whether an asset allocation is discriminatory within the meaning of section 401(a)(4) of the Internal Revenue Code upon the termination of a defined benefit plan. The ruling supersedes Rev. Rul. 55-60, 1955-1 C.B. 37, Rev. Rul. 59-241, 1959-2 C.B. 118, and Rev. Rul. 65-294, 1965-2 C.B. 136.

SEC. 2. BACKGROUND INFORMATION

Section 401(a)(4) of the Code provides that contributions or benefits under the plan shall not discriminate in favor of employees who are officers, shareholders or highly compensated.

Section 411(d)(2) and (d)(3) of the Code provides certain vesting standards regarding prohibited discrimination, which are also qualification standards, in the event of plan termination.

Section 1.401-4(c) of the Income Tax Regulations provides restrictions on the distribution of assets for certain employees in the event of early termination of the plan. Section 1.401-4(c)(1) of the regulations provides that the Commissioner may determine that such restrictions are not necessary to prevent prohibited discrimination in the event of an early plan termination.

Section 4044(a) of Title IV of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 1974-3 C.B. 1, sets forth the rules applicable to the allocation of assets to participants and beneficiaries by priority categories in the event of the termination of a defined benefit plan.

Under section 4044(b)(4) of ERISA and section 1.411(d)-2(a)(2)(ii) of the regulations, assets that would otherwise be allocated pursuant to paragraphs (4)(B), (5) and (6) of section 4044(a) of ERISA may be required to be reallocated to the extent necessary to avoid discrimination within the meaning of section 401(a)(4) of the Code. Further, section 1.411(d)-2(e) of the regulations provides that assets in excess of the early termination limits may be reallocated to avoid discrimination.

SEC. 3. ASSETS NOT LESS THAN PRESENT VALUE OF ACCRUED BENEFIT

In the case of a terminating plan in which the value of plan assets as of the date of termination is not less than the present value of all accrued benefits (whether or not nonforfeitable) as of such date, a distribution of assets to each participant equal to the present value of that participant's accrued benefit will not be discriminatory within the meaning of section 401(a)(4) of the Code if the formula for computing benefits as of the date of termniation would not be discriminatory had the plan not terminated. All present values and the value of plan assets are computed using assumptions that are acceptable to satisfy section 4044 of ERISA.

If the assets as of the date of termination exceed the present value of the accrued benefits (whether or not nonforfeitable) as of such date, the plan will not be considered discriminatory if such excess reverts to the employer or is applied to increase benefits in a nondiscriminatory manner. One method of applying the assets to increase benefits in a nondiscriminatory manner is to amend the plan to provide a new benefit structure such that (1) the benefit structure would not be discriminatory if the plan were not terminated and (2) the present value of the revised accrued benefits (whether or not nonforfeitable) as of the date of termination equals the value of plan assets, and to distribute assets equal to the present value of the revised accrued benefits. The new benefit structure must satisfy other requirements of the law such as sections 411(d)(6) and 415 of the Code.

The guidelines provided by this section may be applied whether or not the termination would otherwise invoke the early termination restrictions described in section 1.401-4(c) of the regulations.

The guidelines described in this section may be illustrated by the following examples:

EXAMPLE 1. A plan provides a benefit of 10% of the first $5,000 of compensation plus 47½% of compensation in excess of $5,000. Such plan satisfies the requirements of Rev. Rul. 71-446, 1971-2 C.B. 187, and is fully integrated. As of the date of termination the assets equal $100,000 and the present value of the accrued benefits (whether or not nonforfeitable) equals $80,000. The plan distributes the $100,000 by providing each participant with assets equal to 125% of the present value of such participant's accrued benefit (whether or not nonforfeitable).

Distributing assets equal to 125% of the present value of the accrued benefits is tantamount to amending the plan by multiplying each of the terms of the benefit formula by 125% and distributing the present value of the accrued benefits. The revised formula would be 12.5% of the first $5,000 of compensation plus 59.375% of compensation in excess of $5,000. The revised formula is discriminatory in an ongoing plan because the formula fails to integrate properly. (See Rev. Rul. 71-446.) Accordingly, such distribution is discriminatory.

EXAMPLE 2. The facts are the same as in Example 7 except that the distribution is revised as follows: By a separate actuarial computation it is determined that a nonintegrated increase in the benefit formula of 1% of all compensation would increase the present value of the accrued benefits by $4,000. The plan has surplus assets of $20,000 ($100,000 of assets as of the date of termination less $80,000, the present value of accrued benefits as of such date). Therefore, an increase of each of the terms of the benefit formula by 5%

$$\frac{(\$20{,}000\text{ surplus})}{(\$\ 4{,}000\text{ present value of accrued benefit for each }1\%\text{ increase in benefit formula})}$$

will produce a benefit formula that would be nondiscriminatory in an ongoing plan and whose present value of the accrued benefits (whether or not nonforfeitable) equals the value of plan assets. The benefit formula is therefore revised to provide 15% of the first $5,000 and 52½% of compensation in excess of $5,000, and assets equal to the revised present value of the accrued benefits may be distributed without causing discrimination.

SEC. 4. ASSETS LESS THAN PRESENT VALUE OF ACCRUED BENEFITS

.01 Applicability—This section applies to the termination of a defined benefit plan in which the value of plan assets as of the date of termination is less than the present value of all accrued benefits (whether or not nonforfeitable) as of such date whether or not the restrictions of section 1.401-4(c) of the regulations apply.

.02 General Rules—The following guidelines apply in testing for discrimination in the case of a plan described in subsection .01 with respect to which the benefit structure, if the plan were not terminated, would not be discriminatory under section 401 (a)(4) of the Code.

(1) Except as provided in paragraph (4), the assets of a plan are allocated in accordance with sections 4044(a)(1), (2), (3), and (4)(A) of ERISA.

(2) Subject to the requirements of paragraph (1), the assets shall be allocated, to the extent possible, so that the rank and file employees receive from the plan at least the same proportion of the present value of their accrued benefits (whether or not nonforfeitable) as employees who are officers, shareholders, or highly compensated.

(3) Notwithstanding any other paragraph, in the case of assets restricted by section 1.401-4(c) of the regulations, assets may be reallocated to the extent necessary to help satisfy paragraph (2).

(4) In the case of a plan establishing subclasses within the meaning of section 4044(b)(6) of ERISA, the assets within any paragraph of section 4044(a) of ERISA may be reallocated within such paragraph to the extent that such reallocation helps to satisfy paragraph (2).

(5) Subject to paragraphs (1), (2), (3), and (4), the assets shall be allocated in accordance with section 4044 (a)(4)(B), (5), and (6) of ERISA.

.03 Examples—The guidelines described in subsection .02 are illustrated by the following examples:

Example 1. A plan described in subsection .01 which provided benefits on an ongoing basis as of the date of termination that were not discriminatory within the meaning of section 401 (a)(4) of the Code, terminates. The plan has two employees: *A*, an officer of the company, and *B*, a rank and file employee. The value of plan assets as of the date of termination is $130,000 which would, without regard to this section, be allocated to the employees under section 4044(a) of ERISA as follows:

Paragraph of section 4044(a) of ERISA	Allocation to Employee *A*	Allocation to Employee *B*
(3)	$120,000	0
(4)(A)	0	0
(5)	10,000	0
(6)	0	0
	$130,000	

The present value of *A*'s and *B*'s accrued benefit on the date of termination, whether or not nonforfeitable, is $240,000 and $60,000, respectively. The limits described in section 1.401-4 (c) of the regulations do not apply.

The proposed distribution described in section 4044(a) of ERISA would not satisfy section 4.02(2) of this revenue ruling because (1) employees who are officers, shareholders or highly compensated would receive 54% $\frac{(\$130{,}000)}{(\$240{,}000)}$ of the present value of their accrued benefit whether or not nonforfeitable and the rank and file employees would receive 0% and (2) there are assets in paragraphs (4)(B), (4) or (6) of section 4044(a) of ERISA to be reallocated to minimize the discrimination. The $10,000 allocated in paragraph (5) to *A* should be reallocated to *B*. *A* would then receive $120,000 (50% of the present value of his accrued benefits whether or not nonforfeitable) and *B* would receive $10,000 (16⅔% of the present value of his accrued benefits whether or not nonforfeitable). This distribution would be deemed nondiscriminatory because the assets have, in accordance with section 4.02(2) of this revenue ruling, been allocated to the extent possible to preclude discrimination.

Example 2. The facts are the same as in Example 1 except the early termination restrictions described in section 1.401-(4)(c) would limit the assets to be allocated to *A* to $100,000. It is proposed to distribute $120,000 to *A* and $10,000 to *B*.

The proposed distribution does not satisfy section 4.02(3) of this revenue ruling because (1) the assets allocated to officers, shareholders, and highly compensated are 50% of the present value of their accrued benefits and the assets allocated to the rank and file employees are 16⅔% of the present value of their accrued benefits and (2) there are assets that are restricted by section 1.401-4(c) of the regulations that may be allocated to preclude discrimination. If an additional $16,000 were allocated to *B* so that *A* would receive $104,000 (43⅓% of the present value of his accrued benefit) and *B* would receive $26,000 (43⅓% of the present value of his accrued benefit) the distribution would be nondiscriminatory even though *A* is receiving $104,000 and the limits described in section 1.401-4(c) would otherwise limit his benefits to $100,000.

Example 3. A plan described in subsection .01, which provides benefits on an ongoing basis that are not discriminatory within the meaning of section 401(a)(4) of the Code, is terminated. The plan has two employees: *A*, a shareholder employer whose benefits are not nonforfeitable, and *B*, a rank and file employee whose entire benefits are nonforfeitable. When the assets are allocated in accordance with section 4044(a) of ERISA only *B* receives an asset allocation. It is proposed to reallocate the assets to provide both *A* and *B* with the same proportion of the present value of their accrued benefits whether or not nonforfeitable.

The proposed reallocation is not permitted. Because the rank and file employees are receiving at least the same percentage of the present value of their accrued benefits as the employees who are officers, shareholders, or highly compensated, there is no discrimination within the meaning of section 401(a)(4) of the Code and no reallocation under section 4.02(2), (3), or (4) of this revenue ruling and section 4044(b)(4) of ERISA is permissible. The assets, in accordance with section 4.02(1) and (5) should be allocated in accordance with section 4044(a) of ERISA.

SEC. 5. EFFECT ON OTHER RULINGS

Rev. Ruls. 55-60, 59-241 and 65-294 are superseded.

Section 411.—Minimum Vesting Standards

26 CFR 1.411(d)-2: Termination or partial termination; discontinuance of contributions.

Whether an asset allocation is discriminatory under section 401(a)(4) of the Code upon the termination of a defined benefit plan. See Rev. Rul. 80-229, page 8.

Section 461.—General Rule for Taxable Year of Deduction

26 CFR 1.461-1: General rule for taxable year of deduction.

Bank; Comptroller of the Currency's semiannual assessment. A calendar year, accrual method bank may not accrue on December 31 the semiannual assessment that the bank is required to pay to the Comptroller of the Currency on or before January 31 for the 6-month period beginning January 1.

Rev. Rul. 80-230

ISSUE

May a bank that uses an accrual method of accounting on a calendar year basis accrue on December 31, 1978, the semiannual assessment required to be paid to the Comptroller of the Currency on or before January 31, 1979, for the 6-month period beginning January 1, 1979?

FACTS

The taxpayer, a bank subject to the jurisdiction of the Comptroller of the Currency, uses an accrual method of accounting for reporting its income on a calendar year basis.

The provisions of 12 U.S.C.A. section 482 (Supp. 1979), which governs the assessment of national banks by the Comptroller of the Currency, provides that:

> The expense of the examinations . . . shall be assessed by the Comptroller of the Currency upon national banks in proportion to their assets or resources. The assessments may be made more frequently than annually at the discretion of the Comptroller of the Currency. The annual rate of such assessment shall be the same for all national banks except that banks examined more frequently than twice in one calendar year shall, in addition, be assessed the expense of these additional examinations.

Section 8.2 (chapter 1 of Bank and Banking Regulations, 12 CFR section 8.2) provides that each national bank and each district bank shall pay to the Comptroller of the Currency on or before January 31 and July 31 of each year a semiannual assessment fee for the 6 month period beginning 30 days before each payment date. Each semiannual assessment is based upon the total assets shown in the bank's quarterly "Consolidated Report of Condition (Including Domestic and Foreign Subsidiaries)" most recently preceding the payment date. Each bank subject to the jurisdiction of the Comptroller of the Currency on the date of the second or fourth condition reports is subject to the full assessment for the next 6 month period without proration for any reason.

The semiannual assessment return for the first 6 months of 1979, based on the condition reports submitted for the fourth reporting period ending December 31, 1978, was prepared by the taxpayer and sent to the Comptroller of the Currency with the required payment on January 30, 1979.

LAW AND ANALYSIS

Section 1.461-1(a)(2) of the Income Tax Regulations provides that under an accrual method of accounting, an expense is deductible for the taxable year in which all the events have occurred that determine the fact of the liability and the amount thereof can be determined with reasonable accuracy.

The semiannual assessment for the first 6 months of 1979 is based upon the total assets reported by the taxpayer on its Consolidated Report of Condition (Including Domestic and Foreign Subsidiaries), filed for the reporting period ending December 31, 1978. The semiannual assessment is not due and payable in 1978 even though the amount thereof can be determined with reasonable accuracy as of the last day of business in 1978.

Generally, under section 1.461-1(a)(2) of the regulations, all the events have occurred that determine the fact of the liability when (1) the event fixing the liability, whether that be the required performance or other event, occurs, or (2) payment therefore is due, whichever happens earliest. Although the semiannual assessment is based upon the December 31, 1978, report of condition, it is not payable until January 31, 1979, and is for the 6-month period beginning January 1, 1979. Thus, all the events that determine the fact of liability for this semiannual assessment occur as of January 1, 1979, and have not yet occurred as of December 31, 1978.

HOLDING

A bank that uses an accrual method of accounting for reporting its income on a calendar year basis may not accrue on December 31, 1978, the semiannual assessment required to be paid to the Comptroller of the Currency on or before January 31, 1979, for the 6-month period beginning January 1, 1979.

Section 482.—Allocation of Income and Deductions Among Taxpayers

26 CFR 1.482-1: Allocation of income and deductions among taxpayers.

The effect of a reduction in the amount of foreign income tax paid by a foreign subsidiary following an allocation of income under section 482 of the Code on the computation of the domestic parent's section 902 deemed paid foreign tax credit. See Rev. Rul. 80-231, page 14.

Section 892.—Income of Foreign Governments and of International Organizations

26 CFR 1.892-1: Income of foreign governments.

T.D. 7707

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Income of foreign governments

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the taxation of income of foreign governments. These regulations provide guidance for taxing foreign sovereigns on their income from commercial activities within the United States.

EFFECTIVE DATE: The regulations are generally effective for income of a foreign government from commercial activities within the United States derived after July 22, 1980.

FOR FURTHER INFORMATION CONTACT: Donald K. Duffy of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T (LR-106-75), 202-566-4336.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On August 15, 1978, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 892 of the Internal Revenue Code of 1954 (43 FR 36111). The amendments were proposed to clarify existing regulations which neither define the term "foreign government" nor establish the types of income excluded from gross income and exempted from taxation. The proposed amendments define a foreign government to include only integral parts and controlled entities of a foreign sovereign. The proposed amendments generally provide that income derived by a foreign government from commercial activities in the United States is not income of a foreign government for purposes of the exemption under section 892.

The proposed amendments in effect provide that if a foreign sovereign separately owns and controls an entity which is not an integral part and which does not constitute a "controlled entity", such an entity is taxed on all of its commercial and noncommercial income under appropriate Internal Revenue Code provisions. The amendments define the term "controlled entity", and in most respects the definition parallels the requirements of Rev. Rul. 75-298, 1975-2 C.B. 290, relating to certain organizations created by foreign governments that are eligible for the section 892 exemption.

The Federal Register published a notice of a public hearing on November 6, 1978 (43 FR 51648). The hearing was held on January 23, 1979.

After consideration of all relevant matters presented by interested persons regarding the proposed amendments, they are adopted as revised by this Treasury decision.

This document also reserves paragraph (c)(2)(i)(*d*) and (*e*) of § 1.892-1. These paragraphs will provide rules for determining whether loans or net leases are to be considered investments. A notice of proposed rulemaking is tbeing published contemporaneously with this Treasury decision setting forth those rules.

DISTINCTION BETWEEN INTEGRAL PARTS AND SEPARATE ENTITIES

Comments from the public questioned whether it was appropriate to draw a distinction between integral parts and separate entities of a foreign sovereign under § 1.892-1(b) for purposes of the definition of the term "foreign government". Section 1.892-1(b) is revised in the final regulations. The revision places less emphasis on both the form of the entity that exercises foreign governmental authority and the extent of its commercial activity in the United States.

PENSION PLANS

One comment suggested clarification of the treatment of pension plans for employees of a foreign government.

Final regulations adopt this suggestion and § 1.892-1(b)(4) provides that certain pension plans qualify for the section 892 exemption even though plan assets are segregated in a separate fund or trust.

EFFECTIVE DATE

Several comments suggested that the effective date be completely prospective. Final regulations adopt this suggestion but also provide retroactivity in cases where no adverse tax consequences arise. Rev. Rul. 75-298 will not apply if these regulations apply.

COMMERCIAL ACTIVITIES

The definition of the term "commercial activities" has been revised. The proposed regulations provide that obtaining and holding net leases on property is a commercial activity. This proposed rule with respect to net leases on real property is withdrawn. A further notice of proposed rulemaking relating to these leases is being published contemporaneously with this Treasury decision.

The final regulations rely generally on the character of an activity, rather than on whether or not the income from the activity is effectively connected with the conduct of a trade or business in the United States, in determining that a particular activity is a commercial activity.

DRAFTING INFORMATION

The principal author of these regulations is Jason R. Felton of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations in matters of both substance and style.

Adoption of amendments to the regulations

After consideration of all relevant matters presented by interested persons regarding the proposed amendments to the regulations under section 892, the following amendments are hereby adopted:

Paragraph 1. Section 1.892-1 is amended as follows:

1. The title to § 1.892-1 is revised.

2. Paragraph (a) is deleted and in lieu thereof new paragraphs (a) through (h) are added.

3. Paragraphs (b)(1) and (2) are redesignated as paragraphs (a) and (b), respectively, of a new § 1.892-2. The amended § 1.892-1 and new § 1.892-2 read as follows:

§ 1.892-1 Income of foreign governments.

(a) *Manner of taxing*—(1) *In general.* Section 892 provides, in general, that the income of a foreign government from sources within the United States is excluded from gross income and exempt from taxation. Paragraph (b) of this section defines a foreign government. In particular it describes the extent to which either an integral part of a foreign sovereign or an entity created by a foreign sovereign will be treated as a foreign government for purposes of section 892. To the extent that income is derived by such an integral part or entity of a foreign sovereign which does not qualify as a foreign government as defined in paragraph (b) of this section, the income is subject to taxation in accordance with appropriate Internal Revenue Code provisions.

(2) *Foreign government exemption.* The income derived by an integral part or controlled entity of a foreign sovereign from investments in the United States in stocks, bonds, or other securities, owned by such integral part or controlled entity, or from interest on deposits in banks of moneys belonging to such integral part or controlled entity, or from any other investment source within the United States, is generally treated as income of a foreign government, which is not included in gross income and is exempt from taxation.

(3) *Foreign government exemption not available.* (i) Income derived by an integral part or controlled entity of a foreign sovereign from commercial activities in the United States is not income of a foreign government for purposes of the exemption from taxation provided in section 892. These amounts are included in income and taxed under appropriate Internal Revenue Code provisions.

(ii) Income derived by an entity created by a foreign sovereign that does not qualify as a controlled entity of the foreign sovereign under paragraph (b)(3) of this section is included in the gross income of the entity and taxed under appropriate Internal Revenue Code provisions.

(b) *Foreign government defined*—(1) *Classes of a foreign government.* For purposes of this section, a foreign government consists only of integral parts or controlled entities of a foreign sovereign to the extent not engaged in commercial activities in the United States.

(2) *Integral part.* An integral part of a foreign sovereign is any person, body of persons, organization, agency, bureau, fund, instrumentality, or other body, however designated, that constitutes a governing authority of a foreign country. The net earnings of the governing authority must be credited to its own account or to other accounts of the foreign sovereign, with no portion inuring to the benefit of any private person. It does not include any individual who is a sovereign, official, or administrator acting in a private or personal capacity.

(3) *Controlled entity.* An entity which is separate in form from a foreign sovereign or otherwise constitutes a separate juridical entity is a controlled entity if it satisfies the following requirements:

(i) It is wholly owned and controlled by a foreign sovereign directly or indirectly through one or more controlled entities;

(ii) It is organized under the laws of the foreign sovereign by which owned;

(iii) Its net earnings are credited to its own account or to other accounts of the foreign sovereign, with no portion of its income inuring to the benefit of any private person; and

(iv) Its assets vest in the foreign sovereign upon dissolution.

The term "controlled entity" does not include any entity owned and controlled by more than one foreign sovereign. Thus, a foreign financial organization organized and wholly owned and controlled by several foreign sovereigns to foster economic, financial, and technical cooperation between various foreign nations is not a controlled entity for purposes of this section.

(4) *Pension trust.* A pension trust established exclusively for employees, or former employees, of a foreign government is a controlled entity if it meets the following requirements:

(i) The funds that comprise the trust are managed by trustees who are employees of, or persons appointed by, the foreign government; and

(ii) The trust forming a part of the pension plan provides for definitely determinable benefits (defined benefit plan) so that it may be concluded that the income of the trust satisfies the obligations of the foreign government to participants under the plan, rather than inuring to the benefit of a private person.

(5) *Political subdivision and transnational entity.* The rules that apply to a foreign sovereign apply to political subdivisions of a foreign country and to transnational entities. A transnational entity is an organization created by more than one foreign sovereign that has broad powers over external and domestic affairs of all participating foreign countries stretching beyond economic subjects to those concerning legal relations and transcending state or political boundaries.

(c) *Characteristization of activities*—(1) *Commercial activities.* Except as provided in paragraph (c)(2) of this section, all activities conducted in the United States which are ordinarily conducted with a view towards the current or future production of income (whether or not such income is from sources within the United States) are commercial activities. For example, leases on real or personal property, other than holding lease described in paragraph (c)(2)(i) of this section, is a commercial activity.

(2) *Activities that are not commercial.*

(i) *Investments.* Investments in the United States in stocks (whether or not a controlling interest investment), bonds, or other securities, loans, net leases on real property, land which is not producing income (other than on its sale or from an investment in net leases on real property), or the holding of deposits in banks are not commercial activities. Consideration of all of the facts and circumstances will determine whether an activity with respect to property described in this paragraph (c)(2)(i) constitutes an investment. The following principles apply in making such a determination;

(*a*) An activity undertaken as a dealer will not be an investment for purposes of this paragraph (c)(2)(i).

(*b*) An activity will not cease to be an investment solely because of the volume of transactions of that activity or because of other unrelated activities.

(*c*) Except in the case of holding stock, an activity will not be an investment merely because the income derived from the activity is not effectively connected with the conduct of a trade or business in the United States. For example, a loan made by a bank, loan company, or similar financial business (open in the United States to the general public) does not constitute an investment.

(*d*) [RESERVED — Rules for loans]

(*e*) [RESERVED—Rules for net leases on real property]

(ii) *Cultural events.* Performances and exhibitions within the United States of amateur athletic events and events devoted to the promotion of the arts by cultural organizations are not commercial activities.

(iii) *Purchasing.* The mere purchase of goods in the United States for use of the foreign sovereign is not a commercial activity.

(iv) *Activities other than trade or business.* For purposes of this paragraph, a particular activity in the United States that does not constitute the conduct of a trade or business in the United States under section 864(b) will be deemed not to be a commercial activity. This paragraph (c)(2)(iv) does not apply if the activity in any year or period constitutes the conduct of a trade or business in the United States under section 864(b). This paragraph (c)(2)(iv) also does not apply to activities involving real property and leases of personal property.

(v) *Not for profit.* Activities that are not customarily attributable to or carried on by private enterprise for profit in the United States are not commercial activities. The fact that in some instances, Federal, State, or local governments of the United States also are engaged in the same or similar activity does not mean that the activity is one described in this paragraph (c)(2)(v). For example, even though the United States Government is engaged in the activity of operating a railroad, operating a railroad is not an activity described in this paragraph (c)(2)(v).

(d) *Other operative sections.* In determining whether income is from sources within or without the United States, see sections 861 through 863 and the regulations thereunder. For purposes of determining whether income is effectively connected with a trade or business, see section 864(c) and the regulations thereunder. For rules with respect to withholding of tax at source, see sections 1441 and 1442 and the regulations thereunder. For rules with respect to methods of accounting and accounting periods, see sections 446 and 441, respectively, and the regulations thereunder.

(e) *Filing of returns.* A return with respect to income taxes under subtitle A shall be made by a foreign sovereign, controlled entity, political subdivision, or a transnational entity with respect to certain amounts included in gross income. See section 6012.

(f) *Relationship of section 892 to certain Code sections*—(1) *Section 893.* The term "foreign government" referred to in section 893 (relating to the exemption for compensation of employees of foreign governments) has the same meaning as given such term in paragraph (b) of this section.

(2) *Section 895.* A foreign central bank of issue (as defined in § 1.895-1(b)) that fails to qualify for the exemption from tax provided by this section may nevertheless be exempt from tax on the items of income described in section 895. Thus, a foreign central bank of issue that is not wholly owned and controlled by a foreign sovereign, although not qualifying for exemption under this section, may be

exempt under section 895 on the items of income enumerated in that section.

(3) *Section 883(b)*. Section 892 and this section do not limit the exemption provided under section 883 (b), relating generally to the exemption of earnings derived by foreign participants from the ownership or operation of communications satellite systems.

(4) *Section 1442*. No withholding is required under sections 1441 and 1442 in the case of income exempt from taxation and not included in gross income under paragraph (a)(2) of this section.

(g) *Illustrations*. This section may be illustrated by the following examples:

Example (1). For 1981, the Office of the President of a foreign country makes investments of funds from the foreign sovereign's treasury in publicly traded stocks, bonds, and other securities, and interest bearing bank deposits. The Office of the President has also purchased in 1981 a hotel in the United States which is operated by a U.S. agent. None of the income from all of these activities inures to the benefit of the President (or any other official of the foreign country) in a private or personal capacity. The sovereign's investment activities do not constitute commercial activities under paragraph (c) of this section because the foreign sovereign has made investments in property described in paragraph (c)(2)(i) of this section. Income from these investments is exempt under paragraph (a)(2) of this section. Income derived from the operation of the hotel is subject to tax since the Office of the President is engaged in commercial activities in the United States by reason of its hotel operations and hence the income therefrom is not income of a foreign government under paragraph (a)(3)(i) of this section. By reason of section 864(c)(3) and § 1.864-4(b), this income is effectively connected for 1981 with the conduct of a trade or business within the United States by the Office of the President and is taxed under section 882.

Example (2). Pursuant to a general agreement on contracts, exchanges, and cooperation between the United States and a foreign country, the State Concert Bureau, a bureau of a foreign sovereign, entered into four separate contracts to be performed in 1981 with a U.S. corporation engaged in the business of promoting international cultural programs. Under the first contract, the State Concert Bureau agreed to send a singer and accompanists on tour for 3 weeks in the United States. Under the second contract, the Bureau agreed to send a conductor on tour for 4 weeks in the United States. Under the third contract, the Bureau agreed to send the State ensemble of folk dance on tour for 5 weeks in the United States. Under the fourth contract, the Bureau agreed to send the State ballet and opera troupe on tour for 6 weeks in the United States. The State Concert Bureau received approximately $80,000 from the performances and from the sale of programs from the tours. This income is exempt from taxation under paragraph (a)(2) of this section since the activities of the Bureau are not commercial activities under paragraph (c)(2)(ii) of this section. Although the performances themselves do not constitute commercial activities, they do constitute the conduct of a trade or business in the United States. As a result, income derived by the State Concert Bureau from sources within the United States from the tour groups' United States radio or television appearances, or from motion picture productions or record and tape recordings of United States performances does not qualify for the exclusion from commercial activities contained in paragraph (c)(2) of this section.

Example (3). In 1981, the Ministry of Culture of foreign country X enters into certain agreements with a U.S. corporation for the television broadcast in the United States of performances by the State ballet troupe during 1981. These performances occur in foreign country X. During 1981, the Ministry of Culture receives $300,000 in royalties and other fees under the terms of the agreement. Since the performances take place outside the United States, and since the activities are not commercial activities under paragraph (c)(2)(iv) of this section, the income from the performances is income of a foreign government and is exempt from taxation under paragraph (a)(2) of this section.

Example (4). (a) In 1981, foreign sovereign Y organizes under its law M Corp. as a wholly owned and controlled government corporation under the auspices of the Ministry of Industry and Tourism. M Corp. engages in the purchasing in the United States of grain and other agricultural goods for free distribution to the poor in country Y. In addition, when purchases of grain exceed demand in foreign country Y (which rarely occurs), M Corp. engages in the sale of grain in the United States. M Corp. also engages in the trading of commodities futures (not for its own account) through a resident broker. Foreign sovereign Y and M Corp. do not have an office or other fixed place of business in the United States through which or by the direction of which the transactions in commodities futures are effected. The purchasing and trading activities of M Corp. are not commercial activities under paragraph (c) of this section. M Corp. is a controlled entity under paragraph (b)(3) of this section. Income from these activities derived by M Corp. from sources within the United States is exempt from taxation under paragraph (a)(2) of this section. However, income derived by M Corp. from the sale of grain in the United States is a commercial activity under paragraph (c) of this section unless M Corp. is not engaged in a trade or business in the United States with respect to its sales activities (paragraph (c)(2)(iv) of this section).

(b) The facts are the same as in example (4)(a), except that in 1982, M Corp. opens an office in Washington, D.C., through which transactions of trading in commodities futures in the United States are effected. These activities are commercial activities under paragraph (c)(1) of this section since M Corp. is now considered to be engaged in a trade or business in the United States under section 864. Thus, paragraph (c)(2)(iv) of this section does not apply. Income from these trading activities is not income of a foreign government under paragraph (a)(3)(i) of this section.

(h) *Effective date*. This section applies to income derived by a foreign sovereign after July 22, 1980, unless the sovereign elects to have it apply to income derived before that date.

§ 1.892-2 Income of international organizations.

(a) *Exempt from a tax*. * * *

(b) *Income received prior to Presidential designation*. * * *

* * * * *

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved July 2, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on July 17, 1980, 3:51 p.m., and published in the issue of the Federal Register for July 22, 1980, 45 F.R. 48882)

Section 902.—Credit for Corporate Stockholder in Foreign Corporation

26 CFR 1.902-1: Credit for domestic corporate shareholder of a foreign corporation.
(Also Section 482; 1.482-1.)

Foreign tax credit; allocation of income to domestic parent; tax deemed paid. The effect of a reduction in the amount of foreign income tax paid by a foreign subsidiary following an allocation of income under section 482 of the Code on the computation of its domestic parent corporation's deemed paid foreign tax credit under section 902 is discussed; Rev. Rul. 76-508 amplified.

Rev. Rul. 80-231

ISSUE

How does the reduction in the

amount of foreign income tax paid by a foreign subsidiary following an allocation of income under section 482 of the Internal Revenue Code affect the computation of its domestic parent corporation's deemed paid foreign tax credit under section 902 of the Code in the circumstances described below?

FACTS

P, a domestic corporation, owns all of the voting stock of *S*, a foreign corporation organized under the laws of foreign country Z. Country Z does not have an income tax convention in force with the United States. *P* and *S* use the accrual method of accounting.

In 1977, *P* sold its products to *S* at a price below *P*'s normal charge to unrelated customers, so that *P* did not realize its normal profit. The Internal Revenue Service proposed an allocation of income under section 482 of the Code for 1977 to reflect an arm's length selling price. For 1977, *S* paid an 80*x* country Z income tax on reported income of 200*x*. Pursuant to the allocation of income under section 482, the Internal Revenue Service reduced *S*'s country *Z* income by 20*x* and increased *P*'s income by the same amount.

P received a dividend of 15*x* from *S* during 1977 out of *S*'s 1977 accumulated profits and claimed a deemed paid foreign tax credit under section 902 of the Code based on the amount of country *Z* taxes paid by *S* in 1977 before the income allocation. The 15*x* dividend was not excluded from *P*'s income under Rev. Proc. 65-17, 1965-1 C.B. 833, and *P* has not elected to compute *S*'s earnings and profits under section 964 of the Code.

LAW AND ANALYSIS

The applicable sections of the Code are 901 and 902. Subject to certain limitations, section 901 permits domestic corporations to claim a credit for income taxes paid or accrued to foreign countries. Under section 902, a domestic corporation owning at least 10 percent of the voting stock of a foreign corporation from which it receives dividends shall be deemed to have paid a specified portion of any creditable income tax paid or deemed paid to any foreign country on or with respect to the accumulated profits of such foreign corporation. The specified portion is in the ratio that the dividends bear to accumulated profits in excess of foreign income taxes.

Section 1.902-1(e)(1) of the Income Tax Regulations provides, in part, that the accumulated profits for any taxable year of a first-tier foreign corporation shall be the sum of the earnings and profits of such corporation for such year, and the foreign income taxes imposed on or with respect to the gains, profits, and income to which such earnings and profits are attributable.

United States principles for computing earnings and profits, not foreign principles, are used to determine the computation of accumulated profits for purposes of section 902. See *H.H. Robertson Co. v. Commissioner*, 59 T.C. 53, 78-79 (1972), *aff'd without opinion*, 500 F.2d 1399 (3d Cir. 1974); *Untermyer v. Commissioner*, 24 B.T.A. 906 (1931), *aff'd per curiam*, 59 F.2d 1004 (2d Cir. 1932), XII-1 C.B. 157 (1933), *cert. denied*, 287 U.S. 647 (1932). Accumulated profits under section 902 are determined on an annual basis. *H.H. Robertson Co. v. Commissioner*, at 78-79.

Foreign income taxes are generally attributed to a particular year in which such taxes are paid or accrued on or with respect to the foreign corporation's accumulated profits, pursuant to section 1.902-1(f) of the regulations.

Rev. Rul. 76-508, 1976-2 C.B. 225, concerns the allocation of income from a foreign subsidiary corporation to its domestic parent under section 482 of the Code. Rev. Rul. 76-508 holds that in such a case the Service can reduce the amount of foreign income taxes paid by the foreign subsidiary that qualify for use by the parent in computing the deemed paid foreign tax credit under section 902.

Under the facts of Rev. Rul. 76-508, the amount of foreign income taxes paid for purposes of section 902 of the Code is reduced because it is presumed that an amount has been paid to the foreign country that exceeds the amount required to be paid pursuant to such country's law and that the amount of the non-required or voluntary overpayment will be refunded. (The word "contribution" as used with respect to overpayments of foreign taxes in Rev. Rul. 76-508 means a voluntary overpayment to the foreign country.)

Generally, for domestic corporations, the earnings and profits of an accrual method taxpayer for a given year are reduced by the amount of tax accrued. A subsequent tax refund increases earnings and profits for that given year, regardless of the year in which such refund is received. *See Sweets Company of America v. Commissioner*, 8 T.C. 1104, 1106 (1947), which indicates that adjustments to earnings and profits on account of mistaken or erroneous overpayments or underpayments of tax for prior years are made as of the years for which the tax was due (accrued).

Thus, a reduction in the amount of foreign income taxes accrued by the amount of a voluntary overpayment, in conjunction with the presumption that the overpayment will be refunded, has an effect on the foreign subsidiary's earnings and profits in the earlier year of accrual of the foreign tax liability. Voluntary overpayments that the foreign corporation has treated as a tax expense item must be treated as a reduction of tax expense in such earlier year. This will increase earnings and profits in excess of foreign income taxes in such earlier year by the amount of the overpayment that it is presumed will be refunded.

When the foreign country actually refunds the voluntary overpayment there is no effect on the earnings and profits or accumulated profits in excess of foreign income taxes (except for exchange rate differentials in certain situations) because the adjustment (increase) to earnings and profits and accumulated profits in excess of foreign income taxes has already taken place.

If it is established to the satisfaction of the Internal Revenue Service that under the provisions of the law of country *Z*, *S* did not pay an amount in excess of that required by such law, or *P* and *S* exhaust all effective and practical remedies and the foreign country does not refund the voluntary overpayment, the refund presumption will be rebutted and the amount of the voluntary overpayment will be treated as a tax expense item in the original year of *S*'s accrual of the foreign tax liability. *S*'s earnings and profits will then be reduced in the original year of *S*'s accrual of the foreign tax liability by the amount of the tax expense that is not refunded. If an income tax convention were in force between the United States and country *Z*, all effective and practical remedies would include requesting consideration of the matter by the United States competent authority.

If *P* and *S* fail to pursue all effective and practical remedies and do not establish that *S* has made payments as required by the law of country *Z*, and it is established that *S* cannot receive a refund of the voluntary overpayment (for example, because the statute of limitations has expired), the amount of foreign income taxes paid, as reduced because of the refund presumption, will not be increased by the amount of the voluntary overpayment.

Moreover, even if *P* and *S* exhaust all effective and practical remedies and country *Z* refuses to refund the voluntary overpayment, the amount of the foreign income taxes paid, as reduced by the refund presumption, will not be increased by the amount of the voluntary overpayment in certain egregious cases, such as where it is clear that *P* and *S* knew or should have known that, under the law of country *Z*, *S* would not have had to make the voluntary overpayment because *P* grossly underpriced its products by selling them to S at substantially below cost and the law of country *Z* provides for arm's length pricing in computing tax liability. Thus, in such a case the amount of foreign income taxes paid will not be increased by the amount of the voluntary overpayment even after the foreign taxing authority and courts refuse for procedural reasons to grant any income tax refund based on increasing the price paid from *S* to *P* pursuant to an appropriate section 482 arm's length allocation by the Service.

In cases where there is a failure to exhaust remedies and in the aforementioned egregious cases, where the foreign income taxes paid (as reduced by the refund presumption) will not be increased by the voluntary overpayment, earnings and profits will be reduced by the amount of the overpayment, but only for the subsequent year when the right to the refund becomes worthless—for example, for the year in which the foreign statute of limitations for such a refund expires. See *Schweppe v. Commissioner,* 8 T.C. 1224 (1947), *aff'd,* 168 F.2d 284 (9th Cir. 1948), regarding the adjustment to earnings and profits in the year an otherwise valid debt becomes worthless because of the expiration of the statute of limitations; and *Sweets Company of America,* which distinguishes for earnings and profits adjustment purposes a mistake situation (such as the deemed rebutted refund presumption) from a subsequent event situation (such as the expiration of the statute of limitations).

HOLDING

The reduction, pursuant to Rev. Rul. 76-508, in the amount of foreign income tax paid by a foreign subsidiary following an allocation of income under section 482 of the Code affects the computation of its domestic parent's section 902 deemed paid foreign tax credit in the following manner:

	Accumulated Profits (as defined in section 902(c)(1))	Foreign Income Taxes Paid	Accumulated Profits (—) Foreign Income Taxes Paid	Dividend	902 Credit	(subject to section 904 limitation)
Year 1 before 482 allocation	200	80	120	15	$\frac{15}{120} \times$	80 = 10
Year 1 after 482 allocation of 20	180	72	108	15	$\frac{15}{108} \times$	72 = 10
Year 1 after a refund of the overpayment is obtained	180	72	108	15	$\frac{15}{108} \times$	72 = 10
Year 1 after exhaustion of administrative remedies and foreign government does not refund overpayment	180[1]	80[1]	100[1]	15	$\frac{15}{100} \times$	80 = 12[1]
Year 1 after failure to exhaust administrative remedies and taxpayer establishes no refund can be obtained (foreign statute of limitations runs in year 4)	180[2]	72[2]	108[2]	15	$\frac{15}{108} \times$	72 = 10

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[1] In those situations in which taxpayer knew or should have known that it was not liable for overpayment of 8, foreign taxes paid will remain at 72 and accumulated profits will remain at 180 resulting in a 902 credit of 10; however, accumulated profits in the year that the statute of limitations runs, year 4, will be reduced by the overpayment of 8.

[2] Foreign income taxes paid remain at 72 on the assumption that had the taxpayer pursued its administrative remedies a refund of 8 would have been received; accumulated profits of the year that the statute of limitations runs, year 4, will be reduced by the overpayment of 8.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 76-508 is amplified.

Section 4061.—Imposition of Tax [Motor Vehicles]

26 CFR 48.4061(a)-1: Imposition of tax; exclusion for light-duty trucks, etc.

Whether certain discounts and allowances may be taken into account in determining the lowest price at which the distributor, a member of the same affiliated group of corporations as the manufacturer, regularly sells truck trailers to independent retailers. See Rev. Rul. 80-232, below.

Section 4216.—Definition of Price [Special Provisions Applicable to Manufacturers Tax]

26 CFR 48.4216(b)-4: Constructive sale price; affiliated corporations.
(Also Section 4061; 48.4061(a)-1.)

Truck trailers; sales price; discounts. In determining the lowest price at which a distributor, a member of the same affiliated group of corporations as the manufacturer, sells truck trailers to independent dealers, certain discounts and allowances may be taken into account, but only if regularly given and not merely offered.

Rev. Rul. 80-232

ISSUE

For purposes of computing the manufacturers excise tax on sales of truck trailers, can certain discounts and allowances be taken into account in determining the lowest price at which a distributor, a member of the same affiliated group of corporations as the manufacturer, regularly sells trailers to independent retailers?

FACTS

The manufacturer sells all its truck trailers to the distributor. The distributor offers and regularly allows the following discounts to its customers: (1) a 1 percent discount from the list price for payment within 15 days; (2) a 2 percent discount on all sales to an authorized stocking dealer; and (3) a 1 to 4 percent discount based on the cumulative volume of purchases by an authorized stocking dealer during the year.

To be a stocking dealer, rather than a non-stocking dealer, a dealer must (1) have adequate facilities and personnel to properly displace and service trailers, (2) be in compliance with state regulations governing the sale and registration of trailers and furnish information satisfactory to the distributor for use in establishing credit, (3) not be a stocking dealer for any other line of trailer considered by the manufacturer to be competitive, and (4) stock the manufacturer's trailers at a quantity satisfactory to the manufacturer.

LAW AND ANALYSIS

Section 4061(a)(1) of the Internal Revenue Code imposes a manufacturers excise tax on truck trailers.

Section 4216(b)(5) of the Code provides that if the manufacturer of a trailer regularly sells such article to a distributor that is a member of the same affiliated group (as defined in section 1504(a)) as the manufacturer, and such distributor regularly sells such article to one or more independent retailers, the constructive sale price of such article shall be 98½ percent of the lowest price for which such distributor regularly sells such article in arm's length transactions to independent retailers.

Section 48.4216(b)-4(f)(1)(i) of the Manufacturers and Retailers Excise Tax Regulations provides that a lowest price shall be determined without requiring that a given percentage of sales be made at that price (provided that the volume of sales made at that price is great enough to indicate that those sales have not been engaged in primarily to establish a lower tax base).

Discounts of the type given in this case, when regularly given by a distributor to a dealer, are properly to be considered in determining the "lowest price" under section 4216(b)(5) of the Code. The fact that a particular discount is offered, in and of itself, is not sufficient.

HOLDING

The discounts and allowances may be taken into account in determining the lowest price at which the distributor regularly sells truck trailers to independent retailers. The maximum percentage volume discount that can be used in the computation is the maximum volume discount at which sales are regularly made. If, for example, the distributor regularly allows the 1 percent early payment discount, the 2 percent authorized stocking dealer discount, and a 3 percent volume discount, but only occasionally makes a sale large enough to qualify for the 4 percent volume discount, the "lowest price" is list price minus the sum of the 1 percent early payment discount, the 2 percent authorized stocking dealer discount and the 3 percent volume discount, that is, list price minus 6 percent.

Part II. Treaties and Tax Legislation

Subpart B.—Legislation and Related Committee Reports

Public Law 96-298
96th Congress, H.R. 7477 [1]
July 1, 1980

An Act to amend the Internal Revenue Code of 1954 to provide a three-month extension of the taxes which are transferred to the Airport and Airway Trust Fund.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. EXTENSION OF TAXES.

(a) TAX ON FUEL USED IN NONCOMMERCIAL AVIATION. — Paragraph (5) of section 4041(c) of the Internal Revenue Code of 1954 (relating to termination of tax on fuel for noncommercial aviation) is amended by striking out "July 1, 1980" and inserting in lieu thereof "October 1, 1980".

(b) TAX ON TRANSPORTATION BY AIR.—Sections 4261(e) and 4271(d) of such Code are each amended by striking out "June 30, 1980" and inserting in lieu thereof "September 30, 1980".

(c) TAX ON USE OF AIRCRAFT.—

(1) IN GENERAL.—Subsection (e) of section 4491 of such Code (relating to termination of tax on use of aircraft) is amended by striking out "July 1, 1980" and inserting in lieu thereof "October 1, 1980".

(2) TRANSITIONAL RULE.—For the period beginning on July 1, 1980, and ending on October 1, 1980—

(A) subsection (a) of section 4491 of such Code shall be applied by substituting "$6.25" for "$25", "½ cent" for "2 cents", and "⅞ cent" for "3½ cents", and

(B) such section 4491 shall be applied by treating such period as a year.

(3) POSTPONEMENT OF DUE DATE FOR FILING RETURN.—The due date for filing any return of the tax imposed by section 4491 of the Internal Revenue Code of 1954 with respect to any use after June 30, 1980, shall not be earlier than October 31, 1980.

(d) EXTENSION OF AIRPORT AND AIRWAY TRUST FUND.—Subsection (b) of section 208 of the Airport and Airway Revenue Act of 1970 [1970-1 C.B. 361, 368] is amended by striking out "July 1, 1980" each place it appears and inserting in lieu thereof "October 1, 1980".

Approved July 1, 1980.

House of Representatives

Report No. 96-1077
2d Session

[Bracketed numerals indicate official report page numbers]

THREE-MONTH EXTENSION OF THE TAXES WHICH ARE TRANSFERRED TO THE AIRPORT AND AIRWAY TRUST FUND

JUNE 5, 1980.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed.

Mr. ULLMAN, from the Committee on Ways and Means, submitted the following report to accompany H.R. 7477.[1]

The Committee on Ways and Means, to whom was referred the bill (H.R. 7477) to amend the Internal Revenue Code of 1954 to provide a 3-month extension of the taxes which are transferred to the Airport and Airway Trust Fund, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment—stated in terms of the page and line numbers of the introduced bill—is as follows:

Page 2, after line 18, insert the following:

(3) POSTPONEMENT OF DUE DATE FOR FILING RETURN.—The due date for filing any return of the tax imposed by section 4491 of the Internal Revenue Code of 1954 with respect to any use after June 30, 1980, shall not be earlier than October 31, 1980.

I. SUMMARY

Under present law, the aviation-related excise taxes now transferred to the Airport and Airway Trust Fund are scheduled either to expire or be reduced on July 1, 1980.

The bill extends the present law aviation excise taxes at their present rate structure for a 3-month period, July 1, 1980-September 30, 1980, in order to provide additional time for the Congress to complete its consideration of the trust fund extension legislation. The Committee on Ways and Means has approved an amendment for a 5-year extension of the trust fund which will be offered as a separate title to H.R. 6721. The bill, H.R. 7477, also extends the transfer of the aviation excise tax revenues to the trust fund for the same 3-month period. In addition, the bill provides that the due date for filing a return for payment of the aircraft use tax for the 3-month period will not be earlier than October 31, 1980.

[2] II. EXPLANATION OF BILL

Present law

Under present law, the aviation-related excise taxes now transferred to the Airport and Airway Trust Fund are scheduled either to expire or be reduced on July 1, 1980. The following table shows the present law aviation excise taxes and the rates scheduled for July 1, 1980, under present law.

SCHEDULE OF AIRPORT AND AIRWAY TRUST FUND EXCISE TAXES UNDER PRESENT LAW

Tax (and Code section)	Present rate	Rate scheduled for July 1, 1980
Air passenger ticket tax (secs. 4261(a) and (b))	8%	5%
Air freight waybill tax (sec. 4271)	5%	----
International departure tax (sec. 4261(c)	$3	----

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[1] House Report No. 96-1077, this page.

[1] Public Law 96-298, this page.

Fuels tax for noncommercial (general) aviation (per gallon) (sec. 4041(c))[1] ------	7¢	[4] 4¢
Aircraft use tax (sec. 4491)[1] ----	(2)	----
Aircraft tires and tubes tax (secs. 4071) ---------	(3)	(3)

[1] The tax does not apply to aircraft, owned by a tax-exempt aircraft museum defined in sec. 404(h), which are operated exclusively for the procurement, care, and exhibition of World War II aircraft.

[2] A tax of two parts: (1) $25 annual per plane registration tax, plus (2) a weight tax of 3½ cents per pound for turbine-powered (jet) aircraft and 2 cents per pound for nonturbine-powered aircraft for each pound in excess of 2,500 pounds of "maximum certificated takeoff weight."

[3] Taxed at the general rates for nonhighway tires (5 cents per pound) and tubes (10 cents per pound) under Code sec. 4071.

[4] Tax on gasoline fuel only. As of July 1, 1980, the additional 3-cents-per-gallon tax on gasoline used in noncommercial aviation aircraft would expire, and the 7-cents-per-gallon tax on non-gasoline fuels (e.g. kerosene—jet fuel) would also expire.

Ways and Means Committee amendment to H.R. 6721

On May 28, 1980, the Ways and Means Committee approved an amendment, which is to be offered as a separate title to H.R. 6721 (the Airport and Airway Improvement Act of 1980), as reported by the Public Works and Transportation Committee and the Science and Technology Committee.

The Ways and Means Committee amendment generally extends the Airport and Airway Trust Fund and the aviation excise taxes transferred to the trust fund through September 30, 1985 (fiscal year 1985). However, certain modifications were made to the aviation taxes: (1) the air passenger ticket tax was extended at 8 percent through September 30, 1982, with a reduction to 5 percent on October 1, 1982; (2) the [3] aircraft use tax was repealed for noncommercial aircraft (i.e., allowed to expire on July 1, 1980), while the use tax on commercial aircraft was extended through September 30, 1985; (3) the fuels tax on noncommercial aviation was increased to 8½ cents per gallon on July 1, 1980 through September 30, 1985, and (4) other amendments were made relating to the 225-mile zone rule for air transportation between the United States, and Canada, and Mexico, the treatment of international uninterrupted flights, and the manner in which airline tickets must show the air fare and the ticket tax.

Reasons for change

The committee concluded that the present law aviation excise taxes should be extended at their present rates for the 3-month period, July 1, 1980-September 30, 1980, in order to provide additional time for orderly Congressional consideration of H.R. 6721. If present law is not extended, the 8-percent air passenger ticket tax will drop to 5 percent on July 1, and the revenues will go into the general fund. Also, the 5-percent waybill tax, the $3 departure tax, and the aircraft use tax will expire on July 1. In addition, the fuels tax on noncommercial aviation jet fuel will expire, and the tax on noncommercial aviation gasoline will drop to 4 cents per gallon. In view of the closeness of the July 1 date, the committee believes that expeditious Congressional action is necessary for a short-term extension of the present law tax rates so that there is some certainty as to the applicable tax rates for the coming months while the Congress considers the extension of the trust fund authorizations.

Explanation of provision

The bill extends the present law aviation taxes at the present tax rates for a 3-month period, or July 1, 1980-September 30, 1980. For purposes of the aircraft use tax, the bill treats the 3-month period as a taxable year at one-fourth the annual tax rate now imposed.[1] (i.e., the $25 annual per plane tax will be $6.25, and the respective weight taxes on jet and non-jet aircraft will be at one-fourth the present tax rates.) Also, the bill provides that the due date for filing a return for the aircraft use tax for the period beginning after June 30, 1980, will not be due earlier than October 31, 1980.

In addition, the bill extends for the 3-month period the transfer of the aviation excise tax revenues to the Airport and Airway Trust Fund.

Effective date

The provisions of the bill are generally effective for the 3-month period July 1, 1980-September 30, 1980. The amendment with respect to the time of filing a return for payment of the aircraft use tax for the 3-month period provides that the due date for such a return will not be earlier than October 31, 1980.

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[1] Under Code section 4491, the taxable year for purposes of the annual aircraft use tax presently is July 1-June 30, with the use tax being imposed (on a prorated basis for the weight portion of the tax) on an aircraft in the month the plane is first used. Payment of the use tax is due generally by the end of the month following the month of first use.

Part IV. Items of General Interest

Revision of Form 6177

Announcement 80-108

The General Assistance Program of the State of New Jersey has been designated by the Department of Health and Human Services as a qualified general assistance program. Participants in this program qualify as members of a targeted group for the targeted jobs credit allowed employers under section 44B of the Internal Revenue Code.

Form 6177, General Assistance Program Determination, has been revised (July, 1980) to include the New Jersey program on its list of qualified general assistance programs. The revised form is now available. Since Form 6177 does not have to be filed for programs on this list, it is no longer required for the New Jersey General Assistance Program. However, Form 6177 must be filed for any other program not specifically included on the list.

Foundation Status of Certain Organizations

Announcement 80-109

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3) of the Code, eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

A Ministry of Light in the World of Darkness, San Antonio, TX
Albuquerque Urban League, Albuquerque, NM
American African Relief Foundation, Inc., Atlanta, GA
American Friends of the Jewish Heritage Center, Inc., Skokie, IL
American Indian Rehabilitation Services, Inc., Chicago, IL
Anduin Institute, El Paso, TX
Animal Concern and Education Corps, Lake Charles, LA
Appalachian Foundation, Burnsville, NC
Applied Youth Development (AYD), Greensboro, NC
Area Improvement for Montelores, Inc., Cortez, CO
Arts World, Inc., Chicago, IL
Asian-American Community Legal Aid Clinic, Chicago, IL
Atlanta Chapter of the American Theatre Organ Society, Inc., Atlanta, GA
Bainbridge Decatur County Humane Society, Inc., Bainbridge, GA
Better Badin, Inc., Badin, NC
Blue Loch Highlanders, Inc., Twin Falls, ID
Breakthrough, Inc., Anchorage, AK
Bureau of Mental Health Services, Inc., Chicago, IL
Capitol Youth Sports Foundation, Inc., Raleigh, NC
Center for Neighborhood Technology, Chicago, IL
Christian Living Conference, Billings, MT
Christian Services, Inc., West LaFayette, IN
Churchland Athletic Boosters Club, Inc., Lexington, NC
Clarksville Senior Citizens Club, Inc., Clarksville, MO
Clayton County Group Home, Inc., Jonesboro, GA
Clearwater Valley Crusade for Christ, Orofino, ID
Clement Freedom House of Tennessee, Frank G., Nashville, TN
Coastal Management Foundation, Lincoln City, OR
Communicative Arts Council, Port Richardson, AK
Connemara, Inc., Galena, IL
Consortium on Drug Abuse of Metropolitan Chicago, Inc., Chicago, IL
Crossroads Lighthouse, Inc., The, Rock Island, IL
Dancers Contemporary Co., Austin, TX
Danish American Language Foundation, Chicago, IL
Deerfield Daycare Center, Inc., The Deerfield, IL
Dogs Organized for Ground Search, Anchorage, AK
Dove Ministries, Inc., Swainsboro, GA
Dyad Theatre Productions, Chicago, IL
Ferndale Child Care Center, Ferndale, WA
Floating Theater, The, Seattle, WA
Foundation for Islamic Culture, Durham, NC
Friends of the Dora Moore School, Inc., Denver, CO
Friends of the Dalles—Wasco County Public Library, The Dalles, OR
Gant Evangelistic Association, Rev. James C., Pinehurst, NC
Gospel Keys, The, Fayetteville, NC
Greensboro Guilford County Gateways, Inc., Greensboro, NC
Griffin Youth Ranch, Inc., Griffin, GA
Haddon Elementary School Association of Parents, Teachers and Students, Lulu D., Bremerton, WA
Harmony Ranch, Inc., Youngsville, NC
Hospice of Churches of Christ, Inc., The, Nashville, TN
Hungarian American Historical Society, Inc.—Szechenyi Club, Chicago, IL
Illinois Youth Soccer Asso., Inc., Northbrook, IL
Information Council for Community Justice, Wheaton, IL
Institute for the Study of the Foundation of Behavior, Philadelphia, PA
Institute of Lithuanian Studies, The, Chicago, IL
International Circuit Courses, Chicago, IL
International Humanities Foundation, Chapel Hill, NC
Irish Family Day, Chicago, IL
Italian-American — Sports Hall of Fame, Inc., Bensenville, IL
Jewish Community Center of Charlotte, Inc., Charlotte, NC

Kellamar Foundation for Underprivileged Children, The, Sebastopol, CA
Kelley Prison Ministries, Inc., Tom, Stephens City, VA
Kelly Orthopaedic Society, Inc., Robert P., Atlanta, GA
Kids, Inc., El Paso, TX
Kingsville Boxing Club, Inc., Kingsville, TX
La Hood's Fellowship Home, Inc., Valdosta, GA
Lake Washington Girls Choir, Seattle, WA
Last State of Franklin, Inc., The, Seymour, TN
Lattings Gospel Church Singers, Inc., The, Memphis, TN
Lawleys Foster Home, Seattle, WA
Lefco Memorial Trust, Beth Davis, Atlanta, GA
Lenox Medical Center, Inc., Lenox, GA
Let's Study the Bible—Together, Woodbridge, VA
Magic Valley Chamber Orchestra, Inc., Jerome, ID
Manhattan Community Center, Manhattan, MT
Manpower Action for Substances Abuse Treatment and Offender Assistance Programs, Inc., Richmond, VA
Metro Help, Inc., Chicago, IL
Mexican Children Refuge, Mercedes, TX
Middle Georgia Symphony Orchestra Association, Inc., Macon, GA
Midwest Conference Ministries, Inc., Barrington, IL
Milledgeville Circuit, Inc., Milledgeville, GA
Montana State Foster Parent Organization, Inc., Kalispell, MT
Mothers of America Alert, Chicago, IL
National Association of Handcraftsmen, Inc., Baltimore, MD
National Council Against Child Pornography, Houston, TX
National Hand Research and Rehabilitation Fund, Inc., The, Washington, D.C.
National Legal Center for Bioethics, Inc., Washington, D.C.
National Mining Hall of Fame and Museum, The, Idaho Springs, CO
National Peace Officers Hall of Fame, Inc., West Monroe, LA
New Horizons, Kent, WA
New Wave Film Society, Newport, OR
North Augusta Senior High Band, North Augusta, SC
North Carolina Academy of Trial Lawyers Foundation, Inc., The, Raleigh, NC
North Carolina Minority Women's Research, Training, and Development Center, Inc., Raleigh, NC
North End Senior League, Beaumont, TX
Oconee Area Home Health Agency, Inc., Milledgeville, GA
Old James County Chapter of East Tennessee Historical Society, Georgetown, TN
Optimist Club Foundation of Bazetta-Cortland Ohio, Inc., The, Cortland, OH
Raleigh-Wake Urban League, Inc., Raleigh, NC
Rental Equipment Industry Foundation, Moline, IL
Roseland Area Redevelopment Enterprises, Chicago, IL
Taos County Humane Association, Taos, NM
Tennessee Association of Primary Health Care Centers, Inc., Nashville, TN
Texas Investigative Reporters' Fund, Austin, TX
Theatre, Etc., Washington, DC
Tok Council on the Arts, Inc., The, Tok, AK
Tri-County Thunderbolts CB Radio Club, Fitzgerald, GA
Tri-Parish Community Development Corporation, Portland, OR
Understanding is Progress, Chicago, IL
United Community Developers, Inc., Gary, IN
United States Independent Telephone Association Foundation, Inc., Washington, DC
United States Naval Academy Class of 1963 Foundation, Inc., Annapolis, MD
United States Society for Handicapped Children, Inc., Decatur, GA
United Way of Lanesburgh Township, Le Sueur County, Minnesota, Inc., New Prague, MN
Valley General Hospital Auxiliary, Renton, WA
Vietnamese American Association of Virginia, Richmond, VA
Virginia Beach Sports Club Athletic Scholarship Fund, Virginia Beach, VA
Voice News Network, Inc., Atlanta, GA
Voluntary Action Center, Norfolk, VA
Volunteer Rescue Squad of Myrtle Beach, Myrtle Beach, SC
Volunteers for America's Needy, Ashland, KY
West End Association, Inc., The, Winston-Salem, NC
Wilderness Encounter, Two Harbors, MN
Wilmington Area Band Boosters, Inc., New Wilmington, PA
Withers Trail Driver Museum, The Mark, Austin, TX
Within These Walls, Inc., Minneapolis, MN
Women's Action Program, Inc., Minot, ND
Women's Advocacy Center of Charleston, The, Charleston, SC
Women's Heritage Association Trust, Columbia, SC
Women's Space, Inc., The, Minneapolis, MN
Wood Station Valley Club, Inc., Ringgold, GA
Xperience Gymnastics Association of Houston, Houston, TX
Young Men's Christian Association of Orangeburg South Carolina, Inc., Orangeburg, SC
Youngstown Goodwill Apartments, Inc., Youngstown, OH
18th Street Youth Center, Chicago, IL

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Robert L. Hamersley	Boise, ID	Certified Public Accountant	Indefinite from July 7, 1980
Daniel C. Lukensow	Arcadia, CA	Enrolled Agent	Eighteen months effective July 28, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 48.4221-2 amended.	Tax-free sales of articles to be used for, or resold for, further manufacture.	July 2, 1980	Aug. 31, 1980
26 CFR 1.1441-4(d) revoked.	Exemption from withholding of tax under chapter 3 with respect to Virgin Islands inhabitants.	July 8, 1980	Sept. 8, 1980
26 CFR 301.6059-1, 301.6692-1 added.	Requirement that the plan administrator of a defined benefit plan periodically file an actuarial report for the plan.	July 8, 1980	Sept. 8, 1980
26 CFR 1.46-1, 1.46-2 amended.	FIFO and other ordering rules for the investment credit.	July 10, 1980	Sept. 8, 1980
26 CFR 1.501(c)(9)-1 as proposed in the Federal Register for January 23, 1969, 34 F.R. 1028, withdrawn; 1.501(c)(9)-1 through 1.501(c)(9)-8 added.	Voluntary employees' beneficiary associations.	July 17, 1980	Sept. 15, 1980
26 CFR 1.72-4, 1.72-15, 1.104-1, 1.105-1, 1.105-2, 1.105-4, 1.106-1, amended; 1.105-7 through 1.105-10, added; 7.105-1, 7.105-2, deleted.	Exclusion of certain disability payments from gross income.	July 9, 1980	Sept. 8, 1980
26 CFR 1.166-1, 1.166-4, 1.381(c)(4)-1, amended; 1.166-10, added.	Reserve for certain guaranteed debt obligations.	July 11, 1980	Sept. 9, 1980
26 CFR 1.892-1 amended.	Determining whether certain income of foreign sovereigns from loans or leases is derived from the conduct of commercial activities in the U.S.	July 22, 1980	Sept. 22, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

Numerical Finding List[1]

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

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* Denotes entry since last publication.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27, dated July 7, 1980.

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______	1930–1	7.30
______	1930–2	9.50
______	*1931–1*	*3.60*
______	1931–2	13.00
______	*1932–1*	*2.80*
______	1932–2	8.65
______	*1933–1*	*3.35*
______	*1933–2*	*3.45*
______	*1934–1*	*3.70*
______	1934–2	14.00
______	1935–1	6.90
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______	*1936–1*	*3.55*
______	*1936–2*	*3.90*
______	*1937–1*	*3.75*
______	1937–2	7.70
______	*1938–1*	*4.05*
______	*1938–2*	*3.50*
______	1939–1–1	8.25
______	1939–1–2	10.90
______	1939–2	9.40
______	1940–1	5.55
______	1940–2	14.00
______	1941–1	*$6.95*
______	*1941–2*	*3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
______	*1944*(*)	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*2.65*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
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______	1957–2	13.00
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______	1958–2	13.00
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______	1959–2	9.60
______	1960–1	9.00
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______	1962–2	13.00
______	1962–3	20.00
______	1963–1	9.00
______	1963–2	10.75
______	1964–1–1	10.00
______	1964–1–2	11.00
______	1964–2	9.80
______	1965–1	10.70
______	1965–2	12.25
______	1966–1	14.00
______	1966–2	14.05
______	1967–1	10.00
______	1967–2	15.00
______	1968–1	14.00
______	1968–2	11.75
______	1969–1	7.50
______	1969–2	6.50
______	1969–3	$12.50
______	1970–1	11.00
______	1970–2	14.00
______	1971–1	10.55
______	1971–2	8.50
______	1972–1	13.50
______	1972–2	13.70
______	1973–1	16.00
______	1973–2	8.30
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______	1974–2	9.95
______	*1974–3*	*8.20*
______	1974–3 Supp.	10.00
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9258

September 2, 1980
Bulletin No. 1980-35

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-233, page 6.

Charitable contributions; fair market value; bibles. A taxpayer purchased bibles from a promoter who asserted that they could be purchased at a considerable discount from "retail" price and claimed that if the taxpayer held the bibles over twelve months and then contributed them to a charitable organization, the taxpayer would be entitled to deduct the "retail" price as a charitable contribution. The charitable deduction is based on the fair market value of the bibles at the time of contribution, and the best evidence of the fair market value at that time is the price at which similar lots of bibles are being sold to others.

Rev. Rul. 80-234, page 6.

Partner; receipt of guaranteed payment; capitalized by partnership. A guaranteed payment, within the meaning of section 707(c) of the Code, that is received by a partner as a finder's fee, is includible in the partner's gross income in the year of receipt, even though the partnership must capitalize and amortize the expense.

Rev. Rul. 80-235, page 7.

Basis; synthetic oil converter purchased for nonrecourse note; partnership. The liability created by an interest-bearing nonrecourse note given by a limited partnership as the total purchase price for a synthetic oil converter and payable out of the partnership's net cash flow may not be included in the partnership's basis in the converter for purposes of investment tax credits. The liability created by a limited partner's written obligation given as part of the purchase price for a partnership interest and payable only from cash distributions from the production activities of the partnership may not be included in the basis of the limited partnership interest.

Rev. Rul. 80-236, page 8.

Small business corporation; net operating loss; research and development agreement. Shareholders contributed cash to a small business corporation in exchange for stock, which was used as security to borrow, through nonrecourse notes, most of the cash contributed. The lender simultaneously sold the notes at face value to a research and development company that was hired by the small business corporation. For purposes of determining the limitation on a shareholder's net operating loss under section 1374(c) of the Code, the cash proceeds of a nonrecourse loan are not part of the basis of the stock received in exchange for such cash, because the various related steps of the financing arrangement are collapsed to show that no cash was actually advanced under the nonrecourse note.

EXCISE TAXES

Rev. Rul. 80-237, page 9.

Paint striping equipment. Sales, by the manufacturer, of certain paint striping equipment units

(Continued on page 4)

Finding Lists begin on page 26.
Announcement Relating to Decisions of the Tax Court on page 5.
Announcement of Voluntary Suspensions on page 24.
Announcement of Notice of Proposed Rulemaking on page 25.
Monthly Index for August begins on page 28.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

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Highlights of this Issue—Continued

(Continued from page 1)

EXCISE TAXES—Cont'd

that are mounted on tax-paid truck chassis are subject to the tax imposed by section 4061(a)(1) of the Code, but amounts charged for equipment that does not contribute to the highway transportation function are not part of the taxable sales price; Rev. Rul. 58-214, dealing with self-propelled line marking machines, is obsoleted.

T.D. 7709, page 11.
Final regulations under sections 6420 and 6427 of the Code relate to claims by aerial applicators for payments equal to the tax on gasoline and certain other fuels that are used on farms for farming purposes.

Pub. L. 96-283, page 16.
The Deep Seabed Hard Mineral Removal Tax Act of 1979 imposes an excise tax on the removal from the deep seabed of nodules containing manganese, nickel, cobalt, or copper effective January 1, 1980.

ADMINISTRATIVE

T.D. 7708, page 14.
Amendments to the regulations under section 7216 of the Code relate to the disclosure of tax return information by tax return preparers.

Del. Order 116 (Rev. 4), page 22.
Extension of time; estate tax returns. The authority to grant extensions of time to file estate tax returns may be redelegated but not below Advisor or Reviewer in the Special Procedures function in District Offices and Office of International Operations; Del. Order 116 (Rev. 3) superseded.

Announcement 80-111, page 23.
The 9¼ percent Treasury Notes of Series K-1983, the 10¾ percent Treasury Notes of Series B-1989, the 10 percent Treasury Bonds of 2005-2010, the 9⅜ percent Treasury Notes of Series S-1982, the 9⅝ percent Treasury Notes of Series E-1985, the 8⅝ percent Treasury Notes of Series T-1982, and the 8⅞ percent Treasury Notes of Series E-1984 will not be acceptable in payment of taxes.

Announcement Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issue or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by Revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the Court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the Tax Court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Arrigoni, James M., et ux [1]	693-78	73	792
Danenberg, Julian S., et ux [2]	2103-76	73	370
Sawyer, Jr., Charles, Est. of, John Sawyer, executor [3]	1004-72	73	1

The Commissioner does NOT ACQUIESCE in the following decision:

Taxpayer	Docket No.	Report	
		Volume	Page
Arrigoni, James M., et ux [4]	693-78	73	792

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[1] Acquiescence in the issue relating to whether petitioners were entitled to an interest expense deduction for the interest portion of the payments made by petitioners for their section 6672 and Minnesota sales tax liabilities.

[2] Acquiescence in the issues relating to (1) whether the court properly determined the amount realized from the transfer of petitioner's stock, (2) whether petitioner was insolvent both before and after the discharge of his indebtedness, and (3) whether any part of the underpayment of petitioner's taxes was due to fraud.

[3] Acquiescence in the issue relating to whether under Ohio law the surviving spouse's share of the residuary estate should be reduced by a proportionate amount of the estate tax in computing the marital deduction.

[4] Nonacquiescence in the issue relating to whether petitioners were entitled to a sales tax deduction for payments they made for one of their corporations' unpaid Minnesota sales taxes.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 38.—Investment in Certain Depreciable Property

26 CFR 1.38-1: Investment in certain depreciable property.

Whether the liability created by a note given as the purchase price for a synthetic oil converter is included in the partnership's basis in the converter for purposes of the investment tax credits. See Rev. Rul. 80-235, page 7.

Section 46.—Amount of Credit

26 CFR 1.46-1: Determination of amount.

Whether the liability created by a note given as the purchase price for a synthetic oil converter is included in the partnership's basis in the converter for purposes of the investment tax credits. See Rev. Rul. 80-235, page 7.

Section 48.—Definitions; Special Rules

26 CFR 1.48-1: Definition of section 38 property.

Whether the liability created by a note given as the purchase price for a synthetic oil converter is included in the partnership's basis in the converter for purposes of the investment tax credits. See Rev. Rul. 80-235, page 7.

Section 170.—Charitable, Etc., Contributions and Gifts

26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance of deduction.

Charitable contributions; fair market value; bibles. A taxpayer purchased bibles from a promoter who asserted that they could be purchased at a considerable discount from "retail" price and claimed that if the taxpayer held the bibles over twelve months and then contributed them to a charitable organization, the taxpayer would be entitled to deduct the "retail" price as a charitable contribution. The charitable deduction is based on the fair market value of the bibles at the time of contribution, and the best evidence of the fair market value at that time is the price at which similar lots of bibles are being sold to others.

Rev. Rul. 80-233

ISSUE

What is the fair market value of bibles that are contributed to charity under the circumstances described below?

FACTS

P is a promoter who sells bibles to individuals. *P* advises potential customers that they can purchase bibles at a considerable discount from "retail" price, hold the bibles for 12 months, and then, by donating them to a qualified charitable organization, claim a charitable deduction for the "retail" price.

In 1979 *D* purchased from *P* 500 copies of a single edition of a modern translation of the bible for a total of 100*x* dollars. Upon receipt of *D*'s payment of 100*x* dollars, *P* furnished *D* with a statement that the 500 copies of the bible had a total retail value of 300*x* dollars.

As part of the purchase agreement, *P* agreed to periodically furnish *D* with lists of religious organizations that were interested in receiving a donation of bibles and for which the use of the books would be related to the organizations' exempt purposes. Pursuant to *P*'s suggestion that only one organization be the recipient of the bibles, *D* selected from the list, *X*, an organization described in section 170(c) of the Internal Revenue Code, to be the recipient. At *D*'s direction, *P* mailed the bibles directly to *X* 13 months after *D* had purchased them from *P*. At the time *D* contributed the bibles to *X*, wholesale dealers of bibles were selling similar lots of bibles to members of the general public for 100*x* dollars.

LAW AND ANALYSIS

Section 170 of the Code provides, subject to certain limitations, a deduction for contributions and gifts to or for the use of organizations described in section 170(c), payment of which is made within the taxable year.

Section 1.170A-1(c)(1) of the Income Tax Regulations provides that if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution reduced as provided in section 170(e)(1) of the Code and section 1.170A-4(a) of the regulations.

Section 1.170A-1(c)(2) of the regulations provides, in part, that fair market value is the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.

To determine fair market value, reference is made to the most active and comparable marketplace at the time of the donor's contribution. The most probative evidence of fair market is the prices at which similar quantities of bibles are sold in arm's-length transactions. *See* Rev. Rul. 80-69, 1980-11 I.R.B. 5. The 100*x* dollars, at which similar lots of bibles were sold to *D* and are still being sold to others, is the best evidence of fair market value at the time the bibles are contributed to *X*.

HOLDING

The fair market value of the bibles contributed to *X* is 100*x* dollars.

Section 707.—Transactions Between Partner and Partnership

26 CFR 1.707-1: Transactions between partner and partnership.

Partner; receipt of guaranteed payment; capitalized by partnership. A guaranteed payment, within the meaning of section 707(c) of the Code, that is received by a partner as a finder's fee, is includible in the partner's gross income in the year of receipt, even though the partnership must capitalize and amortize the expense.

Rev. Rul. 80-234

ISSUE

Is the full amount of a guaranteed payment under section 707(c) of the Internal Revenue Code includible in the gross income of a partner in the year of receipt, under the circumstances described below?

FACTS

A is a partner in partnership *X*. In 1979, pursuant to an agreement between *A* and *X*, *A* received 500*x* dollars as a "finder's fee" for obtaining acceptable applicants for loans. The finder's fee is a part of the acquisition cost of the loans that must be capitalized and amortized over the lives of the loans made to the applicants. See Rev. Rul. 57-400, 1957-2 C.B. 520. *A* included in gross income for 1979, an amount equal to that amount of the expense amortized by *X* in 1979. *X* reports its income on a calendar year basis.

LAW AND ANALYSIS

Section 707(c) of the Code provides that to the extent determined without regard to the income of the partnership, payments to a partner for services or the use of capital shall be considered as made to one who is not a member of the partnership, but only for the purposes of section 61(a) (relating to gross income) and, subject to section 263, for purposes of section 162(a) (relating to trade or business expenses).

Section 1.707-1(c) of the Income Tax Regulations provides that a partner must include such payments as ordinary income for the partner's taxable year within or with which ends the partnership taxable year in which the partnership deducted such payments as paid or accrued under its method of accounting. The partnership must capitalize the expenditure and is recovering the cost through amortization over the life of the asset. *A* is relying on section 1.707-1(c) of the regulations to include in gross income in 1979, only the amount equal to that being deducted by the partnership in 1979. This statement in section 1.707-1(c) relates to section 706(a) of the Code, which is a timing provision only. In this regard, the Tax Court of the United States in *Cagle v. Commissioner*, 539 F.2d 409, 414 N. 7 (5th Cir. 1976), *aff'g* 63 T.C. 86, 95 (1974) commented on the purposes underlying section 1.707-1(c):

> We think that all Congress meant was that guaranteed payments should be included in the recipient partner's income in the partnership taxable year ending with or within which the partner's taxable year ends and in which the tax accounting treatment of the transaction is determined at the partnership level.

See also S. Rept. No. 94-938 (Conf. Rep.), 94th Cong., 2d Sess. 93 (1976), 1976-3 C.B. 131.

This language merely reflects the application of the aggregate rather than the entity approach to the question of timing for inclusion of these amounts in the partner's gross income. The amount received as a finder's fee is includible in the partner's gross income under section 61 of the Code. Section 1.707-1(c) of the regulations does not permit a partner to defer inclusion of any portion of the payment received simply because the partnership that paid or accrued the expense must capitalize and amortize the expense.

HOLDING

The taxpayer *A* cannot apportion the amount received, but must include in gross income in 1979 the 500*x* dollars received in that year as a finder's fee.

Section 722.—Basis of Contributing Partner's Interest

26 CFR 1.722-1: Basis of contributing partner's interest.

Whether the liability created by a written obligation given as part of the purchase price for a partnership interest is included in the basis of the partnership interest. See Rev. Rul. 80-235, this page.

Section 1011.—Adjusted Basis for Determining Gain or Loss

26 CFR 1.1011-1: Adjusted basis.

Whether the liability created by a note given as the purchase price for a synthetic oil converter is included in the partnership's basis in the converter and the liability created by a written obligation given as part of the purchase price for a partnership interest is included in the basis of the partnership interest. See Rev. Rul. 80-235, below.

Section 1012.—Basis of Property—Cost

26 CFR 1.1012-1: Basis of property. (Also Sections 38, 46, 48, 722, 1011; 1.38-1, 1.46-3, 1.48-1, 1.722-1, 1.1011-1.)

Basis; synthetic oil converter purchased for nonrecourse note; partnership. The liability created by an interest-bearing nonrecourse note given by a limited partnership as the total purchase price for a synthetic oil converter and payable out of the partnership's net cash flow may not be included in the partnership's basis in the converter for purposes of investment tax credits. The liability created by a limited partner's written obligation given as part of the purchase price for a partnership interest and payable only from cash distributions from the production activities of the partnership may not be included in the basis of the limited partnership interest.

Rev. Rul. 80-235

ISSUES

(1) Is the liability created by the Purchase Note given as the purchase price for a synthetic oil converter included in the partnership's basis in the converter for purposes of the investment tax credits?

(2) Is the liability created by the 180*x* dollar written obligation given as part of the purchase price for a partnership interest included in the basis of the partnership interest?

FACTS

A, an individual, claimed to have developed a process for the conversion of coal into synthetic fuel. This process has not been commercially tested. In 1979, *P*, a newly organized limited partnership, entered into an agreement whereby *A* is to construct and install the synthetic oil converter for a total purchase price of 18,000*x* dollars. In payment for the converter, *P* issued *A* a ten-year interest-bearing nonrecourse note in the principal amount of 18,000*x* dollars ("Purchase Note"). Principal and interest at 10 percent are payable out of *P*'s net cash flow, beginning on September 1, 1980. If net cash flow is inadequate to meet the annual installment, payment is not due until there is sufficient cash flow, but no later than 1990. The Purchase Note is secured only by the synthetic oil converter.

P has 100 limited partners. Each limited partner acquired its partnership interest for a total purchase price of 200*x* dollars, paid with 20*x* dollars in cash and a 180*x* dollar written obligation to repay a pro rata portion of the principal of the Purchase Note in six equal annual installments, with interest, starting September 1, 1980. Principal and interest on the written obligations, however, will be paid by the limited partners only from cash distributions from *P* that result from the production activities.

LAW AND ANALYSIS

Section 1011(a) of the Internal Revenue Code provides that, in general, the adjusted basis for determining gain or loss from the sale or disposition of property, whenever acquired, will be the basis determined under setcion 1012, adjusted as provided in section 1016.

Section 1012 of the Code provides that, in general, the basis of property will be its cost.

Section 722 of the Code provides that the basis of an interest in a partnership acquired by a contribution of property, including money, to the partnership will be the amount of such money and the adjusted basis of such property to the contributing partner at the time of the contribution.

Section 38 of the Code allows a credit against federal income tax for qualified investment in "section 38 property" as defined in section 48(a)(1). Pursuant to section 48(l), for the period beginning on October 1, 1978 (and ending on December 31, 1982), any energy property, as defined in section 48(l)(2), will be treated as "section 38 property." The amount of the credit will be equal to the sum of the percentages, set forth in section 46(a)(2), of the qualified investment. Section 46(c) provides that the qualified investment is the aggregate of the applicable percentages, determined under section 46(c)(2), of the basis of each new section 38 property placed in service by the taxpayer during the taxable year.

Section 1.46-3(c)(1) of the Income Tax Regulations provides that the basis of any new section 38 property will be determined under the general rules for determining the basis of property and, therefore, the basis of property would generally be its cost.

An obligation, the payment of which is so speculative as to create a contingent liability, cannot be included in the basis of property. *Denver & Rio Grande Western R.R. Co. v. United States,* 505 F.2d 1266 (Ct. Cl. 1974); *Columbus and Greenville Railway Co. v. Commissioner,* 42 T.C. 834 (1964), *aff'd per curiam,* 358 F.2d 294 (5th Cir. 1966); *Albany Car Wheel Co. v. Commissioner,* 40 T.C. 831 (1963), *aff'd per curiam,* 333 F. 2d 653 (2d Cir. 1964); Rev. Rul. 77-110, 1977-1 C.B. 58; and Rev. Rul. 78-29, 1978-1 C.B. 62. The Court of Appeals for the Third Circuit, in *Pierce Estates v. Commissioner,* 195 F.2d 475 (3d Cir. 1952), indicated that a liability is contingent of it is dependent upon the happening of a subsequent event, such as the earning of profits.

There must be adequate net cash flow before *P* has to make a payment of principal of the Purchase Note. Considering the nature of this new business and the fact that *A*'s process is commercially untested, among other factors, no realistic predictions can be made about the success of the converter and therefore the net cash flow of *P* for any year. Because payment under the Purchase Note is contingent upon future cash flow the Purchase Note is a contingent liability.

A limited partner's written obligation to repay a portion of the principal of the Purchase Note also is a contingent liability because it is nothing more than a mere promise to repay a contingent liability and its payment is contingent upon the receipt of cash distributions from *P*. Furthermore, the contribution of a partner's written obligation, its personal note, to the partnership does not increase the basis of the partner's interest under section 722 of the Code because the partner has a zero basis in the written obligation. Payments on the written obligation are added to the partner's basis in the partnership as the payments are actually made.

HOLDINGS

(1) The liability created by the Purchase Note may not be included in *P*'s basis in the synthetic oil converter for purposes of regular and energy investment credits.

(2) The liability created by the written obligation of a limited partner may not be included in the basis of the limited partnership interest.

Section 1374.—Corporation Net Operating Loss Allowed to Shareholders

26 CFR 1.1374-1: Net operating losses involving electing small business corporations.

Small business corporation; net operating loss; research and development agreement. Shareholders contributed cash to a small business corporation in exchange for stock, which was used as security to borrow, through nonrecourse notes, most of the cash contributed. The lender simultaneously sold the notes at face value to a research and development company that was hired by the small business corporation. For purposes of determining the limitation on a shareholder's net operating loss under section 1374(c) of the Code, the cash proceeds of a nonrecourse loan are not part of the basis of the stock received in exchange for such cash, because the various related steps of the financing arrangement are collapsed to show that no cash was actually advanced under the nonrecourse note.

Rev. Rul. 80-236

ISSUE

Are the proceeds received from the financing agreement described below to be included in the basis of stock of a shareholder of an electing small business corporation for purposes of computing a net operating loss allowed under section 1374(c)(2) of the Internal Revenue Code?

FACTS

In 1977, ten individuals formed *X*, a small business corporation, which elected under 1372(c) of the Code not to be subject to the tax imposed by Chapter 1 of the Code. In exchange for stock of *X*, each individual contributed $5,000 cash and $25,000 obtained by means of a financing agreement with *Y*, a commercial lending institution. The financing was evidenced by a nonrecourse note that was secured in part by each individual's stock in *X*.

In conjunction with and as an inducement and consideration for *Y*'s providing the $25,000 to each individual, *Z*, a corporation, agreed to purchase the nonrecourse notes from *Y* at a price equal to the unpaid balance of the notes plus accrued interest. As security for *Z*'s obligation to purchase the notes from *Y*, *Z* delivered and assigned to *Y* a cerificate of deposit issued by *Y* to *Z* in the total amount of $250,000. Simultaneously with *Y*'s providing the $25,000 to each individual and *Z*'s agreement to purchase the nonrecourse notes from *Y*, *X* entered into a contract to have *Z* perform research and development on *X*'s behalf. The contract price for the research and development, all payable at the execution of the contract, was $300,000. *X* reported no income in 1977 and reported a net operating loss of $300,000.

LAW AND ANALYSIS

Section 1374(a) of the Code provides that a net operating loss of an electing small business corporation for any taxable year shall be allowed as a deduction from gross income of the shareholders.

Section 1374(c) of the Code provides, as a limitation, that a shareholder's portion of the net operating loss of an electing small business corporation for any taxable year shall not exceed the sum of—

(a) the adjusted basis of the shareholder's stock in the electing small business corporation, determined as of the close of the taxable year of the corporation, and

(b) the adjusted basis of any indebtedness of the corporation to the shareholder, determined as of the close of the taxable year of the corporation.

Section 174(a) of the Code provides that a taxpayer may treat research or experimental expenditures that are paid or incurred by him during the taxable year in connection with his trade or business as a deductible expense.

The substance, rather than the form, of a transaction in which a taxpayer is involved governs the tax consequences of the transaction. See, for example, *Commissioner v. Court Holding Company,* 324 U.S. 331 (1945), 1945 C.B. 58; *Helvering v. Clifford,* 309 U.S. 331 (1940), 1940-1 C.B. 105; *Gregory v. Helvering,* 293 U.S. 465, XIV-1 C.B. 193 (1935).

In this case, the financing agreement, the research and development contract, and *Z*'s agreement inducing *Y* to provide the financing were all executed and entered into at the same time as part of one transaction. The arrangement cannot reasonably be said to have purpose, substance, or utility apart from its anticipated tax consequences. *See Kapel Goldstein v. Commissioner,* 364 F.2d 734 (2nd Cir. 1966), *aff'g* 44 T.C. 284 (1965), *cert. denied,* 385 U.S. 1005 (1967) and *Knetsch v. United States,* 348 F.2d 932 (Ct. Cl. 1965). In form, *Y* purported to provide financing to the individuals, but as a result of the interdependent simultaneous agreements the funds remained with *Y* as security for *Z*'s obligation to purchase the notes from *Y*. In substance there was no commercial reality to the financing agreement because no one had beneficial use of the financing proceeds, and therefore the maximum amount of research and development expenditures that *X* could have actually incurred is limited to $50,000.

HOLDING

The proceeds from the financing agreement are not included in the basis of stock of a shareholder of an electing small business corporation for purposes of computing the net operating loss allowed under section 1374(c)(2) of the Code.

For taxable years beginning after December 31, 1978, the provisions of section 465 also would apply to the arrangement to deny all deductions to the extent of the amount of the nonrecourse note.

Further, the holdings do not preclude the imposition of penalties under any provision of the Code.

Section 4061.—Imposition of Tax

26 CFR 48.4061(a)-1: Imposition of tax; exclusion for light-duty trucks, etc.

Paint striping equipment. Sales, by the manufacturer, of certain paint striping equipment units that are mounted on tax-paid truck chassis are subject to the tax imposed by section 4061(a)(1) of the Code, but amounts charged for equipment that does not contribute to the highway transportation function are not part of the taxable sales price; Rev. Rul. 58-214, dealing with self-propelled line marking machines, is obsoleted.

Rev. Rul. 80-237

ISSUE

Whether sales, by the manufacturer, of certain paint striping equipment as described below that is installed on tax-paid truck chassis are subject to the manufacturers excise tax imposed by section 4061(a)(1) of the Internal Revenue Code.

FACTS

Unit (1). A paint striping unit that is mounted on a tax-paid truck chassis. The unit consists of a platform; paint tank and pump to fill it; bead tank to add glass beads into the wet paint immediately after it has been sprayed onto the highway; solvent tank to permit cleaning portions of the equipment, including the paint tank; piping for tanks and the pump; heating system to minimize the time it takes to dry paint on the highway; jacketed paint hoses; manifolds; gun carriages and spray guns; and an air compressor and power take-off that primarily operate equipment associated with spraying paint at the job-site.

In operation, paint is drawn from the tank through lines by an intervening hydraulic pump driven by the power take-off and some paint is returned to the tank through return lines to provide agitation. The paint not returned passes into the heating system to the paint hoses which lead to manifolds, and from there to the spray guns. The spray equipment is controlled by operators from a control panel mounted on the platform.

Additional equipment may include an intercom system to permit the operators to communicate with the driver during painting operations; flashing warning lights that stand above the platform and floodlights to permit night painting operations; a mechanical pointer; footage counter; dusting system; a cab console control for circuit breakers, switches and lights to control flashing lights and switches for the spraying system; intermittent line mechanism; control panel seats; flashing signboard; speed meter to provide audio-visual alarms to the driver in operations; and an optical pointer. This equipment is used only at the job site in connection with paint application operations.

Unit (*2*). A pressure-type paint striping unit that is mounted on a tax-paid truck chassis. The unit has the same basic equipment as *Unit* (*1*). This unit transfers paint from the tank to the heating apparatus by air pressure. Instead of return lines to provide agitation, that function is performed by air-operated motors and agitators located on top of the paint tanks. In addition, the power take-off primarily operates the paint fill pumps and the air compressor primarily powers the agitator and pressurizes the tanks.

LAW AND ANALYSIS

Under section 4061(a)(1) of the Code, a tax is imposed on sales of automobile truck bodies and chassis by the manufacturer. Section 4061(a)(2), as added by the Revenue Act of 1971, section 401(a), 1972-1 C.B. 443, 463, applicable to sales on and after December 11, 1971, excludes from the tax imposed by section 4061(a)(1), sales by the manufacturer of truck chassis and bodies suitable for use with a vehicle having a gross vehicle weight of 10,000 pounds or less.

Under sections 48.4061(a)-1(a)(2) and (e)(1) of the Manufacturers and Retailers Excise Tax Regulations, a truck body or chassis is taxable if it is, in any sense, reasonably suitable for use as a component part of a highway vehicle (as defined in section 48.4061(a)-1(d)(1)).

Section 48.4061(a)-1(d)(1) of the regulations provides that the term "highway vehicle" means any self-propelled vehicle, or any trailer or semitrailer, designed to perform a function of transporting a load over public highways, whether or not also designed to perform other functions.

Section 48.4061(a)-1(a)(3)(i) of the regulations includes as part of a taxable truck chassis or body equipment that is installed on a taxable chassis or body and that contributes to the highway transportation function of the chassis or body. This section of the regulations says that loading and unloading equipment is an example of equipment that contributes to the highway transportation function of a chassis or body.

Section 48.4061(a)-1(a)(3)(ii) of the regulations provides that amounts charged for equipment installed on a taxable chassis or body are not part of the taxable sale price if (A) such equipment does not contribute toward the highway transportation function of the chassis or body and (B) the reasonableness of the charge is supported by adequate records.

Rev. Rul. 58-214, 1958-1 C.B. 399, holds that a self-propelled line marking machine designed for use in painting guide lines on highways, streets, parking lots, airports, playgrounds, etc., is not a taxable motor vehicle. This machine consists primarily of an engine for driving a compressor and propelling the machine, a paint tank, spray guns, and controls. It has a steel platform on which a person may stand to steer the vehicle and operate the paint equipment, 4.00 x 8 pneumatic tires having an overall diameter of sixteen inches, a normal painting speed of three to six miles per hour, but does not have head lights or tail lights.

Rev. Rul. 74-47, 1974-1 C.B. 307, holds that power takeoff systems and components thereof that are designed to operate both taxable and nontaxable equipment are not taxable under section 4061(b) of the Code if primarily designed to operate nontaxable equipment. This test is equally appropriate under section 4061(a)(1) for power take-offs and air compressors.

Rev. Rul. 58-214 limits its conclusion to the line marking machine described in that ruling and thus is not applicable to *Units* (*1*) and (*2*) described above.

Moreover, although not expressly stated in Rev. Rul. 58-214, the line marking machine described therein has a gross vehicle weight of less than 10,000 pounds. Thus, effective for sales of the vehicle by the manufacturer on or after December 11, 1971, the vehicle comes within the scope of the exclusion provided by section 4061(a)(2) of the Code.

Units (*1*) and (*2*) described above are component parts of vehicles designed to transport a load over the public highway to a job site. The platform, paint tank and fill pump, bead tank, solvent tank, intervening pump, and the piping and lines used to unload the tanks contribute to the highway transportation of paint to the jobsite. Thus, these articles constitute a truck body of a highway vehicle.

The agitator equipment on *Unit* (*2*) and the power take-off and air compressor on that unit load and unload the unit and thereby are part of the body. The heating system, which is used on both units, is not required to preserve the paint or further liquefy it for unloading and, therefore, it is primarily designed to apply the paint rather than for transportation. Likewise, with respect to both units, the jacketed hoses, manifolds, gun carriages and spray guns, and the above-listed additional equipment are primarily designed for such purpose.

HOLDING

Sales by the manufacturer of *Units* (*1*) and (*2*) are subject to the tax imposed by section 4061(a)(1) of the Code. Amounts charged for the air compressor and power take-off on *Unit* (*2*) are part of the taxable sale price but amounts charged for such articles on *Unit* (*1*) are not part of the taxable sale price provided the reasonableness of the charges is supported by adequate records. In addition, amounts charged with respect to both Units for the heating system, jacketed hoses, manifold, gun carriages, spray guns, intercom system, flashing warning lights and floodlights, mechanical pointer, footage counter, dusting system, cab console control, intermittent line mechanism, control panel seats, flashing signboard, speed meter, and optical pointer are not part of the taxable sale price, provided the charges are properly supported.

EFFECT ON OTHER REVENUE RULING

Rev. Rul. 58-214 is obsolete.

Section 6420.—Gasoline Used on Farms

26 CFR 48.6420(a)-1: Payments to user and ultimate purchaser of gasoline used on a farm for farming purposes.
(Also Section 6427; 48.6427-1.)

T.D. 7709

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PARTS 48 AND 140.—MISCELLANEOUS EXCISE TAXES

Payments to be made to aerial applicators in certain cases

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations governing claims by aerial applicators for payment of an amount equal to the tax imposed on gasoline and special fuels used on farms for farming purposes. Changes to the applicable tax law were made by section 3 of the Act of October 14, 1978 (Public Law 95-458) [1978-2 C.B. 367, 368]. These regulations affect all aerial applicators and all owners, tenants, and operators of farms who employ the services of aerial applicators. The regulations provide the guidance needed to comply with the law.

EFFECTIVE DATE: The regulations apply to payments for gasoline and special fuels used after March 31, 1979, on farms for farming purposes by aerial applicators.

FOR FURTHER INFORMATION CONTACT: H. B. Hartley of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224, Attention: CC:LR:T, 202-566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On December 27, 1979 [44 FR 76563], the Federal Register published proposed amendments to the Miscellaneous Excise Tax Regulations (26 CFR Part 48), and temporary excise tax regulations under section 3 of the Act of October 14, 1978 (Public Law 95-458; 26 CFR Part 140), both relating to claims by aerial applicators for payment of an amount equal to the taxes imposed under sections 4081 and 4041 of the Internal Revenue Code of 1954 ("Code") on gasoline and special fuels used on farms for farming purposes. Sections 6420 and 6427 of the Code authorize the payments to the user and ultimate purchaser of these fuels. The law was amended by section 3 of the Act of October 14, 1978 (Pub. L. 95-458, 92 Stat. 1257) to permit aerial applicators to receive payments as users and ultimate purchasers of fuels they use on farms for farming purposes.

No public comments were received in response to the invitation contained in the proposed amendments to the regulations, and no public hearing on the proposal was held. This document revokes the temporary regulations (26 CFR Part 140) and adopts final regulations (26 CFR Part 48).

PROVISIONS OF THE REGULATIONS

Sections 6420 and 6427 provide, respectively, for payment to the user and ultimate purchaser of an amount equal to the tax imposed under section 4081 on gasoline and under section 4041 on special fuels, if the gasoline or special fuel is used on a farm for farming purposes. For fuel used before April 1, 1979, only the owner, tenant, or operator of a farm is entitled to claim a payment as user and ultimate purchaser. Section 3 of the Act of October 14, 1978, amended sections 6420 and 6427 to entitle aerial applicators to receive these payments for fuels used by them after March 31, 1979. Before an aerial applicator may receive a payment, however, the owner, tenant, or operator of the farm served by the aerial applicator must waive his or her right to receive the payment in a written statement retained by the aerial applicator. The statement waiving the right of the owner, tenant, or operator to be treated as the user and ultimate purchaser of the gasoline or special fuels may be in any form that substantially meets the requirements of the regulations.

ADDITIONAL CONSIDERATIONS

These regulations are needed in order to provide guidance to the public as well as to government employees responsible for implementation of sections 6420 and 6427 of the Code. Considering both the direct and indirect effects of these regulations, it is believed that they satisfactorily implement section 3 of the Act of October 14, 1978 (Public Law 95-458). Evaluation of the effectiveness of the regulations after issuance will be based upon comments received from offices within the Internal Revenue Service and the Treasury Department, and from members of the public.

DRAFTING INFORMATION

The principal author of these regulations is H. B. Hartley of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

The following amendments to the regulations (26 CFR Part 48) are hereby adopted:

PART 48—MANUFACTURERS AND RETAILERS EXCISE TAXES

Paragraph 1. Section 48.6420(a)-1 is retitled and paragraphs (a)(1) and

(b) thereof are amended to read as follows:

§ 48.6420(a)-1. Payments to user and ultimate purchaser of gasoline used on a farm for farming purposes.

(a) *In general.* (1) Section 6420 provides a payment (without interest) to the user and ultimate purchaser of gasoline used on a farm for farming purposes. The amount of the payment is determined by multiplying (i) the number of gallons of gasoline used on the farm for farming purposes by (ii) the rate of tax on gasoline under section 4081 which applied on the date the gasoline was purchased by the user and ultimate purchaser. No payment shall be made for gasoline purchased by a user and ultimate purchaser before January 1, 1956, irrespective of the use of gasoline. For gasoline purchased after December 31, 1955, and used on a farm for farming purposes, payment is made only if the user and ultimate purchaser files a claim at the time and in the manner indicated in these regulations. For rates of tax on gasoline under section 4081, see that section and § 48.4081-1. For the meaning of the terms "used on a farm for farming purposes", "farm", "farming purposes", and "gasoline", see § 48.6420(c)-1. For the meaning of "user and ultimate purchaser" see paragraph (b) of this section.

* * * * *

(b) *User and ultimate purchaser defined.* Except as otherwise provided in section 6420, the term "user and ultimate purchaser" means only an owner, tenant, or operator of a farm. In general, an owner, tenant, or operator of a farm is considered to be the user and ultimate purchaser of gasoline only if the gasoline is (1) purchased by him or her and (2) used for farming purposes on a farm of which he or she is the owner, tenant, or operator. If, however, the cost of gasoline supplied by a particular person (e.g., an owner of a farm) is by agreement borne by the tenant or operator of the farm, the tenant or operator who bore the cost of the gasoline is the user and ultimate purchaser. See paragraph (c) of this section for rules on gasoline used on farms by persons other than the owner, tenant, or operator of the farm.

* * * * *

Par. 2. The second sentence of § 48.6420(a)-1(c)(1) is amended, a new third sentence is inserted therein, and a new example (3) is added to the end of § 48.6420(a)-1(c)(2), all to read as follows:

§ 48.6420(a)-1. Payments to user and ultimate purchaser of gasoline used on a farm for farming purposes.

* * * * *

(c) *Exception with respect to use by custom operator, etc.*—(1) * * * In such a case, the owner, tenant, or operator of the farm on which the gasoline is used is considered to be the user and ultimate purchaser of the gasoline. See, however, section 6420(c)(4) which provides for waivers by owners, tenants, and operators of their right to be so treated when gasoline is used on the farm by an aerial applicator. * * *

(2) The application of paragraph (c)(1) of this section may be illustrated by the following examples.

* * * * *

Example (3). Assume the facts of example (2) except Farmer A executes a timely waiver (as provided in § 48.6420(c)-2) of his right to be treated as user and ultimate purchaser of the fuel used by XYZ Company in dusting his crops. XYZ Company is entitled to receive the payment for the 600 gallons of gasoline actually used by it in the crop dusting operation.

Par. 3. Paragraphs (d) and (e) of § 48.6420(b)-1 are deleted and paragraphs (a), (b), and (c) of that section are amended to read as follows:

(a) *In general.* A claim in respect of gasoline used on a farm for farming purposes must cover one full taxable year. A person's taxable year means his or her taxable year for purposes of subtitle A of the Internal Revenue Code. In the case of persons included under section 6420(g), the calendar year is considered to be the person's taxable year. Gasoline on hand at the end of one taxable year (e.g., fuel in supply tanks of farm machinery or in storage tanks and drums) must be excluded from a claim filed for that year. On the other hand, gasoline used during a taxable year may be covered by a claim for the year even though the gasoline has not been paid for at the time the claim is filed. A claim for any taxable year is not allowable unless filed on or before the last date prescribed by law for filing a claim for credit or refund of overpayment of income tax for the taxable year concerned.

(b) *Limit of one claim during any one taxable year.* Not more than one claim can be filed under section 6420 by any person for gasoline used during any one taxable year.

(c) *Form and content of claim.* All persons except those identified in section 6420(g), must claim any payment allowed them under section 6420 as a credit against tax on their income tax return (or a timely amended return) for the taxable year in which the gasoline was used. For persons identified in section 6420(g), a claim for payment for gasoline used on a farm for farming purposes is made on Form 843 in accordance with the instructions prescribed for the preparation of that form. A claim for a partnership must be shown on the partnership's return.

Par. 4. Paragraph (c)(2)(i) of § 48.6420(c)-1 is amended by deleting the last sentence thereof, and paragraph (c)(5) of that section is amended by deleting the first four words of the third sentence and inserting in lieu thereof, "Since the gasoline must generally".

Par. 5. A new § 48.6420(c)-2 is inserted immediately following § 48.6420(c)-1 to read as follows:

§ 48.6420(c)-2. Payment under section 6420 to be made to aerial applicators in certain cases.

(a) *Effective date.* This regulation is effective for payments for gasoline used after March 31, 1979, by aerial applicators on farms for farming purposes.

(b) *General rule.* Section 6420 provides a payment to the user and ultimate purchaser of gasoline used on a farm for farming purposes of an amount equal to the tax imposed on gasoline under section 4081. The general rule of section 6420(c)(3)(A) is that only the owner, tenant, or operator of a farm is entitled to be treated as a user and ultimate purchaser. Section 6420(c)(4) provides that under section 6420(c)(3)(A), an aerial applicator is entitled to be treated as the user and ultimate purchaser of gasoline used by it on a farm for farming purposes, but only if the owner, tenant, or operator who is otherwise entitled to treatment as the user and ultimate purchaser waives his or her right to the payment.

(c) *Form and manner of waiver.* To waive the right to be treated as user and ultimate purchaser of gasoline which is used on a farm by an aerial applicator, the owner, tenant, or operator of a farm who is otherwise entitled to treatment as user and ultimate purchaser must execute an irrevocable written agreement no later than the date on which the aerial applicator claiming the credit files its return for the taxable year in which the gasoline is used. The agreement must identify the period during which the owner, tenant, or operator waives his or her right to payment. The effective period of the waiver cannot extend beyond the last day of the taxable year of the owner, tenant, or operator of the farm on which the gasoline was used. If the owner, tenant, or operator's taxable year extends beyond the taxable year of the applicator, the applicator can only claim payment for periods included in the applicator's taxable year. Periods after the last day of the applicator's taxable year which are included under the agreement must be claimed on the applicator's return for the next succeeding taxable year. The waiver may be in the form shown under paragraph (g) of this section or in any other form that meets the requirements of these regulations, but must clearly evidence that the owner, tenant, or operator of the farm knowingly gives up the right to receive a payment.

(d) *Agreement included on aerial applicator's invoice.* The agreement waiving a right to receive a payment under section 6420 may be a separate document or may appear on the face or the reverse side of an invoice for aerial application services or other unrelated document from the aerial applicator to the owner, tenant, or operator of the farm. If the waiver agreement appears on an invoice or other unrelated document, however, it must be printed in a section of the invoice or other document clearly set off from all other material contained in the invoice or other document, and it must be printed in type sufficiently large to put the owner, tenant, or operator of the farm on notice that he or she has waived his or her right to receive a payment under section 6420. Additionally, if the waiver agreement appears as part of any invoice or other unrelated document, it must be executed separately from any other item included in the invoice or other document which requires the owner, tenant, or operator's signature.

(e) *Copies of agreement waiving right to payment.* No copies of any agreement waiving a right to payments under section 6420 are to be submitted to the Internal Revenue Service unless a request is made by the Service to the taxpayer for the waivers. Aerial applicators must, however, retain copies of all waivers, and a copy of each waiver must be supplied by the aerial applicator to the owner, tenant, or operator of the farm who waives his or her right to receive a payment. See regulations § 48.6420(f)-1 for general requirements for records to be kept.

(f) *Waiver on behalf of owner, tenant, or operator of farm.* If any owner, tenant, or operator of a farm desires that an agent (e.g., a cooperative) act for him or her or cannot legally bind himself or herself due to infancy or other incompetency, a representative expressly authorized under local law to bind the owner, tenant, or operator in a waiver of his or her rights to payment under section 6420 may sign the waiver on his or her behalf.

(g) *Sample form of agreement.* While no specific form is required for an effective waiver, an acceptable form waiving the right to receive a payment under section 6420 follows:

I hereby waive my right as owner/tenant/operator of a farm located at (address) ______________________ to receive payment or credit from the United States for gasoline used by (aerial applicator) ______________ on the farm in connection with cultivating the soil, or the raising or harvesting of any agricultural or horticultural commodity. This waiver applies to gasoline used during the period ______________________, both dates inclusive.

I understand that by signing this waiver I give up my right to claim any credit or payment for gasoline used by the aerial applicator during the period indicated, and I acknowledge that I have not previously claimed any credit or payment for that gasoline.

____

(Signature of Owner/Tenant/ Operator)

Taxpayer Identification No: ________

Par. 6. A new § 48.6427-1 is inserted following § 48.6421(g)-1 to read as follows:

§ 48.6427-1 Payment under section 6427 to be made to aerial applicators in certain cases.

(a) *Effective date.* This regulation is effective for payments for special fuels used after March 31, 1979, by aerial applicators on farms for farming purposes.

(b) *In general.* Section 6427 provides for payment to the user and ultimate purchaser of certain fuels used on a farm for farming purposes of an amount equal to the amount of tax imposed on these fuels under section 4041. The general rule is that only an owner, tenant, or operator of a farm is entitled to be treated as a user and ultimate purchaser. Section 6427(c) provides that an aerial applicator is entitled to be treated as the user and ultimate purchaser of fuels which it uses on a farm for farming purposes, but only if the owner, tenant, or operator who is otherwise entitled to treatment as the user and ultimate purchaser waives his or her right to the payment.

(c) *Form and manner of waiver.* To waive the right to be treated as user and ultimate purchaser of special fuels which are used on a farm by an aerial applicator, the owner, tenant, or operator of a farm who is otherwise entitled to treatment as user and ultimate purchaser must execute an irrevocable written agreement no later than the date on which the aerial applicator claiming the credit files its return for the taxable year in which the special fuels are used. The agreement must identify the period during which the owner, tenant, or operator waives his or her right to payment. The effective period of the waiver cannot extend beyond the last day of the taxable year of the owner, tenant, or operator of the farm on which the special fuels were used. If the owner, tenant, or operator's taxable year extends beyond the taxable year of the applicator, the applicator can only claim payment for periods included in the applicator's taxable year. Periods after the last day of the applicator's taxable year which are included under the agreement must be claimed on the applicator's return for the next succeeding taxable year. The waiver may be in the form shown under paragraph (g) of this section or in any other form that meets the requirements of these regulations, but must clearly evidence that the owner, tenant, or operator of the farm knowingly gives up the right to receive a payment.

(d) *Agreement included on aerial applicator's invoice.* The agreement waiving a right to receive a payment under section 6427 may be a separate document or may appear on the face or the reverse side of an invoice for aerial application services or other unrelated document from the aerial applicator to the owner, tenant, or operator of the farm. If the waiver agreement appears on an invoice or other unrelated document, however, it must be printed in a section of the invoice or other document clearly set off from all other material contained in the invoice or other document, and it must be printed in type sufficiently large to put the owner, tenant, or operator of the farm on notice that he or she has waived his or her right to receive a payment under section 6427. Additionally, if the waiver agreement appears as part of any invoice or other unrelated document, it must be executed separately from any other item included in the invoice or other document which requires the owner, tenant, or operator's signature.

(e) *Copies of agreement waiving right to payment.* No copies of any agreement waiving a right to payments under section 6427 are to be submitted to the Internal Revenue Service unless a request is made by the Service to the taxpayer for the waivers. Aerial applicators must, however, retain copies of all waivers, and a copy of each waiver must be supplied by the aerial applicator to the owner, tenant, or operator of the farm who waives his or her right to receive a payment. See regulations § 48.6420(f)-1 for general requirements for records to be kept.

(f) *Waiver on behalf of owner, tenant, or operator of farm.* If any owner, tenant, or operator of a farm desires that an agent (*e.g.*, a cooperative) act for him or her or cannot legally bind himself or herself due to infancy or other incompetency, a representative expressly authorized under local law to bind the owner, tenant, or operator in a waiver of his or her rights to a payment under section 6427 may sign the waiver on his or her behalf.

(g) *Sample form of agreement.* While no specific form is required for an effective waiver, an acceptable form waiving the right to receive a payment under section 6427 follows:

I hereby waive my right as owner/tenant/operator of a farm located at (address) ____________________ to receive payment or credit from the United States for special fuels used by (aerial applicator) ________________ on the farm in connection with cultivating the soil, or the raising or harvesting of any agricultural or horticultural commodity. This waiver applies to special fuels used during the period ______________________, both dates inclusive.

I understand that by signing this waiver I give up my right to claim any credit or payment for special fuels used by the aerial applicator during the period indicated, and I acknowledge that I have not previously claimed any credit or payment for that special fuel.

____

(Signature of Owner/Tenant/
Operator)

Taxpayer Identification No: ________

TEMPORARY EXCISE TAX REGULATIONS UNDER SECTION 3 OF THE ACT OF OCTOBER 14, 1978 (PUBLIC LAW 95-458)

Par. 7. 26 CFR Part 140 is revoked.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805) and in section 3 of the Act of October 14, 1978 (Pub. L. 95-458, 92 Stat. 1257).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved July 9, 1980

Donald S. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on July 24, 1980, 8:45 a.m., and published in the issue of the Federal Register for July 25, 1980, 45 F.R. 49544)

Section 6427.—Fuels Not Used for Taxable Purposes

26 CFR 48.6427-1: Payments under section 6427 to be made to aerial applicators in certain cases.

Final regulations relating to claims by aerial applicators for payments equal to the tax on gasoline and certain other fuels that are used on farms for farming purposes. See T.D. 7709, page 11.

Section 7216.—Disclosure or Use of Information by Preparers of Returns

26 CFR 301.7216-2: Disclosure or use without formal consent of the taxpayer.

T.D. 7708

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAP-

TER F.—PART 301.—PROCEDURE AND ADMINISTRATION

Disclosure or use of information by preparers of tax returns

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations under section 7216 of the Internal Revenue Code of 1954, relating to disclosure of tax return information by tax return preparers. The regulations affect tax return preparers and provide them with the guidance needed to comply with the law.

DATES: The amendments are effective as of January 1, 1972.

FOR FURTHER INFORMATION CONTACT: Jacob Feldman of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T, 202-566-3289, not a toll-free call).

SUPPLEMENTARY INFORMATION

BACKGROUND

On February 21, 1980, the Federal Register published proposed amendments to the Regulations on Procedure and Administration (26 CFR Part 301) under section 7216 of the Code. No comments were received with respect to the proposed amendments, and no public hearing was requested or held. The proposed amendments are adopted by this Treasury decision without change.

EXPLANATION

Section 7216(a) provides that a tax return preparer who discloses or uses any tax return information other than for the specific purpose of preparing, or assisting in the preparation of, any tax return of the taxpayer by or for whom the information was made available to the tax return preparer, is guilty of a misdemeanor. Section 7216(b) provides exceptions to the general rule of section 7216(a).

The amendment made to § 301.7216-2(c) of the regulations exempts from the provision of section 7216(a) and § 301.7216-1 the disclosure of income tax information made pursuant to an administrative order, demand, summons, or subpoena issued in the performance of its duties by any State agency, body, or commission charged under the laws of a State or political subdivision of the State with licensing, registration or regulation of tax return preparers. The order, demand, summons, or subpoena must clearly identify the information to be disclosed. Paragraph (c) is also amended to include all Federal agency orders and not simply the orders of a Federal regulatory agency. In addition, § 301.7216-2(n) is amended to permit disclosure to local officials of tax return information relating to the commission of a crime.

DRAFTING INFORMATION

The principal author of these regulations is Jacob Feldman of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to 26 CFR Part 301 are hereby adopted:

§ 301.7216-2 Disclosure or use without formal consent of the taxpayer.

* * * * *

(c) *Disclosure pursuant to an order of a court or of a Federal or State agency.* The provisions of section 7216(a) and § 301.7216-1 do not apply to any disclosure of tax return information if such disclosure is made pursuant to any one of the following documents:

(1) The order of any court of record, Federal, State, or local, or

(2) An administrative order, demand, summons, or subpoena which is issued in the performance of its duties by—

(i) Any Federal agency, or

(ii) A State agency, body, or commision charged under the laws of the State or a political subdivision of the State with the licensing, registration, or regulation of tax return preparers.

Information must be clearly identified in the document in order to be disclosed under this paragraph (c).

* * * * *

(n) *Disclosure to report the commission of a crime.* The provisions of section 7216(a) and § 301.7216-1 do not apply to the disclosure of any tax return information to the proper Federal, State or local official in order, and to the extent necessary, to inform the official of activities which may constitute, or may have constituted, a violation of any criminal law. In addition, such a disclosure made in the bona fide but mistaken belief that the activities constituted a violation of criminal law is not subject to section 7216(a) and § 301.7216-1.

(This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

Jerome Kurtz,
Commissioner of Internal Revenue.

Approved July 15, 1980.

Emil M. Sunley,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on July 24, 1980, 8:45 a.m., and published in the issue of the Federal Register for July 25, 1980, 45 F.R. 49547)

Subpart B.—Legislation and Related Committee Reports

Public Law 96-283
96th Congress, H.R. 2759 [1]
June 28, 1980

An Act to establish an interim procedure for the orderly development of hard mineral resources in the deep seabed, pending adoption of an international regime relating thereto, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Deep Seabed Hard Mineral Resources Act".

* * * * *

SEC. 4. DEFINITIONS.

For purposes of this Act, the term—

(1) "commercial recovery" means—

(A) any activity engaged in at sea to recover any hard mineral resource at a substantial rate for the primary purpose of marketing or commercially using such resource to earn a net profit, whether or not such net profit is actually earned;

(B) if such recovered hard mineral resource will be processed at sea, such processing; and

(C) if the waste of such activity to recover any hard mineral resource, or of such processing at sea, will be disposed of at sea, such disposal;

* * * * *

(9) "permittee" means the holder of a permit issued under title I of this Act to engage in commercial recovery;

(10) "person" means any United States citizen, any individual, and any corporation, partnership, joint venture, association, or other entity organized or existing under the laws of any nation;

* * * * *

(13) "United States" means the several States, the District of Columbia, the Commonwealth of Puerto Rico, American Samoa, the United States, Virgin Islands, Guam, and any other Commonwealth, territory, or possession of the United States; and

* * * * *

TITLE IV—TAX

SEC. 401. SHORT TITLE.

This title may be cited as the "Deep Seabed Hard Mineral Removal Tax Act of 1979".

SEC. 402. IMPOSITION OF TAX ON REMOVAL OF HARD MINERAL RESOURCES FROM DEEP SEABED.

(a) GENERAL RULE.—Chapter 36 of the Internal Revenue Code of 1954 (relating to certain other excise taxes) is amended by adding at the end thereof the following new subchapter.

"Subchapter F—Tax on Removal of Hard Mineral Resources From Deep Seabed

"SEC. 4495. Imposition of tax.
"SEC. 4496. Definitions.
"SEC. 4497. Imputed value.
"SEC. 4498. Termination.

"SEC. 4495. IMPOSITION OF TAX.

"(a) GENERAL RULE.—There is hereby imposed a tax on any removal of a hard mineral resource from the deep seabed pursuant to a deep seabed permit.

"(b) AMOUNT OF TAX. — The amount of the tax imposed by subsection (a) on any removal shall be 3.75 percent of the imputed value of the resource so removed.

"(c) LIABILITY FOR TAX.—The tax imposed by subsection (a) shall be paid by the person to whom the deep seabed permit is issued.

"(d) TIME FOR PAYING TAX.—The time for paying the tax imposed by subsection (a) shall be the time prescribed by the Secretary by regulations. The time so prescribed with respect to any removal shall be not earlier than the earlier of—

"(1) the commercial use of, or the sale or disposition of, any portion of the resource so removed, or

"(2) the day which is 12 months after the date of the removal of the resource.

"SEC. 4496. DEFINITIONS.

"(a) DEEP SEABED PERMIT.—For purposes of this subchapter, the term 'deep seabed permit' means a permit issued under title I of the Deep Seabed Hard Minerals Resources Act.

"(b) HARD MINERAL RESOURCE.—For purposes of this subchapter, the term 'hard mineral resource' means any deposit or accretion on, or just below, the surface of the deep seabed of nodules which contain one or more minerals, at least one of which is manganese, nickel, cobalt, or copper.

"(c) DEEP SEABED.—For purposes of this subchapter, the term 'deep seabed' means the seabed, and the subsoil thereof to a depth of 10 meters, lying seaward of, and outside—

"(1) the Continental Shelf of any nation; and

"(2) any area of national resource jurisdiction of any foreign nation, if such area extends beyond the Continental Shelf of such nation and such jurisdiction is recognized by the United States.

"(d) CONTINENTAL SHELF.—For purposes of this subchapter, the term 'Continental Shelf' means—

"(1) the seabed and subsoil of the submarine areas adjacent to the coast but outside the area of the territorial sea, to a depth of 200 meters or, beyond that limit, to where the depth of the superjacent waters admits of the exploitation of the natural resources of such areas; and

"(2) the seabed and subsoil of similar submarine areas adjacent to the coasts of islands.

"SEC. 4497. IMPUTED VALUE.

"(a) IN GENERAL.—For purposes of this subchapter, the term 'imputed value' means, with respect to any hard mineral resource, 20 percent of the fair market value of the commercially recoverable metals and minerals contained in such resource. Such fair market value shall be determined—

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[1] This publication of the law, House Report No. 96-411, Part 3, page 17, and Senate Report No. 96-307, page 20, are restricted to excerpts involving tax matters. Senate Report Nos. 96-357 and 96-360, and House Report No. 96-411, Parts I, 2, and IV are not published.

"(1) as of the date of the removal of the hard mineral resource from the deep seabed; and

"(2) as if the metals and minerals contained in such resource were separated from such resource and were in the most basic form for which there is a readily ascertainable market price.

"(b) COMMERCIAL RECOVERABILITY.—

"(1) MANGANESE, NICKEL, COBALT, AND COPPER.—For purposes of subsection (a), manganese, nickel, cobalt, and copper shall be treated as commercially recoverable.

"(2) MINIMUM QUANTITIES AND PERCENTAGES.—The Secretary may by regulations prescribe for each metal or mineral quantities or percentages below which the metal or mineral shall be treated as not commercially recoverable.

"(c) SUSPENSION OF TAX WITH RESPECT TO CERTAIN METALS AND MINERALS HELD FOR LATER PROCESSING.—

"(1) ELECTION.—The permittee may, in such manner and at such time as may be prescribed by regulations, elect to have the application of the tax suspended with respect to one or more commercially recoverable metals or minerals in the resource which the permittee does not intend to process within one year of the date of extraction. Any metal or mineral affected by such election shall not be taken into account in determining the imputed value of the resource at the time of its removal from the deep seabed. Any suspension under this paragraph with respect to a metal or mineral shall be permanent unless there is a redetermination affecting such metal or mineral under paragraph (2).

"(2) LATER COMPUTATION OF TAX —If the permittee processes any metal or mineral affected by the election under paragraph (1), or if he sells any portion of the resource containing such a metal or mineral, then the amount of the tax under section 4495 shall be redetermined as if there had been no suspension under paragraph (1) with respect to such metal or mineral. In any such case there shall be added to the increase in tax determined under the preceding sentence an amount equal to the interest (at rates determined under section 6621) on such increase for the period from the date prescribed for paying the tax on the resources (determined under section 4495(d)) to the date of the processing or sale.

"(d) DETERMINATIONS OF VALUE. —All determinations of value necessary for the application of this subchapter shall be made by the Secretary (after consultation with other appropriate Federal officials) on the basis of the best available information. Such determinations shall be made under procedures established by the Secretary by regulations.

"SEC. 4498. TERMINATION.

"(a) GENERAL RULE.—The tax imposed by section 4495 shall not apply to any removal from the deep seabed after the earlier of—

"(1) the date on which an international deep seabed treaty takes effect with respect to the United States, or

"(2) the date 10 years after the date of the enactment of this subchapter.

"(b) INTERNATIONAL DEEP SEABED TREATY.—For purposes of subsection (a), the term 'international deep seabed treaty means any treaty which—

"(1) is adopted by a United Nations Conference on the Law of the Sea, and

"(2) requires contributions to an international fund for the sharing of revenues from deep seabed mining".

(b) CLERICAL AMENDMENT.—The table of subchapters for chapter 36 of such Code is amended by adding at the end thereof the following new item:

"SUBCHAPTER F. Tax on removal of hard mineral resources from deep seabed."

(c) EFFECTIVE DATE.—The amendments made by this section shall take effect on January 1, 1980.

* * * * *

SEC. 404. ACT NOT TO AFFECT TAX OR CUSTOMS OR TARIFF TREATMENT OF DEEP SEABED MINING.

Except as otherwise provided in section 402, nothing in this Act shall affect the application of the Internal Revenue Code of 1954. Nothing in this Act shall affect the application of the customs or tariff laws of the United States.

Approved June 28, 1980.

House of Representatives

Report No. 96-411, Part 3
1st Session

[Bracketed numerals indicate official report page numbers]

DEEP SEABED HARD MINERAL RESOURCES ACT

NOVEMBER 2, 1979

Mr. ULLMAN, from the Committee on Ways and Means, submitted the following report to accompany H.R. 2759[1] which on March 8, 1979, was jointly referred to the Committee on Foreign Affairs, the Committee on Interior and Insular Affairs, the Committee on Merchant Marine and Fisheries, and the Committee on Ways and Means.

The Committee on Ways and Means, to whom was referred the bill (H.R. 2759) to promote the orderly development of hard mineral resources in the deep seabed, pending adoption of an international regime relating thereto, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

The amendment (stated in terms of page and line numbers of the introduced bill) is as follows:

Page 44, line 18, strike out "1978" and insert in lieu thereof "1979".

I. SUMMARY

Under title IV of the bill, an excise tax is imposed on the removal from the deep seabed of nodules containing manganese, nickel, cobalt or copper. The tax rate is 3.75 percent of the "imputed value" of the nodules removed. The imputed value is defined as 20 percent of the fair market value of the commercially recoverable metals or minerals contained in the nodule; thus the tax, in effect, is 0.75 percent of the fair market value of the commercially recoverable metals and minerals in the nodules. The tax will take effect on January 1, 1980, and will terminate when an international deep seabed treaty meeting specified requirements comes into force with respect to the United States, or after 10 years from the date of enactment of the Act, whichever is earlier.

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[1] Public Law 96-283, page 16.

The proceeds of the tax are to be paid into a Deep Seabed Revenue Sharing Trust Fund established by title IV. The amounts in the Trust Fund will be available for appropriation by Congress to make contributions under the international deep seabed treaty. If there is no [2] treaty after 10 years, Congress will determine the disposition of the amounts in the Trust Fund.

H.R. 2759 was also referred to the Committees on Interior and Insular Affairs, Merchant Marine and Fisheries, and Foreign Relations.

II. GENERAL STATEMENT

Present law

At present, the deep seabed is not being mined on a commercial basis. The provisions of H.R. 2759 other than title IV are intended to establish a framework which would permit U.S. persons to undertake deep seabed mining in an orderly manner. Under present law, no Federal excise taxes are imposed on the removal of minerals from the deep seabed.

Reasons for change

Since 1967, discussions have been under way at the United Nations on the use of ocean space. In 1970, the United Nations General Assembly adopted in Resolution 2749 a declaration of principles which stated that "the seabed and ocean floor and the subsoil thereof beyond the limits of national jurisdiction, as well as the resources of the area, are the common heritage of mankind," and that "no state or person, natural or juridical, shall claim, exercise, or acquire rights with respect to the area or its resources incompatible with the international regime to be established and the principle of this Declaration." The United States supported this declaration of principles, while simultaneously maintaining that deep seabed mining constitutes a freedom of the high seas according to the principles of the 1958 Geneva Convention on the Deep Seas. Discussions on these and other matters led the General Assembly to agree to hold a third United Nations Conference on the Law of the Sea.

The Law of the Sea Conference, which was formally opened in 1973, has not yet been able to reach agreement with respect to the creation of a proposed international seabed authority which would govern the exploration for and the mining of minerals from the area of the deep seabed which is beyond the national jurisdiction of the United States or any foreign country. In response to the apparent lack of progress in these negotiations, H.R. 2759, the Deep Seabed Hard Minerals Resources Act, would establish an interim framework governing deep seabed mining until an international treaty enters into force with respect to the United States. The committee believes that the creation of the Revenue Sharing Trust Fund and the imposition of the excise tax on the removal of hard minerals from the deep seabed, as provided by title IV of the bill, demonstrate the United States' commitment to the principle that deep seabed resources are part of the common heritage of mankind.

Explanation of provisions

Excise tax

Under title IV of the bill, an excise tax is imposed on the removal of hard mineral resources from the deep seabed. The holder of a permit (referred to in this explanation as the "mining company") issued under the Act is to be liable for the payment of the tax. The mining company will be liable regardless of whether it removes nod- [3] ules itself from the deep seabed, or authorizes another to remove the nodules on its behalf. Similarly, the mining company is to be liable for the payment of the tax where it acquiesces in the removal of nodules from its permit area by another.

For purposes of the tax, the "deep seabed" is the seabed, including its subsoil to a depth of 10 meters, lying seaward of, and outside (1) the continental shelf of any foreign country, and (2) any foreign country's national resource jurisdiction which is recognized by the United States and which extends beyond the continental shelf of that nation. For this purpose, "continental shelf" means (1) the seabed and subsoil of the submarine areas adjacent to the coast, but outside the area of the territorial sea, to a depth of 200 meters or, beyond that limit, to where the depth of the superjacent waters admits of the exploitation of the natural resources of those areas, and (2) the seabed and subsoil of similar submarine areas adjacent to the coasts of islands. A "hard mineral resource," the removal of which is subject to the tax, is any deposit or accretion on, or just below, the surface of the deep seabed of nodules which contain manganese, nickel, cobalt, or copper. These definitions are the same as those applicable under the other titles of H.R. 2759.

The excise tax is imposed at the rate of 3.75 percent of the "imputed value" of the nodules removed from the deep seabed. The "imputed value" for this purpose is 20 percent of the fair market value of the commercially recoverable metals and minerals contained in the nodules. Thus, the excise tax, in effect, is imposed at the rate of 0.75 percent of the fair market value of the commercially recoverable metals and minerals. The 20-percent figure relates to the estimated proportional share of the costs of the mining process itself in relation to the total costs involved in mining, transporting, processing, and marketing the nodules. This is consistent with the United States' Law of the Sea negotiating position, as it would limit revenue sharing to the mining phase alone. The rate of tax set in the bill is not intended to serve as a guideline or precedent which would be binding for any profit sharing or royalty agreement negotiated by the United States at the Law of the Sea Conference.

The excise tax is to be imposed with respect to any commercially recoverable metals or minerals contained in the nodule, so long as the nodule contains manganese, nickel, cobalt or copper. Thus, the tax is to be imposed on the imputed value of all commercially recoverable minerals contained in the nodules removed from the deep seabed, regardless of whether or not they are one of the four previously mentioned. Commercial recoverability is to be determined with respect to the technical considerations and economic conditions prevailing at the time of removal of the nodules from the deep seabed. Moreover, the tax will be imposed on any manganese, nickel, cobalt or copper from nodules removed from the deep seabed which is processed, used, or sold by the mining company, even if that mineral was not commercially recoverable at the time of removal.

The fair market value of each commercially recoverable metal or mineral contained in a nodule is to be determined (1) as of the date of the removal of the nodule from the seabed and (2) as if it were separated from the nodule and in the most basic form for which there is a readily ascertainable market price and a substantial volume of sales. Determinations of value (including determinations as to the appropri-[4]ate basic form and commercial recoverability) for this and all other purposes under the tax are to be made by the Secretary of the Treasury, after consultation with other appropriate Federal officials, on the basis of the best available information. These determinations are to be made under procedures established by regulations.

Moreover, in order to facilitate both certainty in ascertaining tax liability and the efficient and expeditious administration and collection of the tax, the committee anticipates that the Secretary, pursuant to these procedures, may make determinations as to the value of the nodules removed based, in part, upon reasonable assumptions as to the various metals and minerals generally contained in nodules removed from any particular deep seabed area. For example, the committee anticipates that the Secretary may specify that nodules removed from an area are presumed conclusively to contain x percent of one mineral, y percent of another, and z percent of a third mineral, and that the balance of the nodule consists of minerals which are not commercially recoverable. The Secretary may also by regulations prescribe for each metal or mineral (including manganese, nickel, cobalt, and copper) *de minimis* quantities or percentages below which the metal or mineral will be treated as not commercially recoverable.

Although the excise tax is imposed on the removal of the nodule from the deep seabed, the tax is not payable until the time prescribed by regulation by the Secretary of the Treasury. This time may not be earlier than the earlier of (1) the commercial use or the sale or disposition of any metal or mineral in the nodule so removed, or (2) the day which is 12 months after the date of the removal of the nodule. The tax due at the time would be based on the value of all commercially recoverable metals and minerals in the nodule except those for which the mining company has elected to suspend the tax, as described below. For this purpose, "commercial use" means use as a mineral product and not merely as a bulk material, such as ballast. A "disposition" includes any transfer, *e.g.*, a distribution by a mining company as a dividend or in liquidation or a contribution to capital of a subsidiary, for use as a mineral product and not as bulk material. A disposition would not include abandonment or a transfer to an unrelated party which is not for value.

As an exception to the general rules, the mining company may elect, in a manner to be prescribed by regulations, to have the application of the tax suspended with respect to one or more commercially recoverable metals or minerals contained in the nodules if the mining company does not intend to process, use commercially, or sell that metal or mineral within 1 year after the date of extraction. The imputed value of the metals or minerals with respect to which the election is made is not to be taken into account in determining the tax. However, if the mining company subsequently recovers any metal or mineral with respect to which the election was made from the nodules, or if it uses commercially or sells any portion of the nodules containing a metal or mineral so reserved, the tax is to be redetermined as if the election with respect to that metal or mineral or that portion had not been made. Thus, upon a subsequent processing, commercial use, or sale of a previously reserved metal or mineral (or the resource in which it is contained), an additional tax will be due from the mining company. Furthermore, in such an event, the mining company is also to pay an [5] amount equal to interest (determined at the rates for interest on deficiencies and overpayments of tax) on the additional tax for the period from the date on which the tax would have been imposed if the election had not been made to the date of processing, commercial use, or sale. It is intended that the suspension election may be made with respect to any portion of the nodules recovered. Moreover, redeterminations of the tax shall be made only with respect to those nodules (or the intermediate products of the nodules) which are actually processed, used commercially, or sold. Unless a mining company can identify the nodules, it will be treated as processing, commercially using, or selling them on a first in-first out basis. If the metals or minerals with respect to which an election has been made are never processed, used commercially, or sold, no tax will be payable with respect to them.

The tax is not to apply to any removal of nodules from the deep seabed after the earlier of (1) 10 years after the date of enactment of the Act, or (2) the date on which an international deep seabed treaty to which the Senate has given its advice and consent to ratification takes effect with respect to the United States. For this purpose, an "international deep seabed treaty" means any treaty adopted by the United Nations Conference on the Law of the Sea which requires contributions either by the United States or the mining company to an international fund for the sharing of revenues from deep seabed mining. Any other bilateral or multilateral treaty or agreement which the

United States may enter into which relates to deep seabed mining will not terminate the tax. In case an election has been made to suspend the tax with respect to certain metals or minerals from the tax, the tax will apply to those metals or minerals when they are processed, used, or sold even if that date is subsequent to the termination date of the tax, if removal from the deep seabed occurred prior to the termination date.

Matters relating to collection and other administrative aspects of the tax are to be determined under applicable provisions of the Internal Revenue Code of 1954 and regulations promulgated by the Treasury Department.

Deep Seabed Revenue Sharing Trust Fund

The proceeds of the excise tax are held in a Deep Seabed Revenue Sharing Trust Fund established pursuant to title IV of the bill. The Trust Fund is to be administered by the Treasury Department and is to consist of the amounts appropriated or credited to it in accordance with title IV.

Title IV of the bill provides that amounts in the Trust Fund shall be available, as provided by appropriations Acts, for making contributions which may be required pursuant to an international deep seabed treaty (as described above under the heading "Excise Tax") which may become effective with respect to the United States on or before the date 10 years after the date of the enactment of H.R. 2759. The contributions for which Trust Fund amounts may be appropriated are to be for the purpose of sharing the revenue from deep seabed mining among nations of the world. Nothing in title IV is intended to authorize any program or other activity not otherwise authorized by law.

* * * * *

[6] *Effect on tax, tariff, and customs laws*

The title specifically provides that nothing in H.R. 2759, other than the tax imposed by title IV, shall affect the application of the Internal Revenue Code of 1954 or the application of the customs and tariff laws of the United States. It is anticipated that the tax, customs, and tariff consequences of deep seabed mining will be the subject of future [7] legislative proposals which may be considered by the committee. Accordingly, this provision is intended to make it clear that, pending that consideration, H.R. 2759 will not explicitly or implicitly convey any tax, customs or tariff benefits which would not be available in its absence.

Effective date

The provisions relating to the excise tax on deep seabed mining are to take effect on January 1, 1980. They are to terminate on the earlier of the date 10 years from the date of the enactment of H.R. 2759, or at the time when an international deep seabed treaty comes into effect with respect to the United States.

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Senate Report No. 96-307
1st Session

[Bracketed numerals indicate official report page numbers]

DEEP SEABED MINERAL RESOURCES ACT

August 9, 1979

Mr. Jackson, from the Committee on Energy and Natural Resources, and on behalf of Mr. Cannon, from the Committee on Commerce, Science, and Transportation; and Mr. Church, from the Committee on Foreign Relations, submitted the following report together with additional views to accompany S. 493. [1]

The Committee on Energy and Natural Resources; Commerce, Science and Transportation; and Foreign Relations, to which was jointly referred the bill (S. 493) to promote the orderly development of hard mineral resources in the deep seabed, pending adoption of an international regime relating thereto, and for other purposes, having considered the same, reports favorably thereon with amendments and recommends that the bill, as amended, do pass.

Purpose

The Deep Seabed Mineral Resources Act is designed to promote the conservation and orderly development of the manganese nodule resources of the deep seabed by United States citizens. It is interim legislation which expressly provides that it will be superseded by the terms of any international agreement binding on the United States. Negotiations looking toward such an agreement are currently underway at the Third United Nations Conference on the Law of the Sea.

* * * * *

[64] Department of
the Treasury,
Office of the
General Counsel,
Washington, D.C.,
April 10, 1979.

Hon. Henry M. Jackson,
Chairman, U.S. Senate, Committee on
Energy and Natural Resources,
Washington, D.C.

Dear Mr. Chairman: This is in reply to your request for the views of the Department of the Treasury on S. 493, the "Deep Seabed Mineral Resources Act."

* * * * *

[65] Title V may also be cited as the "Deep Seabed Hard Mineral Removal Tax Act of 1979." The Department has no objection to the provisions contained in section 502 and strongly supports section 504.

However, the Department has two technical comments relating to section 502. First, the definitions in proposed section 4496 of the Internal Revenue Code includes a definition of the Continental Shelf. The Department notes that this definition is broader than the definition of continental shelf areas contained in section 638 of the Internal Revenue Code. Second, the Department notes that the effective date provision in subsection (c) does not require the issuance of regulations required by proposed section 4497 of the Internal Revenue Code dealing with imputed value. Although the imputed value determinations required to be done by regulation could be accomplished by the Secretary of the Treasury without regulations, the Internal Revenue [66] Service will need administrative time to develop the program and forms required by a regulatory scheme.

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[1] Public Law 96-283, page 16.

Amounts equivalent to the taxes imposed under section 502 would be credited to the Deep Seabed Fund established by section 503. The Department supports the establishment of this fund in this case to bolster the principle of the "common heritage of mankind." The 3.75 percent is a reasonable revenue sharing obligation under domestic seabed legislation and is high enough to demonstrate the United States' commitment to this principle.

The Department, however, is reviewing the transfer, management, and expenditures provision of the fund to determine their consistency with current fiscal policy. A separate report will be submitted by the Department to Congress regarding these technical aspects of the Deep Seabed Fund.

The Office of Management and Budget has advised that there is no objection from the standpoint of the Administrations program to the submission of this report to your Committee.

Sincerely yours,

H. C. Stockell, Jr.,
Deputy General Counsel

* * * * *

[96] ADDITIONAL VIEWS OF THE COMMITTEE ON FOREIGN RELATIONS

S. 493 is similar to the bill (S. 2053) reported by the Committee on August 16, 1978. Therefore, in its mark-up on July 30, 1979, the Committee focused primarily upon the differences between S. 493, as reported by the Energy Committee, and the bill reported last session. The Committee also took note of certain changes proposed to the bill by the Commerce Committee in its mark-up of July 27, 1979.

Fifteen principal issues were considered by the Foreign Relations Committee:

1. Deep Seabed Fund and Tax Provisions: Title V

The Committee endorsed the establishment of a deep seabed fund, represented by Title V of S. 493, as providing the basis for United States contributions to any future deep seabed regime established by a Law of the Sea Treaty. It recalled that during its consideration of S. 2053 last year, the Committee had decided to recommend a royalty figure of 10 percent of imputed value, rather than the 3.75 percent contained in S. 493. However, the Committee took note of the fact that the Administration was not supporting this higher royalty figure and that the mining industry was strongly opposed to it. No changes were made in Title V.

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Part III. Administrative, Procedural, and Miscellaneous

Delegation Order No. 166 (Rev. 4) (Effective July 18, 1980)

Authority to Grant Extension of Time to File Income and Estate Tax Returns

The authority granted to the Commissioner of Internal Revenue by 26 CFR 1.6081-1, 26 CFR 20.6081-1 and 26 CFR 301.7701-9 to grant extensions of time to file income and estate tax returns, is hereby delegated to District Directors, Assistant District Directors, Director of International Operations, Assistant Director of International Operations, Service Center Directors and Assistant Service Center Directors.

The authority delegated herein for estate tax returns may be redelegated, but not below:

Advisor/Reviewer, Advisor or Reviewer in the Special Procedures function in District Offices and Office of International Operations.

Senior Tax Examiners in Service Centers.

The authority delegated herein for income tax returns may be redelegated, but not below:

Chief, Special Procedures Staff or Chief, Technical and Office Compliance Branch/Group in District Offices and Office of International Operations; and full working level Tax Examiners in Service Centers.

Delegation Order No. 116 (Rev. 3) [1979-1 C.B. 476], issued January 29, 1979, is superseded.

Jerome Kurtz,
Commissioner.

(Filed by the Office of the Federal Register on July 22, 1980, 8:45 a.m., and published in the issue of the Federal Register on July 23, 1980, 45 F.R. 49204)

Part IV. Items of General Interest

9¼ Percent Treasury Notes of Series K-1983
10¾ Percent Treasury Notes of Series B-1989
10 Percent Treasury Bonds of 2005-2010
9⅜ Percent Treasury Notes of Series S-1982
9⅝ Percent Treasury Notes of Series E-1985
8⅝ Percent Treasury Notes of Series T-1982
8⅞ Percent Treasury Notes of Series E-1984

Announcement 80-111

The Secretary of the Treasury announced the offering of Treasury Notes and Treasury Bonds as follows:

Treasury Department Circular, Public Debt Series 14-80, dated May 1, 1980, and published in the Federal Register for May 6, 1980, 45 F.R. 29965, and the supplement published in the Federal Register for May 12, 1980, 45 F.R. 31253; 9¼ percent Treasury Notes of August 15, 1983, Series K-1983.

Treasury Department Circular, Public Debt Series 15-80, published in the Federal Register for May 6, 1980, 45 F.R. 29967; 10¾ percent Treasury Notes of November 15, 1989, Series B-1989.

Treasury Department Circular, Public Debt Series 16-80, dated May 1, 1980, and published in the Federal Register for May 6, 1980, 45 F.R. 29968, and the supplement published in the Federal Register for May 14, 1980, 45 F.R. 31854; 10 percent Treasury Bonds of 2005-2010.

Treasury Department Circular, Public Debt Series 17-80, dated May 15, 1980, and published in the Federal Register for May 20, 1980, 45 F.R. 33762, and the supplement published in the Federal Register for June 6, 1980, 45 F.R. 38202; 9⅜ percent Treasury Notes of May 31, 1982, Series S-1982.

Treasury Department Circular, Public Debt Series 18-80, dated May 22, 1980, and published in the Federal Register for May 27, 1980, 45 F.R. 35472, and the supplement published in the Federal Register for June 10, 1980, 45 F.R. 39369; 9⅝ percent Treasury Notes of August 15, 1985, Series E-1985.

Treasury Department Circular, Public Debt Series 19-80, dated June 16, 1980, and published in the Federal Register for June 19, 1980, 45 F.R. 41565, and the supplement published in the Federal Register for June 25, 1980, 45 F.R. 42919; 8⅝ percent Treasury Notes of June 30, 1982, Series T-1982.

Treasury Department Circular, Public Debt Series 20-80, dated June 16, 1980, and published in the Federal Register for June 20, 1980, 45 F.R. 41753, and the supplement published in the Federal Register for July 1, 1980, 45 F.R. 44439; 8⅞ percent Treasury Notes of June 30, 1984, Series E-1984.

The income derived from the notes and bonds is subject to all taxes imposed by the Internal Revenue Code. The notes and bonds are subject to estate, inheritance, gift, or other excise taxes whether federal or state, but are exempt from all taxation now or hereafter imposed on the principal or interest thereof by any state, any possession of the United States, or any local taxing authority.

The notes and bonds will be acceptable to secure deposits of public money. They will not be acceptable in payment of taxes.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Robert L. Hamersley	Boise, ID	Certified Public Accountant	Indefinite from July 7, 1980
Daniel C. Lukensow	Arcadia, CA	Enrolled Agent	Eighteen months effective July 28, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.1441-4(d) revoked.	Exemption from withholding of tax under chapter 3 with respect to Virgin Islands inhabitants.	July 8, 1980	Sept. 8, 1980
26 CFR 301.6059-1, 301.6692-1 added.	Requirement that the plan administrator of a defined benefit plan periodically file an actuarial report for the plan.	July 8, 1980	Sept. 8, 1980
26 CFR 1.46-1, 1.46-2 amended.	FIFO and other ordering rules for the investment credit.	July 10, 1980	Sept. 8, 1980
26 CFR 1.501(c)(9)-1 as proposed in the Federal Register for January 23, 1969, 34 F.R. 1028, withdrawn; 1.501(c)(9)-1 through 1.501(c)(9)-8 added.	Voluntary employees' beneficiary associations.	July 17, 1980	Sept. 15, 1980
26 CFR 1.72-4, 1.72-15, 1.104-1, 1.105-1, 1.105-2, 1.105-4, 1.106-1, amended; 1.105-7 through 1.105-10, added; 7.105-1, 7.105-2, deleted.	Exclusion of certain disability payments from gross income.	July 9, 1980	Sept. 8, 1980
26 CFR 1.166-1, 1.166-4, 1.381(c)(4)-1, amended; 1.166-10, added.	Reserve for certain guaranteed debt obligations.	July 11, 1980	Sept. 9, 1980
26 CFR 1.892-1 amended.	Determining whether certain income of foreign sovereigns from loans or leases is derived from the conduct of commercial activities in the U.S.	July 22, 1980	Sept. 22, 1980
26 CFR 20.2055-2(c), 20.2056(a)-1(b)(2) amended; 20.2041-3(d)(6), 20.2056(a)-1(a), 25.2511-1(c), 25.2514-3(c) revised; 20.2056(d)-1 redesignated 20.2056(d)-2 and amended; 20.2045-1, 20.2056(d)-1, 25.2518-1 through 25.2518-4 added.	Disclaimer of property conferred by gift of inheritance.	July 22, 1980	Sept. 22, 1980

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

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Key to Abbreviations:

RR	Revenue Ruling
RP	Revenue Procedure
TD	Treasury Decision
CD	Court Decision
PL	Public Law
EO	Executive Order
DO	Delegation Order
TDO	Treasury Department Order
TC	Tax Convention
SPR	Statement of Procedural Rules
PTE	Prohibited Transaction Exemption

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______	1930–1	7.30
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______	1939–1–1	8.25
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______	*1941–2*	*3.55*
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______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*2.65*
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______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$10.10
______	1957–2	13.00
______	1958–1	9.60
______	1958–2	13.00
______	1958–3	15.00
______	1959–1	15.00
______	1959–2	9.60
______	1960–1	9.00
______	1960–2	11.50
______	1961–1	14.00
______	1961–2	10.00
______	1962–1	14.00
______	1962–2	13.00
______	1962–3	20.00
______	1963–1	9.00
______	1963–2	10.75
______	1964–1–1	10.00
______	1964–1–2	11.00
______	1964–2	9.80
______	1965–1	10.70
______	1965–2	12.25
______	1966–1	14.00
______	1966–2	14.05
______	1967–1	10.00
______	1967–2	15.00
______	1968–1	14.00
______	1968–2	11.75
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September 8, 1980
Bulletin No. 1980-36

9258

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENTS

Announcement 80-115, page 36.
A public hearing will be held on October 8, 1980, on proposed regulations relating to certain shareholder requirements and related matters for electing small business corporations.

Announcement 80-118, page 37.
A public hearing will be held on September 25, 1980, on proposed regulations relating to the tax on the use of fuel in commercial waterway transportation.

INCOME TAX

Rev. Rul. 80-238, page 6.
Call option; dividends received deduction; holding period. The writing of a call option by a domestic corporation on stock held by the corporation does not reduce the holding period that is required by section 246(c)(1)(A) of the Code for purposes of the deduction for dividends received provided by section 243.

Rev. Rul. 80-239, page 7.
Transfer of assets to new corporation; stock for cash and stock. An individual who owned all the stock of a corporation transferred the stock to a new corporation in exchange for all of its stock and cash that was borrowed from a bank. Subsequent to the transfer the new corporation repaid the loan with funds received from the first corporation. The cash received by the individual constitutes a dividend from the old corporation to the extent provided in section 301 of the Code.

Rev. Rul. 80-240, page 8.
Transfer of assets to new corporation; liabilities assumed. In order to acquire indirect ownership of a bank through a bank holding company and to satisfy the appropriate banking rules and regulations, an individual borrowed money from an unrelated financial institution to acquire 90 percent of the bank's stock and acquired the remaining stock with personal funds. The individual then formed a new bank holding company and immediately transferred all of the bank's stock to it in exchange for all of the holding company's stock and the holding company's assumption of the individual's acquisition indebtedness. Section 351(a) of the Code applies to the transfer, the individual is treated as a mere intermediate agent employed solely to satisfy non-tax rules and regulations, and the assumption of the indebtedness is disregarded.

Rev. Rul. 80-244, page 9.
Employee stock options; payment with stock. An explanation is provided of the federal income tax consequences of the acquisition of stock pursuant to the exercise of a nonqualified stock option and payment for the stock with identical shares of the corporation's stock that were previously acquired pursuant to the exercise of a qualified stock option.

Rev. Proc. 80-34, page 34.
Transfer of assets to new corporation; liabilities assumed; ruling guidelines. Procedures are issued to provide guidelines to indicate under what

(Continued on page 4)

Finding Lists begin on page 41.
Announcement of Voluntary Suspensions on page 38.
Announcement of Notice of Proposed Rulemaking on page 39.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

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INCOME TAX—Cont'd

circumstances a ruling may be issued that sections 304(a)(1) and 357(a) of the Code are inapplicable when a newly created corporate transferee assumes a liability incurred in a transaction similar to that described in Rev. Rul. 80-240; Rev. Proc. 80-22 amplified.

EMPLOYEE PLANS

Pub. L. 96-293, page 33.
The effective date of automatic coverage for multiemployer plans under the termination insurance program provided by the Employee Retirement Income Security Act of 1974 is deferred from July 1, 1980 to August 1, 1980.

Announcement 80-112, page 35.
Guidance is provided, pending the issuance of proposed regulations, concerning which employees must be included in a Simplified Employee Pension (SEP) by an employer.

EXEMPT ORGANIZATIONS

Announcement 80-114, page 35.
A listing is given of organizations now classified as private foundations.

ESTATE TAX

Rev. Rul. 80-242, page 27.
Life insurance proceeds; community property; Texas. An individual who was a resident of Texas obtained an insurance policy on the individual's life prior to marriage, paid a portion of the premiums from separate funds and a portion from community funds, and designated the spouse as beneficiary. The amount includible in the individual's gross estate with respect to the insurance policy is reduced by one-half the amount of premiums paid with community funds.

T.D. 7710, page 12.
Amendments to the regulaitons under sections 2032A and 6166 of the Code relate to material participation requirements for valuation of certain farm and closely held business real property and to the method of valuing farm real property according to actual use.

T.D. 7711, page 27.
Temporary regulations under section 2621 of the Code relate to generation-skipping transfer tax return requirements.

ESTATE AND GIFT TAXES

Rev. Rul. 80-241, page 11.
Jointly held property; divorce. A spouse purchased real property with separate funds and took title in the names of both spouses either as tenants by the entirety or as joint tenants with right of survivorship. In a state where a subsequent divorce converts a tenancy by the entirety or a joint tenancy into a tenancy in common, such a divorce would result in a gift of one-half the value of the property. In a state where a joint tenancy is not terminated by divorce, no gift results. Upon the contributor's death more than three years after the divorce the portion of the property that was not considered a gift is includible in the contributor's gross estate.

SELF-EMPLOYMENT TAX

T.D. 7710, page 12.
Amendments to the regulations under section 1402 of the Code relate to the definition of net earnings from self-employment for certain owners and tenants of farms.

EXCISE TAXES

Announcement 80-113, page 35.
Corrections are made to Rev. Proc. 80-19, which provides the method by which tire manufacturers may determine tire and tube weights on an average weight basis for the purpose of computing the tax imposed by section 4071(a) of the Code.

TAX CONVENTIONS

Rev. Rul. 80-243, page 32.
United Kingdom; permanent U.S. establishment; deduction for tax paid on U.S. income. A United Kingdom corporation that has a permanent establishment in the U.S. paid U.K. income tax on business profits attributable to its U.S. operation only because the corporation was a resident of the U.K. Section 906(b)(1)(B) of the Code is not contrary to any treaty provisions, and the corporation may not deduct the U.K. income tax paid on U.S. profits. However, the corporation may deduct the U.K. income tax paid on effectively

(Continued on page 5)

Highlights of this Issue—Continued

(Continued from page 4)

Tax Conventions—Cont'd

connected income from another foreign country. Rev. Ruls. 55-532, 58-310, and 65-234 obsoleted.

ADMINISTRATIVE

T.D. 7710, page 12.

Final regulations under section 6324A of the Code relate to election of a lien in favor of the U.S. by an executor of a decedent's estate who seeks to be discharged from personal liability for a portion of the estate tax that is deferred under section 6166 or 6166A.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 83.—Property Transferred in Connection with Performance of Services

26 CFR 1.83-7: Taxation of nonqualified stock options.

Federal income tax consequences of the acquisition of stock pursuant to the exercise of a nonqualified stock option where payment is made with shares of the same corporation's stock that were previously acquired pursuant to the exercise of a qualified stock option. See Rev. Rul. 80-244, page 9.

Section 164.—Taxes

26 CFR 1.164-1: Deduction for taxes.

Whether, in computing its U.S. taxable income, a U.K. corporation with a permanent establishment in the U.S. is entitled to deduct the U.K. income tax paid attributable to operations of its U.S. permanent establishment. See Rev. Rul. 80-243, page 32.

Section 243.—Dividends Received by Corporations

26 CFR 1.243-1: Deduction for dividends received by corporations.

Whether the writing of a call option by a taxpayer on stock held by such taxpayer will reduce the holding period required by section 246(c)(1)(A) of the Code for purposes of the allowance of the deduction for dividends received provided by section 243 of the Code. See Rev. Rul. 80-238, below.

Section 246.—Rules Applying to Deductions for Dividends Received

26 CFR 1.246-3: Exclusion of certain dividends.
(Also Section 243; 1.243-1.)

Call option; dividends received deduction; holding period. The writing of a call option by a domestic corporation on stock held by the corporation does not reduce the holding period that is required by section 246(c)(1)(A) of the Code for purposes of the deduction for dividends received provided by section 243.

Rev. Rul. 80-238

ISSUE

Does the writing of a "call" option by a taxpayer on stock held by the taxpayer reduce the holding period required by section 246(c)(1)(A) of the Internal Revenue Code for purposes of the allowance of the deduction for dividends received provided by section 243 of the Code?

FACTS

The taxpayer, a domestic corporation engaged in an insurance business, purchases regularly traded common stock of other domestic corporations for investment purposes. In order to earn additional income, the taxpayer writes "call" options on such stock within 15 days of their purchase. The taxpayer receives immediate payment for these options and, in return, provides buyers with the right, for a specified period of time, to demand delivery of the underlying stock at a stated price. For example, the taxpayer purchased stock at $110 per share and sold call options on this stock at $10 per share that could be exercised within six months of purchase, with the striking price for the stock fixed at $130. At the time that the taxpayer wrote the options, the market price of the stock had risen from $110 to $120 per share.

LAW AND ANALYSIS

Section 243 of the Code allows a corporation a deduction for certain amounts received as dividends from a domestic corporation.

Section 246(c)(1)(A) provides that no deduction shall be allowed under section 243 in respect of any dividend on any share of stock that is sold or otherwise disposed of in any case in which the taxpayer has held such share for 15 days or less.

The flush language of section 246(c)(3) of the Code and the Income Tax Regulations thereunder provide that, for purposes of section 246(c)(1)(A), the taxpayer's holding period in stock shall be appropriately reduced (in the manner provided in the regulations) for any interval (during such period) in which the taxpayer has an option to sell, is under a contractual obligation to sell, or has made (and not closed) a short sale of substantially identical stock or securities.

Neither the Code nor the regulations specifically mentions call options. Therefore, it is necessary to determine whether the sale of such options is equivalent to any of the transactions listed in flush language.

The sale of a call option does not create in the seller an option to sell the underlying stock since consummation of the stock sale is under control of the person to whom the call was sold. *See* Rev. Rul. 58-234, 1958-1 C.B. 279. Furthermore, the sale of a call option is not a short sale since it is the sale of the right to acquire stock rather than the sale of the stock itself. *See Provst v. United States*, 269 U.S. 443 (1925), T.D. 3811, V-1 C.B. 417 (1926). Finally, although the writing of a call option on stock owned could be deemed to be a contractual obligation to sell, the legislative history of section 246(c) indicates that, for purposes of section 246(c)(3), it is not.

The flush language of section 246(c)(3) was enacted to reduce a taxpayer's holding period for any interval during which the taxpayer is in both a "long" and a "short" position. S. Rep. No. 1983, 85th Cong., 2nd Sess. 28-9 (1958), 1958-3 C.B. 922, 949-50. This insures that the taxpayer is at the risk of the market for the entire holding period. *See* section 1.246-3(d)(2) of the Income Tax Regulations.

The writing of call options on stock owned affords the writer no protection against loss, beyond the option price received, in the event the underlying stock declines in value. Therefore, since the writing of these options does not place the writer in a risk-free position, it does not come within the intendment of the statute. Such considerations, however, are not applicable to "in-the-money" call options, that is, call options that are sold with a striking price below the market price of the underlying stock on the date that the option is written, since in such a situation the exercise of such options may be virtually guaranteed and the element of risk is either greatly reduced or eliminated.

HOLDING

The writing of a call option by a taxpayer on stock held by the taxpayer does not reduce the holding period required by section 246(c)(1)(A) of the Code for purposes of the allowance of the deduction for dividends received provided by section 243.

Section 301.—Distributions of Property

26 CFR 1.301-1: Rules applicable with respect to distributions of money and other property.
(Also Sections 304, 351; 1.304-2, 1.351-2.)

Transfer of assets to new corporation; stock for cash and stock. An individual who owned all the stock of a corporation transferred the stock to a new corporation in exchange for all of its stock and cash that was borrowed from a bank. Subsequent to the transfer the new corporation repaid the loan with funds received from the first corporation. The cash received by the individual constitutes a dividend from the old corporation to the extent provided in section 301 of the Code.

Rev. Rul. 80-239

ISSUE

Does section 301(c) of the Internal Revenue Code apply to the transaction described below?

FACTS

Individual *A* owned all of the stock of corporation *X*, which is engaged in a profitable manufacturing business. Over the years, *X* has accumulated substantial earnings and profits but had never paid a dividend. *A* decided to broaden the business operations of *X* into other unrelated manufacturing endeavors, and to this end *A* determined that a holding company would be necessary to oversee and control a multifaceted operation. *A* also wanted to initiate some new business ventures as a sole proprietor but did not have the necessary cash without withdrawing funds from *X*. To accomplish these objectives, *A* transferred the stock of *X* to *Y*, a newly created corporation. In exchange, therefor, *A* received the stock of *Y* and 100,000*x* dollars that *Y* had borrowed from a bank. The obligation of *Y* to the bank was guaranteed by *X* and secured by a pledge of the *X* stock to be received pursuant to the overall transaction. Subsequent to the transaction, *Y* repaid the bank loan with funds received from *X*.

LAW, ANALYSIS, AND HOLDING

Section 351(a) of the Code provides, in part, that no gain or loss will be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation.

Section 368(c) of the Code provides that the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

Section 351(b)(1) of the Code provides that if section 351 (a) would apply to an exchange but for the fact that there is received, in addition to the stock or securities permitted to be received under subsection (a), other property or money, then gain (if any) to such recipient will be recognized, but not in excess of the money received, plus the fair market value of such other property received. Under section 351(b)(1), the other property or money is treated as received by the shareholder in part or full payment in exchange for the assets transferred. Section 351(b)(2) provides that no loss will be recognized.

Section 1.351-2(d) of the regulations refers to section 301 of the Code with respect to the taxation of dividends where a distribution by a corporation of its stock in connection with an exchange subject to section 351(a) has the effect of the distribution of a taxable dividend.

Section 1.301-1(l) of the regulations provides that a distribution to shareholders with respect to their stock is within the terms of section 301 of the Code although it takes place at the same time as another transaction if the distribution is in substance a separate transaction whether or not connected in a formal sense.

Section 304(a)(1) of the Code provides, in part, that where one or more persons are in control, as defined in section 304(c), of each of two corporations and, in return for property, one of the corporations acquires stock in the other corporation from the person or persons so in control, the property received will be treated under section 302 as a distribution in redemption of stock of the corporation acquiring such stock. Section 304(c) provides, in part, that control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote, or at least 50 percent of the total value of shares of all classes of stock.

Section 351 of the Code applies to the transfer by *A* of the *X* stock to *Y* in exchange for the *Y* stock because *A* was in control of *Y* (as defined in section 368(c)) immediately after the exchange. It must be determined, however, whether section 351(b) or section 304(a)(1) applies to the cash received by *A* from *Y* in the transaction.

A distribution of the cash directly by *X* to *A* would have been a distribution within the terms of section 301 of the Code. Although in the present case the cash distribution was arranged to be made by newly-organized *Y* corporation, this part of the transaction was in substance a disguised dividend distribution from *X* to *A*. The characterization of a distribution is not necessarily determinative for tax purposes and may be recharacterized to accord with the substance of a transaction. See *Waterman Steamship Corp. v. Commissioner*, 430 F.2d 1185 (5th Cir. 1970). Thus, the receipt of the 100,000*x* dollars by *A* is not governed under the provisions of section 351(b)(1) of the Code. See sections 1.351-2(d) and 1.301-1(l) of the regulations. Also, the provisions of section 304(a)(1) do not have any application to this situation since the substance of the transaction involves no actual receipt by *A* of "property" (cash) that is required to be distributed by *Y*, the acquiring-transferee corporation.

A distribution by one person (*X*) cannot be transformed for tax purposes into a distribution by another (*Y*) by using the latter as a conduit through which to pass the 100,000*x* dollars. Consequently, *A* will be treated as having received a dividend of 100,000*x* dollars from *X* to the extent provided in section 301 of the Code. See *Gold v. Commissioner*, T.C.M. 1958-2. Also see *Minesota Tea Co. v. Helvering*, 302 U.S. 609 (1938), Ct. D. 1305, 1938-1 C.B. 288, and *Higgins v. Smith*, 308 U.S. 473 (1940), Ct. D. 1434, 1940-1 C.B. 127.

Compare Rev. Rul. 80-240, this page, this Bulletin, for tax treatment where the transferor borrowed money to purchase the stock transferred and the transferee corporation assumed the indebtedness.

Section 304.—Redemption Through Use of Related Corporations

26 CFR 1.304-2: Acquisition by related corporation (other than subsidiary).

Whether section 304(a)(1) of the Code applies to cash received by a transferor in the formation of a new holding company. See Rev. Rul. 80-239, page 7.

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26 CFR 1.304-2: Acquisition by related corporation (other than subsidiary).

Whether section 304(a)(1) of the Code applies where a transferor borrowed money to purchase the stock transferred to a newly created corporation that assumes such indebtedness. See Rev. Rul. 80-240, this page.

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26 CFR 1.304-2: Acquisition by related corporation (other than subsidiary).

Whether a ruling may be issued that section 304(a)(1) of the Code is inapplicable when a newly created corporate transferee assumes a liability incurred in a transaction similar to that described in Rev. Rul. 80-240. See Rev. Proc. 80-34, page 34.

Section 351.—Transfer to Corporation Controlled by Transferor

26 CFR 1.351-1: Transfer to corporation controlled by transferor.
(Also Sections 304, 357; 1.304-2, 1.357-1.)

Transfer of assets to new corporation; liabilities assumed. In order to acquire indirect ownership of a bank through a bank holding company and to satisfy the appropriate banking rules and regulations, an individual borrowed money from an unrelated financial institution to acquire 90 percent of the bank's stock and acquired the remaining stock with personal funds. The individual then formed a new bank holding company and immediately transferred all of the bank's stock to it in exchange for all of the holding company's stock and the holding company's assumption of the individuals' acquisition indebtedness. Section 351(a) of the Code applies to the transfer, the individual is treated as a mere intermediate agent employed solely to satisfy non-tax rules and regulations, and the assumption of the indebtedness is disregarded.

Rev. Rul. 80-240

ISSUE

Does section 351(a) of the Internal Revenue Code apply to the transaction described below?

FACTS

X is a corporation engaged in the general banking business that has solely common stock outstanding. In order to acquire indirect ownership of *X* through a bank holding company and to satisfy the appropriate banking rules and regulations, *A*, an individual who previously owned no *X* stock, devised the following plan. *A* first borrowed money from an unrelated financial institution *B* to acquire ninety percent of the *X* stock, pledging the *X* stock as security. *A* acquired the remaining 10 percent of *X* stock with his personal funds. *A* then formed *Y*, a new corporation, to be operated as a bank holding company, and immediately transferred all the *X* stock to Y. In exchange therefor, *Y* issued to *A* all of its stock and assumed the indebtedness incurred by *A*. The assumption by *Y* was done with the agreement of *B* and operated to release *A* from any liability with respect to the borrowed funds.

LAW AND ANALYSIS AND HOLDING

Section 351(a) of the Code provides, in part, that no gain or loss will be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the Code.

Section 368(c) of the Code provides that the term "control" means the ownership of stock possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote and at least 80 percent of the total number of shares of all other classes of stock of the corporation.

Section 304(a)(1) of the Code provides, in part, that where one or more persons are in control, as defined in section 304(c), of each of two corporations and, in return for property, one of the corporations acquires stock in the other corporation from the person or persons so in control, the property received will be treated under section 302 as a distribution in redemption of stock of the corporation acquiring such stock. Section 304(c) provides, in part, that control means the ownership of stock possessing at least 50 percent of the total combined voting power of all classes of stock entitled to vote, or at least 50 percent of the total value of shares of all classes of stock.

Section 357(a) provides, in part, that, except as provided in sections 357(b) and (c), if (1) the taxpayer receives property that would be permitted to be received under section 351 without the recognition of gain if it were the sole consideration, and (2) as part of the consideration, another party to the exchange assumes a liability of the taxpayer, or acquires from the taxpayer property subject to a liability, then such assumption or acquisition shall not be treated as money or other property, and shall not prevent the exchange from being within the provisions of section 351.

Section 351 of the Code applies to the transfer by *A* of the *X* stock to *Y* in exchange for the *Y* stock because *A* was in control of *Y* (as defined in section 368(c)) immediately after the exchange. It must be determined, however, whether section 357(a) or section 304(a)(1) applies to the assumption by *Y* of the indebtedness incurred by *A* in the transaction.

If *A* had first formed *Y* and then had caused *Y* to borrow money from *B* so that *Y* would have directly acquired the 90 percent of the shares of *X* stock, there would have been no need for an assumption of the indebtedness by *Y*. In substance, there was no plan or intention for *A* to either own the *X* stock, or to repay the loan proceeds which were used to acquire that stock. Thus, for federal income tax purposes, *A* will be treated for this part of the transaction as a mere intermediate agent employed solely to satisfy non-tax related rules and regulations and the assumption of the indebtedness will be disregarded. See *Ciaio v. Commissioner*, 47 T.C. 447 (1967), *acq.*, 1967-2 C.B. 2 and *Fox v. Harrison*, 145 F.2d 521 (7th Cir. 1944). Consequently, neither section 357(a) of the Code nor section 304(a)(1) have any application to the transaction since there is no assumption of a liability and also no "property" is distributed by *Y*, the acquiring-transferee corporation, within the meaning of section 304(a)(1).

Compare Rev. Rul. 80-239, page 7, this Bulletin, for tax treatment where a transferor received cash in addition to stock of the transferee corporation.

26 CFR 1.351-1: Receipt of property.

Whether section 351(b) of the Code applies to cash received by a transferor in the formation of a new holding company. See Rev. Rul. 80-239, page 7.

Section 357.—Assumption of Liability

26 CFR 1.351-2: Receipt of property.

Whether a ruling may be issued that section 357(a) of the Code is inapplicable when a newly created corporate transferee assumes a liability incurred in a transaction similar to that described in Rev. Rul. 80-240. See Rev. Proc. 80-34, page 34.

26 CFR 1.357-1: Assumption of liability.

Whether section 357(a) of the Code applies where a transferor borrowed money to purchase the stock transferred to a newly created corporation that assumes such indebtedness. See Rev. Rul. 80-240, page 8.

Section 421.—General Rules

26 CFR 1.421-8: General rules.

Federal income tax consequences of the acquisition of stock pursuant to the exercise of a nonqualified stock option where payment is made with shares of the same corporation's stock that were previously acquired pursuant to the exercise of a qualified stock option. See Rev. Rul. 80-244, this page.

Section 422.—Qualified Stock Options

26 CFR 1.422-1: Qualified stock options—general rules.

Federal income tax consequences of the acquisitition of stock pursuant to the exercise of a nonqualified stock option where payment is made with shares of the same corporation's stock that were previously acquired pursuant to the exercise of a qualified stock option. See Rev. Rul. 80-244, this page.

Section 425.—Definitions and Special Rules

26 CFR 1.425-1: Definitions and special rules applicable to statutory options.

Federal income tax consequences of the acquisition of stock pursuant to the exercise of a nonqualified stock option where payment is made with shares of the same corporation's stock that were previously acquired pursuant to the exercise of a qualified stock option. See Rev. Rul. 80-244, this page.

Section 882.—Tax on Income of Foreign Corporations Connected with United States Business

26 CFR 1.882-1: Taxation of foreign corporations engaged in U.S. business or of foreign corporations treated as having effectively connected income.

Whether, in computing its U.S. taxable income, a U.K. corporation with a permanent establishment in the U.S. is entitled to deduct the U.K. income tax paid attributable to operations of its U.S. permanent establishment. See Rev. Rul. 80-243, page 32.

Section 906.—Nonresident Alien Individuals and Foreign Corporations

Whether, in computing its U.S. taxable income, a U.K. corporation with a permanent establishment in the U.S. is entitled to deduct the U.K. income tax paid attributable to operations of its U.S. permanent establishment. See Rev. Rul. 80-243, page 32.

Section 1031.—Exchange of Property Held for Productive Use or Investment

26 CFR 1.1031(d)-1: Property acquired upon a tax-free exchange.

Federal income tax consequences of the acquisition of stock pursuant to the exercise of a nonqualified stock option where payment is made with shares of the same corporation's stock that were previously acquired pursuant to the exercise of a qualified stock option. See Rev. Rul. 80-244, below.

Section 1036.—Stock for Stock of Same Corporation

26 CFR 1.1036-1: Stock for stock of the same corporation.
(Also Sections 83, 421, 422, 425, 1031; 1.83-7, 1.421-8, 1.422-1, 1.425-1, 1.1031(d)-1.)

Employee stock options; payment with stock. An explanation is provided of the federal income tax consequences of the acquisition of stock pursuant to the exercise of a nonqualified stock option and payment for the stock with identical shares of the corporation's stock that were previously acquired pursuant to the exercise of a qualified stock option.

Rev. Rul. 80-244

ISSUE

What are the federal income tax consequences of the acquisition of stock pursuant to the exercise of a nonqualified stock option, if payment for the stock is made with shares of the same corporation's stock that were previously acquired pursuant to the exercise of a qualified stock option?

FACTS

A corporation, whose outstanding stock consists of a single class of common stock, has a qualified stock option plan described in section 422 of the Internal Revenue Code and a nonqualified stock option plan. An optionee who exercises an option granted under the nonqualified plan may pay for the shares (1) in cash, (2) with previously acquired shares having a fair market value equal to the option price, or (3) with cash and previously acquired shares having a fair market value less than the option price.

On May 1, 1977, an employee of the corporation exercised a qualified stock option and acquired 1,000 shares of stock for 2*x* dollars. The fair market value of the stock steadily increased, and on July 1, 1979, when the employee exercised a nonqualified option (which was granted after April 21, 1969, and did not have a readily ascertainable fair market value when granted) for 2,000 shares of stock, the 1,000 shares of stock acquired pursuant to the qualified option had a fair market value of 6*x* dollars. The employee paid for the 2,000 shares of stock received pursuant to the nonqualified option with the 1,000 shares of identical stock acquired in 1977 when the employee exercised the qualified option. The nonqualified option price for the 2,000 shares of stock was 6*x* dollars; however, the fair market value was 12*x* dollars. Thus, the employee exchanged 1,000 shares of stock with a basis of 2*x* dollars and a fair market value of 6*x* dollars for 2,000 shares of stock with a fair market value of 12*x* dollars.

LAW

Section 421(a)(1) of the Code provides that if a share of stock is transferred to an individual in a transfer in respect of which the requirements of section 422(a) are met, no income results when the share is transferred to the individual upon the exercise of the option with respect to that share.

Section 422(a) of the Code provides that section 421(a) applies with respect to the transfer of a share of stock to an individual pursuant to the exercise of a qualified stock option if no disposition of the share is made by the employee within the three-year period beginning on the day after the day of the transfer of the share.

Section 1.421-8(b) of the Income Tax Regulations provides that a disposition of a share of stock, acquired by the exercise of a statutory option, before the expiration of the applicable holding period, makes section 421 of the Code inapplicable to the transfer of the share. The income attributable to the transfer is treated by the individual as income received in the taxable year in which the disposition occurs.

Section 1.421-8(b)(2) of the regulations provides that section 421 of the Code is not made inapplicable by a transfer before the expiration of the applicable holding period if the transfer is not a disposition of stock as defined in section 425(c).

Section 425(c) of the Code provides that the term "disposition" includes a sale, exchange, gift, or a transfer of legal title, but does not include an exchange to which section 1036 applies.

Section 1036(a) of the Code provides that no gain or loss shall be recognized if common stock in a corporation is exchanged solely for common stock in the same corporation, or if preferred stock in a corporation is exchanged solely for preferred stock in the same corporation.

Section 1031(d) of the Code provides that if property is acquired in an exchange described in section 1036(a), the basis shall be the same as that of the property exchanged.

Section 83(a) of the Code provides that, if, in connection with the performance of services, property is transferred to any person other than the person for whom such services are performed, the excess of (1) the fair market value of the property at the first time the rights of the person having the beneficial interest in the property are transferable or are not subject to a substantial risk of forfeiture, whichever occurs earlier, over (2) the amount (if any) paid for the property, is included in the gross income of the person who performed the services.

Section 83(e) of the Code provides that section 83 does not apply to the transfer of an option without a readily ascertainable fair market value. However, under section 1.83-7(a) of the regulations, if such option is exercised, section 83(a) applies to the transfer of property pursuant to the exercise, and the employee realizes compensation upon the transfer at the time and in the amount determined under section 83(a).

HOLDINGS

The exercise of the nonqualified stock option caused the realization of 6*x* dollars of income under section 83(a) of the Code.

(1) The exchange of 6*x* dollars in value of common stock (1,000 shares) for 6*x* dollars in value of common stock (1,000 shares) qualifies for nonrecognition of gain under section 1036 of the Code. Pursuant to section 1031(d), the employee-shareholder's basis in this 1,000 shares of stock received pursuant to the exercise of the nonqualified option is the same as the employee-shareholder's basis in the 1,000 shares of stock exchanged therefor (2*x* dollars). Therefore, a disposition within the meaning of section 425(c) did not occur because section 1036 applies to the exchange of the 1,000 shares of stock that were acquired in 1977 pursuant to the exercise of the qualified option, and the employee-shareholder did not receive income pursuant to section 1.421-8(b) of the regulations.

(2) The additional 1,000 shares of common stock received by the employee-shareholder are compensation for services under section 83(a) of the Code. Accordingly, the employee-shareholder must include in gross income the fair market value (6*x* dollars) of the additional 1,000 shares of stock received pursuant to the exercise of the nonqualified stock option. The employee-shareholder's basis in the additional 1,000 shares of stock is the same as the amount included in gross income (6*x* dollars).

Section 1402.—Definitions

26 CFR 1.1402(a)-4: Rentals from real estate.

Circumstances in which the owner or tenant of land must include farm rentals in self-employment income, which is subject to social security tax. See T.D. 7710, page 12.

Section 2033.—Property in Which the Decedent Had an Interest

26 CFR 20.2033-1: Property in which the decedent had an interest.

Whether property, held by the decedent and decedent's spouse as tenants by the entirety, which is converted to a tenancy in common upon divorce, is includible in decedent's gross estate under section 2033 of the Code. See Rev. Rul. 80-241, below.

Section 2040.—Joint Interests

26 CFR 20.2040-1: Joint interests.
(Also Sections 2033, 2515; 20.2033-1, 25.2515-1.)

Jointly held property; divorce. A spouse purchased real property with separate funds and took title in the names of both spouses either as tenants by the entirety or as joint tenants with right of survivorship. In a state where a subsequent divorce converts a tenancy by the entirety or a joint tenancy into a tenancy in common, such a divorce would result in a gift of one-half the value of the property. In a state where a joint tenancy is not terminated by divorce, no gift results. Upon the contributor's death more than three years after the divorce the portion of the property that was not considered a gift is includible in the contributor's gross estate.

Rev. Rul. 80-241

ISSUE

What is the proper application of section 2040(a) and section 2515 of the Internal Revenue Code if property was held by the decedent and decedent's spouse as tenants by the entirety, or in the alternative, as joint tenants with right of survivorship and the decedent is divorced prior to death.

FACTS

Situation 1

In 1970, *A* purchased real property for 100*x* dollars and took title in the names of *A* and *B*, as tenants by the entirety. The property was located in State *X*, the jurisdiction where *A* and *B* resided. *A* provided the entire consideration for the property, and *A* did not elect under section 2515(c) of the Code to treat the creation of the tenancy by the entirety as a gift to *B*. Under the laws of State *X*, a tenancy by the entirety, unlike a joint tenancy, cannot be unilaterally severed.

In 1972 *A* and *B* were divorced. Prior to divorce, *A* and *B* did not execute a written agreement relative to their marital and property rights. The divorce decree did not contain any provision regarding the partition and disposition of the real property. However, it did provide for periodic support payments to *B*. *A* died in 1976.

The laws of State *X* provide that upon the dissolution of a marriage by divorce, a tenancy by the entirety is converted by operation of law into a tenancy in common. Each party then own an undivided one-half interest in the property. See for example, *Hendel v. Hendel*, 44 App. Div. 2d 532, 353 N.Y.S. 2d 454 (1974); *McIntyre v. McIntyre*, 377 S.W. 2d 421 (Mo. 1964); *Bernatavicius v. Bernatavicius*, 259 Mass. 486, 156 N.E. 685 (1927).

Situation 2

The facts are the same as in *Situation 1* except that title to the property was originally taken in the names of *A* and *B*, as joint tenants with right of survivorship. *Situation 2* will consider two possible dispositions of the property under state law, as follows:

1. The laws of State *X* provide that if property is held by a husband and wife as joint tenants, the joint tenancy is not affected if the parties are divorced. If the divorce decree or separation agreement does not provide for the disposition of the joint property, the property continues to be held by the parties as joint tenants after the divorce. See, *Bradley v. Mann*, 34 Colo. App. 135, 525 P. 2d 492 (1974), *aff'd* 535 P. d 213 (1975); *Summerlin v. Bowden*, 286 Ala. 391, 240 So. 2d 356 (1970); *Nichols v. Nichols*, 43 Wisc. 2d 346, 168 N.W. 2d 876 (1996); *Witzel v. Witzel*, 386 P. 2d 103 (Wyo. 1963).

2. The laws of State *X* provide that if the divorce decree or separation agreement does not provide for the disposition of the joint property, then the joint tenancy is converted by operation of law into a tenancy in common. *See for example, Ramirez v. Ramirez*, 309 So. 2d 25 (Fla. 1975); *Smith v. Smith*, 169 N.E. 2d 130 (Ind. 1960).

LAW AND ANALYSIS

Section 2033 of the Code includes in the gross estate the value of all property to the extent of the decedent's interest in the property.

Section 2040(a) of the Code provides the general rule that the decedent's gross estate shall include the entire value of property held by the decedent as a joint tenant with right of survivorship, or as a tenant by the entirety, except to the extent that the value of the property is attributable to consideration in money or money's worth furnished by the other joint tenant. *See*, section 2040(b) of the Code, which was added by the Tax Reform Act of 1976, Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 331, for an exception to the general rule of section 2040(a) in a situation in which the creation of tenancy by the entirety or joint tenancy in real property was treated as a gift under section 2515.

The creation of a joint tenancy or tenancy by the entirety in real property is generally considered a gift, for gift tax purposes. However, section 2515(a) provides that the creation of a tenancy by the entirety, or a joint tenancy, in real property by one spouse is not considered a transfer for purposes of the gift tax unless the donor elects to have the transfer treated as a gift. If the donor does not elect to treat the creation of the tenancy as a gift, then pursuant to section 2515(b), the termination of the tenancy other than by reason of the death of a spouse is a gift, ". . . to the extent that the proportion of the total consideration furnished by such spouses multiplied by the proceeds of such termination (whether in form of cash, property, or interests in property) exceeds the value of such proceeds of termination received by such spouse."

Section 25.2515-1(d)(2) of the Gift Tax Regulations defines the term "termination" as follows:

> . . . [A] termination of a tenancy is effected when all or a portion of the property so held by the spouses is sold, exchanged, or otherwise disposed of, by gift or in any other manner, or when the spouses, through any form of conveyance or agreement become tenants in common of the property or

> otherwise alter the nature of their respective interests in the property. . . .

In *Situation 1*, above, upon the issuance of the final court decree the tenancy by the entirety was terminated by operation of law. This termination would be subject to the gift tax. At the time of *A*'s death, the property is not subject to the provisions of section 2040, because the property is not held as a tenancy by the entirety, or a joint tenancy. Only the value of *A*'s undivided one-half interest as a tenant in common is includible in *A*'s gross estate under section 2033 of the Code.

In *Situation 2*, the property was initially purchased in the names of *A* and *B* as joint tenants with right of survivorship. If, under applicable state law the property continues to be held by the parties as joint tenants after the divorce, then upon *A*'s death, section 2040 would be applicable in determining the estate taxation of the property. Since in the situation presented, the entire value of the property is attributable to consideration in money or money's worth furnished by *A*, the entire value of the property on the date of *A*'s death is includible in *A*'s gross estate pursuant to section 2040 of the Code. Further, since the property ownership remained in joint tenancy form there would be no termination for purposes of section 2515, even though the joint tenants are no longer married.

If, on the other hand, state law provided that upon divorce the joint tenancy was converted to a tenancy in common, then only the value of *A*'s interest in the property after the divorce, that is, an undivided one-half interest as a tenant in common, is includible in A's gross estate under section 2033 of the Code. The provisions of section 2040 would not apply to the property interest. Also, the conversion of the joint tenancy into a tenancy in common would be considered a termination subject to the gift tax, under section 2515(b) of the Code.

HOLDINGS

1. *Situation 1*, when, upon divorce, the tenancy by the entirety is converted into a tenancy in common one-half of the value of the property is subject to the gift tax under section 2515. Upon *A*'s death, only the value of an undivided one-half interest as a tenant in common in the property is includible in *A*'s gross estate under section 2033 of the Code.

2. In *Situation 2*, if the joint tenancy remains a joint tenancy after the divorce, then pursuant to section 2040, the entire value of the property on the date of *A*'s death is includible in *A*'s gross estate. If, in *Situation 2*, the property was converted to a tenancy in common upon divorce, then one-half the value of the property is subject to the gift tax at the time, and only the value of an undivided one-half interest as a tenant in common in the property is includible in *A*'s gross estate under section 2033.

Section 2515.—Tenancies by the Entirety in Real Property

26 CFR 25.2515-1: Tenancies by the entirety; in general.

Whether property, held by the decedent and decedent's spouse as tenants by the entirety, which is converted to a tenancy in common upon divorce, is subject to the gift tax under section 2515 of the Code. See Rev. Rul. 80-241, page 11.

Section 6166.—Alternative Extension of Time for Payment of Estate Tax Where Estate Consists Largely of Interest in Closely Held Business

26 CFR 20.6166-1: Election of alternate extension of time for payment of estate tax where estate consists largely of interest in closely held business.

Election by an executor to extend payment of part or all of the portion of the estate tax which is attributable to a closely held business interest. See T.D. 7710, below.

Section 2032A.—Valuation of Certain Farm, etc., Real Property

26 CFR 20.2032A-3: Material participation requirements for valuaiton of certain farm and closely-held business real property.
(Also Sections 1402, 6166, 6324A; 1.1402(a)-4, 20.6166-1, 301.6324A-1.)

T.D. 7710

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART I.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; SUBCHAPTER B, PART 20.—ESTATE TAX; SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Definition of Net Earnings From Self-Employment for Certain Owners and Tenants of Farms

Material Participation Requirements for Valuation of Certain Farm and Closely Held Business Real Property and Method of Valuing Farm Real Property According to Actual Use

Procedure For Various Estate Tax Elections under the Tax Reform Act of 1976

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to material participation requirements for and the method of valuing certain farm real property according to actual use. The document also contains final regulations on the procedure for electing the use valuation, for electing to extend payment of estate tax attributable to interests in closely held businesses, and for electing a special lien in lieu of personal liability for certain deferred amounts of estate tax as well as final regulations on material participation rules for certain tenants and owners of farms for self-employment income tax purposes. Changes to the applicable tax law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1] and the Act of August 7, 1974 (Pub. L. 93-368, [1974-2 C.B. 418], 88 Stat. 422). The regulations provide the public with the guidance needed to comply with those Acts. They affect farm owners and tenants, and estates comprised largely of farm and other closely-held business interests.

DATES: The regulations are effective as follows:

(1) For taxable years beginning after December 31, 1973, in the case of the provisions defining net earnings from self-employment; and

(2) For estates of decedents dying after December 31, 1976, in the case

of the provisions on valuation of farm and closely held business real property, on extension of time to pay estate tax and on the special lien in lieu of personal liability for certain amounts of estate tax.

FOR FURTHER INFORMATION CONTACT: H. B. Hartley of the Leislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3287 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On July 13, 1978, the Federal Register published proposed amendments to the Estate Tax Regulations (26 CFR Part 20) relating to procedures for making the elections provided under sections 2032A, 6166, and 6324A of the Internal Revenue Code of 1954 ("Code") (43 FR 30070). On December 21, 1978, amendments to these July 13, 1978, proposed regulations were published in the Federal Register (43 FR 59517). On July 19, 1978, the Federal Register published proper amendments to the Income Tax Regulations (26 CFR Part 1) under section 1402 (a) of the Code and to the Estate Tax Regulations (26 CFR Part 20) under section 2032A of the Code (43 FR 31039). On September 10, 1979, a portion, proposed § 20.2032A-4(b), of the July 19, 1978, proposed regulations was withdrawn by notice published in the Federal Register (43 FR 52698). Also on September 10, 1979, the Federal Register published new proposed regulations under section 2032A replacing the withdrawn proposal (44 FR 52696). All of these regulations were proposed to conform the regulations to section 10(b) of the Act of August 7, 1974 (Pub. L. 93-368 [1974-2 C.B. 418], 88 Stat. 422) and to sections 2003(a) and 2004(a) and (d) of the Tax Reform Act of 1976 (Pub. L. 94-455 [1976-3 C.B. (Vol. 1) 1], 90 Stat. 1856, 1868).

A public hearing on the July 13, July 19, and December 21, 1978, proposed regulations was held on April 3, 1979. A public hearing was held on the September 10, 1979, proposed regulations on January 16, 1980. After consideration of all written and oral comments regarding the proposed amendments, final regulations are adopted by this Treasury decision.

PROVISIONS OF THE REGULATIONS

Net Earnings from Self-Employment

Section 1402(a)(1) of the Code, as amended in 1974, defines more narrowly the circumstances in which the owner or tenant of land must include farm rentals in self-employment income, which is subject to social security tax. Farm rentals are considered self-employment income when three requirements are met. First, the owner or tenant must arrange for another individual to farm the land. Second, that arrangement must contemplate material participation by the owner or tenant in the operation of the farm. Third, the owner or tenant must in fact participate materially in the operation of the farm.

Consistent with the various court decisions rendered prior to the enactment of Public Law 93-368, the existing regulations provide that the actions of an employee or agent will be attributed to the owner or tenant in determining whether the three requirements for material participation have been met. Thus, owners or tenants of land who arranged with agents (such as professional farm management companies) to manage and supervise the farming of their land had to include the rentals they received in their self-employment income. This was so even though they did not personally participate in the farming operation at all. As a result of this rule, many persons who thought they were merely receiving investment income found themselves liable for social security taxes.

The amendment changed the rule as to agents and employees for years beginning after 1973. Thus, activities of agents and employees are no longer taken into account in determining under section 1402 whether an owner or tenant has materially participated in the farming operation.

Material Participation and Estate Tax Valuation

Code section 2032A allows an executor to elect to value qualified real property used in farming or other closely-held business activity based upon its qualified use rather than its fair market value determined under otherwise applicable estate tax rules. That section requires, however, that the owner or a member of the owner's family materially participate in the operation of the farm or other business for specified periods both before and after the decedent's death.

Along with property owned individually by the decedent, real property owned by a qualified closely-held corporation or partnership or by a trust is permitted to be specially valued for determining the value of the decedent's interest in that business. The regulations provide that where the property is owned in this manner, the participating owner or family member may be an employee rather than be self-employed. Even though the participants are not self-employed, material participation is tested by viewing their activities as if they were self-employed.

Participation is judged in light of actual personal involvement by the decedent and family members. If the involvement occurs on less than a full-time basis, it must be pursuant to an arrangement entered into by the participant (or a member of the participant's family) calling for the activities that occur. Acts of an agent or an employee are not considered in determining whether material participation occurs unless the agent or employee is also a family member.

Material participation, if other than by full-time employment, means a regular process of consultation and inspection with active involvement in making management decisions. Advancing funds or assuming financial responsibility for the business operation are also required. Maintaining one's principal place of residence on the premises in the case of a farm or hotel is a factor in determining the degree of participation.

With corporations and partnerships, activities in the management and operation of the real estate component of the business as a whole are central. Merely holding corporate offices or being a partner in name and financial risk only is not sufficient participation. This is true even where an inactive partner returns his or her distributive share as earnings from self-employment and pays social security taxes on it. Finally, activities which are not contemplated by the required arrangement are not considered in determining whether material participation occurs.

Method of Valuing Farm Real Property under Section 2032A(e)(7)

Section 2032(e)(7) provides a special method for valuing qualified real property used for farming purposes. This method requires the executor to locate tracts of comparable real property which are rented solely for cash. A 5-year average of gross cash rentals from comparable real property, minus State and local real estate taxes, is then capitalized by the average annual effective interest rate charged by Federal land banks on new agricultural loans to farmers and ranchers. These regulations provide the definitions and other information necessary for valuing property according to this method.

If the section 2032A(e)(7) formula valuation method is used, the executor must document to the Internal Revenue Service the actual comparable property and cash rentals upon which the executor relies. If no such rentals are found, the executor may still value the farm real property based upon its current use under the provisions of section 2032A(e)(8).

The rules for valuing real property under section 2032A(e)(7) provided in these regulations apply only to estates where the specially valued real property is directly owned by the decedent. Regulations will be published at a later date detailing the applicability of this valuation method to property owned indirectly through a trust, a partnership, or a corporation.

Election of Use Valuation

The executor must elect special use valuation by attaching a notice of election to a timely filed estate tax return. Normally, this election is irrevocable; however, elections which are timely made on or before August 30, 1980, may be revoked during the 6-month period following that date (or any lesser period remaining before expiration of the statute of limitations). A revocation is to be accompanied by payment of any additional estate tax found due, plus interest.

An agreement signed by all parties with an interest in the property subject to the special use valuation election is also required under section 2032A. This agreement must accompany the notice of election.

Section 20.2032A-8 defines a person with an interest in the property to include all persons in being as of the date of death of the decedent who receive any vested or contingent interest in the property, who receive a power of appointment over the property, who are beneficiaries of a gift over in default of exercise of any such power, or who, under applicable state law, have any legal right which could affect the ultimate disposion of the property.

Alternate Extension of Time for Payment of Estate Tax

Section 6166 allows an executor to elect to defer payment of a percentage of the total estate tax, including the amount of certain deficiencies. The maximum percentage of tax which may be deferred corresponds to the percentage of the adjusted gross estate which is comprised of a closely held business interest (as defined in section 6166(b)(1)).

Normally, the election is made at the time the estate tax return is filed; however, an election may subsequently be made to pay certain deficiencies in installments. Additionally, where the executor is uncertain as to whether the estate needs to defer payment of tax, a protective election may be made when the estate tax return is filed. If a protective election is made, the final election is to be made within 60 days after final values causing the estate to qualify are determined (or agreed to following examination of a return).

Special Lien for Deferred Amount of Estate Tax

Section 6324A allows the executor of a decedent's estate to elect a lien in favor of the United States in lieu of bond or personal liability if an election under section 6166 or section 6166A is made. The election under section 6324A will not be effective unless all parties having an interest in the property subject to the lien sign an agreement in which they consent to the creation of the lien. The agreement must be filed with the notice of election of the lien. The election may be filed at any time prior to payment of the full amount of the estate tax.

ADDITIONAL CONSIDERATIONS

These regulations are needed in order to provide guidance to the public as well as to government employees responsible for implementation of sections 1402(a), 2032A, 6166, and 6324A of the Code. Considering both the direct and indirect effects of these regulations, it is believed that they satisfactorily implement section 10(b) of the Act of August 7, 1974 (Pub. L. 93-368 [1974-2 C.B. 418]), and sections 2003(a) and 2004(a) and (d) of the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 332, 338]. Evaluation of the effectiveness of the regulations after issuance will be based upon comments received from offices within the Internal Revenue Service and the Treasury Department, from other government agencies and from members of the public.

PUBLIC COMMENTS

Seventy-three comments were received in response to the four notices of proposed rulemaking. Two comments urged attributing activities of employees, but not agents, to owners for purposes of meeting both the social security and use valuation material participation requirements. This suggestion was rejected because employees are agents of their employer.

Several comments urged an express statement that use valuation under section 2032A is available even if farming is the only potential use for the real property. Sections 20.2032A-3(a) and 20.2032A-8(a) were changed to reflect this position once the Treasury learned that section 2032A(e)(7) produces land values below even a true current use value and that inequities would result between suburban and strictly rural farms if the limitation were retained. Section 20.2032A-3(b) was changed to clarify that directly owned real property which is passively leased to the decedent's active closely held business (under section 6166(b)(1)) can be qualified property despite the passive lease. A new paragraph (b)(2) was added to § 20.2032A-3 to clarify the treatment of farm buildings as specially valued property under section 2032A.

Section 20.2032A-3(c) was changed in response to the comments to clarify that material participation must occur during periods totalling at least 5 calendar years before and after death and to provide rules under section 2032A(c) for property in which the heirs receive undivided or successive interests. In response to a commentor's question, § 20.2032A-3(c) now also states that simultaneous activities of multiple family members cannot be aggregated to find material participation. Rather, the activities of at least one family member, viewed alone, must constitute material participation at any given time. A statement was also added to clarify that no exception to the material participation requirements is made for periods when real property is owned by the decedent's estate. A new paragraph (d) was added to § 20.2032A-3 to answer questions raised by commentors about property acquired less than 5 years before death and real property, ownership of which is changed from direct to indirect in a nontaxable transfer under section 351 or 721 of the Code during that 5-year period. Proposed § 20.2032A-3(d) on activities required for material participation was renumbered § 20.2032A-3(e) and was modified to state that furnishing of farm equipment by a lessor is not a requirement. The same section now contains an expanded discussion of the relationship of material participation under sections 2032A and 1402(a)(1). Briefly stated, the rule is that payment of self-employment taxes alone is not conclusive as to the presence of material participation. However, when self-employment taxes have not been paid, material participation is presumed not to have occurred unless the executor supplies proof that such participation did in fact occur and demonstrates to the Internal Revenue Service why no such taxes were paid. In addition, any such taxes (plus interest and penalties) determined to be due must be paid.

A new sentence was added to paragraph (e) to reiterate that retention of a farm manager will not automatically disqualify a farm from special use valuation. Clarifying language was also added to that paragraph concernin activities necessary for material participation during nonproducing seasons.

Timber growers requested an explanation of the application of section 2032A to timber farms. A new example (7) has been added to § 20.2032A-3(g) in response to these comments. The example applies the material participation rules to a timber farm.

On September 10, 1979, the definition of gross cash rental contained in the originally published § 20.2032A-4(b) was withdrawn and reproposed. The reproposed section requires executors to rely on actual tracts of comparable property rented solely for cash in valuing farm real property under section 2032A(e)(7). That proposal also specified that state-wide averages of rentals and appraisals cannot be used to value property under section 2032(e)(7). After consideration of all oral and written comments, the Treasury believes that there is no statutory basis for changing the rule as proposed in the Federal Register for September 10, 1979 (44 FR 52696).

Therefore, the final regulations adopt the position proposed on September 10, 1979. If comparable property rented solely for cash is not demonstrated by the executor for all specially valued property, all such property must be valued under section 2032A(e)(8).

Proposed § 20.2032A-8(a) required special use valuation elections to be made on a timely filed estate tax return. Several comments suggested accepting elections first made upon examination of a return. The requested suggestion was not adopted because of statutory restrictions. Several commentors asked that the final regulations include a rule on elections to specially value less than all qualified real property. A new § 20.2032A-8(a)(2) is added to the regulations permitting such partial elections, provided property sufficient to satisfy the statutory thresholds of section 2032A(b)(1)(B) and (C) is specially valued. Paragraph (a)(2) was also modified in response to the public comments to require a statement that specially valued property was owned at least 5 years before the date of the decedent's death rather than the date of acquisition. Further, the request for identification of periods of no material participation and use for farming purposes was restricted to the 8 years preceding the death.

Section 20.2032A-8(b) was changed in response to the comments to make clear that protective elections can be made even if tax is initially due and the estate qualifies based upon returned values.

A witness at the public hearing asked that final regulations include a statement on the duties of the agent designated in the areement to the section 2032A election. Section 20.2032A-8(c) was amended to specify that the agent must have satisfactory evidence of authority to act for the parties to the agreement required under section 2032A(a)(1)(B) and (d)(2) and to indicate the agent's duties. The requirement that certain creditors sign the agreement, contained in proposed § 20.2032A-8(c)(2), was deleted.

Proposed § 20.6166-1(d) was amended to delete any implied limitations on the circumstances in which a protective election can be made. The new rule is consistent with that for protective elections under section 2032A.

Proposed § 20.6324A-1 was rewritten as a cross-reference to new § 301.6324A-1 with the substantive rules contained in proposed § 20.6324A-1 being adopted as §301.6324A-1. This change was made to achieve consistency with other regulations on liens for taxes.

DRAFTING INFORMATION

The principal author of these regulations is H. B. Hartley of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, amendments to the regulations (26 CFR Parts 1, 20, and 301), are hereby adopted as set forth below:

Paragraph 1. Section 1.1402(a) is deleted.

Par. 2. Section 1.1402(a)-4 is amended by revising paragraph (b)(5) and by revising examples (5) and (6) in paragraph (b)(6) to read as follows:

§ 1.1402(a)-4 Rentals from real estate.

* * * * *

(b) *Special rule for "includible farm rental income"*— * * *

(5) *Employees or agents.* An agreement entered into by an employee or agent of an owner or tenant and another person is considered to be an arrangement entered into by the owner or tenant for purposes of satisfying the requirement set forth in paragraph (b)(2) that the income must be derived under an arrangement between the owner or tenant and another person. For purposes of determining whether the arrangement satisfies the requirement set forth in paragraph (b)(3) that the parties contemplate that the owner or tenant will materially participate in the production or management of production of a commodity, services which will be performed by an employee or agent of the owner or tenant are not considered to be services which the arrangement contemplates will be performed by the owner or tenant. Services actually performed by such employee or agent are not considered services performed by the owner or tenant in determining the extent to which the owner or tenant has participated in the production or management of production of a commodity. For taxable years beginning before January 1, 1974, contemplated or actual services of an agent or an employee of the owner or tenant are deemed to be contemplated or actual services of the owner or tenant under paragraphs (b)(3) and (b)(4) of this section.

(6) *Examples.* * * *

Example (5). I owned a farm several miles from the town in which he lived. He rented the farm to J under an arrangement which contemplated I's material participation in the management of production of wheat. I furnished one-half of the seed and fertilizer and all the farm equipment and livestock. He employed K to perform all the services in advising, consulting, and inspecting contemplated by the arrangement. I is not materially participating in the management of production of wheat by J. The work done by I's employee, K, is not attributable to I in determining the extent of I's participation. I's rental income from the arrangement is, therefore, not to be included in computing his net earnings from self-employment. For taxable years beginning before January 1, 1974, however, I's rental income would be includible in those earnings.

Example (6). L, a calendar-year taxpayer, appointed M as his agent to rent his fully equipped farm for 1974. M entered into a rental arrangement with N under which M was to direct the planting of crops, inspect them weekly during the growing season, and consult with N on any problems that might arise in connection with irrigation, etc., while N furnished all the labor needed to grow and harvest the crops. M did in fact fulfill its responsibilities under the arrangement. Although the arrangement entered into by M and N is considered to have been made by L, M's services are not attributable to L, and L's furnishing of a fully equipped farm is insufficient by itself to constitute material participation in the production of the crops. Accordingly, L's rental income from the arrangement is not included in his net earnings from self-employment for that year. For taxable years beginning before January 1, 1974, however, L's rental income would be includible in those earnings.

* * * * *

Par. 3. The following new sections are added following § 20.2032-1.

§ 20.2032A-3 Material participation requirements for valuation of certain farm and closely-held business real property.

(a) *In general.* Under section 2032A, an executor may, for estate tax purposes, make a special election concerning valuation of qualified real property (as defined in section 2032A (b)) used as a farm for farming purposes or in another trade or business. If this election is made, the property will be valued on the basis of its value for its qualified use in farming or the other trade or business, rather than its fair market value determined on the basis of highest and best use (irrespective of whether its highest and best use is the use in farming or other business). For the special valuation rules of section 2032A to apply, the deceased owner and/or a member of the owner's family (as defined in section 2032A(e)(2)) must materially participate in the operation of the farm or other business. Whether the required material participation occurs is a factual determination, and the types of activities and financial risks which will support such a finding will vary with the mode of ownership of both the property itself and of any business in which it is used. Passively collecting rents, salaries, draws, dividends, or other income from the farm or other business is not sufficient for material participation, nor is merely advancing capital and reviewing a crop plan or other business proposal and financial reports each season or business year.

(b) *Types of qualified property*—(1) *In general.* Real property valued under section 2032A must pass from the decedent to a qualified heir or be acquired from the decedent by a qualified heir. The real property may be owned directly or may be owned indirectly through ownership of an interest in a corporation, a partnership, or a trust. However, real property is considered to be qualified real property only if a qualified heir receives or acquires a present interest in the property (determined under section 2503) from the decedent. Where the ownership is indirect, however, the decedent's interest in the business must, in addition to meeting the tests for qualification under section 2032A, qualify under the tests of section 6166(b)(1) as an interest in a closely-held business on the date of the decedent's death and for sufficient other time (combined with periods of direct ownership) to equal at least 5 years of the 8 year period preceding the death. All specially valued property must be used in a trade or business. Directly owned real property that is leased by a decedent to a separate closely held business is considered to be qualified real property, but only if the separate business qualifies as a closely held business under section 6166(b)(1) with respect to the decedent on the date of his or her death and for sufficient other time (combined with periods during which the property was operated as a proprietorship) to equal at least 5 years of the 8 year period preceding the death. For example, real property owned by the decedent and leased to a farming corporation or partnership owned and operated entirely by the decedent and fewer than 15 members of the decedent's family is eligible for special use valuation. Under section 2032A, the term trade or business applies only to an active business such as a manufacturing, mercantile, or service enterprise, or to the raising of agricultural or horticultural commodities, as distinguished from passive investment activities. The mere passive rental of property will not qualify. The decedent must own an equity interest in the farm operation. A trade or business is not necessarily present even though an office and regular hours are maintained for management of income producing assets, as the term "business" is not as broad under section 2032A as under section 162. Additionally, no trade or business is present in the case of activities not engaged in for profit. *See* section 183.

(2) *Structures and other real property improvements.* Qualified real property includes residential buildings and other structures and real property improvements occupied or used on a regular basis by the owner or lessee of real property (or by employees of the owner or lessee) for the purpose of operating the farm or other closely held business. A farm residence occupied by the decedent owner of the specially valued property is considered to be occupied for the purpose of operating the farm even though a family member (not the decedent) was the person materially participating in the operation of the farm as required under section 2032A(b)(1)(C).

(c) *Period material participation must last.* The required participation must last—

(1) For periods totalling 5 years or more during the 8 years immediately preceding the date of the decedent's death; and

(2) For periods totalling 5 years or more during any 8 year period ending after the date of the decedent's death (up to a maximum of 15 years after decedent's death, when the additional estate tax provisions of section 2032A(c) cease to apply).

In determining whether the material participation requirement is satisfied, no exception is made for periods during which real property is held by the decedent's estate. Additionally, contemporaneous material participation by 2 or more family members during a period totalling a year will not result in that year being counted as 2 or more years for purposes of satisfying the requirements of this paragraph (c). Death of a qualified heir (as defined in section 2032A(e)(1)) before the requisite time has passed ends any material participation requirement for that heir's portion of the property as to the original decedent's estate if the heir received a separate, joint or other undivided property interest from the decedent. If qualified heirs receive successive interests in specially valued property (e.g. life estate and remainder interests) from the decedent, the material participation requirement does not end with respect to any part of the property until the death of the last qualified heir (or, if earlier, the expiration of 15 years from the date of the decedent's death). The requirements of section 2032A will fully apply to an heir's estate if an election under this section is made for the same property by the heir's executor. In general, to determine whether the required participation has occurred, brief periods (*e.g.*, periods of 30 days or less) during which there was no material participation may be disregarded. This is so only if these periods were both preceded and followed by substantial periods (*e.g.*, periods of more than 120 days) in which there was uninterrupted material participation. *See* paragraph (e)(1) of this section which provides a special rule for periods when little or no activity is necessary to manage fully a farm.

(d) *Period property must be owned by decedent and family members.* Only real property which is actually owned by any combination of the decedent, members of the decedent's family, and qualified closely held businesses for periods totalling at least 5 of the 8 years preceding the date of decedent's death may be valued under section 2032A. For example, replacement property acquired in a like-kind exchange under section 1031 is considered to be owned only from the date on which the replacement property is actually acquired. On the other hand, replacement property acquired as a result of an involuntary conversion in a transfer that would meet the requirements of section 2032A(h) if it occurred after the date of the decedent's death is considered to have been owned from the date in which the involuntarily converted property was acquired. Property transferred from a proprietorship to a corporation or a partnership during the 8-year period ending on the date of the decedent's death is considered to be continuously owned to the extent of the decedent's equity interest in the corporation or partnership if, (1) the transfer meets the requirements of section 351 or 721, respectively, and (2) the decedent's interest in the corporation or partnership meets the requirements for indirectly held property contained in paragraph (b)(1) of this section. Likewise, property transferred to a trust is considered to be continuously owned if the beneficial ownership of the trust property is such that the requirements of section 6166(b)(1)(C) would be so satisfied if the property were owned by a corporation and all beneficiaries having vested interests in the trust were shareholders in the corporation. Any periods following the transfer during which the interest in the corporation, partnership, or trust does not meet the requirements of section 6166(b)(1) may not be counted for purposes of satisfying the ownership requirement of this paragraph (d).

(e) *Required activities*—(1) *In general.* Actual employment of the decedent (or of a member of the decedent's family) on a substantially full-time basis (35 hours a week or more) or to any lesser extent necessary personally to manage fully the farm or business in which the real property to be valued under section 2032A is used constitutes material participation. For example, many farming operations require only seasonal activity. Material participation is present as long as all necessary functions are performed even though little or no actual activity occurs during nonproducing seasons. In the absence of this direct involvement in the farm or other business, the activities of either the decedent or family members must meet the standards prescribed in this paragraph and those prescribed in the regulations issued under section 1402(a)(1). Therefore, if the participant (or participants) is self-employed with respect to the farm or other trade or business, his or her income from the farm or other business must be earned income for purposes of the tax on self-employment income before the participant is considered to be materially participating under section 2032A. Payment of the self-employment tax is not conclusive as to the presence of material participation. If no self-employment taxes have been paid, however, material participation is presumed not to have occurred unless the executor demonstrates to the satisfaction of the Internal Revenue Service that material participation did in fact occur and informs the Service of the reason no such tax was paid. In addition, all such taxes (including interest and penalties) determined to be due must be paid. In determining whether the material participation requirement is satisfied, the activities of each participant are viewed separately from the activities of all other participants, and at any given time, the activities of at least one participant must be material. If the involvement is less than full-time, it must be pursuant to an arrangement providing for actual participation in the production or management of production where the land is used by any nonfamily member, or any trust or business entity, in farming or another business. The arrangement may be oral or written, but must be formalized in some manner capable of proof. Activities not contemplated by the arrangement will not support a finding of material participation under section 2032A, and activities of any agent or employee other than a family member may not be considered in determining the presence of material participation. Activities of family members are considered only if the family relationship existed at the time the activities occurred.

(2) *Factors considered.* No single factor is determinative of the presence of material participation, but physical work and participation in management decisions are the principal factors to be considered. As a minimum, the decedent and/or a family member must regularly advise or consult with the other managing party on the operation of the business. While they need not make all final management decisions alone, the decedent and/or family members must participate in making a substantial number of these decisions. Additionally, production activities on the land should be inspected regularly by the family participant, and funds should be advanced and financial responsibility assumed for a substantial portion of the expense involved in the operation of the farm or other business in which the real property is used. In the case of a farm, the furnishing by the owner or other family members of a substantial portion of the machinery, implements, and livestock used in the production activities is an important factor to consider in finding material participation. With farms, hotels, or apartment buildings, the operation of which qualifies as a trade or business, the participating decedent or heir's maintaining his or her principal place of residence on the premises is a factor to consider in determining whether the overall participation is material. Retention of a professional farm manager will not by itself prevent satisfaction of the material participation requirement by the decedent and family members. However, the decedent and/or a family member must personally materially participate under the terms of arrangement with the professional farm manager to satisfy this requirement.

(f) *Special rules for corporations, partnerships, and trusts*—(1) *Required arrangement.* With indirectly owned property as with property that is directly owned, there must be an arrangement calling for material participation in the business by the decedent owner or a family member. Where the real property is indirectly owned, however, even full-time involvement must be pursuant to an arrangement between the entity and the decedent or family member specifying the services to be performed. Holding an office in which certain material functions are inherent may constitute the necessary arrangement for material participation. Where property is owned by a trust, the arrangement will generally be found in one or more of four situations. First, the arrangement may result from appointment as a trustee. Second, the arrangement may result from an employer-employee relationship in which the participant is employed by a qualified closely held business owned by the trust in a position requiring his or her material participation in its activities. Third, the participants may enter into a contract with the trustees to manage, or take part in managing, the real property for the trust. Fourth, where the trust agreement expressly grants the management rights to the beneficial owner, that grant is sufficient to constitute the arrangement required under this section.

(2) *Required activities.* The same participation standards apply under section 2032A where property is owned by a qualified closely held business as where the property is directly owned. In the case of a corporation, a partnership, or a trust where the participating decedent and/or family members are employees and thereby not subject to self-employment income taxes, they are to be viewed as if they were self-employed, and their activities must be activities that would subject them to self-employment income taxes were they so. Where property is owned by a corporation, a partnership or a trust, participation in the management and operation of the real prop-

erty itself as a component of the closely held business is the determinative factor. Nominally holding positions as a corporate officer or director and receiving a salary therefrom or merely being listed as a partner and sharing in profits and losses will not alone support a finding of material participation. This is so even though, as partners, the participants pay self-employment income taxes on their distributive shares of partnership earnings under § 1.1402(a)-2. Further, it is especially true for corporate directors in states where the board of directors need not be an actively functioning entity or need only act informally. Corporate offices held by an owner are, however, factors to be considered with all other relevant facts in judging the degree of participation. When real property is directly owned and is leased to a corporation or partnership in which the decedent owns an interest which qualifies as an interest in a trade or business within the meaning of section 6166 (b)(1), the presence of material participation is determined by looking at the activities of the participant with regard to the property in whatever capacity rendered. During any periods when qualified real property is held by an estate, material participation is to be determined in the same manner as if the property were owned by a trust.

(g) *Examples.* The rules for determining material participation may be illustrated by the following examples. Additional illustrations may be found in examples (1) through (6) in § 1.1402(a)-4.

Example (1). A, the decedent, actively operated his 100-acre farm on a full-time basis for 20 years. He then leased it to B for the 10 years immediately preceding his death. By the terms of the lease, A was to consult with B on where crops were to be planted, to supervise marketing of the crop, and to share equally with B in expenses and earnings. A was present on the farm each spring for consultation; however, once planting was completed, he left for his retirement cottage where he remained until late summer, at which time he returned to the farm to supervise the marketing operation. A at all times maintained the farm home in which he had lived for the time he had owned the farm and lived there when at the farm. In light of his activities, assumption of risks, and valuable knowledge of proper techniques for the particular land gained over 20 years of full-time farming on the land involved, A is deemed to have materially participated in the farming business.

Example (2). D is the 70-year-old widow of farmer C. She lives on a farm for which special valuation has been elected and has lived there for 20 years. D leases the land to E under an arrangement calling for her participation in the operation of the farm. D annually raises a vegetable garden, chickens, and hogs. She also inspects the tobacco fields (which produce approximately 50 percent of the farm income) weekly and informs E if she finds any work that needs to be done. D and E share expenses and income equally. Other decisions such as what fields to plant and when to plant and harvest crops are left to E, but D does occasionally make suggestions. During the harvest season, D prepares and serves meals for all temporary farm help. D is deemed to participate materially in the farm operation based on her farm residence and her involvement with the main money crop.

Example (3). Assume that D in example (2) moved to a nursing home 1 year after her husband's death. E completely operated the farm for her for 6 years following her move. If E is not a member of D's family, material participation ceases when D moves; however, if E is a member of D's family, E's material participation will prevent disqualification even if D owns the property. Further, upon D's death, the section 2032A valuation could be elected for her estate if E were a member of her family and the other requirements of section 2032A were satisfied.

Example (4). F, a qualified heir, owned a specially valued farm. He contracted with G to manage the farm for him as F, a lawyer, lived and worked 15 miles away in a nearby town. F supplied all machinery and equipment and assumed financial responsibility for the expenses of the farm operation. The contract specified that G was to submit a crop plan and a list of expenses and earnings for F's approval. It also called for F to inspect the farm regularly and to approve all expenditures over $100. In practice, F visited the farm weekly during the growing season to inspect and discuss operations. He actively participated in making important management decisions such as what fields to plant or pasture and how to utilize the subsidy program. F is deemed to have materially participated in the farm operation as his personal involvement amounted to more than managing an investment. Had F not regularly inspected the farm and participated in management decisions, however, he would not be considered to be materially participating. This would be true even though F did assume financial responsibility for the operation and did review annual crop plans.

Example (5). Decedent I owned 90 percent of all outstanding stock of X Corporation, a qualified closely-held business which owns real property to be specially valued. I held no formal position in the corporation and there was no arrangement for him to participate in daily business operations. I regularly spent several hours each day at the corporate offices and made decisions on many routine matters. I is not deemed to have materially participated in the X Corporation despite his activity because there was no arrangement requiring him to act in the manner in which he did.

Example (6). Decedent J was a senior partner in the law firm of X, Y, and Z, which is a qualified closely held business owning the building in which its offices are located. J ceased to practice law actively 5 years before his death in 1977; however, he remained a full partner and annually received a share of firm profits. J is not deemed to have materially participated under section 2032A even though he still may have reported his distributive share of partnership income for self-employment income tax purposes if the payments were not made pursuant to any retirement agreement. This is so because J does not meet the requirements of actual personal material participation.

Example (7). K, the decedent, owned a tree farm. He contracted with L, a professional forester, to manage the property for him as K, a doctor, lived and worked in a town 50 miles away. The activities of L are not considered in determining whether K materially participated in the tree farm operation. During the 5 years preceding K's death, there was no need for frequent inspections of the property or consultation concerning it, inasmuch as most of the land had been reforested and the trees were in the beginning stages of their growing cycle. However, once every year, L submitted for K's approval a proposed plan for the management of the property over the next year. K actively participated in making important management decisions, such as where and whether a pre-commercial thinning should be conducted, whether the timber was adequately protected from fire and disease, whether fire lines needed to be plowed around the new trees, and whether boundary lines were properly maintained around the property. K inspected the property at least twice every year and assumed financial responsibility for the expenses of the tree farm. K also reported his income from the tree farm as earned income for purposes of the tax on self-employment income. Over a period of several years, K had harvested and marketed timber from certain tracts of the tree farm and had supervised replanting of the areas where trees were removed. K's history of harvesting, marketing, and replanting of trees showed him to be in the business of tree farming rather than merely passively investing in timber land. If the history of K's tree farm did not show such an active business operation, however, the tree farm would not qualify for special use valuation. In light of all these facts, K is deemed to have materially participated in the farm as his personal involvement amounted to more than managing an investment.

Example (8). Decedent M died on January 1, 1978, owning a farm for which special use valuation under section 2032A has been elected. M owned the farm real property for 15 years before his death. During the 4 years preceding M's death (January 1, 1974 through December 31, 1977), the farm was rented to N, a nonfamily member, and neither M nor any member of his family materially participated in the farming operation. From January 1, 1970, until December 31, 1973, both M and his daughter, O, materially participated in the farming operation. The material participation requirement of section 2032A(b)(1)(C)(ii) is not satisfied because material participation did not occur for periods aggregating at least 5 different years of the 8 years preceding M's death.

§ 20.2032A-4 Method of valuing farm real property.

(a) *In general.* Unless the executor of the decedent's estate elects otherwise under section 2032A(e)(7)(B)(ii) or fails to document comparable rented farm property meeting the requirements of this section, the value of the property which is used for farming purposes and which is subject to an election under section 2032A is determined by—

(1) Subtracting the average annual state and local real estate taxes on actual tracts of comparable real property in the same locality from the average annual gross cash rental for that same comparable property, and

(2) Dividing the result so obtained by the average annual effective interest rate charged on new Federal land bank loans.

The computation of each average annual amount is to be based on the 5 most recent calendar years ending before the date of the decedent's death.

(b) *Gross cash rental*—(1) *Generally.* Gross cash rental is the total amount of cash received for the use of actual tracts of comparable farm real property in the same locality as the property being specially valued during the period of one calendar year. This amount is not diminished by the amount of any expenses or liabilities associated with the farm operation or the lease. *See*, paragraph (d) of this section for a definition of comparable property and rules for property on which buildings or other improvements are located and farms including multiple property types. Only rentals from tracts of comparable farm property which are rented solely for an amount of cash which is not contingent upon production are acceptable for use in valuing real property under section 2032A(e)(7). The rentals considered must result from an arm's-length transaction as defined in this section. Additionally, rentals received under leases which provide for payment solely in cash are not acceptable as accurate measures of cash rental value if involvement by the lessor (or a member of the lessor's family who is other than a lessee) in the management or operation of the farm to an extent which amounts to material participation under the rules of section 2032A is contemplated or actually occurs. In general, therefore, rentals for any property which qualifies for special use valuation cannot be used to compute gross cash rentals under this section because the total amount received by the lessor does not reflect the true cash rental value of the real property.

(2) *Special rules*—(i) *Documentation required of executor.* The executor must identify to the Internal Revenue Service actual comparable property for all specially valued property and cash rentals from that property if the decedent's real property is valued under section 2032A(e)(7). If the executor does not identify such property and cash rentals, all specially valued real property must be valued under the rules of section 2032A(e)(8) if special use valuation has been elected. *See*, however, § 20.2032A-8(d) for a special rule for estates electing section 2032A treatment on or before August 30, 1980.

(ii) *Arm's-length transaction required.* Only those cash rentals which result from a lease entered into in an arm's-length transaction are acceptable under section 2032A(e)(7). For these purposes, lands leased from the Federal government, or any state or local government, which are leased for less than the amount that would be demanded by a private individual leasing for profit are not leased in an arm's-length transaction. Additionally, leases between family members (as defined in section 2032A(e)(2)) which do not provide a return on the property commensurate with that received under leases between unrelated parties in the locality are not acceptable under this section.

(iii) *In-kind rents, statements of appraised rental value, and area averages.* Rents which are paid wholly or partly in kind (*e.g.*, crop shares) may not be used to determine the value of real property under section 2032A(e)(7). Likewise, appraisals or other statements regarding rental value as well as area-wide averages of rentals (*i.e.*, those compiled by the United States Department of Agriculture) may not be used under section 2032A(e)(7) because they are not true measures of the actual cash rental value of comparable property in the same locality as the specially valued property.

(iv) *Period for which comparable real property must have been rented solely for cash.* Comparable real property rented solely for cash must be identified for each of the five calendar years preceding the year of the decedent's death if section 2032A(e)(7) is used to value the decedent's real property. Rentals from the same tract of comparable property need not be used for each of these 5 years, however, provided an actual tract of property meeting the requirements of this section is identified for each year.

(v) *Leases under which rental of personal property is included.* No adjustment to the rents actually received by the lessor is made for the use of any farm equipment or other personal property the use of which is included under a lease for comparable real property unless the lease specifies the amount of the total rental attributable to the personal property and that amount is reasonable under the circumstances.

(c) *State and local real estate taxes.* For purposes of the farm valuation formula under section 2032A(e)(7) state and local taxes are taxes which are assessed by a state or local government and which are allowable deductions under section 164. However, only those taxes on the comparable real property from which cash rentals are determined may be used in the formula valuation.

(d) *Comparable real property defined.* Comparable real property must be situated in the same locality as the specially valued property. This requirement is not to be viewed in terms of mileage or political divisions alone, but rather is to be judged according to generally accepted real property valuation rules. The determination of properties which are comparable is a factual one and must be based on numerous factors, no one of which is determinative. It will, therefore, frequently be necessary to value farm property in segments where there are different uses or land characteristics included in the specially valued farm. For example, if section 2032A(e)(7) is used, rented property on which comparable buildings or improvements are located must be identified for specially valued property on which buildings or other real property improvements are located. In cases involving multiple areas or land characteristics, actual comparable property for each segment must be used, and the rentals and taxes from all such properties combined (using generally accepted real property valuation rules) for use in the valuation formula given in this section. However, any premium or discount resulting from the presence of multiple uses or other characteristics in one farm is also to be reflected. All factors generally considered in real estate valuation are to be considered in determining comparability under section 2032A. While not intended as an exclusive list, the following factors are among those to be considered in determining comparability—

(1) Similarity of soil as determined by any objective means, including an official soil survey reflected in a soil productivity index;

(2) Whether the crops grown are such as would deplete the soil in a similar manner;

(3) The types of soil conservation techniques that have been practiced on the two properties;

(4) Whether the two properties are subject to flooding;

(5) The slope of the land;

(6) In the case of livestock operations, the carrying capacity of the land;

(7) Where the land is timbered, whether the timber is comparable to that on the subject property;

(8) Whether the property as a whole is unified or whether it is segmented, and where segmented, the availability of the means necessary for movement among the different segments;

(9) The number, types, and conditions of all buildings and other fixed improvements located on the properties and their location as it affects efficient management and use of property and value per se; and

(10) Availability of, and type of, transportation facilities in terms of costs and of proximity of the properties to local markets.

(e) *Effective interest rate defined*—(1) *Generally.* The annual effective interest rate on new Federal land bank loans is the average billing rate charged on new agricultural loans to farmers and ranchers in the farm credit district in which the real property to be valued under section 2032A is located, adjusted as provided in paragraph (e)(2) of this section. This rate is to be a single rate for each district covering the period of one calendar year and is to be computed to the nearest one-hundredth of one percent. In the event that the district billing rates of interest on such new agricultural loans change during a year, the rate for that year is to be weighted to reflect the portion of the year during which each such rate was charged. If a district's billing rate on such new agricultural loans varies according to the amount of the loan, the rate applicable to a loan in an amount resulting from dividing the total dollar amount of such loans closed during the year by the total number of the loans closed is to be used under section 2032A. Applicable rates may be obtained from the district director of internal revenue.

(2) *Adjustment to billing rate of interest.* The billing rate of interest determined under this paragraph is to be adjusted to reflect the increased cost of borrowing resulting from the required purchase of land bank association stock. For section 2032A purposes, the rate of required stock investment is the average of the percentages of the face amount of new agricultural loans to farmers and ranchers required to be invested in such stock by the applicable district bank during the year. If this percentage changes during a year, the average is to be adjusted to reflect the period when each percentage requirement was effective. The percentage is viewed as a reduction in the loan proceeds actually received from the amount upon which interest is charged.

(3) *Example.* The determination of the effective interest rate for any year may be illustrated as follows:

Example. District X of the Federal land bank system charged an 8 percent billed interest rate on new agricultural loans for 8 months of the year, 1976, and an 8.75 percent rate for 4 months of the year. The average billing rate was, therefore, 8.25 percent [(1.08 × 8/12) + (1.0875 × 4/12) = 1.0825]. The district required stock equal to 5 percent of the face amount of the loan to be purchased as a precondition to receiving a loan. Thus, the borrower only received 95 percent of the funds upon which he paid interest. The applicable annual interest rate for 1976 of 8.68 percent is computed as follows: 8.25 percent × 1.00 (total loan amount) = 8.25 percent (billed interest rate) divided by 0.95 (percent of loan proceeds received by borrower) = 8.68 percent (effective interest rate for 1976).

§ 20.2032A-8 Election and agreement to have certain property valued under section 2032A for estate tax purposes.

(a) *Election of special use valuation*—(1) *In general.* An election under section 2032A is made as prescribed in paragraph (a)(3) of this section and on Form 706, United States Estate Tax Return. Once made, this election is irrevocable; however, see paragraph (d) of this section for a special rule for estates for which elections are made on or before August 30, 1980. Under section 2032A(a)(2), special use valuation may not reduce the value of the decedent's estate by more than $500,000. This election is available only if, at the time of death, the decedent was a citizen or resident of the United States.

(2) *Elections to specially value less than all qualified real property included in an estate.* An election under section 2032A need not include all real property included in an estate which is eligible for special use valuation, but sufficient property to satisfy the threshold requirements of section 2032A(b)(1)(B) must be specially valued under the election. If joint or undivided interests (e.g. interests as joint tenants or tenants in common) in the same property are received from a decedent by qualified heirs, an election with respect to one heir's joint or undivided interest need not include any other heir's interest in the same property if the electing heir's interest plus other property to be specially valued satisfy the requirements of section 2032A(b)(1)(B). If successive interests (e.g. life estates and remainder interests) are created by a decedent in otherwise qualified property, an election under section 2032A is available only with respect to that property (or

portion thereof) in which qualified heirs of the decedent receive all of the successive interests, and such an election must include the interests of all of those heirs. For example, if a surviving spouse receives a life estate in otherwise qualified property and the spouse's brother receives a remainder interest in fee, no part of the property may be valued pursuant to an election under section 2032A. Where successive interests in specially valued property are created, remainder interests are treated as being received by qualified heirs only if (i) a qualified heir receives a present interest in that real property, (ii) all preceding interests in the property are vested absolutely in qualified heirs, and (iii) such remainder interests are not contingent upon surviving an alternate taker who is not a member of the decedent's family or are not vested subjected to divestment in favor of a nonfamily member. For the definition of present interest, *see* section 2503 and the regulations thereunder.

(3) *Time and manner of making election.* An election under this section is made by attaching to a timely filed estate tax return the agreement described in paragraph (c)(1) of this section and a notice of election which contains the following information:

(i) The decedent's name and taxpayer identification number as they appear on the estate tax return;

(ii) The relevant qualified use;

(iii) The items of real property shown on the estate tax return to be specially valued pursuant to the election (identified by schedule and item number);

(iv) The fair market value of the real property to be specially valued under section 2032A and its value based on its qualified use (both values determined without regard to the adjustments provided by section 2032A (b)(3)(B));

(v) The adjusted value (as defined in section 2032A(b)(3)(B) of all real property which is used in a qualified use and which passes from the decedent to a qualified heir and the adjusted value of all real property to be specially valued;

(vi) The items of personal property shown on the estate tax return that pass from the decedent to a qualified heir and are used in a qualified use under section 2032A (identified by schedule and item number) and the total value of such personal property adjusted as provided under section 2032A(b)(3)(B);

(vii) The adjusted value of the gross estate, as defined in section 2032A(b)(3)(A);

(viii) The method used in determining the special value based on use;

(ix) Copies of written appraisals of the fair market value of the real property;

(x) A statement that the decedent and/or a member of his or her family has owned all specially valued real property for at least 5 years of the 8 years immediately preceding the date of the decedent's death;

(xi) Any periods during the 8-year period preceding the date of the decedent's death during which the decedent or a member of his or her family did not own the property, use it in a qualified use, or materially participate in the operation of the farm or other business within the meaning of section 2032A(e)(6);

(xii) Affidavits describing the activities constituting material participation to the decedent of each person taking an interest in each item of specially valued property, and the value of the property interests passing to each such person based on both fair market value and qualified use;

(xiii) Affidavits describing the activities constituting material participation and the identity of the material participant or participants; and

(xiv) A legal description of the specially valued property.

If neither an election nor a protective election is timely made, special use valuation is not available to the estate. *See* section 2032A(d)(1), 6075(a), and 6081(a).

(b) *Protective election.* A protective election may be made to specially value qualified real property. The availability of special use valuation pursuant to this election is contingent upon values as finally determined (or agreed to following examination of a return) meeting the requirements of section 2032A. A protective election does not, however, extend the time for payment of any amount of tax. Rules for such extensions are contained in sections 6161, 6163, 6166, and 6166A. The protective election is to be made by a notice of election filed with a timely estate tax return stating that a protective election under section 2032A is being made pending final determination of values. This notice is to include the following information:

(1) The decedent's name and taxpayer identification number as they appear on the estate tax return;

(2) The relevant qualified use; and

(3) The items of real and personal property shown on the estate tax return which are used in a qualified use, and which pass to qualified heirs (identified by schedule and item number).

If it is found that the estate qualifies for special use valuation based upon values as finally determined (or agreed to following examination of a return), an additional notice of election must be filed within 60 days after the date of such determination. This notice must set forth the information required under paragraph (a)(3) of this section and is to be attached, together with the agreement described in paragraph (c)(1) of this section, to an amended estate tax return. The new return is to be filed with the Internal Revenue Service office where the original return was filed.

(c) *Agreement to special valuation by persons with an interest in property*—(1) *In general.* The agreement required under section 2032A(a)(1)(B) and (d)(2) must be executed by all parties who have any interest in the property being valued based on qualified use as of the date of the decedent's death. In the case of a qualified heir, the agreement must express consent to personal liability under section 2032A(c) in the event of certain early dispositions of the property or early cessation of the qualified use. *See* section 2032A(c)(6). In the case of parties (other than qualified heirs) with interests in the property, the agreement must express consent to collection of any additional estate tax imposed under section 2032A(c) from the qualified property. The agreement is to be in a form that is binding on all parties having an interest in the property. It must designate an agent with satisfactory evidence of authority to act for the parties to the agreement in all dealings with the Internal Revenue Service on matters arising under section 2032A and must indicate the address of that agent.

(2) *Persons having an interest in designated property.* An interest in property is an interest which, as of the date of the decedent's death, can be asserted under applicable local law so as to affect the disposition of the specially valued property by the estate. Any person in being at the death of the decedent who has any such interest in the property, whether present or future, or vested or contingent, must enter into the agreement. Included among such persons are owners of remainder and executory interests, the holders of general or special powers of appointment, beneficiaries of a gift over in default of exercise of any such power, co-tenants, joint tenants and holders of other undivided interests when the decedent held only a joint or undivided interest in the property or when only an undivided interest is specially valued, and trustees of trusts holding any interest in the property. An heir who has the power under local law to caveat (challenge) a will and thereby affect disposition of the property is not, however, considered to be a person with an interest in property under section 2032A solely by reason of that right. Likewise, creditors of an estate are not such persons solely by reason of their status as creditors.

(3) *Consent on behalf of interested party.* If any person required to enter into the agreement provided for by paragraph (c)(1) either desires that an agent act for him or her or cannot legally bind himself or herself due to infancy or other incompetency, or to death before the election under section 2032A is timely exercised, a representative authorized under local law to bind such person in an agreement of this nature is permitted to sign the agreement on his or her behalf.

(4) *Duties of agent designated in agreement.* The Internal Revenue Service will contact the agent designated in the agreement under paragraph (c)(1) on all matters relating to continued qualification under section 2032A of the specially valued real property and on all matters relating to the special lien arising under section 6324B. It is the duty of the agent as attorney-in-fact for the parties with interests in the specially valued property to furnish the Service with any requested information and to notify the Service of any disposition or cessation of qualified use of any part of the property.

(d) *Special rule for estates for which elections under section 2032A are made on or before August 30, 1980.* An election to specially value real property under section 2032A that is made on or before August 30, 1980, may be revoked. To revoke an election, the executor must file a notice of revocation with the Internal Revenue Service office where the original estate tax return was filed on or before January 1, 1981 (or if earlier, the date on which the period of limitation for assessment expires). This notice of revocation must contain the decedent's name, date of death, and taxpayer identification number, and is to be accompanied by remittance of any additional amount of estate tax and interest determined to be due as a result of valuation of the qualified property based upon its fair market value. Elections that are made on or before August 30, 1980, that do not comply with this section as proposed on July 13, 1978 (43 FR 30070), and amended on December 21, 1978 (43 FR 59517), must be conformed to this final regulation by means of an amended return before the original estate tax return can be finally accepted by the Internal Revenue Service.

Par. 4. The third sentence of paragraph (c) of § 20.6081-1 is amended by striking out the first word and inserting in lieu thereof "Except as provided in § 20.2032A-8(d) and § 20.6166-1(h), the".

Par. 5. Section 20.6166 is deleted.

Par. 6. Sections 20.6166-1, 20.6166-2, 20.6166-3, and 20.6166-4 are redesignated §§ 20.6166A-1, 20.6166A-2, 20.6166A-3, and 20.6166A-4 respectively.

Par 7. The following new section is added following § 20.6165-1:

§ 20.6166-1 Election of alternate extension of time for payment of estate tax where estate consists largely of interest in closely held business.

(a) *In general.* Section 6166 allows an executor to elect to extend payment of part or all of the portion of the estate tax which is attributable to a closely held business interest (as defined in section 6166(b)(1)). If it is made at the time the estate tax return is filed, the election is applicable both to the tax originally determined to be due and to certain deficiencies. If no election is made when the estate tax return is filed, up to the full amount of certain later deficiencies (but not any tax originally determined to be due) may be paid in installments.

(b) *Time and manner of election.* The election provided under section 6166(a) is made by attaching to a timely filed estate tax return a notice of election containing the following information:

(1) The decedent's name and taxpayer identification number as they appear on the estate tax return;

(2) The amount of tax which is to be paid in installments;

(3) The date selected for payment of the first installment;

(4) The number of annual installments, including the first installment, in which the tax is to be paid;

(5) The properties shown on the estate tax return which constitute the closely held business interest (identified by schedule and item number); and

(6) The facts which formed the basis for the executor's conclusion that the estate qualifies for payment of the estate tax in installments.

In the absence of a statement in the notice of election as to the amount of tax to be paid in installments, the date selected for payment of the first installment, or the number of installments, the election is presumed to be for the maximum amount so payable and for payment thereof in 10 equal installments, the first of which is due on the date which is 5 years after the date prescribed in section 6151(a) for payment of estate tax.

(c) *Treatment of certain deficiencies*—(1) *No election before assessment of deficiency.* Where a deficiency is assessed and no election, including a protective election, has been made under section 6166(a) to pay any tax in installments, the executor may elect under section 6166(h) to pay the portion of the deficiency attributable to the closely held business interest in installments. However, this is true only if the estate qualifies under section 6166 based upon values as finally determined (or agreed to following examination of a return). Such an election is exercised by filing a notice of election with the Internal Revenue Service office where the estate tax return was filed. The notice of election must be filed within 60 days after issuance of notice and demand for payment of the deficiency, and it must contain the same information as is required under paragraph (b) of this section. The notice of election is to be accompanied by payment of the amount of tax and interest, the date for payment of which has arrived as determined under paragraphs (e) and (f) of this section, plus any amount of unpaid tax and interest which is not attributable to the closely held business interest and which is not eligible for further extension (or currently extended) under another section (other than section 6166A).

(2) *Election made with estate tax return.* If the executor makes an election under section 6166(a) (other than a protective election) at the time the estate tax return is filed and a deficiency is later assessed, the portion of the deficiency which is attributable to the closely held business interest (but not any accrued interest thereon) will be prorated to the installments payable pursuant to the original section 6166(a) election. Any part of the deficiency prorated to an installment, the date for payment of which has arrived, is due upon notice and demand. Interest for any such period, including the deferral period, is payable upon notice and demand.

(3) *Portion of deficiency attributable to closely held business interest.* Only that portion of any deficiency which is attributable to a closely held business interest may be paid in installments under section 6166. The amount of any deficiency which is so attributable is the difference between the amount of tax which the executor has previously elected to pay in installments under section 6166 and the maximum amount of tax which the executor could have elected to pay in installments on the basis of a return which reflects the adjustments that resulted in the deficiency.

(d) *Protective election.* A protective election may be made to defer payment of any portion of tax remaining unpaid at the time values are finally determined (or agreed to following examination of a return) and any deficiencies attributable to the closely held business interest (within the meaning of paragraph (c)(3) of this section). Extension of tax payments pursuant to this election is contingent upon final values meeting the requirements of section 6166. A protective election does not, however, extend the time for payment of any amount of tax. Rules for such extensions are contained in sections 6161, 6163, and 6166A. A protective election is made by filing a notice of election with a timely filed estate tax return stating that the election is being made. Within 60 days after values are finally determined (or agreed to following examination of a return), a final notice of election which sets forth the information required under paragraph (b) of this section must be filed with the Internal Revenue Service office where the original estate tax return was filed. That notice of final election is to be accompanied by payment of any amount of previously unpaid tax and interest, the date for payment of which has arrived as determined under paragraphs (e) and (f) of this section, plus any amount of unpaid tax and interest which is not attributable to the closely held business interest and which is not eligible for further extension (or currently extended) under another section (other than section 6166A).

(e) *Special rules*—(1) *Effect of deficiencies and protective elections upon payment.* Upon election to extend the time for payment of a deficiency or upon final determination of values following a protective election, the executor must prorate the tax or deficiency attributable to the closely held business interest among all installments. All amounts attributed to installments which would have been due had the election been made at the time the tax was due to be paid under section 6151(a) and all accrued interest must be paid at the time the election is made.

(2) *Determination of date for payment of first installment.* The executor may defer payment of tax (but not interest) for any period up to 5 years from the date determined under section 6151(a) for payment of the estate tax. The date chosen for payment of the first installment of tax is not required to be on an annual anniversary of the original due date of the tax; however, it must be the date within any month which corresponds to the day of the month determined under section 6151(a).

(f) *Rule for computing interest.* Section 6601(j) provides a special 4 percent interest rate for the amount of tax (including deficiencies) which is to be paid in installments under section 6166. This special interest rate applies only to that amount of tax which is to be paid in installments and which does not exceed the limitation of section 6601(j)(2). Where payment of a greater amount of tax than is subject to section 6601(j)(2) is extended under section 6166, each installment is deemed to be comprised of both tax subject to the 4 percent interest rate and tax subject to the rate otherwise prescribed by section 6621. The percentage of any installment subject to the special 4 percent rate is equal to the percentage of the total tax payable in installments which is subject to the 4 percent rate. Where an election is made under the provisions of paragraphs (b) or (c)(1) of this section, the 4 percent rate applies from the date on which the estate tax was originally due to be paid. If only a protective election is made, section 6601(j) applies to the amount which is to be paid in installments, limited to the amount of any deficiency, from the due date for payment of estate tax. After the date upon which the section 6166 election is made final, section

6601(j) applies to the entire amount to be paid in installments.

(g) *Relation of sections 6166 and 6166A.* No election may be made under section 6166 if an election under section 6166A applies with respect to an estate. For example, no election can be made under section 6166(h) where an executor has made an election under section 6166A. If an election is timely made under either section 6166 or section 6166A, however, a protective election can be made under the other section at the same time. If the executor then files a timely notice of final election under the section protectively elected and pays any amounts determined to be due currently following final determination of (or agreement as to) estate tax values, the original election under the other provision will be deemed never to have applied to the estate.

(h) *Special rule for estates for which elections under section 6166 are made on or before August 30, 1980.* An election to extend payment of estate tax under section 6166 that is made on or before August 30, 1980 may be revoked. To revoke an election, the executor must file a notice of revocation with the Internal Revenue Service office where the original estate tax return was filed on or before January 1, 1981 (or if earlier, the date on which the period of limitation on assessment expires). This notice of revocation must contain the decedent's name, date of death, and taxpayer identification number, and is to be accompanied by remittance of any additional amount of estate tax and interest determined to be due.

(i) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1)—(i). Based upon values shown on decedent A's timely filed estate tax return, 60 percent of the value of A's adjusted gross estate consisted of a farm which was a closely held business within the meaning of section 6166. A's executor, B, made a protective election under section 6166 when he filed A's estate tax return. B also applied for an extension of time under section 6161 to pay $15,000 of the $30,000 of estate tax shown due on the return. The requested extension was granted and was renewed at the end of 1 year. Eighteen months after the return was filed and after examination of A's estate tax return, the value of the farm was found to constitute 67 percent of the adjusted gross estate. B entered into an agreement consenting to the values as established on examination and to a deficiency of $5,000. B then filed a final notice of election under section 6166, choosing a 5-year deferral followed by 10 annual installment payments and thereby terminated his extension under section 6161 because that amount of tax was then included under the section 6166 election. B could have extended payment of 67 percent of the total estate tax, or $23,450. $23,450 is eligible for installment payments under section 6166 and the section 6166 election is considered to be for that amount. B is considered to have prepaid $3,450 of tax since only $20,000 of tax remained unpaid. The $3,450 is attributed to the first installment of $2,345 and to $1,105 of the second installment which would have been payable under the section 6166 election.

(ii) Had B been granted an extension of time under section 6161 to pay $20,000 of tax, $25,000 would remain unpaid when the final section 6166 election is made. Payment of the full $23,450 (67 percent) of tax which is attributable to the closely held business interest is included under the section 6166 election. The balance of unpaid tax ($1,550) is due upon expiration of the estate's section 6161 extension.

(iii) Assume the facts under example (1)(i). B must pay all unpaid accrued interest with his notice of final election. Since only 18 months have passed, no installments of tax are due. Interest on the $5,000 deficiency is computed at 4 percent per annum for the entire 18 months, and interest for 12 months of that period is currently due to be paid. Interest for the remaining 6 months is due at the next succeeding date for payment of interest. Interest on the $15,000 of tax extended under section 6161 is computed at the rate determined under section 6621 until the date of the final section 6166 election and is due upon termination of the section 6161 extension. After that date, the interest on the $15,000 will also accrue at 4 percent per annum.

Example (2). Assume the facts as in example (1), except B initially made an election under section 6166A and made no protective election under section 6166. Following final determination of values, B is not permitted to make any election under section 6166; however, had B protectively elected section 6166 at the time he made the section 6166A election, he could have terminated the section 6166A election and finally elected under section 6166. In such a case, the full $23,450 of tax attributable to the farm would have been eligible for extension under section 6166. The 4 percent interest rate would apply to the $5,000 deficiency from the original due date of the tax, and, as with the extension under section 6161, it would apply to the amounts extended under section 6166A only from the date on which the election under section 6166 was finalized.

Example (3). C died in 1977. His estate owes Federal estate taxes of $750,000, $500,000 of which is attributable to a closely held business interest. Payment of the $500,000 was extended under section 6166. A 5-year deferral followed by 10 annual installment payments was chosen by C's executor. Under paragraph (f) of this section, only 63.16 percent of each installment will be subject to the special 4 percent interest rate and the remainder will be subject to the rate determined under section 6621. The same rule applies in computing interest for the 5 years during which payment of tax is deferred. (This is so because the 4 percent interest rate applies only to a maximum of $345,800 of tax less the $30,000 of credit allowable under section 2010(a) rather than to the entire $500,000 extended amount.)

Par 8. The following new section is added following § 20.6324-1:

§ 20.6324A-1. Election of and agreement to special lien for estate tax deferred under section 6166 or 6166A.

For regulations concerning the election of and agreement to the special lien for estate tax deferred under section 6166 or 6166A, *see* § 301.6324A-1 of this Chapter (Regulations on Procedure and Administration).

Par. 9. The following new section is added following § 301.6324-1:

§ 301.6324-1. Election of and agreement to special lien for estate tax deferred under section 6166 or 6166A.

(a) *Election of lien.* If payment of a portion of the estate tax is deferred under section 6166 or 6166A, an executor of a decedent's estate who seeks to be discharged from personal liability may elect a lien in favor of the United States in lieu of the bonds required by sections 2204 and 2165. This election is made by applying to the Internal Revenue Service office where the estate tax return is filed at any time prior to payment of the full amount of estate tax and interest due. The application is to be a notice of election requesting the special lien provided by section 6324A and is to be accompanied by the agreement described in paragraph (b)(1) of this section.

(b) *Agreement to lien*—(1) *In general.* A lien under this section will not arise unless all parties having any interest in all property designated in the notice of election as property to which the lien is to attach sign an agreement in which they consent to the creation of the lien. (Property so designated need not be property included in the decedent's estate.) The agreement is to be attached to the notice in which the lien under section 6324A is elected. It must be in a form that is binding on all parties having any interest on the property and must contain the following:

(i) The decedent's name and taxpayer identification number as they appear on the estate tax return;

(ii) The amount of the lien;

(iii) The fair market value of the property to be subject to the lien as of the date of the decedent's death and the date of the election under this section;

(iv) The amount, as of the date of the decedent's death and the date of the election, of all encumbrances on the property, including mortgages and any lien under section 6324B;

(v) A clear description of the property which is to be subject to the lien, and in the case of property other than land, a statement of its estimated remaining useful life; and

(vi) Designation of an agent (including the agent's address) for the beneficiaries of the estate and the consenting parties to the lien for all dealings with the Internal Revenue Service on matters arising under section 6166 or 6166A, or under section 6324A.

(2) *Persons having an interest in designated property.* An interest in property is any interest which as of the date of the election can be asserted under applicable local law so as to affect the disposition of any property designated in the agreement required under this section. Any person in being at the date of the election who has any such interest in the property, whether present or future, or vested or contingent, must enter into the agreement. Included among such persons are owners of remainder and executory interests, the holders of general or special powers of appointment, beneficiaries of a gift over in default of exercise of any such power, co-tenants, joint tenants, and holders of other undivided interests when the decedent held a joint or undivided interest in the property, and trustees of trusts holding any interest in the property. An heir who has the power under local law to caveat (challenge) a will and thereby affect disposition of the property is not, however, considered to be a person with an interest in property under section 6324A solely by reason of that right. Likewise, creditors of an estate are not such persons solely by reason of their status as creditors.

(3) *Consent on behalf of interested party.* If any person required to enter into the agreement provided for by this paragraph either desires that an agent act for him or her or cannot legally bind himself or herself due to infancy or other incompetency, a representative authorized under local law to bind the interested party in an agreement of this nature is permitted to sign the agreement on his or her behalf.

(4) *Duties of agent designated in agreement.* The Internal Revenue Service will contact the agent designated in the agreement under paragraph (b)(1) on all matters relating to continued qualification of the estate under section 6166 or 6166A and on all matters relating to the special lien arising under section 6324A. It is the duty of the agent as attorney-in-fact for the parties with interests in the property subject to the lien under section 6324A to furnish the Service with any requested information and to notify the Service of any event giving rise to acceleration of the deferred amount of tax.

(c) *Partial substitution of bond for lien.* If the amount of unpaid estate tax plus interest exceeds the value (determined for purposes of section 6324A(b)(2)) of property listed in the agreement under paragraph (b) of this section, the Internal Revenue Service may condition the release from personal liability upon the executor's submitting an agreement listing additional property or furnishing an acceptable bond in the amount of such excess.

(d) *Relation of sections 6324A and 2204.* The lien under section 6324A is deemed to be a bond under section 2204 for purposes of determining an executor's release from personal liability. If an election has been made under section 6324A, the executor may not substitute a bond pursuant to section 2204 in lieu of that lien. If a bond has been supplied under section 2204, however, the executor may, by filing a proper notice of election and agreement, substitute a lien under section 6324A for any part or all of such bond.

(e) *Relation of sections 6324A and 6324.* If there is a lien under this section on any property with respect to an estate, that lien is in lieu of the lien provided by section 6324 on such property with respect to the same estate.

(f) *Section 6324A lien to be in lieu of bond under section 6165.* The lien under section 6324A is in lieu of any bond otherwise required under section 6165 with respect to tax to be paid in installments under section 6166 or section 6166A.

(g) *Special rule for estates for which elections under section 6324A are made on or before August 30, 1980.* If a lien is elected under section 6324A on or before August 30, 1980, the original election may be revoked. To revoke an election, the executor must file a notice of revocation containing the decedent's name, date of death, and taxpayer identification number with the Internal Revenue Service office where the original estate tax return for the decedent was filed. The notice must be filed on or before January 31, 1981 (or if earlier, the date on which the period of limitation for assessment expires).

This Treasury decision is issued under the authority contained in sections 2032A and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1856, 68A Stat. 917, 26 U.S.C. 2032A, 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved July 18, 1980.

EMIL M. SUNLEY,
Acting Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on July 28, 1980, 3:16 p.m., and published in the issue of the Federal Register for July 31, 1980, 45 F.R. 50736)

Section 2033.—Property in Which the Decedent Had an Interest

26 CFR 20.2033-1: Property in which the decedent had an interest.

Treatment of proceeds from life insurance policy purchased by a Texas decedent before marriage and supported after marriage by premium payments from community property funds. See Rev. Rul. 80-242, page 27.

Section 2042.—Proceeds of Life Insurance

26 CFR 20.2042-1: Proceeds of life insurance.
(Also Section 2033; 20.2033-1.)

Life insurance proceeds; community property; Texas. An individual who was a resident of Texas obtained an insurance policy on the individual's life prior to marriage, paid a portion of the premiums from separate funds and a portion from community funds, and designated the spouse as beneficiary. The amount includible in the individual's gross estate with respect to the insurance policy is reduced by one-half the amount of premiums paid with community funds.

Rev. Rul. 80-242

ISSUE

What amount is includible in *D*'s gross estate with respect to insurance on *D*'s life, under the circumstances described below?

FACTS

D, a resident of Texas, obtained, when unmarried, a whole life policy of insurance on *D*'s life, in the face amount of $100,000. *D* paid $3,000 in premiums before marriage. After marriage, $12,000 in premiums were paid with funds that were, under the law of Texas, community property. *D* held the incidents of ownership in the policy until death. The surviving spouse, *S*, was the designated beneficiary of the policy.

LAW AND ANALYSIS

Section 2033 of the Internal Revenue Code provides that a decedent's gross estate shall include the value of all property to the extent of the decedent's interest therein at the time of death.

Section 2042(2) includes in the gross estate the proceeds of insurance on the decedent's life if the decedent possessed incidents of ownership in the policy.

Under Texas law the proceeds of an insurance policy belong to the insured's separate estate, if the policy was initially the separate property of the insured when acquired. However, if after the policy is acquired premiums are paid with community funds, then the proceeds are subject to the community estate's right of reimbursement for the return of community funds used to pay the premiums. *Parson v. U.S.*, 46 F. 2d 228 (5th Cir. 1972); *Wildenthal v. Commissioner,* T.C.M. 1970-119; *Gray v. Bush,* 430 S.W. 2d 258 (Tex. Civ. App., 1968); *McCurdy v. McCurdy,* 372 S.W. 2d 381 (Tex. Civ. App. 1963).

In the present case, the policy was the separate property of *D* when acquired and therefore the proceeds belong to *D*'s separate estate. However, since $12,000 in insurance premiums was paid with community funds, the insurance proceeds are subject to the community claim for reimbursement of premiums paid. Therefore, the amount includible in *D*'s gross estate under section 2042(2) of the Code is the face amount of policy proceeds less the amount of premiums paid with community funds, or $88,000. In addition, one-half of the reimbursed premiums ($6,000) is separately includible in *D*'s gross estate under section 2033 of the Code as the value of *D*'s interest, at death, in community property. *See Wildenthal v. Commissioner,* cited above.

The above conclusions regarding the amount includible with respect to the decedent's insurance policy proceeds are in direct conflict with Rev. Rul. 54-272, 1954-2 C.B. 298, which applies a discussion of Louisiana law contained in Paragraph (E) of Rev. Rul. 232, 1953-2 C.B. 268, to similar situations arising under Texas law. Applying Rev. Rul. 54-272, to the facts in the present situation, $100,000 would be includible under section 2042 of the Code. The Service will no longer follow the position stated in Rev. Rul. 54-272 that in cases when the surviving spouse is the beneficiary the full value of the insurance proceeds, purchased in part with community funds, is includible in the gross estate under section 2042. However, in such cases the Service will continue to disallow a deduction under section 2053 for the community's claim for reimbursement, since under Texas law the community's claim for reimbursement of the insurance premiums paid from community funds is a claim on the insurance proceeds rather than a claim on the decedent's estate. *See* sections 20.2053-4 and 20.2053-7 of the Estate Tax Regulations. For the same reason, when the decedent's estate, or someone other than the surviving spouse is the beneficiary, the Service will not allow a deduction under section 2053 with regard to the community's reimbursement claim. However, the community's reimbursement claim will be reflected as a reduction in the amount includible in the gross estate under section 2042.

HOLDING

The amounts includible in *D*'s gross estate are $88,000 as insurance proceeds under section 2042 of the Code and $6,000 as community property under section 2033.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 54-272 is modified with respect to its conclusions that the full value of insurance proceeds purchased in part with community funds is includible in the gross estate, and that a claim by the community for reimbursement for premiums paid with community funds may be allowed as a deduction from the insured's gross estate in cases when either the insured's estate or someone other than the surviving spouse is the named beneficiary.

Section 2621.—Administration

26 CFR 26a.2621-1: Generation-skipping transfer tax return requirements.

T.D. 7711

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B,—PART 26a.—TEMPORARY GENERATION-SKIPPING TRANSFER TAX REGULATIONS UNDER THE TAX REFORM ACT OF 1976

Return requirements

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides a temporary regulation relating to the filing of returns for the tax on generation-skipping transfers. That tax was introduced by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1]. The temporary regulation identifies the person required to make the return of tax and prescribes the time and manner of filing, and the form used to make the return. It affects trustees and beneficiaries of generation-skipping trusts. In addition, the rules contained in the temporary regulation in this document also serve as a notice of proposed rulemaking by which the rules are proposed to be prescribed as final regualtions.

DATE: The regulation applies generally to any generation-skipping transfer made after June 11, 1976.

FOR FURTHER INFORMATION CONTACT: Robert H. Waltuch of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3287, not a toll free call.

SUPPLEMENTARY INFORMATION

BACKGROUND

This document provides a temporary generation-skipping transfer tax regulation under Chapter 13 of the Internal Revenue Code of 1954 (Code), as added by section 2006(a) of the Tax Reform Act of 1976 (Public Law 94-455; 90 Stat. 1879) [1976-3 C.B. (Vol. 1) 1, 355] to provide rules for making the necessary return of tax. The temporary regulation provided by this document will remain in effect until superseded by final regulations on this subject. By a separate document appearing elsewhere in this issue of the Federal Register, the regulation promulgated in this document is also proposed to be prescribed as final Generation-Skipping Transfer Tax Regulations (26 CFR Part 26) under section 2621 of the Code.

PROVISIONS OF THE REGULATION

The generation-skipping transfer tax return consists of a statement filed with the Internal Revenue Service within the time specified in the regulation. The due date depends upon the type of event which gives rise to liability for the tax.

With a taxable distribution, generally it is the distributee of the money or property who must make the return. To enable the distributee to file the return, the distributee must first obtain information from the trustee and in many cases from the Service. Therefore, the regulation requires the trustee to file an information return with the Service and to send a statement to the distributee identifying the portion of a distribution that is taxable. If the distributee needs any additional information to compute the tax imposed on the taxable distribution, the distributee may obtain this information by filing a written request with the Service. After the Service has supplied the requested information, the distributee is then able to compute the tax and file the return. In the case of a taxable termination, the trustee must make the return and if the trustee is in need of additional information the trustee may also file a written request with the Service. Furthermore, the regulation provides guidelines for situations when there is no trustee (as in the case of a trust equivalent) or when the distributee is unable to act for him or herself.

Under the temporary regulations, generally section 643(b) income is computed on an annual basis in determining whether distributions from the trust are taxable distributions. If during the taxable year of the trust there are distributions and a termination, then section 643(b) income is computed for two short periods. This rule will curtail the possible abuse that could arise when the trustee anticipates that a taxable termination will occur during the taxable year of the trust and therefore distributes money or property to a younger generation beneficiary equal in value to what the anticipated section 643(b) income will be for the year. But for this rule, a trustee could distribute unearned but anticipated income prior to a taxable termination and it would not be taxable because of the current income exclusion, nor would it be on hand to be included in the trust on the date of the taxable termination.

DRAFTING INFORMATION

The principal author of this regulation is Robert H. Waltuch of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Waiver of Procedural Requirements of Treasury Directive

There is need for expeditous adoption of the provisions contained in this document because of the need for immediate guidance to persons required to file a return of tax. For this reason, Jerome Kurtz, Commissioner of Internal Revenue, has determined that the provisions of paragraphs 8 through 14 of the Treasury Department directive implementing Executive Order 12044 must be waived.

Adoption of regulations

A new part 26a, Temporary Generation-Skipping Transfer Tax Regulations under the Tax Reform Act of 1976, is hereby added to Title 26 of the Code of Federal Regulations, and the following temporary regulation is hereby adopted:

Sec.
26a.2621-1 Generation-skipping transfer tax return requirements.

Authority. Sections 2622 and 7805, Internal Revenue Code of 1954 (90 Stat. 1887, 68A Stat. 917, 26 USC 2621, 7805).

§ 26a.2621-1 Generation - skipping transfer tax return requirements.

(a) *In general.* Chapter 13 of the Code imposes a tax on generation-skipping transfers, as defined in section 2611. The tax applies to both taxable distributions and terminations of either interests in property or powers over property. For purposes of this part, the term "distributee" means a younger generation beneficiary who actually receives money or property (or has money or property applied for his benefit) from a generation-skipping trust or trust equivalent. This section contains rules for making the required tax return.

(b) *Person required to make return*—(1) *In general.* Except as otherwise provided in this section, the following person must make the required tax return, Form 706-B, Generation-Skipping Transfer Tax Return,—

(i) The distributee in a taxable distribution, as defined in section 2613 (a),

(ii) The trustee in the case of a taxable termination, as defined in section 2613(b), or

(iii) The distributee in the case of a generation-skipping transfer involving a generation-skipping trust equivalent.

(2) *Entity.* If a trust, estate, corporation or partnership is the recipient of money or property in a taxable distribution, then those persons who are assigned to a generation under section 2611(c)(7) shall be treated as distributees to the extent of their interest in the entity and are responsible for filing the return and paying the tax.

(3) *Exceptions*—(i) *Minors.* If a distributee is otherwise required to make a return, but the distributee is a minor, a return must be made by the minor or must be made for the minor by the minor's guardian or other person charged with the care of the minor's person or property.

(ii) *Returns made by agents.* The return of tax may be made by an agent if, by reason of disease, injury, illness or absence from the country, the person liable for making the return is unable to make it. Mere convenience is not sufficient reason for authorizing an agent to make the return. If the return is made by an agent, the return must be ratified by the principal within a reasonable time after such person becomes able to do so. If not ratified, it will not be the return required by the statute. The ratification must be in the form of a statement executed under penalties of perjury by the principal and filed with the Internal Revenue Service office with which the return was filed. It must state specifically that the return made by the agent has been carefully examined and that the principal ratifies the return. If a return is signed by an agent, a statement fully explaining the inability of the principal must accompany the return.

(iii) *Returns filed by fiduciary or executor on behalf of distributee.* A fiduciary acting as the guardian or committee of an insane person must make the required return. If a distributee who would be required to make the return for a transfer dies after the transfer occurs but before the return is filed, the executor or other person in possession of the decedent's assets is required to make the return.

(4) *Special rules*—(i) *Joint and undivided interests with distributees making return.* If paragraph (b)(1) of this section requires the distributee to make the tax return and if more than one distributee of a deemed transferor receives an interest in or power over property jointly, or simultaneously receives other undivided interests in property, all of the distributees must jointly make the return. Should any distributee fail to join in making the return, the remaining distributees must make a return for the entire transfer. This return must identify the distributee not joining in it and the property interests passing to that distributee. The tax is to be computed on the entire transfer and is to be paid in full by the distributees making the return, unless their liability under paragraph (h)(1) of this section is less than that amount, in which case an amount equal to their full liability must be remitted. This payment does not, however, relieve the non-filing distributee of any liability under state law to the person who filed the return for tax attributable to property received by the non-filing distributee.

(ii) *Multiple trustees.* In the case of a taxable termination, if there is more than one trustee of a generation-skipping trust, the return may be made by any one of them. The return must identify the trustees not joining in it. Payment of the entire amount of tax is due with the return.

(c) *Time and manner of filing return*—(1) *In general.* Form 706-B must be filed with the Internal Revenue Service office with which an estate or gift tax return of the deemed transferor must be filed. It must be filed—

(i) Except as provided in paragraph (c)(1)(ii) of this section, in the case of a taxable distribution or termination that occurs before the death of the deemed transferor, on or before the expiration of 6 months after the close of the taxable year of the trust (or in the case of a trust equivalent, the close of the deemed transferor's taxable year in which the transfer occurred).

(ii) In the case of a taxable distribution or termination that occurs within the same taxable year as the death of the deemed transferor, or any time after the death of the deemed transferor, on or before the later of the expiration of 6 month after the last day allowed for filing the estate tax return (including extensions), or 6 months after the close of the taxable year of the trust (or in the case of a trust equivalent, the close of the distributee's taxable year in which the transfer occurred).

When, under section 2613(b), any transfer is deemed to occur later than it actually does, the time for filing the return is to be measured from the date on which the transfer is deemed to occur (see also paragraph (k) of this section for initial filing date).

(2) *Transfers within 3 years of death of deemed transferor.* If a deemed transferor dies within 3 years after a generation-skipping transfer has occurred, an amended return must be filed for the transfer. The due date for the return is determined as if the prior transfer occurred at the same time as the deemed transferor's death and the tax must be recomputed as if the transfer had occurred immediately after the deemed transferor's death. Only one amended return need be filed by each distributee who filed previously. It must include all transfers that occurred within 3 years prior to the deemed transferor's death and any increase in tax must be paid by that distributee. If the rules under § 26a.2621-1(g)(2) (relating to a distribution and a termination occurring during the same taxable year) apply, then those persons required to file a return under § 26a.2621-1(b) because of a distribution in a short period (described in paragraph (g)(2) of this

section) and an amended return for transfers within 3 years of death are required to file only one return which includes all the transfers that occurred during the 3-year period.

(d) *Form of return.* Form 706-B must be filed in accordance with its instructions.

(e) *Requirement of return where no tax is due.* A return of tax for every generation-skipping transfer, as defined in section 2611(a), and every transfer that would be a generation-skipping transfer but for the application of section 2613(a)(4)(A) or (b)(5)(A), must be made as provided in this section. This is so even if no tax liability arises from a given transfer.

(f) *Information return*—(1) *General rule.* In the case of a generation-skipping transfer, the trustee must complete and file Form 706-B(1), *Information Return by Trustee for a Taxable Distribution or Termination From a Generation-Skipping Trust,* with the same Internal Revenue Service Center with which the distributee must file Form 706-B. Only one Form 706-B is required to be filed for younger generation beneficiaries having the same deemed transferor. In addition, the trustee must complete and send Form 706-B(2), *Beneficiary's Share of a Taxable Distribution From a Generation-Skipping Trust,* to each distributee required to file Form 706-B within the time the trustee is required to file Form 706-B(1).

(2) *Time for filing.* If the due date of the 706-B is determined under § 26a.2621-1(c)(1)(i), then Form 706-B(1) must be filed on or before the fifteenth day of the third month following the close of the taxable year of the trust. If the due date of Form 706-B is determined under §26a.2621-1(c)(1)(ii), then Form 706-B(1) must be filed on or before the later of the fifteenth day of the third month following the close of the taxable year of the trust, or the fifteenth day of the third month following the last day allowed for filing the estate tax return.

(g) *Taxable distributions*—(1) *Annual return.* The return required by this section must include all taxable distributions received by the distributee from a trust that occurred during the taxable year of the trust. For the sole purpose of determining the rate at which a taxable distribution is taxed, all taxable distributions that relate to the same deemed transferor and that are from the same or different trusts which have the same taxable year are treated as occurring simultaneously during the taxable year (or short period) and the rules under section 2602 apply in computing the tax on each.

(2) *Exception.* If, in addition to taxable distributions occurring during the taxable year of the trust, there is also a taxable termination which is not the result of the death of the deemed transferor, then for the purpose of determining whether distributions exceed the amount of section 643(b) income, section 643(b) income is computed separately for each of two periods. The first period begins on the first day of the taxable year of the trust and ends on the day immediately preceding the day on which the taxable termination occurs (or is deemed to occur). The second begins the day the taxable termination occurs (or is deemed to occur) and ends on the last day of the taxable year. If the termination is the result of the death of a deemed transferor, the first period ends immediately before the termination occurs (or is deemed to occur) and the second period begins immediately after the termination occurs(or is deemed to occur). The amount of section 643(b) income for each period is then determined as if each short period were a short taxable year. If after computing section 643(b) income for each period, distributions during a period exceed section 643(b) income for that period, then the return must be filed for the year if the distribution of the money or property meets the definition of a taxable distribution. If after computing section 643(b) income for the first short period the income exceeds the amount distributed, then the excess is treated as earned during the second short period.

(3) *Examples.* This paragraph may be illustrated by the following examples.

Example (1). Assume A creates a generation-skipping trust with the income and/or corpus payable to his child B and his grandchildren C and D (the children of B) for their joint lives and the life of the survivor, and upon the death of the last survivor to the grandchildren of B per stirpes. Assume that the grandchild exclusion has been utilized and that all section 643(b) income has been distributed previously. During the year 1990 C received $40,000 from the trust and D received $110,000. B has made no gifts during his lifetime and there have been no other generation-skipping transfers. Since C and D both have the same deemed transferor, the transfers are treated as occurring simultaneously and the tax is computed in the following manner:

(1)	Fair market value of property transferred to C & D	$150,000
(2)	Prior generation-skipping transfers	0
(3)	Adjusted taxable gifts	0
(4)	Taxable estate	0
(5)	Total	$150,000
(6)	Tax on amount on line 5	$ 38,800
(7)	Tax due from C $\frac{(\ 40,000}{(150,000} \times 38,800)$	$ 10,347
(8)	Tax due from D $\frac{(110,000}{(150,000} \times 38,800)$	$ 28,453

Example (2). Assume A creates a generation-skipping trust with the income and/or corpus payable in the sole discretion of the trustee to his child B, grandchild C, and great grandchild D for their joint lives and for the lives of the survivors. Upon the death of the last survivor the trust corpus is to be distributed to A's great great grandchlidren per stirpes. The trust is a calendar year taxpayer. On January 1, 1990, the trustee distributes $20,000 to C. On June 1, 1990, B dies. Section 643(b) income for the full year is $30,000, one-half ($15,000) of which was earned between Jan. 1, 1990, and June 1, 1990. Thus, under paragraph (c) $5,000 ($20,000 minus $15,000) of the $20,000 distribution is a taxable distribution.

(h) *Liability for tax*—(1) *Distributee.* If the tax imposed is not paid when due, each distributee (whether or not required to file a return) that receives property from the trust at the same time as or any time after a generation-skipping transfer is personally liable for the tax under section 2603(a)(1)(B) as a distributee to the extent of an amount equal to the fair market value of the property received determined as of the date of the distribution.

(2) *Trustees.* In the case of a taxable termination, if a trustee is required to make the return, the trustee is personally liable for the tax imposed on the transfer if the tax is not paid when due. This liability applies whether or not a trustee joins in making the tax return in situations involving multiple trustees or makes the return when it is the sole trustee. If a trustee pays the tax determined to be due based on

written data furnished by the Service, the trustee is not personally liable for any tax exceeding the amount determined to be due based on that data. This limit on a trustee's personal liability applies only if all the required information that was furnished to the Service by the trustee (or trustees) was accurate and complete. An increase in tax based on a higher property valuation than that claimed by the trustee is, for example, the result of inaccurate information and therefore the trustee will be liable for any increase in tax.

(3) *Lien on property.* The tax imposed by section 2601 is a lien on all property transferred in a generation-skipping transfer until the tax is fully paid or becomes unenforceable by reason of lapse of time. The lien attaches at the time of the generation-skipping transfer and is in addition to the lien for taxes under section 6321. Thus, for example, if property passes to more than one person in a simultaneous transfer as described in section 2602 (b), the property passing to each person is liable for the full amount of tax caused by the total transfer.

(i) This designation is not used.

(j) *Request to Internal Revenue Service for information*—(1) *In general.* A trustee or distributee may, before making a generation-skipping transfer tax return, request in writing that the Internal Revenue Service supply it with a statement showing—

(i) The amount of the deemed transferor's adjusted taxable gifts within the meaning of section 201(b) as modified by section 201(e),

(ii) The amount of the deemed transferor's taxable estate and the estate tax thereon before allowance of any credits,

(iii) The amount of prior generation-skipping transfers with respect to the deemed transferor,

(iv) The amount of prior generation-skipping transfers that occurred within three years prior to the deemed transferor's death and the amount of the generation-skipping transfer tax paid with respect to these transfers,

(v) The amount of generation-skipping transfer tax imposed before the allowance of any credits with respect to prior generation-skipping transfers,

(vi) The amount of State death tax credit allowed on the deemed transferor's estate tax return and the amount of State death tax credit allowed on prior generation-skipping transfer tax returns,

(vii) The amounts necessary to complete Schedule F, Credit for Tax on Prior Transfers,

(viii) The amount of the grandchild exclusion that has been used for transfers to a grandchild of the grantor,

(ix) The amount of any taxable distributions or taxable terminations that occurred during the same taxable year and that were made from other trusts having the same deemed transferor, and

(x) Any other data that may be needed to complete Form 706-B, *Generation-Skipping Transfers Tax Return.*

(2) *Filing of request.* The request for the information specified in paragraph (j)(1) of this section must be in writing and signed by any person required to file the return. It must be addressed to the Internal Revenue Service office with which an estate or gift tax return of the deemed transferor would be filed. It should be filed not less than 90 days before the due date of the generation-skipping tax return for the transfer involved. If the request is filed less than 90 days before the due date of the return, the failure to obtain the information will not be considered reasonable cause for failing to file a timely return or to pay the tax under section 6651. The written request should include the following information:

(i) The name and taxpayer identification number of the deemed transferor and of the grantor;

(i) A statement of the specific information requested from the Service;

(iii) In the case of a trustee or other agent, a certified copy of its appointment.

(k) *Initial filing date.* Notwithstanding any other provision of these regulations, the time for filing the Form 706-B shall be the date determined under paragraph (c) of this section or February 5, 1981, whichever is later.

There is a need for immediate guidance with respect to the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue it with notice and public procedure under subsection (b) of section 553 of Title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in section 2622 and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1887, 68A Stat. 917, 26 U.S.C. 2622, 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved July 18, 1980.

EMIL M. SUNLEY,
Acting Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on August 4, 1980, 8:45 a.m., and published in the issue of the Federal Register for August 5, 1980, 45 F.R. 51771)

Section 6324A.—Special Lien for Estate Tax Deferred Under Section 6166

26 CFR 301.6324A-1: Election of and agreement to special lien for estate tax deferred under section 6166 or 6166A.

Election of a lien in favor of the U.S. by executor of a decedent's estate who seeks to be discharged from personal liability. See T.D. 7710, page 12.

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions

United States-United Kingdom Income Tax Convention

T.D. 5569, 1947-2 C.B. 100 1980-21 I.R.B. 5

(Also Part I, Sections 164, 882, 906; 1.164-1, 1.882-1.)

United Kingdom; permanent U.S. establishment; deduction for tax paid on U.S. income. A United Kingdom corporation that has a permanent establishment in the U.S. paid U.K. income tax on business profits attributable to its U.S. operation only because the corporation was a resident of the U.K. Section 906(b)(1)(B) of the Code is not contrary to any treaty provisions, and the corporation may not deduct the U.K. income tax paid on U.S. profits. However, the corporation may deduct the U.K. income tax paid on effectively connected income from another foreign country. Rev. Ruls. 55-532, 58-310, and 65-234 obsoleted.

Rev. Rul. 80-243

ISSUE

Is a United Kingdom corporation with a permanent establishment in the United States entitled to deduct, in computing its taxable income for United States income tax purposes, the United Kingdom income tax it paid that is attributable to operations of its United States permanent establishment?

FACTS

X, a United Kingdom corporation, has a United States branch that constitutes a permanent establishment within the meaning of:

(1) Article II(1)(l) of the United States-United Kingdom Income Tax Convention (Old Convention), T.D. 5569, 1947-2 C.B. 100, as last modified by a Supplementary Protocol, signed on March 17, 1966, and generally effective for taxable years beginning on or after January 1, 1966, 1966-2 C.B. 582 (Old Supplementary Protocol); and (2) Article 5(1) of the New United States-United Kingdom Income Tax Convention (New Convention), 1980-21 I.R.B. 5 as modified by three Supplementary Protocols, signed, respectively, on August 26, 1976, March 31, 1977, and March 15, 1979, all generally effective for taxable years beginning on or after January 1, 1975.

Pursuant to Article III(1) of the Old Convention and Article 7(1) of the New Convention, *X* is subject to and pays United States tax on its business profits attributable to the income from the branch operation. The branch earns income attributable to the United States trade or business from both United States and foreign sources.

On its 1974 and 1975 federal income tax returns, filed on a calendar year basis, *X* deducted United Kingdom income tax it paid on its business profits attributable to the income from the branch operation. The United Kingdom income tax paid by *X* was imposed solely because *X* was a resident of the United Kingdom.

LAW AND ANALYSIS

Under section 882(a)(1) of the Internal Revenue Code a foreign corporation engaged in a trade or business within the United States during the taxable year shall be taxable on its taxable income which is effectively connected with the conduct of a trade or business within the United States. Section 882(c)(1)(A) provides that a foreign corporation shall be allowed deductions to the extent they are connected with income which is effectively connected with the conduct of a trade or business within the United States.

Section 164(a)(3) of the Code provides that state and local, and foreign income taxes shall be allowed as a deduction for the taxable year within which paid or accrued.

Section 906(b)(1)(B) of the Code provides a rule for determining the amount of foreign tax paid or accrued in order to determine deductions allowable to a foreign corporation under section 882(c). It states that there shall not be taken into account any amount of tax to the extent the tax so paid or accrued is imposed with respect to income from sources within the United States that would not be taxed by such foreign country but for the fact that such corporation was created or organized under the law of such foreign country or is domiciled for tax purposes in such country.

Under Article III(3) of the Old Convention, as modified by the Old Supplementary Protocol, in determining the industrial and commercial profits of a United States permanent establishment, deductions are allowed for all expenses that would be deductible if the permanent establishment were an independent enterprise, if they are reasonably connected with the taxable profits, wherever the expenses are incurred. Under Article 7(3) of the New Convention, in determining the profits of a United States permanent establishment, deductions are allowed for those expenses which are incurred for the purposes of the permanent establishment, wherever those expenses are incurred. Neither Article III(3) of the Old Convention nor Article 7(3) of the New Convention elaborates on what income tax expenses are allowed as deductions.

Article II(3) of the Old Convention and Article 3(2) of the New Convention provide that, with respect to the application of the respective Conventions by one of the Contracting Parties, any term not otherwise defined shall, unless the context otherwise requires, and subject to Article 25 (Mutual Agreement Procedure), have the meaning which it has under the laws of that Contracting Party relating to the taxes which are the subject of the Convention. Since neither Article II(3) of the Old Convention nor Article 3(2) of the New Convention elaborate on what income tax expenses are allowed as deductions, the context of those Articles does not otherwise require, and there has been no mutal agreement under Article 25(3), reference is made to United States internal law in accordance with Article II(3) of the Old Convention and Article 3(2) of the New Convention to determine what tax expenses are allowed as deductions.

Under the Code in effect at the time the Old Convention was signed, and subsequently at the time the Old Supplementary Protocol was signed and became effective, a deduction was allowed by United States internal tax law for a ratable portion of the United Kingdom income taxes paid by United Kingdom corporations in computing taxable income from sources within the United States. *See* Rev. Rul. 55-532, 1955-2 C.B. 592, as clarified by Rev. Rul. 58-310, 1958-1 C.B. 262. See also Rev. Rul. 65-234, 1965-2 C.B. 238. However, section 906(b)(1)(B) of the Code, added by the Foreign Investors Tax Act of 1966, Pub. L. 89-809, 1966-2 C.B. 656 (FITA), has the effect of denying this deduction unless the application of section 906(b)(1)(B) would be contrary to an existing treaty obligation, in which case section 110 of FITA provides that section 906(b)(1)(B) shall not apply.

The Old Convention as it is currently constituted does not contain a provision requiring that an interpretation be made with reference to internal law in effect on a particular date, although such references were included elsewhere in the Old Convention in the past. See, for example, Article XIII (1) of the Old Convention, prior to amendment by Article 9 of the Old Supplementary Protocol, which provided, with respect to the foreign tax credit applicable to certain dividends and royalties, that the credit would be allowed "[s]ubject to sections 901 to 905 of the United States Internal Revenue Code as in effect on the 1st day of January 1956." Therefore, in determining what income tax expenses are deductible by *X* for 1974 in computing its United States income tax liability under the Code, section 906(b)(1)(B) must be applied even though it was not in the Code at the time the Old Convention and the Old Supplemental Protocol became effective.

Section 110 of FITA does not prevent the application of section 906(b)(1)(B) under the Old Convention. Article III(3), as previously indicated, does not elaborate on what income tax expenses are allowed as deductions and section 906(b)(1)(B) is, therefore, not contrary to the Old Convention. Similarly, the provisions of section 906(b)(1)(B) are not contrary to Article 7(3) of the New Convention, which also does not address what income tax expenses are deductible. Therefore, pursuant to Articles II(3) and 3(2) of the Old and New Conventions, respectively, section 906(b)(1)(B) applied and precludes *X* from taking a deduction on its 1974 and 1975 federal income tax returns for foreign taxes that are paid with respect to income from sources within the United States that would not be taxed by the United Kingdom but for the fact that *X* is domiciled for tax purposes in the United Kingdom.

However, section 906(b)(1)(B) does not preclude *X* from taking a deduction for foreign taxes for its 1974 and 1975 taxable years that are paid with respect to income from foreign sources subject to taxation by the United States. To the extent that foreign source income subject to United States taxation is derived from the United Kingdom, then *X* may deduct any United Kingdom tax paid on such income for purpose of computing *X*'s United States taxable income. To the extent that foreign source income subject to United States taxation is derived from a source other than the United Kingdom, the deduction for United Kingdom tax paid on such income is limited to any United Kingdom tax paid in excess of a United Kingdom tax credit allowed as a result of the payment of income tax to the foreign income source country.

HOLDINGS

A United Kingdom corporation having a permanent establishment in the United States cannot deduct, in computing its taxable income for United States purposes, United Kingdom income tax imposed solely because the corporation is a resident of the United Kingdom and paid with respect to income from sources within the United States. However, such corporation may deduct the amount of United Kingdom income tax it paid with respect to the permanent establishment's income from foreign sources attributable to its permanent establishment to the extent such tax exceeds the United Kingdom tax credit allowed as a result of payment of income tax to the foreign income source country. In this latter situation, in which the foreign income source country is not the United Kingdom, the corporation is also entitled to deduct any income taxes paid to such country subject to the limitations of section 906(b)(1)(B).

EFFECT ON OTHER REVENUE RULINGS

Rev. Ruls. 55-532, 58-310 and 65-234 involve the deductibility of the United Kingdom income tax paid by United Kingdom corporations doing business in the United States with respect to income from sources within the United States prior to the enactment of section 906(b)(1)(B) of the Code. Consequently, these revenue ruling are obsoleted.

Subpart B.—Legislation and Related Committee Reports

Public Law 96-293
96th Congress, H.R. 7685
June 30, 1980

An Act to amend title IV of the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1] to postpone for one month the date on which the corporation must pay benefits under terminated multiemployer plans.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 4082(c) of title IV of the Employee Retirement Income Security Act of 1974 (relating to effective dates; special rules) as amended by Public Law 95-214, Public Law 96-24 [1979-2 C.B. 471], and Public Law 96-239 [1980-24 I.R.B. 20] is further amended—

(1) by striking "July 1, 1980" in paragraphs (1), (2), and (4) and substituting "August 1, 1980" in each such paragraph; and

(2) by striking "June 30, 1980" in paragraphs 2(B) and 4(D) and substituting "July 31, 1980" in each such paragraph.

Approved June 30, 1980.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.201: Rulings and determination letters.
(Also Part I, Sections 304, 357; 1.304-2, 1.357-1.)

Rev. Proc. 80-34

SECTION 1. BACKGROUND

Section 4.01 of Rev. Proc. 80-22, 1980-26 I.R.B. 26, provides a list of those areas of the Internal Revenue Code under the jurisdiction of the Assistant Commissioner (Technical) in which the Internal Revenue Service will not ordinarily issue advance ruling or determination letters. A list of these areas is set forth in section 4.01 of the revenue procedure.

SEC. 2. PROCEDURE

Rev. Proc. 80-22 is amplified to include the following under section 4.01:

Sections 304 and 357.—Redemption Through Use of Related Corporation; Assumption of Liability.—A transaction similar to that described in Rev. Rul. 80-240, at page 8, holding that sections 304(a)(1) and 357(a) of the Code are inapplicable because there was no assumption of liability, unless the taxpayer can satisfy the Internal Revenue Service that the liability was incurred by the taxpayer as a mere intermediary agent for the newly created corporate transferee. To establish this, the taxpayer must submit to the Internal Revenue Service documented evidence, composed at the time the liability was incurred, which indicates that the unrelated lender had agreed to release the transferor-borrower from any and all obligation on the liability in favor of the corporate transferee. Further, the taxpayer must show, or represent to, the Internal Revenue Service that the transfer and assumption actually occurred, or will actually occur, within 12 months of the date the debt was incurred.

SEC. 3. EFFECTIVE DATE

This revenue procedure will apply to all ruling requests on hand in the National Office on September 8, 1980, the date of publication of this revenue procedure in the Internal Revenue Bulletin, as well as to requests received thereafter.

SEC. 4. EFFECT ON OTHER REVENUE PROCEDURES

Rev. Proc. 80-22 is amplified.

Part IV. Items of General Interest

SEP IRAs—Employer Contributions

Announcement 80-112

Proposed regulations on the Simplified Employee Pension (SEP) will include several rules designed to alleviate certain problems faced by employers who contribute to a SEP. Until these proposed regulations are published, taxpayers may rely on the guidance provided below to resolve the issues specifically covered.

The Revenue Act of 1978, Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, added the SEP provisions to the Internal Revenue Code. These provisions allow employers to contribute to the Individual Retirement Account or Annuity (IRA) of each of their employees amounts which may exceed the normal limits on deductions for employee contributions to an IRA.

In order to utilize a SEP, an employer must comply with certain statutory requirements, including requirements pertaining to which employees must be allowed to participate in the SEP. Basically, an employer who makes payments to a SEP in a particular year must contribute on behalf of each employee who has attained age 25 and has worked for the employer during at least three of the immediately preceding five calendar years. The proposed regulations will provide, however, that employers need not contribute for a particular calendar year on behalf of an employee whose compensation was less than $200 for that calendar year.

An employer must contribute on behalf of all employees who met the SEP eligibility requirements during the year for which a contribution is made, including those individuals who no longer are employed by the employer on the SEP contribution date. Although the Service recognizes that this may present difficulties under certain circumstances, employers must contribute on behalf of these employees, including deceased employees, even if the present whereabouts of these individuals is unknown. If the individual either had not previously established an IRA or had established an IRA but had closed it prior to the employer's SEP contribution date for the current year, the employer is obligated to establish an IRA on behalf of each such employee.

Notice of the employer's SEP contribution is to be given in person or by mail to the last known address of such former employee. Employers who have made contributions on behalf of such employees must maintain records of such payments which include the names of such employees, the amounts contributed on behalf of each such employee, and the name and address of the institution where each such employee's account is maintained.

An IRA may satisfy the requirements of section 408 of the Code even though an employer establishes the IRA on behalf of an employee who otherwise has not set up an IRA to receive the employer's SEP contribution.

The proposed regulations will also provide that a SEP need not be established until the contribution is made for that particular calendar year. Thus, employers are not necessarily required to establish a SEP for a particular year by the last day of that calendar year.

Contributions made on behalf of individuals who are no longer employed by the employer at the end of the employer's taxable year will be considered timely even if made after the due date of the employer's tax return if they are made by December 31, 1980.

Correction of Rev. Proc. 80-19

Announcement 80-113

Rev. Proc. 80-19, 1980-25 I.R.B. 45 is corrected to read as follows:

Page 45—Sec. 3.03. First paragraph should be numbered "1."

Page 46—The following paragraph is inserted as number "2" immediately preceding Sec. 3.04:

2 A multiple-plant manufacturer may have individual plant information submitted to the industry group from a company-designated consolidation point. Such information must be provided to the industry group no later than the date the individual plant would be required to report it. This also applies to 3.04 and 3.05 below.

Page 48—Sec. 3.063, Line 10—The phrase ", or have weighed," should be inserted between the words "weigh" and "a".

Page 48—Sec. 3.082—Lines 5, 6, and 7—The phrase ", where it is importing within a category tires of a single specification weight," is deleted.

Page 48—Sec. 3.09, Second paragraph, Lines 5, 6, and 7—The phrase ", where it is importing within a category tires of a single specification weight," is deleted.

Page 48—Sec. 3.11, Line 3—The phrase "if the inaccuracy is other than of a de minimis nature," is inserted after "inaccurate,".

Page 49.—Sec. 4.03, Line 7—The word "second" is inserted after "the".

These corrections will be reflected in Rev. Proc. 80-19 when it is published in 1980-1 C.B.

Foundation Status of Certain Organizations

Announcement 80-114

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3) of the Code, eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Academy of Art College Library Fund, Inc., San Francisco, CA

Adams Foundation, Inc., Ann, Jacksonville, FL
Amateur Computer Group of New Jersey, Inc., Union County Technical Institute, Scotch Plains, NJ
American Council of the Blind of New Jersey, Inc., Old Bridge, NJ
American Institute of Mythographic Research and Studies of Primary Energy Sources, Inc., Coconut Grove, FL
Animal Alliance Welfare League Inc. of New Jersey, Elizabeth, NJ
Anoka Area Hockey Association Inc., Anoka, MN
Blake Genealogical Society, James T., Provo, UT
Carmody Scholarship Fund, Inc., Donald, Berlin, NJ
Carolina Home Health Services, Inc., Taylors, SC
Charity Ball Board of Greenville, South Carolina, Greenville, SC
Chinatown Neighborhood Center, San Francisco, CA
Club Social Montevideo Uruguay, Newark, NJ
Common Space, Minneapolis, MN
Community Resources Council, Inc., Decatur, GA
Concern, Inc., Elizabeth, NJ
Conjart, Inc., Milltown, NJ
Dayton Community Corp., Newark, NJ
Dorton Family Genealogical Association, Salt Lake City, UT
Dover Youth Inc., Dover, NJ
East-West Foundation, Inc., Atlanta, GA
Effective Training Corp., Libertyville, IL
Employment and Training Corporation of America, The, Durham, NC
Essex Services, Inc., Newark, NJ
Faith Ministries, Inc., Cherry Hill, NJ
Freehold Area Hospital Doctors "Wives" Association, Inc., Freehold, NJ
Friends of the Mansion of Smithville, The, Smithville, Mt. Holly, NJ
Georgia Association of Nurse Anesthetists Scholarship Fund, Augusta, GA
Gloucester County Child Care Council, Inc., Woodbury, NJ
Hadley Family Association, Inc., John Hipwell, Ogden, UT
Hamilton-Van Wagoner House, The, Clifton, NJ
Hillsborough Education Association, Hillsborough, NJ
Human Resources Development, East Orange, NJ
Jewish Media Foundation, Paterson, NJ
Knoxville Daycare Home Association, Knoxville, TN
Madison County Arts Council, Inc., Hot Springs, NC
McCabe Memorial Foundation, Everett, San Rafael, CA
Middlesex County Unemployed/Employed Council, New Brunswick, NJ
Miles Family Association, Albert, Salt Lake City, UT
Newark Downtown Educational Center and Day Care Center, Newark, NJ
North State Public Video, Inc., Chapel Hill, NC
North 25 Housing Corp., Trenton, NJ
Northern California Shining Light Ministries, Inc., San Jose, CA
Oregon Educational Research Association, Eugene, OR
OZ, Inc., Lincoln, NE
Parsippany Soccer Club, Parsippany, NJ
Penns Grove Day Care and Community Center, Penns Grove, NJ
Riverside Church of Gospel, Inc., Jacksonville, FL
Sadsbury Township East Side Fire Department, Conneaut Lake, PA
St. Bethlehem Little League, Inc., St. Bethlehem, TN
Salt Cellar, The, Charlotte, NC
Saxifrage, Chapel Hill, NC
Smyrna Towers, Inc., Atlanta, GA
South Georgia Outreach Ministries, Inc., Douglas, GA
Southeast Raleigh Athletic Organization, Inc., Raleigh, NC
Southeastern Angiographic Society Inc., Savannah, GA
200th Anniversary Committee for the Valley Forge Washington, Stanford, CA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Shareholder Requirements Relating to Electing Small Business Corporations—Public Hearing

Announcement 80-115 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to certain shareholder requirements, and related matters, for electing small business corporations.

DATES: The public hearing will be held on October 8, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by September 24, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-277-76), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION

The subject of the public hearing is proposed regulations under sections 1371 and 1372 of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Thursday, April 17, 1980, at page 26092 (45 FR 26092).

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[1] Filed by the Office of the Federal Register on August 7, 1980, 8:45 a.m., and published in the issue of the Federal Register for August 8, 1980, 45 F.R. 52824.

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments by the time prescribed in the notice of proposed rulemaking, and also desire to present oral comments at the hearing on the proposed regulations, should submit an outline of the comments to be presented at the hearing and the time they wish to devote to each subject by September 24, 1980. Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive on improving government regulations appearing in the Federal Register for Wednesday, November 8, 1978.

Excise Tax on Fuel Used in Commercial Waterway Transportation—Public Hearing

Announcement 80-118 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to the new excise tax on the use of fuel in commercial waterway transportation.

DATES: The public hearing will be held on September 25, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by September 11, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-175-78), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION

The subject of the public hearing is proposed regulations under section 4042 of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Monday, June 9, 1980 (45 FR 38412).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of oral comments to be presented at the hearing and the time they wish to devote to each subject by September 11, 1980.

Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive on improving government regulations appearing in the Federal Register for Wednesday, November 8, 1978.

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[1] Filed by the Office of the Federal Register on August 22, 1980, and published in the issue of the Federal Register for August 25, 1980, 45 F.R. 56364.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Robert L. Hamersley	Boise, ID	Certified Public Accountant	Indefinite from July 7, 1980
Daniel C. Lukensow	Arcadia, CA	Enrolled Agent	Eighteen months effective July 28, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.501(c)(9)-1 as proposed in the Federal Register for January 23, 1969, 34 F.R. 1028, withdrawn; 1.501(c)(9)-1 through 1.501(c)(9)-8 added.	Voluntary employees' beneficiary associations.	July 17, 1980	Sept. 15, 1980
26 CFR 1.166-1, 1.166-4, 1.381(c)(4)-1, amended; 1.166-10, added.	Reserve for certain guaranteed debt obligations.	July 11, 1980	Sept. 9, 1980
26 CFR 1.892-1 amended.	Determining whether certain income of foreign sovereigns from loans or leases is derived from the conduct of commercial activities in the U.S.	July 22, 1980	Sept. 22, 1980
26 CFR 20.2055-2(c), 20.2056(a)-1(b)(2) amended; 20.2041-3(d)(6), 20.2056(a)-1(a), 25.2511-1(c), 25.2514-3(c) revised; 20.2056(d)-1 redesignated 20.2056(d)-2 and amended; 20.2045-1, 20.2056(d)-1, 25.2518-1 through 25.2518-4 added.	Disclaimer of property conferred by gift of inheritance.	July 22, 1980	Sept. 22, 1980
26 CFR 26a.2621-1 added.	Generation-skipping transfer tax return requirements.	Aug. 5, 1980	Oct. 6, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

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* Denotes entry since last publication.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27, dated July 7, 1980.

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1932–1	*2.80*
1932–2	8.65
1933–1	*3.35*
1933–2	*3.45*
1934–1	*3.70*
1934–2	14.00
1935–1	6.90
1935–2	14.00
1936–1	*3.55*
1936–2	14.00
1937–1	13.00
1937–2	7.70
1938–1	16.00
1938–2	13.00
1939–1–1	8.25
1939–1–2	10.90
1939–2	9.40
1940–1	5.55
1940–2	14.00
1941–1	*$6.95*
1941–2	*3.55*
1942–1	7.25
1942–2	*5.55*
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1948–2	7.50
1949–1	*6.90*
1949–2	*2.80*
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1950–2	*4.70*
1951–1	12.00
1951–2	*5.05*
1952–1	*2.55*
1952–2	7.05
1953–1	*4.25*
1953–2	12.00
1954–1	12.00
1954–2	12.00
1955–1	10.25
1955–2	13.00
1956–1	15.00
1956–2	18.00
1957–1	$16.00
1957–2	13.00
1958–1	9.60
1958–2	13.00
1958–3	15.00
1959–1	15.00
1959–2	9.60
1960–1	19.00
1960–2	11.50
1961–1	14.00
1961–2	10.00
1962–1	14.00
1962–2	13.00
1962–3	20.00
1963–1	9.00
1963–2	10.75
1964–1–1	10.00
1964–1–2	11.00
1964–2	9.80
1965–1	10.70
1965–2	12.25
1966–1	14.00
1966–2	14.05
1967–1	10.00
1967–2	14.00
1968–1	14.00
1968–2	11.75
1969–1	14.00
1969–2	6.50
1969–3	$12.50
1970–1	11.00
1970–2	14.00
1971–1	10.55
1971–2	8.50
1972–1	13.50
1972–2	13.70
1973–1	16.00
1973–2	8.30
1974–1	11.00
1974–2	9.95
1974–3	*8.20*
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1975–1	13.25
1975–2	13.00
1976–1	11.00
1976–2	10.25
1976–3–1	9.50
1976–3–2	16.00
1976–3–3	10.00
1977–1	10.75
1977–2	11.75
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9258

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-245, page 6.

Research and experimental expenses; environmental impact studies. A public utility company conducted, and paid another organization to conduct, environmental impact studies to support its application to state regulatory agencies to expand its generating facilities. The expenses are not research and experimental expenditures within the meaning of section 174 of the Code. However, if not chargeable to a capital account, the expenses are deductible business expenses.

Rev. Rul. 80-246, page 7.

Transfer of foreign branch with losses; recapture of loss. The amount of gain that a domestic corporation must recognize as ordinary foreign source income pursuant to Rev. Rul. 78-201 on the incorporation of its foreign branch that had incurred annual losses since its creation is reduced by the amount of taxable income realized and recognized by the domestic corporation under section 904(f)(3)(A) of the Code, on the transfer of assets to the new foreign corporation; Rev. Rul. 78-201 amplified.

Rev. Rul. 80-247, page 9.

Transfer of foreign branch with losses; abandonment of certain assets. Losses that must be recaptured under Rev. Rul. 78-201, as a result of the incorporation of a foreign branch operation, include expenses directly related to branch property not transferred but abandoned as worthless; Rev. Rul. 78-201 amplified.

Rev. Rul. 80-248, page 10.

Interest; "reverse mortgage loan"; when deducted and when included. Interest on a "reverse mortgage loan" that is added monthly to the outstanding loan balance as it accrues is neither includible in a cash method lender's gross income nor deductible by a cash method borrower at the time it is added.

Rev. Rul. 80-249, page 11.

Residence; installment sale; election; gross profit. A taxpayer who realized a gain on the sale of a principal residence elected to exclude the gain under section 121 of the Code and elected to use the installment method of reporting income from the sale. In determining the amount of each installment payment that is reportable under the installment method of accounting, gross profit in the formula provided in section 453(a)(1) is the amount of the gain that is not excludable from gross income.

Rev. Rul. 80-251, page 5.

Industrial development bonds; security interest. The proceeds of bonds issued by a city will be loaned to developers of industrial buildings. Payments by the developers of principal and interest due on their loans will not be pledged as security for, and will not coincide with, debt service on the bonds. However, over the term of the bonds the payments by the developers will be approximately equal in present value to the debt service on the bonds. Because the "trade or business test" and the "security interest test" will be satis-

(Continued on page 4)

Finding Lists begin on page 21.
Announcement of Voluntary Suspensions on page 19.
Announcement of Notice of Proposed Rulemaking on page 20.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

The contents of this publication are not copyrighted and may be reprinted freely. A citation of the Internal Revenue Bulletin as the source would be appropriate.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

fied, the bonds will be industrial development bonds within the meaning of section 103(b)(2) of the Code. Rev. Rul. 75-403 revoked.

T.D. 7712, page 12.
Amendments to the regulations relate to exceptions to the definition of U.S. property under section 956 of the Code and to computation of the investment of earnings in U.S. property by controlled foreign corporations.

ESTATE TAX

Rev. Rul. 80-250, page 15.
Administration expenses; interest on federal estate tax; when deductible. Interest expense charged on the extended payment of federal estate tax is deductible when the interest accrues. No deduction is allowable on the estate tax return for an estimate of interest expense to be incurred in the future.

EMPLOYMENT TAXES

Rev. Proc. 80-35, page 17.
Employee; periods ending before 1981. Rev. Proc. 78-35 is modified to reflect changes made by Pub. L. 96-167 to section 530 of the Revenue Act of 1978, which, as amended, provides that an individual who has not been treated as an employee by a taxpayer for any period ending before 1981 will not be deemed to be an employee for that period unless the taxpayer had no reasonable basis for not treating the individual as an employee.

EXCISE TAXES

Notice 80-8, page 17.
Windfall profit tax; inflation adjustment factor. For purposes of computing the windfall profit tax, the inflation adjustment for the quarter ending December 31, 1980, is .0924 for tier 1 or tier 2 oil and .1144 for tier 3 oil.

ADMINISTRATIVE

Announcement 80-116, page 18.
Form 1138, Extension of Time for Payment of Taxes by a Corporation Expecting a Net Operating Loss Carryback, has been revised to clarify the filing deadline.

Announcement 80-117, page 18.
Form 4789, Currency Transaction Report, is being revised to reflect new reporting rules for banks and other financial institutions that file the report on individual customer currency transactions of over $10,000.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-7: Interest.

Inclusion in gross income of interest on a reverse mortgage loan. See Rev. Rul. 80-248, page 10.

Section 103.—Interest on Certain Governmental Obligations

26 CFR 1.103-7: Industrial development bonds.
(Also Section 7805; 301.7805-1.)

Industrial development bonds; security interest. The proceeds of bonds issued by a city will be loaned to developers of industrial buildings. Payments by the developers of principal and interest due on their loans will not be pledged as security for, and will not coincide with, debt service on the bonds. However, over the term of the bonds the payments by the developers will be approximately equal in present value to the debt service on the bonds. Because the "trade or business test" and the "security interest test" will be satisfied, the bonds will be industrial development bonds within the meaning of section 103(b)(2) of the Code. Rev. Rul. 75-403 revoked.

Rev. Rul. 80-251

ISSUE

Will bonds that a city proposes to issue be "industrial development bonds" within the meaning of section 103(b)(2) of the Internal Revenue Code?

FACTS

In order to provide loans to developers of industrial buildings, city *M* proposes to issue general obligation bonds that will be secured by *M*'s full faith and credit. Bond proceeds will be paid by the bond purchaser to the city director of finance, who will remit the proceeds to the board of finance (board) for deposit in the board's bank account. The board will disburse the proceeds for approved loans as directed by an administrative body of *M*. Repayment by developers of all loans made from bond proceeds will be made to the board. The board will transfer the funds to the director of finance for credit to the general fund of *M*.

In its annual budget, *M* includes in its general fund all debt service (principal and interest payments) on all outstanding general obligations. *M* is required by state legislation to levy ad valorem taxes at a rate and in an amount sufficient to produce revenue to pay debt service on such obligations.

Substantially all of the loans of bond proceeds will be used by the developers in connection with the purchase, construction, or reconstruction of industrial buildings that will be leased or sold to persons who are not "exempt persons" within the meaning of section 103(b)(3) of the Code for use in their trades or businesses.

The industrial buildings purchased, constructed, or reconstructed with bond proceeds will not be pledged as security for payment of debt service on the bonds. *M* will secure all loans to the developers financed with the bond proceeds with mortgages on the facilities financed by the loans. Payments by the developers of principal and interest due with respect to loans made from bond proceeds will not be pledged as security for payment of debt service on the bonds and such payments will not match or coincide with debt service amounts due with respect to the bonds. The interest paid by the developers on the loans made from bond proceeds may be less than, equal to, or greater than the interest paid by *M* on the bonds. However, it is anticipated that over the term of the bonds the principal and interest payments to be made by the developers and the total debt service on the bonds will be approximately equal in present value.

The bonds will not be "arbitrage bonds" within the meaning of section 103(c) of the Code.

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include interest on the obligations of a state or the political subdivision of a state.

Section 103(b)(1) of the Code provides that, except as otherwise provided in section 103(b), any industrial development bond shall be treated as an obligation that is not an obligation described in section 103(a)(1).

Section 103(b)(2) of the Code provides that the term "industrial development bond" means any obligation (A) that is issued as part of an issue all or a major portion of the proceeds of which are to be used directly or indirectly in any trade or business carried on by any person who is not an exempt person (as defined in section 103(b)(3)), and (B) the payment of the principal or interest on which (under the terms of such obligation or any underlying arrangement) is, in whole or in major part (i) secured by any interest in property used or to be used in a trade or business or in payments in respect of such property, or (ii) to be derived from payments in respect to property, or borrowed money, used or to be used in a trade or business.

Section 1.103-7(b)(3) of the Income Tax Regulations provides that the trade or business test relates to the use of the proceeds of a bond issue. The test is met if all or a major portion (more than 25 percent) of the proceeds of a bond issue is used in a trade or business carried on by a nonexempt person. For example, if all or a major portion of the proceeds of a bond issue is to be loaned to one or more private business users, or is to be used to acquire, construct, or reconstruct facilities to be leased or sold to such private business users, and such proceeds or facilities are to be used in trades or businesses carried on by them, such proceeds are to be used in a trade or business carried on by persons who are not exempt persons, and the debt obligations comprising the bond issue satisfy the trade or business test.

Section 1.103-7(b)(4) of the regulations provides that the security interest test relates to the nature of the security for, and the source of, the payment of either the principal or interest on a bond issue. The nature of the security for, and the source of, the payment may be determined from the terms of the bond indenture or on the basis of an underlying arrangement. An underlying arrangement can be inferred from all the facts and circumstances.

Example (14) of section 1.103-7(c) of the regulations, which illustrates the existence of an underlying arrangement, reads as follows:

> J, a political subdivision of a State, will issue several series of bonds from time to time and will use the proceeds to rehabilitate urban areas. More than 25 percent of the proceeds of each issue will be used for the rehabilitation and construction of buildings which will be leased or sold to nonexempt persons for use in their trades or businesses. There is no limitation either on the number of issues or the aggregate amount of bonds which may be outstanding. No group of bondholders has any legal claim prior to any other bondholders or creditors with respect to specific revenues of J, and there is no arrangement whereby revenues from a particular project are paid into a trust or constructive trust, or sinking fund, or are otherwise segregated or restricted for the benefit of any group of bondholders. There is, however, an unconditional obligation by J to pay the principal and interest on each issue of bonds. Further, it is apparent that J requires the revenues from the lease or sale of buildings to nonexempt persons in order to pay in full the principal and interest on the bonds in question. The bonds are industrial development bonds because a major portion of the proceeds will be used in the trades or businesses of nonexempt persons and, pursuant to an underlying arrangement, payment of the principal and interest is, in major part, to be derived from payments in respect of property or borrowed money used in the trades or businesses of nonexempt persons.

An underlying arrangement will always be inferred if the payments to be made by the industrial user or users and the debt service on the bonds are approximately equal in present value. Other facts that tend to show an underlying arrangement are, first, that payments made by the industrial user or users are material to the security for the bonds, and second, that the identity of the industrial user or users can be determined with reasonable certainty at the time of issue.

In Rev. Rul. 75–403, 1975–2 C.B. 37, a state proposed to issue bonds in order to make loans to nursing homes to finance the costs necessary to meet federal and state safety standards. The bonds were to be secured by the full faith and credit of the state. The nursing home loan repayments, the assets financed by such loans, and any other security on the nursing home loans were not to be pledged as security for the payment of principal or interest on the proposed bonds. Rev. Rul. 75–403 holds that the security interest test contained in section 103 (c)(2) (redesignated section 103(b) (2)) of the Code will not be satisfied and the bonds will not be industrial development bonds.

In this case the bond proceeds will be loaned to developers for use in constructing or reconstructing industrial buildings that will be leased or sold to nonexempt persons. Because the building financed by the bond proceeds will be used in the trades or businesses of the nonexempt persons, the bond proceeds will be considered used in the trades or businesses of nonexempt persons and the "trade or business test" described in section 1.103-7(b)(3) of the regulations will be satisfied.

Although payments of principal of and interest on the loans by developers will not coincide with debt service on the bonds, an underlying arrangement can be inferred because the payments to be made by the developers and the debt service on the bonds are approximately equal in present value. Consequently, the payment of principal of and interest on *M*'s bonds will be derived from payments in respect of property, or borrowed money, used or to be used in a trade or business within the meaning of section 103(b) (2)(B)(ii) of the Code. See example (14) of section 1.103-7(c) of the regulations. Therefore, the "security interest test" described in section 1.103-7(b)(4) will be satisfied.

The Service has reconsidered Rev. Rul. 75–403 and because Rev. Rul. 75–403 did not focus on whether an underlying arrangement would cause the security interest test to be satisfied, the Service will no longer follow that revenue ruling.

HOLDING

The bonds to be issued by *M* will be "industrial development bonds" within the meaning of section 103(b)(2) of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 75–403 is revoked.

PROSPECTIVE APPLICATION

Pursuant to the authority contained in section 7805(b) of the Code, this revenue ruling will not apply to obligations sold prior to September 15, 1980, the date this revenue ruling is published in the Internal Revenue Bulletin.

Section 121.—One-Time Exclusion of Gain from Sale of Principal Residence by Individual Who Has Attained Age 55

26 CFR 1.121-1: Gain from sale or exchange of residence of individual who has attained age 55.

Determination of the amount of each installment payment that is reportable under the installment method of accounting where the taxpayer elects to exclude gain pursuant to section 121 of the Code. See Rev. Rul. 80-249, page 11.

Section 163.—Interest

26 CFR 1.163-1: Interest deduction in general.

Deduction for interest on a reverse mortgage loan. See Rev. Rul. 80-248, page 10.

Section 174.—Research and Experimental Expenditures

26 CFR 1.174-2: Definition of research and experimental expenditures.

Research and experimental expenses; environmental impact studies. A public utility company conducted, and paid another organization to conduct, environmental impact studies to support its application to state regulatory agencies to expand its generating facilities. The expenses are not research and experimental expenditures within the meaning of section 174 of the Code. However, if not chargeable to a capital account, the expenses are deductible business expenses.

Rev. Rul. 80-245

ISSUE

Are the taxpayer's expenditures for environmental impact studies prepared in connection with the expansion of its facilities research and experimental expenditures within the meaning of section 174 of the Internal Revenue Code?

FACTS

In 1978, the taxpayer, a public utility company, planned expansion of its facilities for generating electricity. The taxpayer conducted various studies needed to support its application to be filed with state regulatory agencies for a construction permit to expand its facilities.

Because the taxpayer's expansion involved both the construction of a nuclear power plant and the installation of an ultra high voltage electric transmission line, the state regulatory agencies required that the taxpayer conduct several types of environmental impact studies for site selection. The studies measured specific site conditions and the resulting environmental impact of the construction and operation of the expanded facilities. Part of the studies were conducted directly by the taxpayer. The taxpayer used a research organization to conduct the remainder of the studies on its behalf.

During 1978, several studies were conducted either by the taxpayer or on its behalf. The studies identified suitable locations for the plant, ascertained the socio-economic impact of the plant on the surrounding community, ascertained the impact of the facility on the terrestrial ecology of the proposed site, considered the commercial disposition of fly ash waste generated by an alternative coal powered plant in order to meet state environmental standards, predicted noise levels at the construction site, considered the impact of construction and operation of the facilities on the aquatic environment of the inland streams located on two of the sites, and projected the air pollution and radiation emissions of the coal powered and nuclear powered facilities.

LAW AND ANALYSIS

Section 174 of the Code allows a taxpayer to treat research or experimental expenditures paid or incurred by the taxpayer during the taxable year in connection with the taxpayer's trade or business as expenditures that are deductible.

Section 1.174-2(a)(1) of the Income Tax Regulations provides that the term "research and experimental expenditures" as used in section 174 of the Code means expenditures incurred in connection with the taxpayer's trade or business that represent research and development costs in the experimental or laboratory sense. The term includes generally all such costs incident to the development of an experimental or pilot model, a plant process, a product, a formula, an invention, or similar property, and the improvement of already existing property of the type mentioned. The term does not include expenditures such as those for the ordinary testing or inspection of materials or products for quality control or those for efficiency surveys, management studies, consumer surveys, advertising or promotions.

Section 1.174-2(a)(2) of the regulations provides that research and experimental expenditures include not only costs paid or incurred by the taxpayer for research and experimentaiton undertaken directly by the taxpayer, but also to expenditures paid or incurred for research or experimentation carried on in behalf of the taxpayer by another person or organization.

Rev. Rul. 67–401, 1967–2 C.B. 123, holds that expenses for legal and accounting work incurred by the taxpayer in obtaining a federal income tax ruling and a determination from a regulatory commission regarding the effect of a research and development project on the taxpayer's rate structure are not deductible as research and experimental expenditures under section 174(a) of the Code.

Rev. Rul. 73–275, 1973–1 C.B. 134, holds that the cost of the taxpayer's product engineering department to develop and design a specially-built automated manufacturing system for a customer's specific order at the taxpayer's risk are deductible as research and experimental expenditures within the meaning of section 174 of the Code even though each product design results in the production of only one machine system.

In the present situation, the taxpayer conducted extensive studies in support of its application to expand its facilities for generating electricity. The studies were not incidental to the development of an experimental or pilot model, a plant process, a product, a formula, an invention or similar property. The facilities to be expanded by the taxpayer did not involve an experimental or pilot project. Rather, the studies represented a search for the effect of the construction on the surrounding environment to support the taxpayer's application with various regulatory agencies to expand its facilities.

HOLDING

The taxpayer's expenditures for environmental impact studies prepared in connection with the expansion of its facilities are not research and experimental expenditures within the meaning of section 174 of the Code. Whether such expenses are capital expenditures will depend upon the facts of the particular case. The expenses, if not chargeable to a capital account, are ordinary and necessary business expenses deductible under section 162(a).

Section 351.—Transfer to Corporation Controlled by Transferor

26 CFR 1.351-1: Transfer to corporation controlled by transferor.

Whether the nonrecognition of gain provisions of section 351 of the Code apply to a domestic person's transfer of the properties of its foreign branch that were used predominantly without the United States to a foreign corporation solely in exchange for all of the stock of such corporation. See Rev. Rul. 80-246, below.

Section 367.—Foreign Corporations

26 CFR 7.367(a)-1: Ruling requests under section 367 relating to certain transfers involving a foreign corporation.
(Also Sections 351, 904; 1.351-1.)

Transfer of foreign branch with losses; recapture of loss. The amount of gain that a domestic corporation must recognize as ordinary foreign source income pursuant to Rev. Rul. 78-201 on the

incorporation of its foreign branch that had incurred annual losses since its creation is reduced by the amount of taxable income realized and recognized by the domestic corporation under section 904(f)(3)(A) of the Code, on the transfer of assets to the new foreign corporation; Rev. Rul. 78-201 amplified.

Rev. Rul. 80-246

ISSUE

Is the amount of gain that a domestic transferor (*P*) must recognize as ordinary foreign source income on the incorporation of its foreign branch operations, pursuant to Rev. Rul. 78-201, 1978-1 C.B. 91, because of losses incurred by the foreign operations prior to incorporation, reduced by the amount of taxable income realized and recognized to *P*, under section 904(f)(3)(A) of the Internal Revenue Code, upon the transfer of the branch assets to the new foreign corporation?

FACTS

P is a domestic corporation that is engaged in the manufacture and sale of plastic components for radio and television manufacturers in the United States. In 1977 *P* commenced these same activities in country *A* as a branch operation. For each of *P*'s calendar taxable years, 1977, 1978, and 1979, the country *A* branch had a loss of 100*x* dollars (or a total of 300*x* dollars for this period) as a result of deductions taken by *P* under section 167 and certain other sections of the Code, for expenses incurred by its branch operations in country *A*. *P* had no other foreign operations and no other revenue, or losses, from sources without the United States during this period. In each of the years 1977, 1978, and 1979, the country *A* branch losses reduced the amount of *P*'s income subject to federal income tax.

On January 1, 1980, *P* transferred the property used by the country *A* branch to a new country *A* corporation (Newco) in exchange for all of the Newco stock and Newco's assumption of *P*'s liabilities attributable to its country *A* branch.

The fair market value of, and *P*'s basis in, the assets transferred exceeded the sum of the liabilities assumed, plus the amount of the liabilities to which the tranfserred assets were subject. The excess of the fair market value of such property (assets transferred plus liabilities assumed) over *P*'s adjusted basis therein exceeds *P*'s overall foreign loss. Newco will continue to conduct the business that *P* conducted in country *A*. The foreign transferee, Newco, will not be engaged in a trade or business in the United States within the meaning of section 864 of the Code, and will have no income from sources within the United States within the meaning of section 861. The transfer of assets in exchange for stock would have fulfilled all of the requirements of section 351 had the transferee, Newco, been a domestic corporation. Furthermore, the transfer met the requirements of section 3.02(1) of Rev. Proc. 68-23, 1968-1 C.B. 821 (relating to transfers of property to foreign corporations). Within 183 days of the beginning of the transfer *P* requested a ruling from the Internal Revenue Service that the transaction was not in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes within the meaning of section 367(a)(1).

P agreed to recognize as gain on the transfer an amount of ordinary foreign source income equal to the sum of the country *A* branch losses previously incurred, pursuant to Rev. Rul. 78-201. However, *P* requested that this amount be reduced by the amount of taxable income it would realize and recognize, under section 904(f)(3)(A) of the Code, because of the transfer of its branch property to Newco.

LAW AND ANALYSIS

In Rev. Rul. 78-201 a domestic corporation operated a branch in a foreign country. The domestic corporation incurred losses in connection with its branch that reduced its worldwide income subject to federal income tax. The domestic corporation transferred the assets of its branch to a newly formed corporation in the foreign country in exchange for all of its stock. Income subsequently earned by the new corporation will therefore not be included in the domestic corporation's worldwide income subject to federal income tax. Since the transfer thus gives rise to a potential mismatching of related income and losses, Rev. Rul. 78-201 required the United States transferor (the domestic corporation) to recognize as gain on the transfer an amount of ordinary foreign source income equal to the sum of the branch losses previously incurred, as a condition for obtaining a ruling that the exchange was not in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes within the meaning of section 367(a)(1) of the Code. Further, there was not an overall foreign loss, within the meaning of section 904, in Rev. Rul. 78-201.

In the instant case the losses incurred by the country *A* branch operations prior to its incorporation were taken into account by *P* and reduced the amount of *P*'s income subject to federal income tax. As a result of the incorporation of *P*'s country *A* branch operations, the income to be produced by these operations, that is indirectly attributable to the losses, will not be taken into account by *P*, and, thus, will not increase the amount of *P*'s worldwide income subject to federal income tax. The effect of the incorporation will therefore be a mismatching of revenue, deductions, and credits, when income is finally produced. Accordingly, *P* must recognize as gain on the transfer, pursuant to Rev. Rul. 78-201, an amount of ordinary foreign source income equal to the sum of the branch A losses previously incurred ($300*x*), in order for *P*'s exchange of property for Newco stock not to be in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes within the meaning of section 367(a)(1) of the Code. This income must be recognized as ordinary foreign source income by *P* for its taxable year in which the transfer occurred (1980).

Section 904(f)(1) of the Code provides, generally, that where an overall loss from foreign operations reduces United States tax on United States source income of the taxpayer, the tax benefit derived from this loss is recaptured when the taxpayer subsequently derives income from the foreign operations. In general, the recapture is accomplished by treating a portion of subsequently derived foreign income as taxable income from United States sources. Section 904(f)(3)(A) provides, generally, that for purposes of applying section 904(f)(1), when property that was used predominantly outside of the United States in a trade or business is disposed of, the overall foreign losses not previously recaptured under section 904(f)(1) will be recaptured in an amount equal to the lesser of the remaining losses or the excess of the fair market value of such property over its adjusted basis. This is accomplished by treating the gain realized on the disposition as taxable income from sources without the United States which section 904(f)(1) then treats as income from sources within the United States. Section 904(f)(3)(B)(i) provides that a disposition includes a sale or exchange of property whether or not gain or loss is recognized on the transfer.

In the instant case, *P* is required, therefore, to include in its taxable income for its 1980 taxable year, as income from sources within the United States, the amount specified in section 904(f)(3)(A) of the Code. Since *P*'s overall foreign loss (300*x* dollars) was less than the amount realized on the transfer of the branch assets, and since the transfer constituted a disposition, *P* must realize and recognize 300*x* dollars in taxable income, for 1980, as foreign source income under section 904(f)(3)(A), and treat that amount as income from sources within the United States, pursuant to section 904(f)(1).

Section 904(f)(3)(A) of the Code and Rev. Rul. 78-201 operate independently of one another. To the extent there is an overlap of Rev. Rul. 78-201 and section 904(f)(3)(A), their effect on the transfer should be integrated in order to prevent double recapture.

HOLDING

The amount of gain that *P* must recognize as ordinary foreign source income (300*x* dollars, which is the sum of the branch losses) on the transfer of its branch assets to Newco in exchange for Newco stock, pursuant to Rev. Rul. 78-201, is reduced by the amount of taxable income realized and recognized by *P*, under section 904(f)(3)(A) of the Code, on the same transfer or disposition (300*x* dollars, which is the amount of the overall foreign loss).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 78-201 is amplified.

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26 CFR 7.367(a)-1: Ruling request under section 367 relating to certain transfers involving a foreign corporation.

Transfer of foreign branch with losses; abandonment of certain assets. Losses that must be recaptured under Rev. Rul. 78-201, as a result of the incorporation of a foreign branch operation, include expenses directly related to branch property not transferred but abandoned as worthless; Rev. Rul. 78-201 amplified.

Rev. Rul. 80-247

ISSUE

Do the losses recaptured under Rev. Rul. 78-201, 1978-1 C.B. 91, pursuant to incorporation of a branch operation, include expenses directly related to branch property not transferred but abandoned as worthless?

FACTS

P is a domestic corporation that is engaged in the exploration, development, and sale of mineral properties in the United States. *P* owns certain mineral properties in country *A*. In 1977 *P* commenced business operations in country *A*. These operations were carried on by a branch that *P* established in country *A*.

Beginning in 1977, deductions were taken by *P* under section 167 and certain other sections of the Code for expenses incurred by its branch operations. Because of these deductions the country *A* branch sustained losses of $100*x* in 1977, 1978, and 1979 (a total of $300*x*). *P*'s taxable income from sources within the United States was $1,000*x* each year for 1977 through 1979, and the branch *A* losses reduced *P*'s worldwide taxable income for these years. During each of the three years *P*'s other foreign branches had income in excess of the losses of the branch in country *A*.

On January 1, 1980, *P* transferred certain assets of its country *A* branch to Newco, a corporation newly created under the laws of country *A*, solely in exchange for all of Newco's stock. The assets transferred consisted of certain equipment and those mineral properties located in country *A* that were expected to produce income in excess of expenses starting in 1982. The mineral properties of *P*'s country *A* branch that had no commercial value were not transferred and will be abandoned as worthless. Expenses of $200*x* were directly attributable to the branch *A* properties transferred. Expenses of $100*x* were directly attributable to the branch *A* properties not transferred.

The fair market value of, and *P*'s basis in, the assets transferred exceeded the sum of the liabilities to which the transferred assets were subject. No liabilities were assumed. Newco will continue to conduct the business that *P* conducted in country *A*. The foreign transferee, Newco, will not be engaged in a trade or business in the United States within the meaning of section 864 of the Code, and will have no income from sources within the United States within the meaning of section 861. The transfer of assets in exchange for stock would have fulfilled all of the requirements of section 351 had the transferee, Newco, been a domestic corporation. Furthermore, the transfer met the requirements of section 3.02(1) of Rev. Proc. 68-23, 1968-1 C.B. 821. Within 183 days of the beginning of the transfer *P* requested a ruling from the Internal Revenue Service that the transaction was not in pursuance of a plan of tax avoidance within the meaning of section 367(a)(1).

LAW AND ANALYSIS

Section 367(a)(1) of the Code provides that if, in connection with any exchange described in section 351, there is a transfer of property by a United States person to a foreign corporation, for purposes of determining the extent to which gain shall be recognized on such transfer, a foreign corporation shall not be considered to be a corporation unless, pursuant to a request filed no later than the close of the 183rd day after the beginning of such transfer, it is established to the satisfaction of the Secretary that such exchange is not in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes.

Section 351(a) of the Code provides that no gain or loss shall be recognized if property is transferred to a corporation by one or more persons solely in exchange for stock or securities in such corporation and immediately after the exchange such person or persons are in control (as defined in section 368(c)) of the corporation.

Rev. Proc. 68-23 sets forth guidelines to be used by taxpayers and their representatives in connection with requests for rulings required under section 367 of the Code in respect of certain types of transactions involving foreign corporations. Section 3.02(1) of Rev. Proc. 68-23 relates to transfers to foreign corporations controlled by domestic transferors and provides that such a transfer of property will ordinarily receive favorable consideration where the transferred property is to be devoted by the transferee foreign corporation to the active conduct, in any foreign country, of a trade or business. It is contemplated that the transferee foreign corporation, in addition to the active conduct of a trade or business, will have need for a substantial investment in fixed assets in such business.

Section 2.02 of Rev. Proc. 68-23 provides, however, that in reviewing each request for ruling to determine whether a favorable section 367 ruling should be issued under the guidelines, the Service reserves the right to issue an adverse ruling if, based on all the facts and circumstances of a case, it is determined that the taxpayer has not established that tax avoidance is not one of the principal purposes of the transaction.

P's transfer of certain of its mineral properties to Newco solely in exchange for all of Newco's stock is an exchange described in section 351 of the Code, but unless it is established under section 367(a)(1) that the transfer to Newco was not in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes, Newco will not be considered to be a corporation for purposes of section 351. Since the nonrecognition of gain provisions of section 351 apply only if Newco is considered to be a corporation, failure to satisfy section 367(a)(1) would therefore result in recognition of any gain realized by *P* on the transfer.

In Rev. Rul. 78-201 a domestic corporation operated a branch in a foreign country. The domestic corporation incurred losses in connection with its branch that reduced its worldwide income subject to federal income tax. The domestic corporation transferred the assets of its branch to a newly formed corporation in the foreign country in exchange for all of its stock. Income subsequently earned by the new corporation will therefore not be included in the domestic corporation's worldwide income subject to federal income tax. Since the transfer thus gives rise to a potential mismatching of related income and loss, Rev. Rul. 78-201 required the United States transferor (the domestic corporation) to recognize as gain on the transfer an amount of ordinary foreign source income equal to the sum of the branch losses previously incurred, as a condition for obtaining a ruling that the exchange was not in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes within the meaning of section 367(a)(1) of the Code. Further, if the transferor recognizes the amount set forth in Rev. Rul. 78-201 as gain, then the transferor's basis in the stock received, and the corporation's basis in the property received from the transferor, will each be increased by the amount of gain recognized to the transferor pursuant to sections 358(a)(1) and 362(a), respectively, since the transaction qualifies as an exchange to which section 351 applies. Rev. Rul. 78-201 indicates that the domestic corporation operated a single branch and a single business in the foreign country, that the business of the branch had incurred the losses, and that it was the business of the branch that was being incorporated.

In the instant case the losses that *P* incurred in connection with its mineral exploration, development, and property sales business in country *A* had reduced the amount of *P*'s worldwide income subject to federal income tax. As a result of the incorporation of *P*'s country *A* business (that is, all properties that were not to be abandoned), the income to be produced by *P*'s country *A* business will not be taken into account by *P*, and thus will not increase the amount of *P*'s worldwide income subject to federal income tax.

P's mineral exploration, development, and property sales business in country *A* was a complete business operation in itself, and that business and the losses incurred by that business were unrelated to *P*'s other worldwide business operations. Although the branch *A* properties that were transferred directly incurred losses of $200*x* and the branch *A* properties to be abandoned directly incurred losses of $100*x*, *P*'s branch *A* was comprised of both the properties that were transferred and the properties that were not transferred. *P* effectively incorporated the entire branch *A* business. It was the business, and not the specific parcels of property, that incurred the losses.

HOLDING

Pursuant to Rev. Rul. 78-201, *P* must recognize as gain on the transfer an amount of ordinary foreign source income equal to the sum of the country *A* branch losses previously incurred (that is, $300*x*) in order for *P*'s exchange of property for Newco stock not to be deemed to be in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes within the meaning of section 367(a)(1) of the Code. This income must be recognized as ordinary foreign source income by *P* for its taxable year in which the transfer occurred (1980).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 78-201 is amplified.

Section 451.—General Rule for Taxable Year of Inclusion

26 CFR 1.451-2: Constructive receipt of income.
(Also Sections 61, 163, 461; 1.61-7, 1.163-1, 1.461-1.)

Interest; "reverse mortgage loan"; when deducted and when in-

cluded. Interest on a "reverse mortgage loan" that is added monthly to the outstanding loan balance as it accrues is neither includible in a cash method lender's gross income nor deductible by a cash method borrower at the time it is added.

Rev. Rul. 80-248

ISSUES

When is interest on a "reverse mortgage loan" includible in the gross income of a lender and deductible by a borrower under the circumstances described below?

FACTS

A state permits various kinds of lending institutions located within the state to make reverse mortgage loans to individuals who own their own homes, which they occupy as their principal residence. A reverse mortgage loan is secured by a mortgage on the borrower's principal residence. A reverse mortgage loan is one in which the lending institution commits itself to a principal amount, not to exceed 80 percent of the appraised value of the property, which is paid to the borrower in installments over a period of months or years. Repayment of the loan is due when the principal amount has been fully paid to the borrower, the residence that secures the loan is sold, the borrower dies, or the borrower ceases to use the home as the borrower's principal residence. The loan agreement may provide that interest will be added to the outstanding loan balance monthly as it accrues. The outstanding loan balance is the current amount of money owed by the borrower to the lending institution and includes the total of the installments paid by the lender to date, the total accrued interest if any to date, and any other charges, such as taxes and insurance, paid to date by the lender upon the borrower's failure to make such payment. The primary purpose of the reverse mortgage loan is to enable elderly persons with limited incomes to remain in their homes.

A lending institution made a reverse mortgage loan to an individual who qualified for such a loan. The loan agreement provides that interest will be added to the outstanding loan balance monthly as it accrues. Both the lender and the borrower use the cash receipts and disbursements method of accounting.

LAW AND ANALYSIS

(1) Section 451 of the Internal Revenue Code provides that the amount of any item of gross income is includible in the gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, such amount is to be properly accounted for as of a different period.

Section 1.451-(a) of the Income Tax Regulations provides that income is includible in gross income for the taxable year in which it is actually or constructively received by the taxpayer, unless it is includible in a different year in accordance with the taxpayer's method of accounting.

Section 1.451-2(a) of the regulations provides that income although not actually reduced to a taxpayer's possession is constructively received by the taxpayer in the taxable year during which it is credited to the taxpayer's account, set apart for the taxpayer, or otherwise made available so that the taxpayer may draw upon it at any time, or so that the taxpayer could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

In this case, the loan agreement provides that interest will be added to the outstanding loan balance monthly as it accrues. However, this interest is not received by the bank, nor is it available to be drawn upon by the bank. Therefore, the bank is not in actual or constructive receipt of the interest when it is added to the outstanding loan balance.

(2) Section 163(a) of the Code allows as a deduction all interest paid or accrued within the taxable year on indebtedness.

Section 461(a) of the Code provides that the amount of any allowable deduction shall be taken for the taxable year that is the proper taxable year under the method of accounting used in computing taxable income.

Section 1.461-1(a)(1) of the regulations provides that, under the cash receipts and disbursements method of accounting, amounts representing allowable deductions shall, as a general rule, be taken into account for the taxable year in which paid.

If a taxpayer who uses the cash receipts and disbursement method of acounting owes interest on an obligation and gives a note to the creditor to cover the interest, the taxpayer has not paid the interest for federal income tax purposes. The payment occurs when the taxpayer pays the interest in cash or by transferring property. See *McAdams v. Commissioner*, 15 T.C. 231 (1950), *aff'd* 198 F.2d 54 (5th Cir. 1952); *Bramer v. Commissioner*, 6 T.C. 1027 (1946), *aff'd* 161 F.2d 185 (3rd Cir. 1947). See also Rev. Rul. 76-135, 1976-1 C.B. 114, which states that actual payments of cash are required as a basis for any deductions allowable to a taxpayer who uses the cash receipts and disbursements method of accounting.

HOLDINGS

The interest is includible in the lender's gross income when it is actually or constructively received by the lender and is deductible by the borrower when it is actually paid by the borrower. Actual or constructive receipt or payment does not occur when the interest is added to the outstanding loan balance. Therefore, the interest is neither includible in the lender's gross income nor deductible by the borrower at that time.

Section 453.—Installment Method

26 CFR 1.453-1: Installment method of reporting income.
(Also Section 121; 1.121-1.)

Residence; installment sale; election; gross profit. A taxpayer who realized a gain on the sale of a principal residence elected to exclude the gain under section 121 of the Code and elected to use the

installment method of reporting income from the sale. In determining the amount of each installment payment that is reportable under the installment method of accounting, gross profit in the formula provided in section 453(a)(1) is the amount of the gain that is not excludable from gross income.

Rev. Rul. 80-249

ISSUE

How is the amount of each installment payment that is reportable under the installment method of accounting determined when the taxpayer elects to exclude gain pursuant to section 121 of the Internal Revenue Code?

FACTS

During the taxable year, the taxpayer sold the taxpayer's principal residence for $300,000. The taxpayer's adjusted basis in the residence was $140,000 and the realized gain from the sale was $160,000 ($300,000 sales price less $140,000 adjusted basis).

The taxpayer satisfied the requirements of section 121 of the Code and made an election under that section to exclude from gross income $100,000 of the gain from the sale. The transaction satisfied the requirements of section 453(b), and the taxpayer also elected to report the taxable gain using the installment method of accounting provided by section 453. The taxpayer does not intend to purchase another principal residence, and therefore, section 1034 is not applicable.

LAW AND ANALYSIS

Section 453(b) of the Code permits a taxpayer to report certain qualifying gains from the sale or other disposition of real property on the installment method of accounting in the manner prescribed in section 453(a). Section 453(a)(1) provides for reporting as income in each taxable year the proportion of the installment payments actually received in that year which the gross profit realized or to be realized bears to the total contract price.

Section 1.453-1(b) of the Income Tax Regulations provides that gross profit, in the case of the sale of real property, means the selling price less the adjusted basis as defined in section 1011 of the Code and the regulations thereunder.

Rev. Rul. 75, 1953-1 C.B. 83, and Rev. Rul. 65-155, 1965-1 C.B. 356, involve the use of the installment method in situations in which there is a partial nonrecognition of gain pursuant to the provisions of section 1034 of the Code, relating to gain on the sale of a principal residence, and section 1031(b), relating to gain from exchanges not solely in kind. In those revenue rulings, the recognized gain is substituted for the gross profit for purposes of determining the amount of each installment that is includible in gross income.

In the instant case, as in Rev. Rul. 75 and Rev. Rul. 65-155, only a portion of the realized gain on the sale is includible in gross income.

HOLDING

For purposes of determining the amount of each installment payment that is reportable under the installment method of accounting, gross profit in the formula provided in section 453(a)(1) of the Code is the amount of the gain that is not excludable from gross income under section 121. Thus, the taxpayer in this case must report as income in each year an amount equal to one fifth ($60,000/$300,000) of the installment payments received in that year.

Section 461.—General Rule for Taxable Year of Deduction

26 CFR 1.461-1: General rule for taxable year of deduction.

When interest on a reverse mortgage loan is deductible by a borrower who uses the cash receipts and disbursements method of accounting. See Rev. Rul. 80-248, page 10.

Section 904.—Limitation on Credit

Whether sections 904(f)(3)(A) and 904(f)(1) recapture the remaining overall foreign loss when a domestic corporation transfers all of the properties of its foreign branch that were used predominantly without the United States to a newly formed foreign corporation solely in exchange for all of the stock of such corporation. See Rev. Rul. 80-246, page 7.

Section 956.—Investment of Earnings in United States Property [Controlled Foreign Corporations]

26 CFR 1.956-2: Definition of United States property.
(Also Section 958; 1.958-2.)

T.D. 7712

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX: TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Investment in United States property by controlled foreign corporations

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the exceptions to the definition of United States property under section 956(b)(2) of the Internal Revenue Code of 1954. Changes in the applicable tax law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. Vol. 1) 1]. This document also contains final regulations under section 956(c) which affect the computation of the investment of earnings in United States property by controlled foreign corporations. The regulations provide the public with the guidance needed to comply with the provisions of the Tax Reform Act of 1976 as well as guidance with respect to the clarification of existing regulations. The final regulations affect controlled foreign corporations making certain investments in United States property and their United States shareholders.

DATE: The amendments in general apply to taxable years beginning after December 31, 1975 except that the amendment to § 1.956-2(c)(2) applies with respect to pledges made after September 8, 1980.

FOR FURTHER INFORMATION CONTACT: Jacob Feldman of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C.

20224, Attention: CC:LR:T, 202-566-3289, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On April 23, 1979, the Federal Register published proposed regulations under sections 956 and 958 of the Internal Revenue Code of 1954 (44 FR 23880). Amendments under sections 956(a), (b)(2), and 958 were proposed to conform the regulations to amendments made to the Code by section 1021 of the Tax Reform Act of 1976 (90 Stat. 1618). Amendments made under section 956 (c) were intended to clarify existing regulations. A public hearing was held on October 30, 1979. After consideration of all comments regarding the proposed amendments, this Treasury decision is adopted.

DISCUSSION

The proposed amendments made changes to the regulations under sections 956(b) and 958 to conform the regulations to amendments made to the Code by section 1021 of the Tax Reform Act of 1976 (90 Stat. 1618). In addition, amendments were made to the regulations under section 956 (c) to clarify existing regulations.

Proposed § 1.956-2(c)(2) dealing with indirect pledges or guarantees has been modified. Under the final regulations the pledge of stock of a controlled foreign corporation will be considered as an indirect pledge of the assets of the controlled foreign corporation only if at least 66⅔ percent of the voting power of the stock of the controlled foreign corporation is pledged and only if, in addition, the pledge of stock is accompanied by negative covenants or similar restrictions. This provision applies to pledges made after September 8, 1980.

Proposed § 1.956-2(c)(3) dealing with the facilitation of loans to shareholders has been eliminated. Although the Committee Report accompanying the Tax Reform Act of 1976 supports the position taken in the proposed regulations, a number of comments were received that the proposed section was too vague and could be misconstrued to cover situations not prohibited by section 956. Any need for specificity will be covered in rulings on particular facts. Examples (4) and (5) under proposed § 1.956-2(c)(3) have also been eliminated. Example (4) dealt with the operation of an effective date which has been modified and Example (5) dealt with the concept of facilitation.

A change was also made under proposed § 1.956-2(b)(1)(ix) in order to expand the concept of "when used" to include situations in which equipment has been purchased for use and not as yet used. Another change of a clarifying nature was made under § 1.956-2(b)(1)(ix) with respect to the definition of movable drilling rigs and other oil and gas exploration and exploitation equipment used on the continental shelf of the United States.

DRAFTING INFORMATION

The principal author of these regulations is Jacob Feldman of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to the regulations are hereby adopted:

Par. 1. Paragraph (b) of § 1.956-1 is amended by redesignating subparagraphs (2) and (3) as subparagraphs (3) and (4), respectively, and by adding new subparagraph (2) to read as set out below:

§ 1.956-1 Shareholder's pro rata share of a controlled foreign corporation's increase in earnings invested in United States property.

* * * * *

(b) *Amount of a controlled foreign corporation's investment of earnings in United States property.* * * *

(2) *Aggregate amount of United States property.* For purposes of determining an increase in earnings invested in United States property for any taxable year beginning after December 31, 1975, the aggregate amount of United States property held by a controlled foreign corporation at the close of—

(i) Any taxable year beginning after December 31, 1975, and

(ii) The last taxable year beginning before January 1, 1976

does not include stock or obligations of a domestic corporation described in section 956(b)(2)(F) or movable property described in section 956(b)(2)(G).

Par. 2. Section 1.956-2 is amended as follows:

1. Paragraph (b)(1) is amended by revising subdivision (iii), by redesignating subdivision (viii) as subdivision (x), and by adding subdivisions (viii) and (ix) as set forth below.

2. Paragraph (c) is amended as follows:

a. Subparagraph (1) is amended by deleting "subparagraph (2)" from the first sentence and by inserting in lieu thereof "subparagraph (4)", and by deleting the last sentence and the examples.

b. Subparagraph (2) is redesignated as subparagraph (4) and new subparagraphs (2) and (3) are added to read as set forth below.

3. Paragraph (d)(1)(i) is revised by deleting "of paragraph (a)" from the first sentence, and by revising paragraph (d)(1)(i)(*b*) to read as set forth below.

4. Paragraph (d)(2) is revised by deleting "of paragraphs (a)(1)(iii) and (b)(1)(v)" from the first sentence.

§ 1.956-2 Definition of United States property.

(b) *Exceptions*—(1) *Excluded property.* * * *

(iii) Deposits with persons carrying on the banking business, unless the deposits serve directly or indirectly as a pledge or guarantee within the meaning of paragraph (c) of this section. See paragraph (e)(2) of § 1.956-1.

* * * * *

(viii) For taxable years beginning after December 31, 1975, the voting or nonvoting stock or obligations of an unrelated domestic corporation. For purposes of this subdivision, an unrelated domestic corporation is a domestic corporation which is neither a United States shareholder (as defined in section 951(b)) of the controlled foreign corporation making the investment, nor a corporation 25 percent or more of whose total combined voting power of all classes of stock entitled to vote is owned or considered as owned (within the meaning of section 958(b)) by United States shareholders of the controlled foreign corporation making the investment. The determination of whether a domestic corporation is an unrelated corporation is made immediately after each acquisition of stock or obligations by the controlled foreign corporations.

(ix) For taxable years beginning after December 31, 1975, movable drilling rigs or barges and other movable exploration and exploitation equipment (other than a vessel or an aircraft) which are used exclusively on the Continental Shelf (as defined in section 638) of the United States in the exploration for, development, removal or transportation of natural resources from or under ocean waters. Property of the kind described in this subdivision which is being constructed or is in storage or in transit within the United States meets the requirements of § 1.956-2(b)(1) defining excluded property if it is actually used on the Continental Shelf by the last day of the taxable year following the year of purchase, commencement of storage or commencement of transit, and has not been used by the taxpayer anyplace else. In general, the type of property which qualifies for the exception under this subdivision includes any movable property which would be entitled to the investment credit if used outside the United States in certain geographical areas of the Western Hemisphere pursuant to section 48(a)(2)(B)(x) (without reference to sections 49 and 50).

* * * * *

(c) *Treatment of pledges and guarantees*—(1) *General rule.* * * *

(2) *Indirect pledge or guarantee.* If the assets of a controlled foreign corporation serve at any time, even though indirectly, as security for the performance of an obligation of a United States person, then, for purposes of paragraph (c)(1) of this section, the controlled foreign corporation will be considered a pledgor or guarantor of that obligation. For this purpose the pledge of stock of a controlled foreign corporation will be considered as the indirect pledge of the assets of the corporation if at least 66⅔ percent of the total combined voting power of all classes of stock entitled to vote is pledged and if the pledge of stock is accompanied by one or more negative covenants or similar restrictions on the shareholder effectively limiting the corporation's discretion with respect to the disposition of assets and the incurrence of liabilities other than in the ordinary course of business. This paragraph (c)(2) applies only to pledges and guarantees which are made after September 8, 1980. For purposes of this paragraph (c)(2) a refinancing shall be considered as a new pledge or guarantee.

(3) *Illustrations.* The following examples illustrate the application of this paragraph (c):

Example (1). A, a United States person, borrows $100,000 from a bank in foreign country X on December 31, 1964. On the same date controlled foreign corporation R pledges its assets as security for A's performance of A's obligation to repay such loan. The place at which or manner in which A uses the money is not material. For purposes of paragraph (b) of § 1.956-1, R Corporation will be considered to hold A's obligation to repay the bank $100,000, and, under the provisions of paragraph (e)(2) of § 1.956-1, the amount taken into account in computing R Corporation's aggregate investment in United States property on December 31, 1964, is the unpaid principal amount of the obligation on that date ($100,000).

Example (2). The facts are the same as in example (1), except that R Corporation participates in the transaction, not by pledging its assets as security for A's performance of A's obligation to repay the loan, but by agreeing to buy for $100,000 at maturity the note representing A's obligation if A does not repay the loan. Separate arrangements are made with respect to the payment of the interest on the loan. The agreement of R Corporation to buy the note constitutes a guarantee of A's obligation. For purposes of paragraph (b) of § 1.956-1, R Corporation will be considered to hold A's obligation to repay the bank $100,000, and, under the provisions of paragraph (e)(2) of § 1.956-1, the amount taken into account in computing R Corporation's aggregate investment in United States property on December 31, 1964, is the unpaid principal amount of the obligation on that date ($100,000).

Example (3). A, a United States person, borrows $100,000 from a bank on December 10, 1981, pledging 70 percent of the stock of X, a controlled foreign corporation, as collateral for the loan. A and X use the calendar year as their taxable year. In the loan agreement, among other things, A agrees not to cause or permit X Corporation to do any of the following without the consent of the bank:

(a) Borrow money or pledge assets, except as to borrowings in the ordinary course of business of X Corporation;

(b) Guarantee, assume, or become liable on the obligation of another, or invest in or lend funds to another;

(c) Merge or consolidate with any other corporation or transfer shares of any controlled subsidiary;

(d) Sell or lease (other than in the ordinary course of business) or otherwise dispose of any substantial part of its assets;

(e) Pay or secure any debt owing by X Corporation to A; and

(f) Pay any dividends, except in such amounts as may be required to make interest or principal payments on A's loan from the bank.

A retains the right to vote the stock unless a default occurs by A. Under paragraph (c)(2) of this section, the assets of X Corporation serve indirectly as security for A's performance of A's obligation to repay the loan and X Corporation will be considered a pledgor or guarantor with respect to that obligation. For purposes of paragraph (b) of § 1.956-1, X Corporation will be considered to hold A's obligation to repay the bank $100,000 and under paragraph (e)(2) of § 1.956-1, the amount taken into account in computing X Corporation's aggregate investment in United States property on December 31, 1981, is the unpaid principal amount of the obligation on that date.

(d) *Definitions*—(1) *Meaning of "acquired".* (i) *Applicable rules.* For purposes of this section—

* * * * *

(*b*) Property which is an obligation of a United States person with respect to which a controlled foreign corporation is a pledgor or guarantor (within the meaning of paragraph (c) of this section) shall be considered acquired when the corporation becomes liable as a pledgor or guarantor or is otherwise considered a pledgor or guarantor (within the meaning of paragraph (c)(2) of this section); and

* * * * *

Par. 3. Section 1.958-2 is amended as follows:

1. The first sentence of paragraph (a) is revised as set out below.

2. Subparagraph (b)(3) is amended by adding a new sentence immediately after the first sentence as set forth below.

3. Subparagraph (d)(2) is amended by adding a new sentence immediately after the first sentence as set forth below.

§ 1.958-1 Constructive ownership of stock.

(a) *In general.* Section 958(b) provides that, for purposes of sections 951(b), 954(d)(3), 956(b)(2), and 957, the rules of section 318(a) as modified by section 958(b) and this section shall apply to the extent that the effect is to treat a United States person as a United States shareholder within the meaning of section 951(b), to treat a person as a related person within the meaning of section 954(d)(3), to treat the stock of a domestic corporation as owned by a United States shareholder of a controlled foreign corporation under section 956(b)(2), or to treat a foreign corporation as a controlled foreign corporation under section 957. * * *

(b) *Members of family.* * * *

(3) *Stock owned by nonresident alien individual.* * * * However, this limitation does not apply for purposes of determining whether the stock of a domestic corporation is owned or considered as owned by a United States shareholder under section 956(b)(2) and § 1.956-2(b)(1)(viii). * * *

(d) *Attribution to partnerships, estates, trusts, and corporations.* * * *

(2) *Limitation.* * * * This limitation does not apply for purposes of determining whether the stock of a domestic corporation is owned or considered as owned by a United States shareholder under section 956(b)(2) and § 1.956-2(b)(1)(viii). * * *

(This Treasury decision is issued under the authority contained in sections 956(c) and 7805 of the Internal Revenue Code of 1954 (76 Stat. 1017, 68A Stat. 917; 26 U.S.C. 956(c) and 26 U.S.C. 7805 respectively).)

JEROME KURTZ,
Commissioner of Internal Revenue.

Approved July 18, 1980.

EMIL M. SUNLEY,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 6, 1980, 8:45 a.m., and published in the issue of the Federal Register for August 7, 1980, 45 F.R. 52373)

Section 958.—Rules for Determining Stock Ownership

26 CFR 1.958-2: Constructive ownership of stock.

Amendments to the regulations relating to exceptions to the definition of United States property under section 956 of the Code and computation of the investment of earnings in United States property by controlled foreign corporations. See T.D. 7712, page 12.

Section 2053.—Expenses, Indebtedness, and Taxes

26 CFR 20.2053-3: Deductions for expenses of administering estate.
(Also Sections 6161, 6163, 6166, 6166A; 20.6161-1, 20.6163-1, 20.6166-1, 20.6166A-1.)

Administration expenses; interest on federal estate tax; when deductible. Interest expense charged on the extended payment of federal estate tax is deductible when the interest accrues. No deduction is allowable on the estate tax return for an estimate of interest expense to be incurred in the future.

Rev. Rul. 80-250

ISSUE

When does interest expense charged pursuant to the executor's election to extend payment of the estate tax liability become deductible under section 2053(a)(2) of the Code?

FACTS

The decedent, *D*, died in 1978. The executor of *D*'s estate elected to pay a portion of the estate tax liability in installments in accordance with the provisions of section 6166A of the Code. In preparing the federal estate tax return for *D*'s estate, the executor estimated the total amount of interest expense that would be incurred by the estate in the future with respect to the section 6166A election. The exector claimed a deduction for this estimated amount of future expense as an expense of administration under section 2053(a)(2) of the Code.

LAW AND ANALYSIS

Section 2053(a)(2) of the Code and section 20.2053-3(a) of the Estate Tax Regulations provide an estate tax deduction for administration expenses that are actually and necessarily incurred in the administration of the decedent's estate and are allowable by the laws of the jurisdiction under which the estate is being administered.

Sections 20.2053-1(b)(3) and 20.2053-3(a) of the regulations provide that if the amount of an expense otherwise deductible under section 2053 of the Code is not actually incurred (i.e. accrued) at the time of the final audit of the estate tax return, then no deduction will be allowed for the expense at that time, unless the expense is ascertainable with reasonable certainty. No deduction can be taken based on a vague or uncertain estimate.

Interest expense payable incident to the extension of the time for payment of tax under section 6166A is deductible as an expense of administration under section 2053(a)(2) of the Code, if the expense is allowable under the laws of the jurisdiction in which the estate is being administered. *Estate of Bahr v. Commissioner*, 68 T.C. 74 (1977), *acq.* 1978-1 C.B. 1. See also, Rev. Rul. 78-125, 1978-1 C.B. 292.

In situations where the executor elects to extend the time for the payment of the estate tax under section 6166A the executor has the option to accelerate payment, and in certain circumstances must accelerate payment. See section 6166A(h) of the Code. The possibility that payment may be accelerated renders any estimate of future interest charges vague and uncertain, within the meaning of section 20.2053-1(b)(3) of the regulations.

Accordingly, interest expense incurred under section 6166A is deductible when the interest accrues. When the interest becomes deductible and the estate claims the deduction under section 2053(a)(2), the estate tax is recomputed. The recomputation will result in a reduction of the estate tax and previously accrued interest. Installments due will be recomputed accordingly. However, no refund will be made until the entire tax liability has been paid. Interest accrues daily. However, for purposes of administrative convenience taxpayers should claim the deduction at the time of the annual dates prescribed for payment under section 6166A. If the entire tax balance and accrued interest is prepaid at one time, the accrued interest is deductible at that time.

HOLDING

Interest expense charged pursuant to the executor's election to extend payment of the estate tax liability is deductible when the interest accrues. Therefore, no deduction is allowable on *D*'s estate tax return for the estimate of interest expense to be incurred in the future.

The conclusion of this revenue ruling applies as well to interest on estate tax, the payment of which is extended under sections 6161, 6163 or 6166 of the Code.

Section 3102.—Deduction of Tax from Wages

26 CFR 31.3102-1: Collection of and liability for, employee tax; in general.

Modified procedures relating to the employment tax status of independent contractors. See Rev. Proc. 80-35, page 17.

Section 3111.—Rate of Tax [Federal Insurance Contributions Act]

26 CFR 31.3111-4: Liability for employer tax.

Modified procedures relating to the employment tax status of independent contractors. See Rev. Proc. 80-35, page 17.

Section 3301.—Rate of Tax [Federal Unemployment Tax Act]

26 CFR 31.3301-1: Persons liable for tax.

Modified procedures relating to the employment tax status of independent contractors. See Rev. Proc. 80-35, page 17.

Section 3403.—Liability for Tax

26 CFR 31.3403-1: Liability for tax.

Modified procedures relating to the employment tax status of independent contractors. See Rev. Proc. 80-35, page 17.

Section 6161.—Extension Of Time for Paying Tax

26 CFR 20.6161-1: Extension of time for paying tax shown on return.

When interest expense charged pursuant to the executor's election in accordance with the provisions of section 6161 of the Code to extend payment of the estate tax liability becomes deductible under section 2053(a)(2) of the Code. See Rev. Rul. 80-250, page 15.

Section 6163.—Extension of Time for Payment of Estate Tax on Value of Reversionary or Remainder Interest in Property

26 CFR 20.6163-1: Extension of time for payment of estate on value of reversionary or remainder interest in property.

When interest expense charged pursuant to the executor's election in accordance with the provisions of section 6163 of the Code to extend payment of the part of the estate tax liability attributable to the value of a reversionary or remainder interest in property included in the value of the decedent's gross estate becomes deductible under section 2053(a)(2) of the Code. See Rev. Rul. 80-250, page 15.

Section 6166.—Alternate Extension of Time for Payment of Estate Tax Where Estate Consists Largely of Interest in Closely Held Business

26 CFR 20.6166-1: Election of alternate extension of time for payment of estate tax where estate consists largely of interest in closely held business.

When interest expense charged pursuant to the executor's election in accordance with the provisions of section 6166 of the Code to pay a portion of the estate tax liability in installments becomes deductible under section 2053(a)(2) of the Code. See Rev. Rul. 80-250, page 15.

Section 6166A.—Extension of Time for Payment of Estate Tax Where Estate Consists of Interest in Closely Held Business

26 CFR 20.6166A-1: Extension of time for payment of estate tax where estate consists largely of interest in closely held business.

When interest expense charged pursuant to the executor's election in accordance with the provisions of section 6166A of the Code to pay a portion of the estate tax liability in installments becomes deductible under section 2053(a)(2) of the Code. See Rev. Rul. 80-250, page 15.

Section 7805.—Rules and Regulations

26 CFR 301.7805-1: Rules and regulations.

Nonretroactive application of a revenue ruling relating to the classification of municipal bonds as industrial development bonds. See Rev. Rul. 80-251, page 5.

Part III. Administrative, Procedural, and Miscellaneous

Notice 80-8

Inflation Adjustment for Computation of Windfall Profit Tax

Section 4989(b) of the Internal Revenue Code requires the determination of an inflation adjustment factor for use in computing the windfall profit tax.

The Service has determined that, for oil removed during the October-December quarter of 1980, the inflation adjustments are as follows:

Tier 1 or Tier 2 oil	0.0924
Tier 3 oil	0.1144

Worksheets for computation of the windfall profit tax are included in the Instructions for Form 6047, Windfall Profit Tax, and an explanation of the inflation adjustment may be found in the Specific Instructions for Line 4 of the worksheets.

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26 CFR 601.401: Employment taxes.
(Also Part I, Sections 3102, 3111, 3301, 3403; 31.3102-1, 31.3111-4, 31.3301-1, 31.3403-1.)

Rev. Proc. 80-35

SECTION 1. PURPOSE

The purpose of this revenue procedure is to amend Sec. 2 and Sec. 3.03 of Rev. Proc. 78-35, 1978-2 C.B. 536, which provides instructions for implementing the provisions of section 530 of the Revenue Act of 1978, Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, 119, relating to the employment tax status of independent contractors and employees.

SEC. 2. BACKGROUND

Rev. Proc. 78-35 is modified to reflect changes made to section 530 of the Act by Pub. L. 96-167, 1980-5 I.R.B. 12, 14, pertaining to the extension of certain dates in section 530 of the Act.

SEC. 3. IMPLEMENTATION

.01 Sec. 2 of Rev. Proc. 78-35 is modified to read as follows:

"Section 530(a)(1) of the Act, as amended, provides that if, for purposes of the employment taxes under subtitle C of the Internal Revenue Code, a taxpayer did not treat an individual as an employee for any period ending before January 1, 1981, then the individual will be deemed not to be an employee for that period, unless the taxpayer had no reasonable basis for not treating the individual as an employee. For any period during 1979 or 1980, the relief applies only if (1) all federal tax returns (including information returns) required to be filed by the taxpayer with respect to the individual for the period are filed on a basis consistent with the taxpayer's treatment of the individual as not being an employee, and (2) the treatment is consistent with the treatment for periods beginning after December 31, 1977."

.02 Sec. 3.03 of Rev. Proc. 78-35 is modified to read as follows:

".03 *Consistency in 1979 and 1980*

The relief under section 530(a)(1) of the Act, as amended, does not apply to the employment tax treatment of any individual for any period during 1979 or 1980, if the taxpayer (or a predecessor) treated any individual holding a substantially similar position as an employee for employment tax purposes for any period beginning after December 31, 1977. This provision prevents taxpayers from changing the way they treat workers solely to take advantage of the relief provisions. The application of this provision to predecessors is intended to prevent evasion of this rule, for example, by reincorporations. H.R. Rep. No. 95-1748, indicates that it is expected that legislation is to be developed to clarify the employment tax status of individuals."

SEC. 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 78-35 is modified.

Part IV. Items of General Interest

Form 1138, Extension of Time for Payment of Taxes by a Corporation Expecting a Net Operating Loss Carryback, Revised

Announcement 80-116

Form 1138, Extension of Time for Payment of Taxes by a Corporation Expecting a Net Operating Loss Carryback, has been revised to clarify the filing deadline. Form 1138 must be filed within the tax year of the expected net operating loss but before the tax to be postponed for the preceding year is required to be paid.

Forms 1138 (Rev. July 1980) are now available in Service offices.

Form 4789, Currency Transaction Report, Revised

Announcement 80-117 [1]

Banks and other financial institutions are subject to new rules governing the reports they must file on their individual customer currency transactions over $10,000.

Under the new rules, a financial institution must file a report within 15 days after the transaction and keep a copy of the report for five years. The institution also must verify and record more specific information about the customer's identity. The regulations further limit an institution's authority to exempt transactions from reporting and require that the institution keep a record of all exemption authorizations.

The changes, effective July 7, 1980, are described in regulations published in the Federal Register on June 5, 1980, dealing with financial recordkeeping and reporting of currency and foreign transactions under Title 31, Code of Federal Regulations, Part 103.

Such transactions are reported on Form 4789, Currency Transaction Report, which is being revised along with the related instructions to reflect the new rules. The revised form should be available at Service district offices in September. Until then, financial institutions should use the current Forms 4789 and include the information required by the new regulations.

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[1] Based on News Release IR 80-87, dated August 12, 1980.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individual has been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Daniel C. Lukensow	Arcadia, CA	Enrolled Agent	Eighteen months effective July 28, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.892-1 amended.	Determining whether certain income of foreign sovereigns from loans or leases is derived from the conduct of commercial activities in the U.S.	July 22, 1980	Sept. 22, 1980
26 CFR 20.2055-2(c), 20.2056(a)-1(b)(2) amended; 20.2041-3(d)(6), 20.2056(a)-1(a), 25.2511-1(c), 25.2514-3(c) revised; 20.2056(d)-1 redesignated 20.2056(d)-2 and amended; 20.2045-1, 20.2056(d)-1, 25.2518-1 through 25.2518-4 added.	Disclaimer of property conferred by gift or inheritance.	July 22, 1980	Sept. 22, 1980
26 CFR 26a.2621-1 added.	Generation-skipping transfer tax return requirements.	Aug. 5, 1980	Oct. 6, 1980
26 CFR 1.183-1, 1.212-1(h), 1.262-1(b)(3), amended; 1.280A-1 through 1.280A-3, added.	Deductions for business use or rental of dwelling unit.	Aug. 7, 1980	Oct. 6, 1980

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27, dated July 7, 1980.

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September 22, 1980
Bulletin No. 1980-38

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENT

Announcement 80-123, page 24.
A public hearing will be held on October 14, 1980, concerning proposed regulations relating to voluntary employees' beneficiary associations.

INCOME TAX

Rev. Rul. 80-254, page 15.
Earned income; royalties. Royalties paid to a writer by a publisher for the transfer of property rights of the writer in the writer's products are earned income under section 911(b) of the Code; Rev. Rul. 71-315 modified.

Rev. Proc. 80-36, page 18.
Certification; residential energy credit. Procedures are set forth for a manufacturer to make application for "certification" that an item will be treated as insulation, an energy-conserving component, or renewable energy source property under the provisions of section 44C of the Code.

T.D. 7717, page 5.
Final regulations under section 44C of the Code relate to the residential energy credit.

Notice 80-9, page 18.
The applicable interest rate on the amount of additional tax attributable to any nonqualified withdrawals from a capital construction fund established under section 607 of the Merchant Marine Act is 10.36 percent for withdrawals made in taxable years beginning in 1980.

Announcement 80-119, page 21.
For taxable years beginning in 1980, the tax credit for making renewable energy source expenditures for a principal residence is increased to 40 percent of the first $10,000 of such expenditures.

Announcement 80-124, page 24.
Various areas of the states of Nebraska, Pennsylvania, and Wisconsin have been declared disaster areas in which losses qualify for the special tax treatment under section 165(h) of the Code.

EMPLOYEE PLANS

Rev. Rul. 80-252, page 14.
Profit-sharing; small business corporation; contributions from accumulated profits. The profit-sharing plan of an electing small business corporation does not fail to qualify merely because the plan document permits contributions to the plan from the corporation's accumulated profits as determined under generally accepted accounting principles, even though these amounts have previously been taxed to the shareholders under section 1373 of the Code. Such contributions are deductible under section 404(a)(3). Rev. Rul. 71-257 superseded.

Rev. Rul. 80-253, page 15.
Benefits; limitations; actuarial adjustments; defined benefit plans. Adjustments made in accordance with reasonable assumptions, including those in accordance with the rules in Rev. Rul.

(Continued on page 4)

Finding Lists begin on page 28.
Announcement of Voluntary Suspensions on page 25.
Announcement of Notice of Proposed Rulemaking on page 26.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

EMPLOYEE PLANS—Cont'd

71-446, Rev. Rul. 76-47, or the proposed revenue ruling in Announcement 78-96, will meet the requirements for making actuarial adjustments required in applying the limitations on benefits under section 415(b)(1) of the Code.

Announcement 80-120, page 21.
Examples are provided of the coordination of vesting and discrimination rules for employee retirement plans that may be included in the final regulations under section 411(d)(1) of the Code for determining if a plan's vesting schedule discriminates in favor of certain types of employees.

EXEMPT ORGANIZATIONS

Announcement 80-121, page 22.
A listing of organizations now classified as private foundations is given.

ESTATE TAX

Rev. Rul. 80-255, page 15.
Trust; retained interest; after-born and after-adopted children. The provision in a trust instrument for the inclusion of all the settlor's after-born and after-adopted children as additional beneficiaries is not the retention of a power to change the beneficial interests of the trust within the meaning of sections 2036(a)(2) and 2038(a)(1) of the Code.

Announcement 80-125, page 24.
A printing error is corrected in T.D. 7710, which relates to material participation requirements for valuation of certain farm and closely held business real property and to the method of valuing farm real property according to actual use.

GIFT TAX

Announcement 80-122, page 24.
Form 709-A, United States Short Form Gift Tax Return, a new gift tax return for married donors who are required to file but who owe no taxes because of gift splitting with their spouses, will be available by January 1981 for gifts made in 1980.

EXCISE TAXES

Rev. Rul. 80-256, page 16.
Truck sold after exempt lease. The tax imposed by section 4061(a) of the Code applies to a manufacturer's retail sale of a truck that when new had first been leased under an exempt lease. For such sales after 1978, the tax base is 90 percent of the actual selling price after taking into account the adjustments provided by section 4216(a). For pre-1979 sales, the tax base is the higher of 75 percent of the actual selling price or the manufacturer's cost of production adjusted by straight line depreciation and limited to actual sales price. Rev. Rul. 74-577 obsoleted.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 44C.—Residential Energy Credit

26 CFR 1.44C-1: Residential energy credit.

T.D. 7717 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Residential energy credit

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the residential energy credit. Changes to the applicable tax laws were made by the Energy Tax Act of 1978 [Pub. L. 95-618, 1978-3 C.B. (Vol. 2), 1]. These regulations provide the public with guidance needed for determining whether a residential energy credit is available with respect to certain expenditures.

DATE: The amendments are effective with respect to expenditures made after April 19, 1977, and before January 1, 1986.

FOR FURTHER INFORMATION CONTACT: Walter H. Woo of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3297).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On May 23, 1979, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 44C and 1016 of the Internal Revenue Code of 1954 and to the Statement of Procedural Rules (26 CFR Part 601). The amendments were proposed to conform the regulations to section 101 of the Energy Tax Act of 1978 (92 Stat. 3175). A public hearing was held on September 12, 1979. After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision. A new § 1.44C-6 is added to deal with the procedure and criteria for additions to the list of energy-conserving components or renewable energy sources which was previously the subject of § 1.44C-5. Section 1.44C-6 is reserved in this Treasury decision and will be dealt with in another regulation project. It should be noted that this Treasury decision does not reflect any of the amendments to section 44C made by the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B. 2].

The effectiveness of these regulations will be evaluated on the basis of comments and information received from the public, other Government agencies, and offices within the Treasury Department and Internal Revenue Service. Under the regulations, no additional reporting or filing requirements have been imposed on taxpayers.

IN GENERAL

The Energy Tax Act of 1978 provides a residential energy credit for insulation, certain other energy-conserving components, and certain renewable energy source property expenditures made in connection with the taxpayer's principal residence. In the case of insulation and other energy-conserving components, the credit is 15 percent of the first $2,000 of expenditures, for a maximum credit of $300. In the case of solar, wind, and geothermal energy property, the credit provided by the 1978 Act is 30 percent of the first $2,000 of expenditures and 20 percent of the next $8,000 of expenditures, for a maximum credit of $2,200 for expenditures made after April 19, 1977 and before January 1, 1980. It should be noted that the Crude Oil Windfall Profit Tax Act of 1980 has increased the credit for solar, wind, and geothermal property to 40 percent of $10,000 for a maximum of $4,000 for expenditures made after December 31, 1979 and before January 1, 1986. The taxpayer must reduce the maximum amount of allowable expenditures with respect to the dwelling unit to be used in computing the credit by the prior expenditures which were made by the taxpayer, and which were taken into account in computing the credit for prior taxable years.

The credit applies only to expenditures made on or after April 20, 1977, and before January 1, 1986. A credit with respect to expenditures made during 1977 (*i.e.*, on or after April 20) is to be claimed on the taxpayer's 1978 tax return. In the case of insulation and other energy-conserving component expenditures, the credit is available only with respect to a taxpayer's principal residence the construction (including reconstruction) of which was substantially completed before April 20, 1977. To the extent that the credit exceeds the taxpayer's tax liability, the taxpayer is allowed to carry over the unused credit to subsequent taxable years beginning before January 1, 1988.

DEFINITIONS OF QUALIFIED ITEMS

A number of comments requested that the definitions of various items qualifying for the credit be expanded, *e.g.*, that the definition of insulation be expanded to include awnings and shades; that the definition of a storm or thermal window be revised to include window films; and that the definition of solar energy property be made to include woodburning stoves or heat pumps. The regulations have not been expanded to include these items because we believe that Congress did not intend their inclusion. In the case of insulation, the regulations have been clarified to provide that an item must be installed between a conditioned area (*i.e.*, heated or cooled by conventional or renewable energy source means) and a nonconditioned area to qualify as insulation (except when installed on a water heater, water pipe, or heating/cooling duct).

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[1] This publication of the Treasury Decision contains the complete text of the amendments to the regulations. The instructions for modifying the notice of proposed rulemaking have been omitted.

It was suggested that the definition of a storm or thermal window should be in terms of R-values, rather than inches of insulating material. The regulations have been amended to reflect this suggestion.

Several comments suggested that the rule excluding materials and components having a dual purpose from the definition of solar energy property be deleted. It was argued that this rule would disqualify most expenditures for passive solar construction or for modifications to an existing structure. Additional comments requested that the regulations be revised to allow a partial credit for materials and components that serve a dual purpose. The dual purpose rule was not deleted or modified to allow a partial credit in view of the support for the exclusion found in the House and Senate reports to the Act which clearly require the exclusion of property with a significant structural function.

However, the regulations have been revised to include a more comprehensive definition of a passive solar system. The final regulations provide that a qualifying passive solar system used for heating purposes must be composed of the following components: a solar collection area, an absorber, a storage mass, a heat distribution method, and heat regulation devices.

In response to inquiries, the definition of wind energy property has been revised to make it clear that devices that use wind merely to ventilate do not qualify as wind energy property.

The residential energy credit applies to property which transmits or uses energy derived from a geothermal deposit to heat or cool a dwelling or provide hot water for use within the dwelling. Several comments suggested that the definition of geothermal deposit be revised either by deleting the 60° Celsius temperature limitation or by lowering the temperature limitation. The temperature limitation has been lowered to 50° Celsius. It has been concluded that 50° Celsius is an appropriate measure for determining whether heat is derived from geothermal reservoirs (heated by the earth's magma) or is derived from heat associated with ground water that is affected by atmospheric temperatures.

DEFINITION OF CONSTRUCTION

One comment objected to defining reconstruction as construction for purposes of the April 20, 1977, cut-off date for new construction. This objection was rejected on the ground that a house that is reconstructed is basically a new house. Therefore, the cut-off date pertaining to new construction should also be applicable to reconstruction.

CERTIFICATION PROCEDURE

One comment suggested that the regulations be revised to allow request from any source for certification of items as qualifying for the credit. This suggestion was not adopted because the statute only authorizes the manufacturer to seek certification of an item.

It should be noted that the certification procedure is the subject of Rev. Proc. 80-36 [page , this Bulletin].

DRAFTING INFORMATION

The principal author of this regulation is Walter H. Woo of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to 26 CFR Part 1 are hereby adopted:

Paragraph 1. There are inserted immediately after § 1.44-5 the following new sections:

§ 1.44C-1 Residential energy credit.

(a) *General rule.* Section 44C provides a residential energy credit against the tax imposed by chapter 1 of the Internal Revenue Code. The credit is an amount equal to the individual's qualified energy conservation expenditures (set out in paragraph (b)) plus the individual's qualified renewable energy source expenditures (set out in paragraph (c)) for the taxable year. However, the credit is subject to the limitations described in paragraph (d) and the special rules contained in § 1.44C-3. The credit is nonrefundable (that is, the credit may not exceed an individual's tax liability for the taxable year). However, any unused credit may be carried over to succeeding years to the extent permitted under paragraph (e). Renters as well as owners of a dwelling unit may qualify for the credit. See § 1.44C-3(h) for the rules relating to the allocation of the credit in the case of joint occupants of a dwelling unit.

(b) *Qualified energy conservation expenditures.* In the case of any dwelling unit, the qualified energy conservation expenditures are 15 percent of the energy conservation expenditures made by the taxpayer with respect to the dwelling unit during the taxable year, but not in excess of $2,000 of such expenditures. See § 1.44C-2(a) for the definition of energy conservation expenditures.

(c) *Qualified renewable energy source expenditures.* In the case of any dwelling unit, the qualified renewable energy source expenditures are the renewable energy source expenditures made by the taxpayer with respect to the dwelling unit during the taxable year, but not in excess of—

(1) 30 percent of the expenditures up to $2,000, plus

(2) 20 percent of the expenditures over $2,000, but not more than $10,000.

See § 1.44C-2(b) for the definition of renewable energy source expenditures.

(d) *Limitations*—(1) *Minimum dollar amount.* No residential energy credit shall be allowed with respect to any return (whether joint or separate) for any taxable year if the amount of the credit otherwise allowable (determined without regard to the tax liability limitation imposed by paragraph (d)(3) of this section) is less than $10.

(2) *Prior expenditures taken into account*—(i) *In general.* For purposes of determining the credit for expendi-

tures made during a taxable year, the taxpayer must reduce the maximum amount of allowable expenditures with respect to the dwelling unit in computing qualified energy conservation expenditures (under paragraph (b)) or qualified renewable energy conservation expenditures (under paragraph (c)) by prior expenditures which were made by the taxpayer or by joint occupants (see § 1.44C-3(h)) with respect to the same dwelling unit, and which were taken into account in computing the credit for prior taxable years. The reduction of the maximum amount under paragraph (c) must first be made with respect to the first $2,000 of expenditures (to which a 30 percent rate applies) and then with respect to the next $8,000 of expenditures (to which a 20 percent rate applies). This reduction must be made if all or any part of the credit was allowed in or was carried over from a prior taxable year.

(ii) *Change of principal residence.* A taxpayer is eligible for the maximum credit for qualifying expenditures made with respect to a new principal residence notwithstanding the allowance of a credit for qualifying expenditures made with respect to the taxpayer's previous principal residence. Furthermore, except in certain cases involving joint occupancy (see §1.44C-3(h)), a taxpayer is eligible for the maximum credit notwithstanding the allowance of a credit to a prior owner of the taxpayer's new principal residence.

(iii) *Example.* The rules with respect to the reduction for prior expenditures are illustrated by the following example:

Example. In 1978, A has $1,000 of energy conservation expenditures and $5,000 of renewable energy source expenditures in connection with A's principal residence. A's residential energy credit for 1978 is $1,350, made up of $150 of qualified energy conservation expenditures (15 percent of $1,000) plus $1,200 of qualified renewable energy source expenditures (30 percent of the first $2,000 plus 20 percent of the next $3,000). In 1979 A has an additional $2,000 of energy conservation expenditures and $3,000 of renewable energy source expenditures in connection with the same principal residence. A's residential energy credit for 1979 is $750, made up of $150 of qualified energy conservation expenditures (15 percent of the new maximum $1,000, which was reduced from $2,000 by $1,000 of energy conservation expenditures taken into account in 1978) plus $600 of qualified renewable energy source expenditures (20 percent of $3,000, which reflects the reduction of the maximum allowable expenditures by the $5,000 of renewable energy source expenditures taken into account in 1978). The maximum residential energy credit allowable to A with respect to the same principal residence in subsequent years in which the credit is allowable is $400 (20 percent of the new maximum of $2,000 for renewable energy source expenditures and none for energy conservation expenditures).

(3) *Tax liability limitation.* The credit allowed by this section shall not exceed the amount of the tax imposed by chapter 1 of the Internal Revenue Code of 1954 for the taxable year, reduced by the sum of the credits allowable under—

(i) Section 32 (relating to tax withheld at source on nonresident aliens and foreign corporations and on tax-free covenant bonds),

(ii) Section 33 (relating to the taxes of foreign countries and possessions of the United States),

(iii) Section 37 (relating to retirement income),

(iv) Section 38 (relating to investment in certain depreciable property),

(v) Section 40 (relating to expenses of work incentive programs),

(vi) Section 41 (relating to contributions to candidates for public office),

(vii) Section 42 (relating to the general tax credit),

(viii) Section 44 (relating to purchase of new personal residence),

(ix) Section 44A (relating to expenses for household and dependent care services), and

(x) Section 44B (relating to employment of certain new employees).

(e) *Carryover of unused credit.* If the credit allowable by this section exceeds the tax liability limitation imposed by section 44C(b)(5) and paragraph (d)(3) of this section, the excess credit shall be carried over to the succeeding taxable year and added to the credit allowable under this section for the succeeding taxable year. A carryover that is not used in the succeeding year because it exceeds the tax liability limitation shall be carried over to later taxable years until used, except that no excess credit may be carried over to any taxable year beginning after December 31, 1987.

§ 1.44C-2 Definitions.

For purposes of section 44C and the regulations thereunder—

(a) *Energy conservation expenditures*—(1) *In general.* The term "energy conservation expenditure" means an expenditure made on or after April 20, 1977, and before January 1, 1986, by a taxpayer for insulation or any other energy-conserving component, or for labor costs allocable to the original installation of such insulation or other component, if all of the following conditions are satisfied:

(i) The insulation (as defined in paragraph (c)) or other energy-conserving component (as defined in paragraph (d)) is installed in or on a dwelling unit that is used as the taxpayer's principal residence when the installation is completed. See § 1.44C-3(e) for the definition of principal residence.

(ii) The dwelling unit is located in the United States (as defined in section 7701(a)(9)).

(iii) The construction of the dwelling unit was substantially completed before April 20, 1977. See § 1.44C-3 (f) for the definition of the terms "construction" and "substantially completed". In the case of expenditures made with respect to the enlargement of a dwelling unit, the construction of the enlargement must have been substantially completed before April 20, 1977.

(2) *Examples.* The application of this paragraph may be illustrated by the following examples:

Example (1). In 1978, A spent $500 for the purchase and installation of new storm windows to replace old storm windows, $100 to reinstall old storm windows, and $150 to transfer to A's house insulation which had been installed in A's garage. Only the $500 spent for new storm windows qualifies as an energy conservation expenditure. The $100 spent to reinstall storm windows and the $150 spent to transfer insulation to A's house do not qualify since the only installation costs that qualify are those for the original installation of energy conservation property the original use of which commences with the taxpayer.

Example (2). In June 1977, B purchased for B's principal residence a new house that was substantially completed before April 20, 1977. Pursuant to B's request the builder installed storm windows on May 1, 1977, the cost of this option being included in the purchase price of the house. The portion of the purchase price of the residence allocable to the storm windows constitutes an energy conservation expenditure.

However, no other part of the purchase price may be allocated to energy conservation property (insulation and other energy conserving components) installed before April 20, 1977. To qualify as an energy conservation expenditure, an expenditure must be made (*i.e.*, installation of the energy conservation property must be completed) on or after April 20, 1977.

(b) *Renewable energy source expenditures.* The term "renewable energy source expenditure" means an expenditure made on or after April 20, 1977, and before January 1, 1986, by a taxpayer for renewable energy source property (as defined in paragraph (e)), or for labor costs properly allocable to the on-site preparation, assembly, or original installation of such property, if both of the following conditions are satisfied:

(1) The renewable energy source property is installed in connection with a dwelling unit that is used as the taxpayer's principal residence when the installation is completed. See § 1.44C-3(e).

(2) The dwelling unit is located in the United States (as defined in section 7701(a)(9)).

Eligibility as a renewable energy source expenditure does not depend on the date of construction of the dwelling unit. Thus, such an expenditure may be made in connection with either a new or an existing dwelling unit. Renewable energy source expenditures need only be made in connection with a dwelling, rather than in or on a dwelling unit. For example, a solar collector that otherwise constitutes renewable energy source property is not ineligible merely because it is installed separately from the dwelling unit. The term "renewable energy source expenditure" does not include any expenditure allocable to a swimming pool even when used as an energy storage medium or to any other energy storage medium whose primary function is other than the storage of energy. It also does not include the cost of maintenance of an installed system or the cost of leasing renewable energy source property.

(c) *Insulation.* The term "insulation" means any item that satisfies all of the following conditions:

(1) The item is specifically and primarily designed to reduce, when installed in or on a dwelling or on a water heater, the heat loss or gain of such dwelling or water heater. To qualify as insulation the item must be installed between a conditioned area and a nonconditioned area (except when installed on a water heater, water pipe, or heating/cooling duct). Thus, for example, awnings do not qualify as insulation. For purposes of this section the term "conditioned area" means an area that has been heated or cooled by conventional or renewable energy source means. Insulation includes materials made of fiberglass, rock wool, cellulose, urea based foam, urethane, vermiculite, perlite, polystyrene, and extruded polystyrene foam.

(2) The original use of the item begins with the taxpayer.

(3) The item can reasonably be expected to remain in operation at least 3 years.

(4) The item meets the applicable performance and quality standards prescribed in § 1.44C-4 (if any) that are in effect at the time the taxpayer acquires the item.

The term "insulation" shall not include items whose primary purpose is not insulation (*e.g.*, whose function is primarily structural, decorative, or safety-related). For example, carpeting, drapes (including linings), shades, wood paneling, fireplace screens (including those made of glass), new or replacement walls (except for qualifying insulation therein) and exterior siding do not qualify although they may have been designed in part to have an insulating effect.

(d) *Other energy-conserving components.* The term "other energy-conserving component" means any item (other than insulation) that satisfies all of the following conditions:

(1) The original use of the item begins with the taxpayer.

(2) The item can reasonably be expected to remain in operation for at least 3 years.

(3) The item meets the applicable performance and quality standards prescribed in § 1.44C-4 (if any) that are in effect at the time of the taxpayer's acquisition of the item.

(4) The item is one of the following items:

(i) *A furnace replacement burner.* The term "furnace replacement burner" means a device (for oil and gas-fired furnaces or boilers) that is designed to achieve a reduction in the amount of fuel consumed as a result of increased combustion efficiency. The burner must replace an existing burner. It does not qualify if it is acquired as a component of, or for use in, a new furnace or boiler.

(ii) *A device for modifying flue openings.* The term "device for modifying flue openings" means an automatically operated damper that—

(A) Is designed for installation in the flue, between the barometric damper or draft hood and the chimney, of a furnace; and

(B) Conserves energy by substantially reducing the flow of conditioned air through the chimney when the furnace is not in operation. Conditioned air is air that has been heated or cooled by conventional or renewable energy source means.

(iii) *A furnace ignition system.* The term "furnace ignition system" means an electrical or mechanical device, designed for installation in a gas-fired furnace or boiler that automatically ignites the gas burner. In order to qualify, the device must replace a gas pilot light. Furthermore, it does not qualify if it is acquired as a component of, or for use in, a new furnace or boiler.

(iv) *A storm or thermal window or door.* The terms "storm or thermal window" and "storm or thermal door" include the following:

(A)(*1*) A window placed outside or inside an ordinary or prime window, creating an insulating air space.

(*2*) A window with enhanced resistance to heat flow through the glazed area by multi-glazing.

(*3*) A window that consists of glass or other glazing materials that have exception heat-absorbing or heat-reflecting properties. For purposes of this subdivision (iv), the term "glazing material" does not include films and coatings applied on the surface of a window.

(B)(*1*) A second door, installed outside or inside a prime exterior door, creating an insulating air space.

(2) A door with enhanced resistance to heat flow through the glazed area by multi-glazing.

(3) A prime exterior door that has an R-value (a measurement of the ability of insulation to resist the flow of heat) of at least 2 throughout.

For purposes of this subdivision, "multi-glazing" is an arrangement in which two or more sheets of glazing material are affixed in a window or door frame to create one or more insulating air spaces. Multi-glazing can be achieved by installing a preassembled, sealed insulating glass unit or by affixing one or more additional sheets of glazing onto an existing window (or sash) or door. For purposes of this subdivision, a storm or thermal window or door does not include any film applied on or over the surface of a window or door.

(v) *Automatic energy-saving setback thermostat.* The term "automatic energy-saving setback thermostat" means a device that is designed to reduce energy consumption by regulating the demand on the heating or cooling system in which it is installed, and uses—

(A) A temperature control device for interior spaces incorporating more than one temperature control level, and

(B) A clock or other automatic mechanism for switching from one control level to another.

(vi) *Caulking and weatherstripping.* The term "caulking" means pliable materials used to fill small gaps at fixed joints on buildings to reduce the passage of air and moisture. Caulking includes, but is not limited to, materials commonly known as "sealants", "putty", and "glazing compounds". The term "weatherstripping" means narrow strips of material placed over or in movable joints of windows and doors to reduce the passage of air and moisture.

(vii) *Energy usage display meter.* The term "energy usage display meter" means a device the sole purpose of which is to display the cost (in money) of energy usage in the dwelling. It may show cost information for electricity usage, gas usage, oil usage, or any combination thereof. The device may measure energy usage of the whole dwelling, or individual appliances or systems on an instantaneous or cumulative basis.

(viii) *Components specified by the Secretary.* The Secretary (or his delegate) may, in his discretion, after consultation with the Secretary of Energy and the Secretary of Housing and Urban Development (or their delegates), and any other appropriate Federal officers, specify by regulation other energy-conserving components for addition to the list of qualified items. See § 1.44C-6 for the procedures and criteria to be used in determining whether an item will be considered for addition to the list of qualified items by the Secretary. The term "other energy-conserving component" is limited to items in a category specifically listed in section 44C(c)(4)(A)(i) through (vii) or added by the Secretary.

(e) *Renewable energy source property*—(1) *In general.* The term "renewable energy source property" includes any solar energy property, wind energy property, geothermal energy property, or property referred to in subparagraph (2), which meets the following conditions:

(i) The original use of the property begins with the taxpayer.

(ii) The property can reasonably be expected to remain in operation for at least 5 years.

(iii) The property meets the applicable performance and quality standards prescribed in § 1.44C-4 (if any) that are in effect at the time of the taxpayer's acquisition of the property.

Renewable energy source property does not include heating and cooling systems which serve to supplement renewable energy source equipment in heating or cooling a dwelling unit, and which employ a form of energy (such as electricity, oil or gas) other than solar, wind, or geothermal energy (or other forms of renewable energy provided in subparagraph (2)). Thus, heat pumps or oil or gas furnaces, used in connection with renewable energy source property, are not eligible for the credit. In order to be eligible for the credit for renewable energy source property, the property (as well as labor costs properly allocable to on-site preparation, assembly or installation of equipment) must be clearly identifiable. See § 1.44C-3(l) for recordkeeping rules.

(2) *Renewable energy source specified by the Secretary.* In addition to solar, wind, and geothermal energy property, renewable energy source property includes property that transmits or uses another renewable energy source that the Secretary (or his delegate) specifies by regulations, after consultation with the Secretary of Energy and the Secretary of Housing and Urban Development (or their delegates), and any other appropriate Federal officers, to be of a kind that is appropriate for the purpose of heating or cooling the dwelling or providing hot water for use within the dwelling. For purposes of this section, references to the transmission or use of energy includes its collection and storage. See § 1.44C-6 for the procedures and criteria to be used in determining when another energy source will be considered for addition to the list of qualified renewable energy sources.

(f) *Solar energy property*—(1) *In general.* The term "solar energy property" means equipment and materials of a solar energy system as defined in this paragraph (and parts solely related to the functioning of such equipment) which, when installed in connection with a dwelling, transmits or uses solar energy to heat or cool the dwelling or to provide hot water for use within the dwelling. For this purpose, solar energy is energy derived directly from sunlight (solar radiation). Property which uses, as an energy source, fuel or energy which is indirectly derived from sunlight (solar radiation), such as fossil fuel or wood or heated underground water is not considered solar energy property. Materials and components of "passive solar systems" as well as "active solar systems", or a combination of both types of systems may qualify as solar energy property.

(2) *Active solar system.* An active solar system is based on the use of mechanically forced energy transfer, such as the use of fans or pumps to circulate solar generated energy, or thermal energy transfer, such as systems utilizing thermal siphon principles. Generally, this is accomplished through the use of equipment such as

collectors (to absorb sunlight and create hot liquids or air), storage tanks (to store hot liquids), rockbeds (to store hot air), thermostats (to activate pumps or fans which circulate the hot liquids or air), and heat exchangers (to utilize hot liquids or air to heat air or water).

(3) *Passive solar system.* A passive solar system is based on the use of conductive, convective, or radiant energy transfer. In order to qualify as a passive solar system, a solar system used for heating purposes must contain all of the following: a solar collection area, an absorber, a storage mass, a heat distribution method, and heat regulation devices. The term "solar collection area" means an expanse of transparent or translucent material, such as glass which is positioned in such a manner that the rays of the sun directly strike an absorber. The term "absorber" means a surface, such as a floor, that is exposed to the rays of the sun admitted through the solar collection area, which converts solar radiation into heat, and then transfers the heat to a storage mass. The term "storage mass" means material, such as masonry, that receives and holds heat from the absorber and later releases the heat to the interior of the dwelling. The storage mass must be of sufficient volume, depth, and thermal energy capacity to store and deliver adequate amounts of solar heat for the relative size of the dwelling. In addition, the storage mass must be located so that it is capable of distributing the stored heat directly to the habitable areas of the dwelling through a heat distribution method. The term "heat distribution method" means the release of radiant heating from the storage mass within the habitable areas of the dwelling, or convective heating from the storage mass through airflow paths provided by openings or by ducts in the storage mass, to habitable areas of the dwelling. The term "heat regulation devices" means shading or venting mechanisms (such as awnings or insulated drapes) to control the amount of solar heat admitted through the solar collection areas and nighttime insulation or its equivalent to control the amount of heat permitted to escape from the interior of the dwelling.

(4) *Components with dual function.* To the extent that a passive or active solar system utilizes portions of the structure of a residence, only the materials and components whose sole purpose is to transmit or use solar radiation (and labor costs associated with installing such materials and components) are included within the term "solar energy property". Accordingly, materials and components that serve a dual purpose *e.g.,* they have a significant structural function or are structural components of the dwelling (and labor costs associated with installing such materials and components) are not included within the term "solar energy property". For example, solar collectors and roof ponds that form part of a roof (including additional structural components to support the roof), windows (including clerestories and skylights), and greenhouses do not qualify as solar energy property. In the case of a trombe wall (a south facing wall composed of a mass wall and exterior glazing), the mass wall (and labor costs associated with installing the mass wall) will not qualify. However, the exterior (non-window) glazing will qualify. Any shading, venting and heat distribution mechanisms or storage systems that do not have a dual function will also qualify.

(g) *Wind energy property.* The term "wind energy property" includes equipment (and parts solely related to the functioning of such equipment) which, when installed in connection with a dwelling, transmits or uses wind energy to produce energy in a useful form for personal residential purposes. Examples of equipment using wind energy to produce energy in a useful form are windmills, wind-driven generators, power conditioning and storage devices that use wind to generate electricity or mechanical forms of energy. Devices that use wind merely to ventilate do not qualify as wind energy property.

(h) *Geothermal energy property.* The term "geothermal energy property" includes equipment (and parts solely related to the functioning of such equipment) necessary to transmit or use energy from a geothermal deposit to heat or cool a dwelling or provide hot water for use within the dwelling. Equipment such as a pipe that serves both a geothermal function (by transmitting hot geothermal water within a dwelling) and a non-geothermal function (by transmitting hot water from a water heater within a dwelling) does not qualify as geothermal property. A geothermal deposit is a geothermal reservoir consisting of natural heat which is from an underground source and is stored in rocks or in an aqueous liquid or vapor (whether or not under pressure), having a temperature exceeding 50 degrees Celsius as measured at the wellhead or, in the case of a natural hot spring (where no well is drilled), at the intake to the distribution system.

§ 1.44C-3 Special rules.

(a) *When expenditures are treated as made*—(1) *Timeliness of an expenditure for the energy credit.* In general, for the purpose of determining whether an expenditure qualifies as being timely for the residential energy credit under section 44C (*i.e.,* is made after April 19, 1977, and before January 1, 1986), the expenditure is treated as made when original installation of the item is completed. Thus, solely for that purpose, the time of payment or accrual is irrelevant.

(2) *Special rule for renewable energy source expenditures in the case of construction or reconstruction of a dwelling.* In the case of renewable energy source expenditures in connection with the construction or reconstruction of a dwelling that becomes the taxpayer's new principal residence, the expenditures are to be treated as made (for the purpose of determining the timeliness of an expenditure for the residential energy credit) when the taxpayer commences use of the dwelling as his or her principal residence following its construction or reconstruction. The term "reconstruction" means the replacement of most of a dwelling's major structural components such as floors, walls, and ceiling. When a taxpayer reoccupies a reconstructed dwelling that was the taxpayer's principal residence prior to reconstruction, a renewable energy source expenditure is considered made when the original installation of the

renewable energy source property is completed.

(3) *Taxable year in which credit is allowable.* For the purpose of determining the taxable year in which the credit for an expenditure is allowable (once it has qualified as timely under subparagraph (1) or (2)), an expenditure is treated as made on the later of (i) the date on which it qualifies as timely, or (ii) the date on which it is paid or incurred by the taxpayer.

(b) *Expenditures in 1977.* No credit under section 44C shall be allowed for any taxable year beginning before 1978. However, the amount of any credit under section 44C for the taxpayer's first taxable year beginning after December 31, 1977, shall take into account qualified energy conservation expenditures and qualified renewable energy source expenditures made during the period beginning April 20, 1977, and ending on the last day of such first taxable year.

(c) *Expenditures financed with Federal, etc., grants.* Qualified expenditures financed with Federal, State or other grants shall be taken into account for purposes of computing the residential energy credit only if such amounts are taxable as gross income under section 61 (relating to the definition of gross income) and the regulations thereunder.

(d) *Expenditures qualifying both as energy conservation expenditures and renewable source expenditures.* In the case of an expenditure which meets both the definition of an energy conservation expenditure (as defined in § 1.44C-2(a)) and a renewable energy source expenditure (as defined in § 1.44C-2(b)), the taxpayer may claim either a credit under §1.44C-1(b) (relating to qualified energy conservation expenditures) or §1.44C-1(c) (relating to qualified renewable energy source expenditures) but may not claim both credits with respect to the same expenditure.

(e) *Principal residence.* For purposes of section 44C, the determination of whether a dwelling unit is the taxpayer's principal residence shall be made under principles similar to those applicable to section 1034 and the regulations thereunder (relating to sale or exchange of a principal residence) except that ownership of the dwelling unit is not required. In making this determination, the period for which a dwelling is treated as a taxpayer's principal residence includes the 30-day period ending on the first day on which the dwelling unit would (but for this sentence) be treated as being used as the taxpayer's principal residence under principles similar to those applicable to section 1034. Thus, installations that are completed within that 30-day period may be eligible for the credit although, in the absence of the 30-day rule, the date of habitation of the dwelling unit by the taxpayer would mark the beginning of the taxpayer's use of the unit as a principal residence.

(f) *Construction substantially completed.* Construction of a dwelling unit is substantially completed when construction has progressed to the point where the unit could be put to use as a personal residence, even though comparatively minor items remain to be finished or performed in order to conform to the plans or specifications of the completed building. For this purpose, construction includes reconstruction as defined in paragraph (a)(2). This rule may be illustrated by the following example:

Example. On January 1, 1979, A purchases a dwelling that is to become A's principal residence. The dwelling unit was originally constructed in 1950. A spends $50,000 to reconstruct the dwelling by replacing most of the dwelling's major structural components such as floors, walls and ceilings. Included in the cost is $3,000 attributable to energy-conserving components. Reconstruction is substantially completed on April 1, 1979, and A moves into the reconstructed residence on May 1, 1979. Since construction includes reconstruction, A's reconstructed residence is not considered substantially completed before April 20, 1977. Thus, amounts spent with respect to A's reconstructed residence for energy-conserving components do not qualify as energy conservation expenditures

(g) *Residential use of property.* To be eligible for the residential energy credit, expenditures must be made for personal residential purposes. If at last 80 percent of the use of a component or item of property is for personal residential purposes, the entire amount of the energy conservation expenditure or the renewable energy source expenditure is taken into account in computing the credit under this section. If less than 80 percent of the use of a component or item of property is for personal residential purposes, the amount of an expenditure taken into account is the amount that bears the same ratio to the amount of the expenditure as the amount of personal residential use of the component or item bears to its total use. For purposes of this paragraph, use of a component or an item of property with respect to a swimming pool is not a use for a personal residential purpose. The rules with respect to residential use of property are illustrated by the following examples:

Example (1). In 1978 A makes an expenditure of $3,000 for the installation of storm windows of which 50 percent is on the portion of A's dwelling used as the principal family residence and 50 percent is on the portion of the dwelling used as an office. A has made no other energy conservation expenditures for the residence. The allowable energy conservation expenditure is $1,500 (50 percent of $3,000), the portion attributable to residential use. Therefore, the residential energy credit is $225 (the qualified conservation expenditure of 15 percent of $1,500).

Example (2). During 1979, B makes $10,000 of renewable energy source expenditures on solar energy property for B's principal residence. Approximately 60 percent of the use of the solar energy property will be for heating B's swimming pool; the other 40 percent will be for heating the dwelling unit. B had not previously made renewable energy source expenditures with respect to the residence. Since use for a swimming pool is not considered a residential use, less than 80 percent of the use of B's solar energy property is considered used for personal residential purposes. Therefore, only $4,000 (40 percent of $10,000), the proportionate part of B's expenditures representing personal residential use, is treated as a renewable energy source expenditure. B is allowed a $1,000 residential energy credit (30 percent of $2,000 plus 20 percent of $2,000) for 1979.

(h) *Joint occupancy*—(1) *In general.* If two or more individuals jointly occupied and used a dwelling unit as their principal residence during any portion of a calendar year—

(i) The amount of the credit allowable under section 44C by reason of energy conservation expenditures or by reason of renewable energy source expenditures shall be determined by treating all of the joint occupants as one taxpayer whose taxable year is such calendar year; and

(ii) The credit under section 44C allowable to each joint occupant for the taxable year with which or in which such calendar year ends shall be an amount which bears the same ratio to the amount determined under paragraph (h)(1)(i) of this section as the amount of energy conservation expenditures or renewable energy source expenditures made by that occupant bears to the total amount of each type of such expenditures made by all joint occupants during such calendar year.

The provisions of this subparagraph may be illustrated by the following example:

Example. A, a calendar year taxpayer, and B, a June 1 fiscal year taxpayer, make energy conservation expenditures of $2,000 (A making expenditures of $500 and B making expenditures of $1,500) on their principal and jointly occupied residence in 1978. A and B have not previously made energy conservation expenditures with respect to this residence. Of the $300 credit (15 percent of $2,000), $75 will be allocated to A ($500/$2,000 × $300) and $225 to B ($1,500/$2,000 × $300). A will claim the allocable share of the credit on A's 1978 tax return and B will claim the allocable share of the credit on B's tax return for the fiscal year ending May 31, 1979.

(2) *Minimum credit.* The fact that one joint occupant may be unable to claim all or part of the credit under section 44C because of insufficient tax liability or because that occupant's allowable credit does not exceed the $10 minimum credit (as set forth in paragraph (d)(1) of § 1.44C-1) shall have no effect upon the computation of the amount of the allowable credits for the other joint occupants.

(3) *Prior expenditures.* Because joint occupants are treated as one taxpayer for purposes of determining the residential energy credit, the maximum amount of energy conservation expenditures or renewable energy source expenditures must be reduced by the total amount of such expenditures made in connection with the dwelling unit during prior calendar years in which any one of the residents of the unit during the current calendar year was a resident (whether made by the current resident or by an individual previously occupying the dwelling with the current resident). However, the preceding sentence shall not apply to prior expenditures no part of which was taken into account in computing the credits under section 44C for such years. Prior years' expenditures are not to be allocated among joint occupants to take into account the specific expenditures of each of the occupants in prior years.

(4) The rules of this paragraph may be illustrated by the following examples:

Example (1). Assume A and B have together made prior years' energy conservation expenditures of $1,600 (A having made $1,200 of expenditures and B having made $400) on their principal and jointly occupied residence. In the current year, each makes energy conservation expenditures of $300 with respect to the same residence. The maximum qualified expenditure with respect to the residence is reduced by the $1,600 of prior expenditures made by A and B. Therefore, only $400 of the $600 current expenditures are eligible as energy conservation expenditures. The resulting residential energy credit is $60 (15 percent of $400) of which $30 apiece will be allocated to A and B ($300/$600 × $60). The fact that A had previously computed the credit in prior years with respect to $1,200 of the total $1,600 of expenditures is irrelevant to the apportionment of the credit in the current year.

Example (2). Spouses C and D make $10,000 of renewable energy source expenditures with respect to their principal residence, half of which is paid by each spouse. No prior renewable energy source expenditures have been taken into account with respect to that residence by either C or D. C and D file separate returns for the calendar year. Under the joint occupancy rule, the maximum allowable renewable energy source credit with respect to C and D's principal residence is $2,200 (30 percent of the first $2,000, and 20 percent of the next $8,000 of expenditures). Half of this amount, or $1,100, will be allowed to each spouse. If either spouse makes renewable energy source expenditures with respect to the same principal residence in future years, none of those expenditures would be qualified renewable energy source expenditures for which a credit can be claimed. That is, not more than $2,200 may be taken in the aggregate by C and D as a renewable energy source credit with respect to their principal residence.

Example (3). In 1978, E and F make energy conservation expenditures of $1,500 on their principal and jointly occupied residence. In 1979, E moves away and G becomes the other joint occupant of the residence. F and G make energy conservation expenditures of $1,000 in 1979. In 1980 F moves away and H moves in with G. G and H make energy conservation expenditures of $500. The maximum qualified expenditure made by F and G with respect to the residence is reduced by the $1,500 of prior expenditures made in 1978 by E and F. The maximum qualified expenditures made by G and H with respect to the residence is reduced only by the expenditures in prior years in connection with the residence during which either C or H was a joint occupant. Accordingly, the maximum qualified expenditures made by G and H with respect to the residence is reduced only by the $1,000 of prior expenditures made in 1979 by F and G.

(i) *Condominiums and cooperative housing corporations.* An individual who is a tenant stockholder in a cooperative housing corporation (as defined in section 216) or who is a member of the condominium management association with respect to a condominium which he or she owns shall be treated as having made a proportionate share of the energy conservation expenditures or renewable energy source expenditures of such corporation or association. The cooperative stockholder's allocable share of the expenditures is to be the same as his or her proportionate share of the cooperative's total outstanding stock (including any stock held by the corporation). However, in the case where only certain cooperative stockholders are assessed for the expenditures made by the cooperative housing corporation, only those cooperative stockholders that are assessed shall be treated as having made a share of the expenditures of such corporation. In such case, the cooperative stockholder's share of the expenditures is the amount that the stockholder is assessed. The allocable share of a condominum management association member's energy conservation or renewable energy source expenditures is the amount that the member is assessed (or would be assessed in the case where expenditures are from general funds) by the association as a result of such expenditures. The residential energy credit for a qualified expenditure is allowable for the year in which the association or corporation has completed original installation of the item (or has paid or incurred the expenditure, if later). For purposes of this paragraph, the term 'condominium management association" means an organization meeting the requirements of section 528(c)(1) of the Code (other than subparagraph (E) of that section), with respect to a condominium project substantially all the units of which are used as residences.

(j) *Joint ownership of renewable energy source property*—(1) *In general.* Renewable energy source property includes property which is jointly owned by the taxpayer and another person (or persons). For example, the fact that a windmill, solar collector, or geothermal well and distribution system is owned by two or more individuals does not by itself preclude qualification as renewable energy property.

(2) *Example*. The application of this subparagraph may be illustrated by the following example:

Example. A, B, and C each has a separate principal residence. They agree to finance jointly the construction of a solar collector, each providing one-third of the costs and taking one-third of the output of the collector. Each will separately pay for the costs of connecting the solar collector with his or her principal residence. Provided the solar collector and connection equipment otherwise qualify as renewable energy source property, A, B, and C will each be considered to have made renewable energy source expenditures equal to one-third of the cost of the collector plus his or her separate connection costs. Such expenditures will be subject to the limitations and other rules separately applicable to A, B, and C with respect to each principal residence, such as those with respect to the $10 minimum (§ 1.44C-1(d)(1)), prior expenditures (§ 1.44C-1(d)(2)), residential use (paragraph (g) of this section), and joint occupancy (paragraph (h) of this section).

(k) *Basis adjustments*. If a credit is allowed under section 44C for any expenditure with respect to any property, the increase in the basis of that property which would (but for this paragraph) result from such expenditure shall be reduced by the amount of the credit allowed.

(l) *Recordkeeping*—(1) *In general*. No residential energy credit is allowable unless the taxpayer maintains the records described in paragraph (l)(2) of this section. The records shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.

(2) *Records*. The taxpayer must maintain records that clearly identify the energy-conserving components and renewable energy source property with respect to which a residential energy credit is claimed, and substantiate their cost to the taxpayer, any labor costs properly allocable to them paid for by the taxpayer, and the method used for allocating such labor costs.

§ 1.44C-4 Performance and quality standards.

[Reserved.]

§ 1.44C-5 Certification procedures.

(a) *Certification that an item meets the definition of an energy-conserving component or renewable energy source property*. Upon the request of a manufacturer of an item pursuant to paragraph (b) of this section which is supported by proof that the item is entitled to be certified, the Assistant Commissioner (Technical) shall certify (or shall notify the manufacturer that the request is denied) that:

(1) The item meets the definition of insulation (see § 1.44C-2(c)(1)).

(2) The item meets the definition of an other energy-conserving component specified in section 44C(c)(4) (see § 1.44C-2(d)(4)).

(3) The item meets the definition of solar energy property (see § 1.44C-2(f)), wind energy property (see § 1.44C-2(g)), or geothermal energy property (see § 1.44C-2(h)).

(4) The item meets the definition of a category of energy-conserving component that has been added to the list of approved items pursuant to paragraph (d)(4)(viii) of § 1.44C-2.

(5) The item meets the definition of renewable energy source property that transmits or uses a renewable energy source that has been added to the list of approved renewable energy sources pursuant to paragraph (e)(2) of § 1.44C-2.

(b) *Procedure*—(1) *In general*. A manufacturer of an item desiring to apply under paragraph (a) shall submit the application to the Commissioner of Internal Revenue, Attention: Assistant Commissioner (Technical), T:C:E, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. Upon being advised by the National Office, orally or in writing, that an adverse decision is contemplated a manufacturer may request a conference. The conference must be held within 21 calendar days from the date of that advice. Procedures for requesting an extension of the 21-day period and notifying the manufacturer of the Service's decision on that request are the same as those applicable to conferences on ruling requests by taxpayers (see section 9.05 of Rev. Proc. 80-20 [page , this Bulletin]).

(2) *Contents of application*. The application shall include a description of the item (including appropriate design drawings and specifications) and an explanation of the purpose and function of the item. There shall accompany the application a declaration in the following form: "Under penalties of perjury, I declare that I have examined this application, including accompanying documents and, to the best of my knowledge and belief, the facts presented in support of the application are true, correct, and complete." The statement must be signed by the person or persons making the application.

(c) *Effect of certification under paragraph (a)*. Certifications granted under paragraph (a)(1), (2), or (3) will be applied retroactively to April 20, 1977. However, certifications granted under paragraph (a)(4) or (5) will be applied retroactively only to the date the applicable energy-conserving component or renewable energy source was added by Treasury decision to the list of qualifying components or sources. Certification of an item under this section means that the applicable definitional requirement of § 1.44C-2 is considered satisfied in the case of any person claiming a residential energy credit with respect to such item. However, it does not relieve manufacturers of the need to establish that their items conform to performance and quality standards (if any) provided under § 1.44C-4 and that their items can reasonably be expected to remain in operation at least 3 years, in the case of insulation and other energy-conserving components, or at least 5 years, in the case of renewable energy source property.

§ 1.44C-6 Procedure and criteria for additions to the approved list of energy-conserving components or renewable energy sources.

[Reserved.]

Par. 2. Section 1.1016 is deleted.

Par. 3. Section 1.1016-5 is amended

by adding a new paragraph (t) to read as follows:

§ 1.1016-5 Miscellaneous adjustments to basis.

* * * * *

(t) *Section 44C credit*. In the case of property with respect to which a credit has been allowed under section 44C (relating to residential energy credit), basis shall be adjusted as provided in paragraph (k) of § 1.44C-3.

(This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

JEROME KURTZ,
Commissioner of Internal Revenue.

Approved July 30, 1980.

DONALD C. LUBICK,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 26, 1980, 4:04 p.m., and published in the issue of the Federal Register for August 29, 1980, 45 F.R. 57712)

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26 CFR 1.44C-5: Certification procedures.

The procedures necessary for a manufacturer to make application for "certification" that an item will be treated as insulation, an energy-conserving component, or renewable energy source property for the purposes of section 44C of the Code. See Rev. Proc. 80-36, page 18.

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401-1: Qualified pension, profit-sharing and stock bonus plans.
(Also Sections 404, 1372; 1.404(a)-9, 1.1372-1.)

Profit-sharing; small business corporation; contributions from accumulated profits. The profit-sharing plan of an electing small business corporation does not fail to qualify merely because the plan document permits contributions to the plan from the corporation's accumulated profits as determined under generally accepted accounting principles, even though these amounts have previously been taxed to the shareholders under section 1373 of the Code. Such contributions are deductible under section 404(a)(3). Rev. Rul. 71-257 superseded.

Rev. Rul. 80-252

The purpose of this Revenue Ruling is to restate under current law Rev. Rul. 71-257, 1971-1 C.B. 131. The issues presented are (1) whether the profit-sharing plan of an electing small business corporation will fail to qualify because the plan document allows contributions to the plan to be made from accumulated profits (when there are no current profits) and (2) whether these contributions are deductible under section 404(a)(3) of the Internal Revenue Code.

A corporation that was an electing small business corporation as defined in section 1371(b) of the Code for each year of its existence established in its first year of existence a trusteed profit-sharing plan that meets the requirements of sections 401 and 1379. The plan provides that employer contributions will be made out of current or accumulated profits in an amount equal to 15 percent of the total compensation of participants.

As determined under its method of accounting, which reflected generally accepted accounting principles and practices, for each of its first two years the corporation had a profit. In each of the first two years, the employer made contributions to the profit-sharing trust in an amount equal to 15 percent of the participants' total compensation, which was less than the profit for each of the years. By the close of the second plan year, the corporation had $25,000 in accumulated profits under its method of accounting. This amount also represented income that had previously been taxed to the shareholders in accordance with section 1373 of the Code but not distributed to them. For its third year (without regard to any contribution to its profit-sharing trust) the corporation incurred a loss of $5,000. Nonetheless, the employer contributed $15,000 to the profit-sharing trust, representing 15 percent of the participants' total compensation.

Section 401(a) of the Code sets forth the basic requirements which the trust of a profit-sharing plan must meet in order to constitute a qualified trust. Section 1.401-1(b)(1)(ii) of the Income Tax Regulations provides that a profit-sharing plan within the meaning of section 401 of the Code is a plan established and maintained by an employer to provide for the participation in the employer's profits by employees or their beneficiaries.

Section 404(a)(3) of the Code provides limits on the deductible contributions to a qualified profit-sharing trust.

Section 1.1372-1(c) of the regulations provides in part that, to the extent not inconsistent with subchapter S, other provisions of chapter 1 of the Code apply to an electing small business corporation in the same manner as they would if no election had been made.

Rev. Rul. 66-174, 1966-1 C.B. 81, holds that a profit-sharing plan will not fail to qualify under section 401 of the Code merely because it provides that contributions shall be made from current profits and accumulated earned surplus, as determined under generally accepted accounting principles and practices, without regard to whether the employer has current or accumulated earnings and profits for federal income tax purposes.

An electing small business corporation's profit-sharing plan likewise will not fail to qualify because it provides that contributions to the plan may be made from accumulated, as well as current, profits, as determined under generally accepted accounting principles and practices, even though the accumulated profits represent income that previously had been taxed to the shareholders under section 1373 of the Code and thus are not considered accumulated profits for federal income tax purposes.

Under its method of accounting, the electing small business corporation in this example had accumulated profits that exceeded the sum of the loss plus the contribution to the profit-sharing plan for the third year. Thus, this corporation had profits from which it could contribute to its profit-sharing plan for the third year, despite having incurred a loss in that year. Also, because the plan does not fail to qualify, the corporation is entitled to deduct its contributions to the extent provided by section 404(a)(3) of the Code.

Accordingly, the profit-sharing plan of the electing small business corporation does not fail to qualify because the plan document permits contributions to the plan to be made from current or accumulated profits, and the contributions to the plan are deductible as provided by section 404 (a)(3) of the Code.

Rev. Rul. 71-257 is superseded because the position stated therein is restated under current law in this revenue ruling.

Section 404.—Deduction for Contributions of an Employer to an Employees' Trust or Annuity Plan and Compensation Under a Deferred-Payment Plan

26 CFR 1.404(a)-9: Contributions of an employer to an employees' profit-sharing or stock bonus trust that meets the requirements of section 401(a); application of section 404(a)(3)(A).

Whether the profit-sharing plan of an electing small business corporation will fail to qualify because the plan document allows contributions to the plan to be made from accumulated profits (when there are no current profits), and whether the contributions are deductible under section 404(a)(3) of the Code. See Rev. Rul. 80-252, page 14.

Section 415.—Limitations on Benefits and Contributions Under Qualified Plans

Benefits; limitations; actuarial adjustments; defined benefit plans. Adjustments made in accordance with reasonable assumptions, including those in accordance with the rules in Rev. Rul. 71-446, Rev. Rul. 76-47, or the proposed revenue ruling in Announcement 78-96, will meet the requirements for making actuarial adjustments required in applying the limitations on benefits under section 415(b)(1) of the Code.

Rev. Rul. 80-253

This revenue ruling provides guidance for making the actuarial adjustments required in applying the limitations on benefits provided by section 415(b)(1) of the Internal Revenue Code.

Section 415(b)(1) of the Code provides maximum dollar and percentage of compensation limitations on the benefits that may be provided by a defined benefit plan.

Section 415(b)(2) of the Code provides for actuarial equivalent adjustments in applying these limitations if benefits are in a form other than a straight life annuity or if plan benefits commence before age 55.

These actuarial equivalent adjustments must be made on the basis of reasonable actuarial assumptions.

For this purpose, adjustments made in accordance with the rules enunciated in Rev. Rul. 76-47, 1976-1 C.B. 109, or Rev. Rul. 71-446, 1971-2 C.B. 187, or the proposed revenue ruling published in Announcement 78-96, 1978-23 I.R.B. 42 are deemed to be made on the basis of reasonable actuarial assumptions.

Section 911.—Income Earned by Individuals in Certain Camps

26 CFR 5b.911-2: Qualifying earned income.

Earned income; royalties. Royalties paid to a writer by a publisher for the transfer of property rights of the writer in the writer's products are earned income under section 911(b) of the Code; Rev. Rul. 71-315 modified.

Rev. Rul. 80-254

Rev. Rul. 71-315, 1971-2 C.B. 271, holds that royalties paid to a writer by a publisher for the transfer of property rights of the writer in the writer's products are not earned income within the meaning of section 911(b) of the Internal Revenue Code. Rev. Rul. 71-315 also provides that amounts received by a writer under a personal service contract to write weekly articles for a newspaper and to write a book are earned income within the meaning of section 911(b).

In *Tobey v. Commissioner*, 60 T.C. 227 (1973), *acq.* 1979-1 C.B. 1, the United States Tax Court held that income from the sale of paintings created by the taxpayer is earned income under section 911 of the Code. See also Rev. Rul. 79-85, 1979-1 C.B. 246.

HOLDING

Because of the acquiescence in *Tobey,* the royalties paid to the writer in Rev. Rul. 71-315, by the publisher for the transfer of property rights of the writer in the writer's products are now considered to be earned income within the meaning of section 911(b) of the Code.

Rev. Rul. 71-315 correctly holds that amounts received by the writer under a contract to write weekly articles for a newspaper and to write a book are earned income under section 911(b).

Rev. Rul. 71-315 is modified.

Section 1372.—Election by Small Business Corporation

26 CFR 1.1372-1: Election by small business corporation.

Whether the profit-sharing plan of an electing small business corporation will fail to qualify because the plan document allows contributions to the plan to be made from accumulated profits (when there are no current profits), and whether the contributions are deductible under section 404 (a)(3) of the Code. See Rev. Rul. 80-252, page 14.

Section 2036.—Transfers With Retained Life Estate

26 CFR 20.2036-1: Transfers with retained life estate.
(Also Section 2038; 20.2038-1.)

Trust; retained interest; after-born and after-adopted children. The provision in a trust instrument for the inclusion of all the settlor's after-born and after-adopted children as additional beneficiaries is not the retention of a power to change the beneficial interests of the trust within the meaning of sections 2036(a)(2) and 2038(a)(1) of the Code.

Rev. Rul. 80-255

ISSUE

For purposes of sections 2036(a)(2) and 2038(a)(1) of the Internal Revenue Code, did a decedent-settlor retain a power to change the beneficial interests of a trust, requiring inclusion of the trust property in the settlor's gross estate, if under the trust instrument all of the decedent-settlor's after-born and after-adopted children were to become trust beneficiaries?

FACTS

In 1975, the decedent, *D,* created an irrevocable trust. The trust instrument provided that income was to be paid in equal shares to *D*'s children. Principal was to be distributed twenty-one years after the creation of the trust in equal shares to each child (or the child's heirs). The trust instrument also provided that the children of *D,* born or adopted after the creation of the trust, were to be additional beneficiaries. When the trust was created, *D* had two children, *A* and *B.* In 1978, *D*'s third child, *C,* was born.

D died in 1980. At that time, *A, B,* and *C* were beneficiaries of the trust.

LAW AND ANALYSIS

Section 2036(a)(2) of the Code provides that the value of the gross estate shall include the value of any interest in property transferred by a decedent if the decedent has retained for life the right, alone or in conjunction with any person, to designate the persons who shall possess or enjoy the property or the income therefrom.

Section 2038(a)(1) of the Code provides that the value of the gross estate shall include the value of all property transferred by the decedent if the enjoyment of the property was subject to change at his death through the exercise of a power by the decedent, alone or in conjunction with any person, to alter, amend, revoke, or terminate.

Rev. Rul. 72-307, 1972-1 C.B. 307, provided that the power to cancel a group-term life insurance policy solely terminating employment is not an incident of ownership, under section 20.2042-1(c) of the Estate Tax Regulations, in the policy. The revenue ruling at 308, stated:

> An insured's power to cancel his insurance coverage by terminating his employment is a collateral consequence of the power that every employee has to terminate his employment. The examples in section 20.2042-1(c) of the regulations, on the other hand, concern powers that directly affect the insurance policy or the payment of its proceeds without potentially costly related consequences. Where the power to cancel an insurance policy is exercisable only by terminating employment, it is not deemed to be an incident of ownership in the policy.

Accordingly, the revenue ruling held that the value of the proceeds of the group insurance was not includible in the decedent's gross estate under section 2042 of the Code. In *Estate of Whitworth,* T.C.M. 1963-41, the Tax Court concluded that Congress did not intend to include the ability to terminate one's employment, thereby revoking a spouse's rights to pension benefits, as a power to revoke within the meaning of section 2038.

In *Estate of Tully v. United States,* 528 F. 2d 1401 (Ct. Cl. 1976), the decedent-employee entered into an employment contract whereby the employer promised to pay death benefits to the decedent's widow. The court held that the decedent did not have a power to revoke under section 2038(a)(1) of the Code, even though the decedent could have divorced the spouse, thereby eliminating the spouse's possible status as widow. The court said: "In reality, a man might divorce his wife, but to assume that he would fight through an entire divorce process merely to alter employee death benefits approaches the absurd."

Likewise, the act of bearing or adopting children is an act of independent significance, the incidental and collateral consequence of which is to add the child as beneficiary to the trust. Although *D*'s act of bearing or adopting children will automatically result in adding the child as beneficiary to the trust, such result is merely a collateral consequence of the bearing or adopting children. Cf. Rev. Rul. 75-415, 1975-2 C.B. 374.

Thus, a trust provision automatically including the settlor's after-born and after-adopted children as beneficiaries is not equivalent to the settlor's retention of a power to designate or change beneficial interests within the meaning of sections 2036(a) and 2038 of the Code.

For the same reason, at the time of creation of the trust, *D* is not treated as having reserved a power to change beneficial interests under section 25.2511-2(c) of the Gift Tax Regulations as a result of providing in the trust instrument that *D*'s after-born or after-adopted children are to be trust beneficiaries. *Cf.* Rev. Rul. 55-678, 1955-2 C.B. 389. Therefore, *D*'s establishment of the trust was a completed gift, because *D* did not retain dominion and control over the transferred property.

HOLDING

D did not retain a power to change the beneficial interests of the trust, for purposes of sections 2036(a)(2) and 2038(a)(1) of the Code, notwithstanding that all of *D*'s after-born and after-adopted children were to become beneficiaries. Therefore, the trust property is not includible in *D*'s gross estate.

Section 2038.—Revocable Transfers

26 CFR 20.2038-1: Revocable transfers.

Whether a decedent-settlor retains a power to change the beneficial interests of a trust if under the trust instrument all of the decedent-settlor's after-born and after-adopted children are to become trust beneficiaries. See Rev. Rul. 80-255, page 15.

Section 4061.—Imposition of Tax [Motor Vehicles]

26 CFR 48.4061(a)-1: Imposition of tax; exclusion for light-duty trucks, etc.
(Also Sections 4216, 4217, 4221; 48.4216(b)-2, 48.4217-2, 48.4221-6.)

Truck sold after exempt lease. The tax imposed by section 4061(a) of the Code applies to a manufacturer's retail sale of a truck that when new had first been leased under an exempt lease. For such sales after 1978, the tax base is 90 percent of the actual selling price after taking into account the adjustments provided by section 4216(a). For pre-1979 sales, the tax base is the higher of 75 percent of the actual selling price or the manufacturer's cost of production adjusted by straight line depreciation and limited to actual sales price. Rev. Rul. 74-577 obsoleted.

Rev. Rul. 80-256

ISSUE

Does the manufacturers excise tax

imposed by section 4061(a) of the Internal Revenue Code apply under the circumstances described below?

FACTS

A truck manufacturer, regularly engaged in selling its trucks at retail in arm's length transactions, leased a new truck to a school for six months to meet the school's temporary needs. The lease agreement contained no option to renew and no option to purchase. The lease payments to the manufacturer by the school were not subject to the manufacturers excise tax imposed by section 4061(a) of the Code by reason of the exemption provided by section 4221(a)(5). At the end of the six-month period the manufacturer sold the truck at retail and at arm's length.

LAW AND ANALYSIS

Section 4061(a) of the Code imposes a tax on the sale by the manufacturer, producer, or importer of certain enumerated articles, including automobile truck chassis and bodies, unless such articles are suitable for use with a vehicle having a gross vehicle weight of 10,000 pounds or less.

Section 4217(a) of the Code provides that, for purposes of the manufacturers excise taxes imposed under Chapter 32 (which includes section 4061), the lease of an article (including any renewal or any extension of a lease or any subsequent lease of such article) by the manufacturer, producer, or importer is considered to be a sale of such article. Section 4217(d)(2) provides rules for determining the amount of tax payable upon the sale of an article by the manufacturer where the manufacturer has previously leased such article under a taxable lease.

In this case the manufacturer leased the truck under an exempt lease and then sold it to a nonexempt purchaser. The fact that the exempt lease occurred prior to the sale does not remove the sale from the scope of section 4061(a)(1) of the Code. The language of section 4217(d) indicates that Congress did not intend that a lease of an article insulate a later sale of such article from manufacturers excise tax because that section provides rules for determining the amount of tax due upon a sale of an article following a taxable lease of such article. Thus, the manufacturer's sale in this case is subject to tax under section 4061(a)(1).

However, the amount of tax due on the sale of the article is not governed by section 4217(d)(2) of the Code because the rules stated therein apply only in the case of a sale following a taxable lease. Accordingly, the tax base is determinable under the general rule of section 4061(a). Since the sale is at retail, the constructive sale price provisions of section 4216(b)(1)(A), as amended by Pub. L. No. 95-458, section 1, 1978-2 C.B. 367, 368, are applicable.

Under section 4216(b)(1)(A) of the Code, as amended, where a manufacturer, producer, or importer of taxable truck bodies and chassis sells such articles at retail, the tax is to be computed on a constructive sale price that is a percentage of the actual selling price. This percentage is to be based on the highest price for which such articles are sold by manufacturers and producers in the ordinary course of trade, as determined by the Service. The manufacturer's cost is not a factor. This section, as amended, is effective with respect to sales on or after January 1, 1979.

Rev. Rul. 79-33, 1979-1 C.B. 356, effective with respect to sales on or after January 1, 1979, provides that where a manufacturer, producer, or importer of a taxable truck chassis or body, or truck-tractor, sells such articles at retail, the basis for computing manufacturers excise tax is 90 percent of the actual selling price after taking into account the adjustments provided by section 4216(a) of the Code.

Rev. Rul. 74-577, 1974-2 C.B. 349, provides that the manufacturers excise tax applies to a manufacturer's retail sale of a bus that when new had been leased to an organization under an exempt lease, and the tax base is the higher of 75 percent of the actual selling price or the manufacturer's cost of producing the new vehicle adjusted by straight line depreciation and limited to the actual sales price. However, under section 4063(a)(6) of the Code, as amended by Pub. L. No. 95-618, section 231(a), 1978-3 C.B. (Vol. 2) 1, 13, the manufacturers excise tax does not apply with respect to buses sold after November 9, 1978.

HOLDING

The tax imposed by section 4061(a)(1) of the Code applies to a manufacturer's retail sale of a truck that when new had first been leased to an organization under an exempt lease. With respect to sales on or after January 1, 1979, the tax base is 90 percent of the actual selling price after taking into account the adjustments provided by section 4216(a). No further adjustment under section 4216 is allowable. With respect to sales prior to January 1, 1979, the tax base is the higher of 75 percent of the actual selling price or the manufacturer's cost of producing the new vehicle adjusted by straight line depreciation and limited to actual sales price.

EFFECT ON OTHER DOCUMENTS

Rev. Rul. 74-577 is hereby declared obsolete.

Section 4216.—Definition of Price

26 CFR 48.4216(b)-2: Constructive sale price; basic rules.

Basis for tax on a manufacturer's retail sale of a truck that when new had first been leased to an organization under an exempt lease. See Rev. Rul. 80-256, page 16.

Section 4217.—Leases

26 CFR 48.4217.2: Limitation on amount of tax applicable to certain leases.

Basis for tax on a manufacturer's retail sale of a truck that when new had first been leased to an organization under an exempt lease. See Rev. Rul. 80-256, page 16.

Section 4221.—Certain Tax-Free Sales

26 CFR 48.4221-6: Tax-free sales of articles to nonprofit educational organizations.

Basis for tax on a manufacturer's retail sale of a truck that when new had first been leased to an organization under an exempt lease. See Rev. Rul. 80-256, page 16.

Part III. Administrative, Procedural, and Miscellaneous

Notice 80-9

Notice—Merchant Marine and Fisheries Capital Construction Funds—Applicable Rates of Interest on Nonqualified Withdrawals

Under the authority in section 607 (h)(4) of the Merchant Marine Act, 1936, (46 U.S.C. 1101), as amended by section 21 of the Merchant Marine Act of 1970 (84 Stat. 1031) [Pub. L. 91-469, 1970-2 C.B. 372], we hereby determine and announce that the applicable rate of interest on the amount of additional tax attributable to any nonqualified withdrawals from a capital construction fund established under section 607 of the Act shall be 10.36 percent, with respect to nonqualified withdrawals made in the taxable year beginning in 1980.

The determination of the applicable rate of interest with respect to nonqualified withdrawals was computed according to the joint regulations issued under the Act (46 CFR Part 391 § 391.7(e)(2)(ii)) by multiplying 8 percent by the ratio which (a) the average yield on 5-year Treasury securities for the calendar year immediately preceding the beginning of such taxable year, bears to (b) the average yield on 5-year Treasury securities for the calendar year 1970. The applicable rate so determined was computed to the nearest one-hundredth of 1 percent.

Dated: August 11, 1980.

SAMUEL B. NEMIROW,
Assistant Secretary for Maritime Affairs.

RICHARD A. FRANK,
Administrator, National Oceanic and Atmospheric Administration.

DONALD C. LUBICK,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 18, 1980, 8:45 a.m., and published in the issue of the Federal Register for August 19, 1980, 45 F.R. 55250)

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Section 44C; 1.44C-5.)

Rev. Proc. 80-36

SECTION 1. PURPOSE

The purpose of this revenue procedure is to set forth procedures necessary for a manufacturer to make application for "certification" that an item will be treated as insulation, an energy-conserving component, or renewable energy source property, under the provisions of section 44C of the Internal Revenue Code.

SEC. 2. BACKGROUND

Section 44C of the Code allows an individual a credit against federal income tax in an amount equal to the sum of the qualified energy conservation expenditures plus the qualified renewable energy source expenditures. Manufacturers of items may apply to the Secretary to certify that such items will be treated for purposes of the residential energy credit as insulation, other energy-conserving components, or renewable energy source property. Section 44C(c)(6)(A)(ii) provides that the Secretary shall by regulations establish a procedure for obtaining this certification. Such procedure is established in section 1.44C-5 of the Income Tax Regulations and is implemented in this revenue procedure.

SEC. 3. GENERAL PRACTICES AND DEFINITIONS

.01 This revenue procedure covers applications for "certification" that for purposes of the residential energy credit, an item will be treated as:

(a) insulation,

(b) other energy-conserving components, or

(c) renewable energy source property.

.02 A "certification" is a written statement given by the National Office of the Internal Revenue Service to a manufacturer of an item certifying that the item meets the definition of insulation, other energy-conserving components, or renewable energy source property as defined in section 1.44C-2 of the regulations.

.03 A "certification" means only that the item meets the applicable definitional requirement in the case of any person claiming a residential energy credit with respect to such an item. It does not mean that the Service certifies that the item meets any performance or quality standards (if any) in effect at the time, that the item will save energy or money, or that the Service assumes any warranty or liability for the item's performance.

.04 Certification is available only to the manufacturer of an item. Requests for certifications will not be accepted from wholesalers, distributors, jobbers, importers, retailers, trade, business, or industry associations, consumer groups, governmental agencies, or individual taxpayers who are not the manufacturers of the item.

.05 Nothing in this revenue procedure is to be construed as preventing a taxpayer from requesting a ruling on the eligibility of any item for the residential energy credit. Such requests for a ruling are to be made in accordance with the procedures of Rev. Proc. 80-20, 1980-26, I.R.B. 7.

.06 Applications for certification of an item that has been specified by the Secretary as an energy-conserving component pursuant to section 1.44C-2(d)(4)(viii) of the regulations or as a renewable energy source pursuant to section 1.44C-2(e)(2) may be made under this revenue procedure.

.07 A manufacturer may apply on the same application for one or several items to be certified as meeting the definitional requirement of one or more categories. For example, the item, or items meet the definition of (1) more than one type of energy-conserving component, (2) insulation, and (3) renewable energy source properties, or any combination of these three categories. However, no more than five items may be included in any one application.

.08 It is not necessary to apply for separate certification of similar items that differ only in model number, size, or other parameters that do not change the inherent nature of the item.

.09 Granting of a certification to one manufacturer of an item does not grant certification to a similar product made by another manufacturer.

.10 Lack of certification of an item does not in itself disqualify that item for the residential energy credit if it otherwise qualifies.

.11 The Service in making the decision whether an item meets the definitional requirement in order to be certified may consult with the Secretary of the Department of Energy, the Secretary of the Department of Housing and Urban Development or any other appropriate sources to obtain their views concerning the item in question.

.12 The definitional requirements of items qualifying for certification are found in the following sections of the regulations:

Insulation, section 1,44C-2(c) with the exception of subparagraphs (2), (3), and (4).

Energy-conserving components, section 1.44C-2(d)(4).

Solar energy property, section 1.44C-2(f).

Wind energy property, section 1.44C-2(g).

Geothermal energy property, section 1.44C-2(h).

.13 Certifications granted for items that are specified in section 44C of the Code as added by the Energy Tax Act of 1978, Pub. L. 95-618, 1978-3 C.B. (Vol. 2) 1, will be applied retroactively to April 20, 1977. However, certifications granted to energy-conserving components or renewable energy source property that were added in accordance with section 1.44C-6 of the regulations will be applied retroactively only to the date the applicable energy-conserving component or renewable energy source property was added by Treasury Decision 7717, page 5, this Bulletin, to the lists of qualifying energy-conserving components or renewable energy sources.

SEC. 4. INSTRUCTIONS TO THE MANUFACTURER

.01 It is necessary to submit only one copy of an application for certification unless the application requests certification for more than one item; if so, a duplicate copy is to be submitted for each item in excess of one.

.02 An application for certification and any factual information subsequently submitted must be accompanied by a declaration in the following form: "Under penalties of perjury, I declare that I have examined this application including accompanying documents, and to the best of my knowledge and belief, the facts presented in support of the application are true, correct, and complete." In the case of a noncorporate manufacturer, it must be signed by the person or persons on whose behalf the application is made. In the case of a corporate manufacturer, the person who signs must be an officer of the corporation who has personal knowledge of the facts.

.03 In cases in which application for certification is requested for more than one item, or one item is to be certified in more than one category, the Service generally will issue a single certification. However, the manufacturer may apply for a separate certification for each item or each category. Unless the Service determines that it is not feasible or not in the best interest of the Service to comply with the manufacturer's application in such cases, separate certifications will be issued.

.04 Each application for certification must contain a complete statement of all the facts concerning each item. These facts must include but are not limited to:

(1) an explanation of the purpose and function of the item;

(2) a complete description of the item including design drawings and material specifications necessary to demonstrate the purpose and functions of the item; and

(3) the manner in which the item is to be used for its intended purpose.

In addition, photographs, appropriate samples, or other information to demonstrate that the item meets the definition of the claimed category may be included. Original documents or other material that the manufacturer may want returned should not be submitted because they will become part of the Service file and will not be returned. Material facts furnished to the Service by telephone or orally at a conference must be promptly confirmed by letter to the Service accompanied by a declaration in the form described in section 4.02. This confirmation must be furnished within 21 calendar days to be considered part of the application. Procedures for requesting an extension of the 21-day period and notifying the manufacturer or the manufacturer's representative of the Service's decision are the same as those stated in section 9.05 of Rev. Proc. 80-20.

.05 The application for a certification should be addressed to the Internal Revenue Service, Assistant Commissioner (Technical), Attention T:C:E, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

.06 A manufacturer may obtain information regarding the status of an application by calling the person whose name and telephone number is shown on the acknowledgement of receipt of the application.

.07 A manufacturer who desires a conference in the event an adverse determination is proposed to its application for certification may indicate such desire in writing when filing the application or soon thereafter.

.08 Replies to applications for certification sent to manufacturers under section 44C of the Code will be made open to public inspection under the procedures in section 6110, the regulations thereunder, and the Statement of Procedural Rules. In order to assist the National Office in complying with the provisions of section 6110, the manufacturer must follow the provisions of section 9.09 of Rev. Proc. 80-20.

.09 If the application is signed by a representative of the manufacturer or if the representative is to appear before the Service in connection with the application, the provisions of Rev. Proc. 80-20, section 9.10, are to be followed.

.10 If the manufacturer has more than one representative see Rev. Proc. 80-20, section 9.11.

.11 Any application for a certification that does not comply with all the provisions of this revenue procedure will be handled in the manner provided in Rev. Proc. 80-20, section 9.13.

.12 The order in which the Service processes applications for certification and requests for expeditious handling is explained in section 9.15 of Rev. Proc. 80-20.

.13 If a dispute arises between the manufacturer and the Service over the Service's intention to disclose the determination in regard to an application for certification pursuant to section 6110(f) of the Code or notations of third party contacts pursuant to section 6110(d), such disputes will be handled according to sections 9.19 and 9.20 of Rev. Proc. 80-20.

SEC. 5. CONFERENCES IN THE NATIONAL OFFICE

If the National Office considers it to be helpful in reaching a decision or when an adverse decision to an application for certification is indicated and the manufacturer had requested a conference in such circumstances, the manufacturer will be notified by telephone, if possible. The conference must be held within 21 calendar days after such contact has been made. Procedures for requesting an extension of the 21-day period and notifying the manufacturer or the manufacturer's representative of the Service's decision are the same as those stated in section 9.05 of Rev. Proc. 80-20.

If such a conference is held the procedure for the conference will be handled as provided for in section 11 of Rev. Proc. 80-20.

SEC. 6. WITHDRAWAL OF REQUESTS

An application for a certification may be withdrawn at any time prior to the signing of the letter of reply. Even though an application is withdrawn, all correspondence and exhibits will be retained by the Service and will not be returned to the manufacturer. In appropriate cases, the Service may publish its determination in a revenue ruling or revenue procedure.

SEC. 7. AREAS NOT COVERED BY THIS REVENUE PROCEDURE

This revenue procedure covers application for certification only. Applications for additions to the list of other energy-conserving components or other forms of renewable energy property as provided in section 1.44C-6 of the regulations or additions to the list of specially defined energy property under section 48(1) of the Code may not be made under this revenue procedure.

SEC. 8. EFFECTIVE DATE

This revenue procedure is effective September 22, 1980, the date of publication in the Internal Revenue Bulletin.

Part IV. Items of General Interest

Credits for Making Renewable Energy Source Expenditures Increased

Announcement 80-119 [1]

Taxpayers may now get increased tax credits for making renewable energy source expenditures for their principal residences.

For tax years beginning in 1980, the Crude Oil Windfall Profit Tax Act of 1980, Pub. L. 96-223, 1980-3 C.B. 2, increases the credit for such expenditures to 40 percent of the first $10,000 of such expenditures or a maximum of $4,000. Formerly, this credit was 30 percent of the first $2,000 and 20 percent of the next $8,000 or a maximum of $2,200.

Qualifying expenditures are those made for property that transmits or uses solar or wind energy or energy derived from geothermal deposits to heat, cool, or provide hot water or electricity for use within a residence. The Act added, for expenditures beginning in 1980, property providing electricity.

The 15 percent credit for energy conservation expenditures such as insulation, storm windows and doors, weather stripping, caulking, and certain furnace modifications is unchanged by the new legislation.

Further information on energy tax credits is contained in Publication 903, Energy Credits for Individuals. This publication is currently being revised to include the new provisions and will be available from local Service offices in January 1981.

Coordination of Vesting and Discrimination Rules for Employee Retirement Plans

Announcement 80-120 [2]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Announcement.

SUMMARY: This document announces that the Internal Revenue Service has published a news release, IR-80-85, dated August 4, 1980, that provides examples of the coordination of vesting and discrimination rules for employee retirement plans that may be included in the final regulations for determining if a plan's vesting schedule discriminates in favor of certain types of employees.

FOR FURTHER INFORMATION CONTACT: George H. Bradley of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3486, not a toll-free call.

Announcement

Proposed regulations for Internal Revenue Code section 411(d)(1) were published in the Federal Register on April 9, 1980 (45 FR 24201). In response to comments received, modifications to the proposed regulations were published in the Federal Register on June 12, 1980, (45 FR 39869) with three examples showing how the facts and circumstances test for discriminatory vesting in the proposed regulations was to be applied.

At the July 10, 1980, public hearing on the modified proposed regulations several commenters asked the IRS to include the three examples in the final regulations and to provide additional examples as guidance. The Treasury Department has indicated that other examples will be publicized before the final regulations are adopted so that the public and members of Congress can make comments.

The three original examples, with modifications, and two new examples are attached to IR-80-85. All five examples may be included in the final regulations under 411(d)(1).

Written comments on the examples should be sent to: Commissioner of Internal Revenue, Attention: CC:LR:T (EE-164-78), 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

EXAMPLES (IR 80-85)

The following five examples are being considered for inclusion in the final regulations under section 411(d)(1) of the Code.

Each of the first four examples illustrates a particular set of facts and circumstances under which a plan's vesting schedule is not considered discriminatory under section 411(d)(1)(B). Each of the four examples is to be applied independently. Thus, if a plan satisfies the reasonable cross section test illustrated in *Example 2*, the vesting schedule is not considered to be discriminatory even if the accrued benefit test illustrated in *Example 1* is not satisfied.

Example 5 illustrates a set of facts and circumstances under which a plan's vesting schedule is considered discriminatory in the absence of other facts and circumstances.

Furthermore, each of the five examples applies whether the plan is a defined benefit or a defined contribution plan.

EXAMPLES

Example 1. A plan has the "10-year cliff" vesting schedule described in section 411(a)(2)(A). The total present value of the employer-derived accrued benefits for the officers (within the meaning of section 410(b)(1)(B)) and 5% or more shareholders (determined using the attribution rules of section 1563(e), without regard to section 1563(e)(3)(C)), is less than the total present value of the vested employer-derived accrued benefits (including more than a nominal amount of vested employer-derived accrued benefits for rank-and-file employees) of all other current employees covered by the plan. Because the vested employer-derived accrued benefits provided employees who are not officers or shareholders are at least equal to the total accrued employer-derived benefits provided officers and shareholders, the plan's vesting schedule is not considered to be discriminatory.

Example 2. A plan covers all of an employer's employees, except those employees described in section 410(b)(2)(A). The plan has the 10-year cliff vesting schedule described in section 411(a)(2)(A) for all covered employees. It is clear that the class of employees who have vested benefits under the plan, as compared with all employees, other than employees described in section 410(b)(2)(A), would satisfy the nondiscriminatory classification test of section 410(b)(1)(B) by covering a reasonable cross section. Because a reasonable cross section of all employees, excluding employees described in section 410(b)(2)(A), under the plan have vested benefits, the vesting schedule of the plan is considered to be nondiscriminatory. [*Examples 3* and *4* also illustrate the reasonable cross section test.]

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[1] Based on News Release IR-80-91, dated August 22, 1980.

[2] Filed by the Office of the Federal Register on August 6, 1980, and published in the issue of the Federal Register for August 7, 1980, 45 F.R. 52399. Examples published with New Release IR 80-85, dated August 4, 1980, are included.

Example 3. A noncontributory plan covering all employees, except those employees described in section 410(b)(2)(A), provides for vesting at a rate of 20 percent after completion of 2 years of service with an additional 10 percent for each year thereafter.

The following table shows, by compensation ranges, the number of vested participants currently employed (counting each partially vested participant as a partial participant) as compared to all employees, except those employees described in section 410(b)(2)(A).

Compensation Range	Vested Participants*	All Employees, Except Section 410(b)(2)(A) Employees
$50,001 and up	2**	2
20,001-50,000	0	0
15,001-20,000	1	3
10,001-15,000	.7	3
0-10,000	1	3
Total	4.7	11

* For purposes of this test, each participant who is an officer or shareholder is deemed to be 100 percent vested whether or not application of the plan's vesting schedule results in a lesser percentage of vesting. A highly compensated employee (who is not an officer or shareholder) will be treated in the same manner as above only if it is probable that such an employee will become 100 percent vested.

** Officer or shareholder.

This group of vested participants would satisfy the nondiscriminatory classification test of section 410(b)(1)(B) by covering a reasonable cross section. Therefore, because a reasonable cross section of all employees, except those described in section 410(b)(2)(A), have vested benefits, the vesting schedule of the plan is not discriminatory.

Example 4. A noncontributory plan covering all employees, except those employees described in section 410(a)(1)(A) (younger than age 25, less than 1-year service) provides for vesting of 40 percent after 4 years of employment plus an additional 5 percent for each of the next 2 years of employment plus an additional 10 percent for each year thereafter (4/40 vesting).

The following table shows, by compensation ranges, the number of vested participants currently employed (counting each partially vested participant as a partial participant) as compared to all employees.

Compensation Range	Vested Participants*	All Employees Including Section 410(a)(1)(A) Employees
$40,001 and up	1**	1
30,001-40,000	0	0
25,001-30,000	1**	1
20,001-25,000	1	1
15,001-20,000	2.5	4
10,001-15,000	1	4
7,501-10,000	2.4	7
0- 7,500	1	7
Total	9.9	25

* For purposes of this test, each participant who is an officer or shareholder is deemed to be 100 percent vested whether or not application of the plan's vesting schedule results in a lesser percentage of vesting. A highly compensated employee (who is not an officer or shareholder) will be treated in the same manner as above only if it is probable that such an employee will become 100 percent vested.

** Officer or shareholder.

This group of vested participants would satisfy the nondiscriminatory classification test of section 410(b)(1)(B) by covering a reasonable cross section. Therefore, because a reasonable cross section of all employees, including those described in section 410(a)(1)(A), have vested benefits, the vesting schedule of the plan is not discriminatory.

Example 5. A noncontributory plan covers, and has covered for all years, five employees and satisfies the minimum participation requirements of section 410. The plan provides for "4/40 vesting," as described in *Example 4*. After six years of operation only one employee, X, has any vested employer-derived benefits. No other employee, past or present, has received or is entitled to any vested employer-derived benefit under the plan. X is the sole shareholder of Company B. Absent a showing of other facts and circumstances, the vesting schedule of Plan B is discriminatory.

Foundation Status of Certain Organizations

Announcement 80-121

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Acts Fellowship, Palaskala, OH
African Communications Liaison Service, Inc., Washington, DC
American Italian Bicentennial Commission, Inc., Washington, DC

American Opera Scholarship Society, Washington, DC
Art, Research, and Curriculum Associates, Inc., Oakland, CA
Assist, Inc., Vienna, VA
Audubon County Health Opportunities Organization, Inc., Audubon, IA
Bedke, Andrews, Sagers, Chase Genealogical Association, The, Salt Lake City, UT
Chile Committee for Human Rights, The, Washington, DC
Citizens Action Committee to Fight Inflation, The, Washington, DC
Crank Evangelistic Association, Inc., David, St. Louis, MO
Dance Theatre Associates, Inc., Cedar Rapids, IA
E R M, St. Louis, MO
Education for Living with Breast Surgery, Inc., Potomac, MD
Eternal Life Ministries, Glendale, MO
Friends of Monnett, Inc., New Concord, OH
Fuller Life Institute, Inc., Scottsdale, PA
Great Plains Black Museum Archives and Interpretative Center, Inc., Omaha, NE
Greater Baltimore Committee Foundation, Inc., Baltimore, MD
Hispanic Women's Center, Inc., Washington, DC
Historic Hyde Park, Inc., St. Louis, MO
Housing Assistance, Inc., Kansas City, MO
Human Behavior Foundation, Ltd., The, College Park, MD
Industrial Training Center, Washington, DC
Institute for Advanced Christian Education, Minneapolis, MN
International Foundation for Police Research, Washington, DC
International Nonprofit Charity Corp., The, Wilmington, DE
Kisima Films, Inc., Washington, DC
Layne Evangelistic Association, Marvin, Forest, VA
Metro-Erie Meals on Wheels, Inc., Erie, PA
Midlands Mental Health Association, Omaha, NE
Milligan Community Center, Inc., Maggie & J.O. & Harland, Scribner, NE
Missouri Tax Justice Research, University City, MO
Murray Evangelistic Association, Inc., M. E., St. Louis, MO
National Alcoholism Awareness Society, Inc., Lincoln, NE
Obadiah Fellowship, Columbia, IL
Old Oakland Association, Oakland, CA
P & R Institute, Longmont, CO
Peninsula Youth House, Inc., Hampton, VA
Pennsylvania Diabetes Institute Foundation, Elkins Park, PA
Pennsylvania Research Institute, Inc., Pittsburgh, PA
Pentagram Players Co., Hendersonville, NC
Performing Arts Umbrella, Inc., The, Washington, DC
Perth Amboy UAW Housing Corp., Cranford, NJ
Peterson-Bahde-Coleman Homes, Inc., Redfield, SD
Phillippine American Community of Bergen County, Paramus, NJ
Pili-Pili, Washington, DC
Pilot Medical Park, Pilot Mountain, NC
Pittsburgh Action Against Rape (PAAR), Pittsburgh, PA
Pointe Coupee Health Care, Inc., Metairie, LA
Portland Conservatory Theatre, Portland, OR
Positive Productions, Inc., Washington, DC
Prepare the Way Ministries, Dayton, OH
Prison Prayer Ministry, Reston,.VA
Professional Home Health Agency, Butler, PA
Prytania Parents and Faculty Club, Inc., The, New Orleans, LA
Ringwood Football Boosters, Ringwood, NJ
Rutgers-Camden Tennis Endowment Fund, Camden, NJ
SAIR, Pittsburgh, PA
SALT, Rockford, IL
Salt Shaker Ministries, Inc., Elburn, IL
San Antonio Opera Association, San Antonio, TX
San Francisco Medical Research Foundation, Inc., Fairfax, CA
Save Kahok Athletics, Collinsville, IL
Save Sight Foundation, Inc., New Orleans, LA
Serenity Home, Inc., Fredericksburg, VA
Shekinah Ministries, Pittsburgh, PA
Singer Memorial Fund, Hank, Glenview, IL
South Austin Coalition Community Council (SACCC), Chicago, IL
South Hills Geriatric Council, Pittsburgh, PA
Southern New Jersey Council for the Fine Arts, Vineland, NJ
Southwest Association of Student Assistance Programs, Inc., San Antonio, TX
Sparks of Life, Colville, OR
Spectrum-Youth Television Network, Chicago, IL
Stanley Research Foundation, Salt Lake City, UT
Sterling Youth Soccer Association, Reston, VA
Story County Sexual Assault Care Center, Inc., Ames, IA
Sun Yat-Sen Institute, Dr., Skokie, IL
Sunrise in Glory Evangelistic Association, Inc., Cedar Falls, NC
Union Montclair Housing Corp., Montclair, NJ
United States Team Handball Federation, Short Hills, NJ
Vallev Inter-Faith Task Force, The, Valley, NE
Ward I, Inc., Washington, DC
Warner Industries, Inc., Cokato, MN
Wesley Colonial Towers of Bound Brook, Inc., Bound Brook, NJ
Winona Good News Translators, Inc., Winona, MN
Young Men's Christian Association of South Boston and Halifax County, Inc., South Boston, VA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Form 709-A, United States Short Form Gift Tax Return

Announcement 80-122 [1]

A new short form gift tax return for married donors who are required to file but owe no taxes because of gift splitting with their spouses will be available by January 1981 for gifts made in 1980.

Form 709-A, United States Short Form Gift Tax Return, may be used by married taxpayers whose gifts of cash or certain other property are not more than $6,000 during the calendar year to each third-party donee.

Under section 2513 of the Code, if a husband and wife consent, all gifts made by either to third parties during a calendar quarter may be considered as made one-half by each.

The new form is filed annually for all four quarters of the year, rather than quarterly as is the longer Form 709, and is due by April 15 following the calendar year in which gifts are made. Also, unlike the Form 709, the new short form does not require any computations.

Voluntary Employees' Beneficiary Associations—Public Hearing

Announcement 80-123 [2]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to voluntary employees' beneficiary associations.

DATES: The hearing will be held on October 14, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by September 30, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (EE-153-78), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under section 501(c)(9) of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Thursday, July 17, 1980 (45 FR 47871).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking, September 15, 1980, and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of oral comments to be presented at the hearing and the time they wish to devote to each subject by September 30, 1980.

Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive on improving government regulations appearing in the Federal Register for Wednesday, November 8, 1978.

Disaster Areas

Announcement 80-124

The President of the United States has determined that the areas listed below were adversely affected by disasters of sufficient severity and magnitude to warrant federal disaster assistance.

Taxpayers who suffered losses in these areas as a result of these disasters may elect the special tax treatment provided under section 165(h) of the Internal Revenue Code. Section 1.165-11 of the Income Tax Regulations sets forth the procedure for making this election. Losses not incurred with respect to a trade or business or any transaction entered into for profit will not qualify for treatment under section 165(h) unless such losses qualify as casualty losses.

State: Nebraska
Counties affected: Hall, Hamilton, Merrick
Type of disaster: Severe storms and tornadoes
Begun on or about: June 3, 1980

State: Pennsylvania
Counties affected: Armstrong, Butler, Clarion
Type of disaster: Severe storms and flooding
Begun on or about: August 14, 1980

State: Wisconsin
Counties affected: Chippewa, Dunn, Eau Claire, Pierce
Type of disaster: Severe storms and flooding
Begun on or about: July 15, 1980

Correction of T.D. 7710

Announcement 80-125

T.D. 7710, 1980-36 I.R.B. 12, relating to material participation requirements for valuation of certain farm and closely held business real property and to the method of valuing farm real property according to actual use, contains a printing error on page 22. § 20.2032A-8(a)(3)(xii) should read as follows:

> (xii) The name, address, taxpayer identification number, and relationship to the decedent of each person taking an interest in each item of specially valued property, and the value of the property interests passing to each such person based on both fair market value and qualified use;

This correction will be reflected in T.D. 7710 when it is republished in 1980-2 C.B.

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[1] Based on News Release IR-80-89, dated August 22, 1980.

[2] Filed by the Office of the Federal Register on August 29, 1980, and published in the issue of the Federal Register for September 2, 1980, 45 F.R. 58143.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Daniel C. Lukensow	Arcadia, CA	Enrolled Agent	Eighteen months effective July 28, 1980
Ralph D. Lider	New Bedford, MA	Attorney	Indefinite effective August 18, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 26a.2621-1 added.	Generation-skipping transfer tax return requirements.	Aug. 5, 1980	Oct. 6, 1980
26 CFR 1.183-1, 1.212-1(h), 1.262-1(b)(3), amended; 1.280A-1 through 1.280A-3, added.	Deductions for business use or rental of dwelling unit.	Aug. 7, 1980	Oct. 6, 1980
26 CFR 301.7609-1 through 301.7610-1 added.	Administrative summonses.	Aug. 21, 1980	Oct. 20, 1980
26 CFR 1.6012-2(e), 1.6012-3(a)(5), 1.6033-2(a)(2)(i), 53.6071-1, 301.6204-1, 301.6211-1, 301.6212-1, 301.6213-1, 301.6501(c)-1, 301.6501(e)-1, 301.6503(a)-1(a), 301.6512-1, 301.6601-1(d), 301.6653-1, 301.6659-1, 301.6861-1, 301.6862-1(a), 301.6863-1(b), amended; 53.6011-1(e), 54.6011-1, 301.6501(n)-1 through 301.6501(n)-3, 301.6503(g)-1, 301.6511(f)-1, 301.7422-1, 301.7454-2, added; 301.6503(g)-1 redesignated as 301.6503(f)-1.	Procedure and administration of certain excise taxes.	Aug. 25, 1980	Oct. 24, 1980
26 CFR 53.4942(a)-3 revised.	Set-asides made by private foundations.	Aug. 26, 1980	Oct. 27, 1980
26 CFR 1.482-2, 1.483-1, amended.	Imputed interest rate on loans between related entities and on deferred payments in the case of certain sales of property.	Aug. 29, 1980	Oct. 28, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

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* Denotes entry since last publication.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27, dated July 7, 1980.

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1932–1	*2.80*	1947–2	3.40	1961–2	10.00	1974–2	9.95
1932–2	8.65	*1948–1*	*3.15*	1962–1	14.00	*1974–3*	*8.20*
1933–1	*3.35*	1948–2	7.50	1962–2	13.00	1974–3 Supp.	10.00
1933–2	*3.45*	*1949–1*	*6.90*	1962–3	20.00	1975–1	13.25
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1935–1	6.90	*1950–2*	*4.70*	1964–1–1	10.00	1976–2	10.25
1935–2	*14.00*	*1951–1*	*12.00*	1964–1–2	11.00	1976–3–1	9.50
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1936–2	*14.00*	*1952–1*	*2.55*	1965–1	10.70	1976–3–3	10.00
1937–1	*13.00*	1952–2	7.05	1965–2	12.25	1977–1	10.75
1937–2	7.70	*1953–1*	*4.25*	1966–1	14.00	1977–2	11.75
1938–1	*16.00*	1953–2	12.00	1966–2	14.05	1978–1	11.75
1938–2	*13.00*	1954–1	12.00	1967–1	10.00	1978–2	13.00
1939–1–1	8.25	1954–2	12.00	1967–2	14.00	1978–3–1	12.25
1939–1–2	10.90	1955–1	10.25	1968–1	14.00	1978–3–2	9.00
1939–2	9.40	1955–2	13.00	1968–2	11.75	1979–1	14.00
1940–1	5.55	1956–1	15.00	1969–1	14.00	1979–2	15.00
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Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENT

Announcement 80-127, page 25.
A public hearing will be held on November 5, 1980, concerning proposed regulations relating to the filing of returns for the tax on generation-skipping transfers.

INCOME TAX

Rev. Rul. 80-257, page 5.
Arbitrage bonds; proceeds invested by city pension fund. A city is required by state law to levy sufficient property taxes annually to provide the required funding for its firefighters' pension fund. The city proposes to issue general obligation bonds and distribute the proceeds to the pension fund for investment in obligations producing yields materially higher than the yield on the city's bonds. As a result, the city expects to substantially reduce the amount of taxes that it will have to levy in future years to maintain the pension fund reserves. The bonds will be arbitrage bonds within the meaning of section 103(c)(2) of the Code.

Rev. Proc. 80-37, page 22.
Areas in which advance rulings will not be issued; transfers to controlled corporation. The Service will not ordinarily issue advance rulings under section 351 of the Code on the tax effect of a transfer when part of the consideration received by the transferors consists of bonds, debentures, or any other evidences of indebtedness of the transferee and the term of the indebtedness is either less than ten years or a determination as to whether the indebtedness is properly classified as debt or equity is required in order to establish that the requirements of section 351 are met; Rev. Proc. 80-22 amplified.

Rev. Proc. 80-38, page 22.
Areas in which advanced rulings will not be issued; classification of aliens. Advance rulings or determination letters will not ordinarily be issued concerning the classification of alien individuals as resident or nonresident, under section 871 of the Code and the regulations thereunder, with respect to situations in which the determination is dependent on factual representations that cannot be confirmed until the close of the individual's affected taxable year(s); Rev. Proc. 80-22 amplified.

Pub. L. 96-320, page 19.
Interest on guaranteed obligations under the Merchant Marine Act as amended by the Ocean Thermal Energy Conversion Act of 1980 is includible in gross income. For purposes of the Merchant Marine Act, the definition of a vessel operated in the foreign commerce of the U.S. is expanded.

Announcement 80-126, page 25.
Form 6199, Certification of Youth Participating in a Qualified Cooperative Education Program, has been revised to reflect a change in the law made by the Technical Corrections Act of 1979.

(Continued on page 4)

Finding Lists begin on page 29.
Announcement of Voluntary Suspension on page 26.
Announcement of Notice of Proposed Rulemaking on page 27.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

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Highlights of this Issue—Continued

(Continued from page 1)

EMPLOYEE PLANS

Rev. Rul. 80-258, page 6.
Distributions; employer's stock; net unrealized appreciation; taxability. A qualified profit-sharing plan provides for the purchase of the employer's stock from employer and employee contributions and reinvestment of dividends. Upon an employee's separation from service, the plan provides for a distribution of the employer's stock attributable to the employee's contributions and to a portion of the reinvested dividends. An explanation is provided of the taxability of the distribution of appreciated stock under the plan. Rev. Rul. 67-165 superseded.

EXEMPT ORGANIZATIONS

Rev. Rul. 80-259, page 7.
Application for exemption; when exempt. An organization that is organized and operated exclusively for charitable purposes and is not a private foundation applied for recognition of its exempt status six years after it was incorporated. During its first three taxable years the organization's gross receipts were less than $15,000. During the fourth year its gross receipts for that year and the preceding two taxable years were greater than $15,000. The organization is not exempt under section 501(c)(3) of the Code from the beginning of its fourth year until the date it filed the required notice. Consideration will be given in applying the Commissioner's discretionary authority under section 1.9100-1 of the regulations to extend the time for satisfying the notice requirement.

Rev. Proc. 80-39, page 22.
Private foundations; taxable expenditures; employer-related educational loans. Guidelines are provided for determining whether educational loans made by private foundations under employer-related loan programs are taxable expenditures under section 4945 of the Code.

T.D. 7715, page 16.
Amendments to the regulations under section 4942 of the Code relate to the use of blockage or similar factors in determining the value of a private foundation's noncharitable assets, consisting of listed securites, to determine the amount foundations must distribute annually for charitable purposes.

ESTATE TAXES

Rev. Rul. 80-260, page 8.
Administration expenses; claims against estate; rate of exchange. In computing the amount deductible under section 2053 of the Code, the rate of exchange to be used in determining the U.S. dollar value of administration expenses incurred in a foreign country is the rate in effect on the date the payment is made. The rate to be used in determining the value of foreign claims against the estate is the rate in effect on the date of death (or alternate valuation date), provided the claim is properly valued at that date. If post-death events must be considered in valuing the claim, the rate on the date of payment is used in determining the value of the claim.

T.D. 7713, page 10.
Amendments to the regulations under section 2601 of the Code implement the effective date provisions of the new tax on generation-skipping transfers that was added by the Tax Reform Act of 1976.

GIFT TAX

Rev. Rul. 80-261, page 9.
Present v. future interest; right to share in trust corpus; exclusion. A gift of a right to demand and receive at least a pro rata portion of trust corpus conveyed to several donees is a gift of a present interest to the extent of each donee's pro rata portion, and the annual exclusion under section 2503 of the Code is allowable.

EMPLOYMENT TAXES

Page 18.
Railroad retirement; rate determination; quarterly. The Railroad Retirement Board has determined that the rate of tax imposed by section 3221(c) of the Code shall be twelve and one-half cents for the quarter beginning October 1, 1980.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-7: Interest.

Whether interest to be paid on obligations of a political subdivision of a state will be exempt from tax. See Rev. Rul. 80-257, this page.

Section 72.—Annuities; Certain Proceeds of Endowment and Life Insurance Contracts

26 CFR 1.72-11: Amounts not received as annuity payments.

Taxability of the employer's appreciated stock distributed from a qualified profit-sharing plan upon an employee's separation from service. See Rev. Rul. 80-258, page 6.

Section 103.—Interest on Certain Governmental Obligations

26 CFR 1.103-13: Arbitrage bonds.
(Also Section 61; 1.61-7.)

Arbitrage bonds; proceeds invested by city pension fund. A city is required by state law to levy sufficient property taxes annually to provide the required funding for its firefighters' pension fund. The city proposes to issue general obligation bonds and distribute the proceeds to the pension fund for investment in obligations producing yields materially higher than the yield on the city's bonds. As a result, the city expects to substantially reduce the amount of taxes that it will have to levy in future years to maintain the pension fund reserves. The bonds will be arbitrage bonds within the meaning of section 103(c)(2) of the Code.

Rev. Rul. 80-257

ISSUE

Will bonds issued by city *X* be arbitrage bonds as a result of the investment of bond proceeds by the trustees of the city *X* firefighters' pension fund?

FACTS

X is a political subdivision of state *Y*. *X* proposes to issue general obligation bonds maturing serially over 25 years, and to distribute the bond proceeds to the pension fund.

The statute enacted by the state *Y* legislature establishing city pension funds provides that the fund is a body politic and corporate, and is separate and apart from *X* and state *Y*. Under the statute, the trustees of the pension fund include certain officers of the fire department of *X*, representatives of the active firefighters, and a representative of the retired firefighters. The statute provides that the trustees are considered to be officials of the body politic and corporate.

The state statute provides for payment of pensions from the fund to retired firefighters and certain surviving relatives in amounts determined on the basis of each firefighter's age, salary, and years of creditable service with the fire department, rather than on the basis of earnings on, or appreciation of, assets in the pension fund. No separate accounts are established with the pension fund for individual firefighters.

Under the state statute, liabilities of the pension fund are the obligations of *X*. Moreover, *X* is required to levy a tax annually on all taxable property located within its bounds in an amount sufficient (1) to cover current service costs (sometimes referred to as "normal costs") and (2) to provide for amortization of unfunded accrued liabilities in the fund over a 20-year period. Since the statute was enacted, *X* has made annual contributions from taxes in an amount necessary to meet these funding requirements. However, *X* anticipates that contribution of the bond proceeds to the fund will satisfy the entire unfunded accrued liability of the pension fund. This contribution will equal approximately 10 times the annual contribution required under the statute to amortize unfunded accrued liabilities.

Tax revenues generated under the state statute will be used to pay debt service on the bonds.

The state statute requires investment of pension funds in certain enumerated categories of investment, including bonds of the United States. *X* reasonably expects that the trustees will use the bond proceeds to acquire obligations not described in section 103(a)(1) of the Internal Revenue Code producing yields materially higher than the yield on *X*'s bonds during the term of the bonds. *X* further expects that such investment of the bond proceeds will substantially reduce the amount of taxes *X* will have to levy in future years to maintain the pension fund reserves.

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include interest on obligations of a state or a political subdivision of a state.

Section 103(c)(1) of the Code provides that, with certain exceptions, an arbitrage bond is not treated as an obligation described in section 103(a)(1).

Section 103(c)(2) of the Code provides that the term "arbitrage bond" means any obligation that is issued as part of an issue all or a major portion of the proceeds of which are reasonably expected to be used directly or indirectly (A) to acquire securities or obligations that may be reasonably expected at the time of issuance of such issue to produce a yield over the term of such issue that is materially higher than the yield on obligations of such issue, or (B) to replace funds that were used directly or indirectly to acquire securities or obligations described in (A).

Because the amount of benefits paid by the pension fund is determined according to the age, salary, and years of service of the firefighters, the trustees' success or failure in investing the pension funds will not affect the amount of pensions paid. However, the success or failure of the trustees' investments, including investment of bond proceeds, will directly affect the amount of taxes that *X* must levy in future years, since *X* will remain obligated under the state statute to levy taxes annually as needed to cover normal costs and to amortize any unfunded accrued liabilities of the fund. Thus, the determination whether *X* will raise or lower taxes in future years will be dependent upon the yield and obligations acquired by the trustees with bonds proceeds. Consequently, *X* anticipates a substantial direct benefit from investment of bond proceeds by the trustees.

Therefore, it is concluded that all of the bond proceeds are reasonably expected to be used to acquire securities that are reasonably expected to produce yields materially higher than the yield on *X*'s bonds within the meaning of section 103(c)(2).

HOLDING

The bonds will be arbitrage bonds within the meaning of section 103(c)(2) of the Code. Therefore, interest on the bonds will not be excludable from gross incomes of the bondholders under section 103(a)(1).

Section 402.—Taxability of Beneficiary of Employees' Trust

26 CFR 1.402(a)-1: Taxability of beneficiary under a trust which meets the requirements of section 401(a).
(Also Section 72; 1.72-11.)

Distributions; employer's stock; net unrealized appreciation; taxability. A qualified profit-sharing plan provides for the purchase of the employer's stock from employer and employee contributions and reinvestment of dividends. Upon an employee's separation from service, the plan provides for a distribution of the employer's stock attributable to the employee's contributions and to a portion of the reinvested dividends. An explanation is provided of the taxability of the distribution of appreciated stock under the plan. Rev. Rul. 67-165 superseded.

Rev. Rul. 80-258

The purpose of this revenue ruling is to restate, under current law, Rev. Rul. 67-165, 1967-1 C.B. 89.

Rev. Rul. 67-165 discusses the taxability of distributions of stock of the employer corporation, pursuant to an exempt employees' profit-sharing plan, under the circumstances described below.

An employer corporation established a qualified profit-sharing plan under section 401(a) of the Internal Revenue Code and contributed fifty cents out of profits for each dollar contributed to the trust by an employee-participant. The plan provided that all contributions were to be invested in common stock of the employer corporation. Dividends received on such stock were also invested in the corporation's common stock.

The interest of each employee in the trust was represented by units allocated to his or her account. Units credited to an employee's account as a result of his or her own contributions were known as member-units. Units credited to an employee's account as a result of the corporation's contributions were known as employer-units. Both member-units and employer-units included stock that was attributable to reinvested cash dividends received by the trust represented by units already credited to an employee's account. Therefore, any employee who withdrew his or her member-units withdrew some shares that were, and some that were not, attributable to the employee's own contributions.

Upon separation from the service of the employer, an employee could withdraw all of the member-units credited to the account. Employer-units were not subject to withdrawal at such time but, rather, had to be left in the employee's account until the employee attained age 65. All withdrawals were paid in full shares of the corporation's common stock, to the extent possible, with any balance being paid in cash.

Section 402(a)(1) of the Code provides that "the amount actually distributed or made available to any distributee" by an exempt employees' trust shall be taxable to him or her in the year in which so distributed or made available under section 72 (relating to annuities). Section 402(a)(1) excludes from the amount actually distributed or made available to any distributee the "net unrealized appreciation in securities of the employer corporation attributable to the amount contributed by the employee." Special tax treatment is accorded lump-sum distributions as defined in section 402(e)(4).

Thus, the net unrealized appreciation attributable to employee contributions will be excluded from the distributee's gross income. The net unrealized appreciation which is not attributable to employee contributions will be included in gross income except to the extent excluded by section 72(e)(1)(B) of the Code. That section provides that if any amount is not received as an annuity, then such amount shall be included in gross income but only to the extent that it (when added to amounts previously received which were excludable from gross income) exceeds the aggregate consideration paid.

In determining the amount of net unrealized appreciation that is attributable to the amount contributed by the employee for purposes of section 402(a)(1) of the Code, section 1.402(a)-1(b)(3)(ii) of the Income Tax Regulations provides that the amount contributed by the employee for the purchase of securities shall be solely the portion of his or her actual contributions properly allocable to such securities and shall not include any part of the increment in the trust expended for such securities.

Section 1.402(a)-1(b)(2)(i) of the regulations provides that the amount of net unrealized appreciation in securities of the employer corporation which are distributed by the trust is the excess of the market value of such securities at the time of distribution over the cost or other basis of such securities to the trust. Section 1.402(a)1(b)(3)(iii) states that the amount of the net unrealized appreciation which is attributable to the employee's contribution is that proportion of the net unrealized appreciation which the employee's contributions allocable to such securities bear to the cost or other basis to the trust of the securities.

In applying section 1.402(a)-1(b)(3)(iii) of the regulations to a distribution of securities of the employer which were purchased partially with employee contributions and partially with increments in the trust, the amount of net unrealized appreciation attributable to the employee's contributions is the amount of appreciation which bears the same relationship to the total net unrealized appreciation in such securities as the part of the cost of such securities paid with the employee's contributions bears to the total cost of the securities.

The remainder of the fair market value of the securities distributed is includible in the distributee's gross income under section 72(e)(1)(B) of the Code to the extent it exceeds the employee's contributions as defined in section 72(f). The effect of this computation is to include in the gross income of the distributee the increments of the trust used to purchase the stock plus that portion of the net unrealized appreciation allocable thereto. Amounts thus included in gross income are to be considered part of the basis of the securities in the hands of the distributee for purposes of determining gain or loss on their subsequent disposition.

Under the facts presented, the employee may withdraw only his or her member-units upon separation from the service of the employer prior to age 65. Such withdrawal does not constitute a lump-sum distribution within the meaning of section 402(e)(4) of the Code.

Accordingly, the employee is entitled to exclude from gross income under section 402(a)(1) of the Code only that portion of the total net unrealized appreciation that is allocable to the part of the stock purchased with his or her own contributions. The remainder of the fair market value of the securities distributed is includible in the gross income of the distributee under section 72(e)(1)(B) to the extent it exceeds the employee's contributions as defined in section 72(f).

Rev. Rul. 67-165 is superseded because the position set forth therein is restated, under current law, in this revenue ruling.

Section 508.—Special Rules With Respect to Section 501(c)(3) Organizations

26 CFR 1.508-1: Notices.
(Also Section 1.9100-1.)

Application for exemption; when exempt. An organization that is organized and operated exclusively for charitable purposes and is not a private foundation applied for recognition of its exempt status six years after it was incorporated. During its first three taxable years the organization's gross receipts were less than $15,000. During the fourth year its gross receipts for that year and the preceding two taxable years were greater than $15,000. The organization is not exempt under section 501(c)(3) of the Code from the beginning of its fourth year until the date it filed the required notice. Consideration will be given in applying the Commissioner's discretionary authority under section 1.9100-1 of the regulations to extend the time for satisfying the notice requirement.

Rev. Rul. 80-259

ISSUE

In the situation described below, what effect does the application of section 508(a) of the Internal Revenue Code have on the effective dates of exempt status of an organization otherwise described in section 501(c)(3)?

FACTS

The organization is organized and operated exclusively for charitable purposes within the meaning of section 501(c)(3) of the Code, and is not a private foundation within the meaning of section 509(a). It was incorporated on January 1, 1973, and files returns on a calendar year basis. On March 1, 1979, it applied to the Internal Revenue Service for recognition of exempt status under section 501(c)(3). Its gross receipts during the years 1973 through 1979 were as follows:

Taxable Year Ending	*Gross Receipts*
1973	$ 3,600
1974	2,900
1975	400
1976	12,600
1977	76,400
1978	96,200
1979	142,400

LAW

Section 508(a) of the Code provides, with certain exceptions, that an organization organized after October 9, 1969, shall not be treated as an organization described in section 501(c)(3) unless it gives notice to the Secretary that it is applying for recognition of such status within the time prescribed by the regulations for giving such notice.

Section 508(c)(1)(B) of the Code provides that the provisions of section 508(a) shall not apply to any organization that is not a private foundation (as defined in section 509(a)) and the gross receipts of which in each taxable year are normally not more than $5,000.

Section 1.508-1(a)(2)(i) of the Income Tax Regulations provides that the notice referred to in section 508(a) of the Code must be filed within 15 months from the end of the month in which an organization was organized. Such notice is filed by submitting a properly completed and executed Form 1023, Application for Recognition of Exemption.

Section 1.508-1(a)(3)(ii) of the regulations provides that the gross receipts of an organization are normally not more than $5,000 if—

> (a) During the first taxable year of the organization the organization has received gross receipts of $7,500 or less;
>
> (b) During its first two taxable years the aggregate gross receipts received by the organization are $12,000 or less; and
>
> (c) In the case of an organization which has been in existence for at least three taxable years, the aggregate gross receipts received by the organization during the immediately preceding two taxable years plus the current year are $15,000 or less.

The regulations further provide that if an organization fails to meet the requirements of (a), (b), or (c), then the organization shall be required to file the required notice described in section 508(a) of the Code within 90 days after the end of the period described in (a), (b), or (c), in lieu of the period prescribed in section 1.508-1 (a)(2)(i). Thus, for example, if an organization meets the $7,500 requirement of (a) for its first taxable year, but fails to meet the $12,000 requirement of (b) for the period ending with its second taxable year, then the organization shall meet the notification requirement if it files such notification within 90 days after the close of its second taxable year. If an organization that has been in existence at least three taxable years meets the requirements of (a), (b), and (c) with respect to all prior taxable years, but fails to meet the requirements of (c) with respect to the current taxable year, the notification requirements shall not apply with respect to its prior years. In such a case, the organization shall not be treated as described in section 501(c)(3) for a period beginning with such current taxable year and ending when such notice is given under section 508(a)(2).

ANALYSIS

The organization's aggregate gross receipts during the taxable years ending in 1973, 1974, and 1975 were $6,900. Therefore, the organization was not required to file an application for recognition of exemption within 90 days after the end of its 1975 taxable year. Accordingly, the organization is exempt under section 501(c)(3) of the Code, effective for the period beginning on January 1, 1973, and ending on December 31, 1975.

The organization's aggregate gross receipts during the taxable years ending in 1974, 1975, and 1976 were $15,900. Accordingly, the exception set forth in section 1.508-1(a)(3)(ii)(c) of the regulations does not apply, and the organization was required to file an application for recognition of exemption within 90 days after the end of its 1976 taxable year.

Due to the fact that the organization failed to file its application within the required time period, it is not exempt under section 501(c)(3) of the Code during the period beginning on January 1, 1976, and ending on February 28, 1979, because it did not satisfy the notification requirement of section 508(a). However, the organization is exempt under section 501(c)(3), effective as of March 1, 1979, the date on which the required notice was given.

HOLDING

The organization is not exempt under section 501(c)(3) of the Code during the period beginning on January 1, 1976, and ending on February 28, 1979, because it did not satisfy the notification requirement of section 508(a). However, the organization is exempt under section 501(c)(3) for the period beginning on January 1, 1973, and ending on December 31, 1975, and is also exempt effective as of March 1, 1979, the date on which the required notice was given.

In addition, the organization may qualify for exemption under section 501(c)(4) of the Code for the period it is not exempt under section 501(c)(3). See Rev. Rul. 80-108, 1980-16 I.R.B. 8, which holds that an organization that otherwise qualifies for exemption under both sections 501(c)(3) and 501(c)(4), but that did not file for recognition of exemption under section 501(c)(3) within 15 months from the end of the month in which it was organized as required by section 1.508-1(a)(2)(i) of the regulations, may be exempt under section 501(c)(4) from the date of its inception.

APPLICATION FOR EXTENSIONS OF THE TIME FOR FILING NOTICE UNDER SECTION 508(a)

The Service will give consideration to applying the Commissioner's discretionary authority under section 1.9100-1 of the regulations to extend the time for satisfying the notice requirement of section 508(a) of the Code.

Under section 1.9100-1 of the regulations the Commissioner has discretion, upon a showing of good cause by a taxpayer, to grant a reasonable extension of time fixed by the regulations for making an election or application for relief in respect of tax under subtitle A of the Internal Revenue Code, provided:

(1) the time for making the election or application is not expressly prescribed by the statute;

(2) the request for the extension is filed with the Commissioner within a period of time the Commisioner considers reasonable under the circumstances; and

(3) it is shown to the Commissioner's satisfaction that granting the extension will not jeopardize the Government's interests.

Rev. Proc. 79-63, 1979-2 C.B. 578, sets forth information and representations that must be furnished by the taxpayer and some factors that will be taken into consideration in determining whether such extensions will be granted. Also, see section 3.02 of Rev. Proc. 80-24, 1980-26 I.R.B. 31, for the applicable procedures to be followed in making a request.

Section 871.—Tax on Nonresident Alien Individuals

26 CFR 1.871-1: Classification and manner of taxing alien individuals.

Whether advance rulings or determination letters will ordinarily be issued to classify aliens as resident or nonresident under section 871 of the Code and the regulations thereunder. See Rev. Proc. 80-38, page 22.

Section 2053.—Expenses, Indebtedness, and Taxes

26 CFR 20.2053-1: Deduction for expenses, indebtedness and taxes; in general.

Administration expenses; claims against estate; rate of exchange. In computing the amount deductible under section 2053 of the Code, the rate of exchange to be used in determining the U.S. dollar value of administration expenses incurred in a foreign country is the rate in effect on the date the payment is made. The rate to be used in determining the value of foreign claims against the estate is the rate in effect on the date of death (or alternate valuation date), provided the claim is properly valued at that date. If postdeath events must be considered in valuing the claim, the rate on the date of payment is used in determining the value of the claim.

Rev. Rul. 80-260

ISSUE

What is the proper foreign exchange rate to be used in determining the United States dollar value of administration expenses and claims incurred in a foreign country, for purposes of computing the amount deductible under section 2053 of the Internal Revenue Code?

FACTS

The decedent *D*, a United States citizen, died on September 27, 1979. In administering *D*'s estate, the executor incurred expenses in *X* country in connection with property *D* owned in *X* that was includible in *D*'s gross estate. In addition, *D* had incurred debts in *X* that were payable by *D*'s estate. The administration expenses and the debts were allowable deductions under section 2053(a)(2) and (a)(3) of the Code.

LAW AND ANALYSIS

Section 2053(a)(2) and (a)(3) of the Code provide deductions for administration expenses and claims against the estate.

With regard to administration expenses, section 20.2053-3(a) of the Estate Tax Regulations provides that only expenses actually incurred in the administration of the estate are deductible. See also sections 20.2053-3(b) and (c) of the regulations which provide the general rule that executor's commissions and attorney's fees are deductible as administration expenses in such amount ". . . as has *actually been paid*, ..." (Emphasis added.) Thus, the amount of the deduction allowable for administration expenses is based on the amount actually paid by the estate rather than on a date of death valuation of anticipated expenses.

Accordingly, the foreign exchange rate in effect at the time of payment should be used in determining the United States dollar amount of the expense and, therefore, the amount deductible under section 2053(a)(2) of the Code. See Rev. Rul. 75-439, 1975-2 C.B. 359, which holds that in computing the section 2014 credit for foreign death tax the rate of exchange in effect at the time each payment of foreign death tax is made is used to convert the foreign death taxes paid into United States dollars.

If an administration expense has not yet been paid at the time the return is filed, then an estimated United States dollar amount may be deducted provided the expense is ascertainable with reasonable certainty and will be paid. See section 20.2053-1(b)(3) of the regulations.

Generally, a claim against the estate that otherwise satisfies the requirements of section 2053(a)(3) of the Code is valued, for deduction purposes, as of the date of death. However, under appropriate circumstances, postdeath events are taken into consideration in valuing a claim otherwise deductible under section 2053(a)(3). See *Commissioner v. Estate of Shively*, 276 F.2d 372 (2d Cir. 1960), and *Chesterton v. United States*, 551 F.2d 278 (Ct. Cl. cert. denied, 434 U.S. 835 (1977)), both holding that the decedent's former spouse's claim for periodic support payments until death or remarriage was to be valued for purposes of section 2053(a)(3) based on the actual amounts paid, since the former spouse remarried shortly after the decedent's death.

Therefore, if the claim would properly be valued as of the date of death (or alternate valuation date), then the foreign exchange rate on that date must be used in determining the United States dollar value of the claim and, thus, the amount deductible under section 2053(a)(3) of the Code. However, if postdate events must be considered in valuing the claim for section 2053(a)(3) deduction purposes, then the exchange rate in effect on the date of the payment (or dates of payment in situations involving a series of payments) is used in determining the value of the claim.

HOLDING

1. The foreign exchange rate in effect on the date the payment is made is used, for purposes of section 2053(a)(2) of the Code, in determining the United States dollar value of foreign administration expenses.

2. The foreign exchange rate in effect on the date of death (or alternate valuation date), is used for purposes of section 2053(a)(3) of the Code, in determining the United States dollar value of foreign claims against the estate, provided the claim is properly valued on that date for purposes of section 2053(a)(3). The foreign exchange rate on the date of payment is used in determining the United States dollar value of the claim, if postdeath events must be considered in valuing the claim.

Section 2503.—Taxable Gifts

26 CFR 25.2503-3(a): Future interests in property.

Present v. future interest; right to share in trust corpus; exclusion. A gift of a right to demand and receive at least a pro rata portion of trust corpus conveyed to several donees is a gift of a present interest to the extent of each donee's pro rata portion, and the annual exclusion under section 2503 of the Code is allowable.

Rev. Rul. 80-261

ISSUE

Is a donor entitled to the annual exclusion, under section 2503(b) of the Internal Revenue Code, for a gift of a portion of trust corpus to a donee if an interest in the corpus was also conveyed by the donor, at the time of the gift, to other persons, under the circumstances described below?

FACTS

In 1976, *G*, the settlor, established a trust and transferred $13,000 to the trustee. Under the provisions of the trust instrument, *A, B, C, D,* and *E* each had the right to receive a total sum of $4,000 of trust corpus by submitting a written demand to the trustee. However, if there was insufficient corpus to satisfy all of the demands, then the corpus was to be distributed on a pro rata basis among those donees demanding corpus. If any donee received an amount greater than the pro rata share of the trust corpus, the donee would be required to immediately reimburse the trustee for the excess amount in the event the trust corpus was insufficient to satisfy demands made by other donees.

LAW AND ANALYSIS

Section 2503(b) of the Code provides an exclusion of the first $3,000 of gifts made to any person by the donor during the calendar year. This exclusion applies to all gifts other than gifts of future interests. The fact that the donee must first make a demand for the corpus does not make the donee's interest a future interest. If a donee is assured of receiving some minimum amount of trust corpus, then the section 2503(b) exclusion for a gift of a present interest is allowable for the amount that the donee will receive with certainty notwithstanding that the donee must first make a demand for the corpus.

In the present situation, since each donee's demand for corpus is assured of being satisfied on a pro rata basis to the extent of $2,600, each gift of corpus is a gift of a present interest in the amount of $2,600.

HOLDING

G is entitled to an annual exclusion for each donee in the amount of $2,600.

Section 2601.—Tax Imposed [Tax on Certain Generation-Skipping Transfers]

26 CFR 26.2601-1: Effective date.

T.D. 7713

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART 26.—GENERATION-SKIPPING TRANSFER TAX REGULATIONS

Effective date provisions for generation-skipping transfer tax.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations implementing the effective date provisions of the new tax on generation-skipping transfers that was added by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1]. The regulations reflect changes made to the effective date provisions by the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol 1) 1], and affect all persons creating, or increasing the amount of, a generation-skipping transfer after June 11, 1976.

DATES: The regulations are effective for certain generation-skipping transfers (as defined in section 2611(e)) made after June 11, 1976.

FOR FURTHER INFORMATION CONTACT: Fred E. Grundeman of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. Attention CC:LR:T 202-566-3287, not a toll-free number.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On December 21, 1978, the Federal Register published proposed regulations implementing the new generation-skipping transfer tax (26 CFR Part 26) under Chapter 13 of the Internal Revenue Code of 1954 (43 FR 59849). A public hearing was held on April 10, 1979. After consideration of all written and oral comments regarding the proposed regulations, final regulations are adopted by this Treasury decision.

PROVISIONS OF THIS REGULATION

Under Chapter 13, a tax is imposed on every generation-skipping transfer occurring after June 11, 1976. However, section 2006(c) of the Tax Reform Act of 1976 (P.L. 94-455, 90 Stat. 1879) [*supra* at 365] provides that certain trusts in existence on that date (or created under wills in existence on that date) are excluded by effective date and transition rules from the application of the generation-skipping transfer tax provisions. The Code further provides that a trust, which is otherwise excluded from the new tax, may become subject to the tax if additions to corpus are made after June 11, 1976.

The regulations provide guidelines for determining which trusts in existence on June 11, 1976, are excluded from Chapter 13 under the effective date rule; which trusts in existence on June 11, 1976, are excluded from Chapter 13 by the transition rule; and what effect additions or amendments to trusts occurring after June 11, 1976, will have.

ADDITIONAL CONSIDERATIONS

These regulations are needed in order to provide guidance to the public as well as to government employees responsible for the implementation of Chapter 13 of the Code. Considering both the direct and indirect effects of these regulations, it is believed that they satisfactorily implement section 2006(c) of the Tax Reform Act of 1976 [*supra* at 365], as amended by section 702(n)(1) of the Revenue Act of 1978 [*supra* at 169]. Evaluation of the effectiveness of the regulations after issuance will be based upon comments received from offices within the Internal Revenue Service and the Treasury Department, other government agencies, and the public.

PUBLIC COMMENTS

Fifty-four comments were received in response to the proposed regulations. The comments focused principally on three areas of the proposal: the definition of the term "revocable", the characterization of accumulated income as an addition to the corpus of a trust, and the characterization of a codicil as an amendment to a will at the time of execution even though ambulatory until death. The Treasury Department agrees that in these areas, as well as others, modification of the proposed regulations is appropriate.

The regulation has been revised to follow the structure of the statute more closely. It now provides an effective date rule applicable to irrevocable trusts and a transition rule applicable to wills and revocable trusts where the testator/creator dies before January 1, 1982. Under the regulation a trust will be treated as a revocable trust only if the trust would have been included in a decedent's estate under section 2038 (without regard to powers relinquished during the prior 3-year period) if the decedent had died on June 11, 1976. Furthermore, the regulation provides that accumulated income will not be an addition to the corpus of a trust. Finally, a post June 11, 1976, codicil will not be considered a disqualifying amendment to a will if it does not ultimately result in a change to the will which creates or increases the amount of a generation-skipping transfer.

Five comments were received on the transition rule treatment of mental incompetence. The Department agrees that the proposal provided results not contemplated by the statute. Accordingly, it has been revised to provide that the transition rule will apply to individuals who were mentally incompetent on June 11, 1976, for a minimum of two years after competency has been regained.

The Department believes Congress intended transitional relief be denied where individuals, after consideration of the generation-skipping aspects of their existing estate plans, alter those plans in a manner that creates or increases the amount of a generation-skipping transfer. Several commentors stated, however, that the proposed transition rule treatment of amendments to wills and revocable trusts left a number of questions unanswered and did not grant sufficient relief. In response to these comments, the proposal has been clarified in several respects. First, the regulation makes it clear that amendments to any instrument falling within the transition rule (including trust equivalents) will result in loss of "grandfathering" for all generation-skipping transfers under that instrument. Second, the word "technical" has been deleted from subsection (e)(1)(ii) because it was confusing and redundant. Third, several examples have been added. Fourth, the "independent effect" concept (under which each amendment would be tested against the facts as they exist on the date of death) has been replaced by a "cumulative effect" rule. The regulation now provides that in testing whether an amendment results in the creation or increase in the amount of a generation-skipping transfer, the instruments that exist on the date of death (or any prior taxable distribution or termination) will be compared to the instruments that existed on June 11, 1976.

Several commentors felt that a republication of a will that was in existence on June 11, 1976, should be treated as a will in existence on that date, arguing that the "revival" concept recognized in the proposal is a technicality. After reconsideration, the Department believes it would be unwise to modify the proposed rule. The apparent intent of Congress was to provide transitional relief for those wills that would be effective were the testator to die on June 11, 1976. The rule as proposed requires that any instrument "in place" on that date, be probated, and, therefore, open to challenge. Treating a republication as the original instrument, would place the Internal Revenue Service in the impractical position of "proving" that the instrument being republished not only was a valid will but that it was the instrument that would have controlled the devolution of the testator's property had the testator died on June 11, 1976.

The proposed regulation provided that post June 11, 1976, additions to both irrevocable and revocable trusts would subject a proportionate amount of transfers from the trust to Chapter 13. Upon reconsideration the Treasury Department believes that the statute distinguishes between additions to trusts subject to the effective date rule and those subject to the transition rule. Thus, under the final regulation, an addition to the corpus of an irrevocable trust will result in a proportionate part of future distributions being subject to tax, while an addition to a revocable trust will result in future distributions being fully subject to tax. However, to alleviate potentially harsh results, the regulation provides that if all post June 11, 1976, additions to a revocable trust are set aside as a separate fund prior to January 1, 1982, only the separate fund will be subject to Chapter 13.

Other comments suggested that either tracing or segregation of assets should be allowed as an alternative to the proposed rule that generation-skipping transfers occurring subsequent to an addition to corpus of an irrevocable trust are proportionately "tainted"; *i.e.*, subject to tax under Chapter 13, to the same extent that the value of the corpus represented added assets immediately after the additions. The Treasury Department continues to believe that a single approach provides the more equitable result in terms of both trust and tax administration.

A number of commentors stated that "additions" to the corpus of a trust should only occur where property is conveyed to the trust from an outside source. They argued that the "constructive addition" concept adopted in the proposal was not intended by Congress. After reconsideration, the Department feels the legislative history does not support the position of the commentors. The structure of the statute (including both an effective date rule and a transition rule) and the language in the Conference Committee Report (expressly providing that "grandfather" protection will not in all cases be applicable to an irrevocable trust subject to a "limited" power of appointment) clearly indicate a congressional intent to provide relief from the provisions of Chapter 13 only in those cases where the generation-skipping transfer could not be avoided. Thus, subject to the application of the transition rule, it is appropriate to subject property to the generation-skipping tax where an individual is, for gift and estate tax purposes, treated as owning the property. This result is accomplished by the "constructive addition" concept.

As a number of commentors noted, the generation-skipping tax is essentially complementary to the estate and gift taxes and burdensome legal and administrative questions may arise if traditional transfer tax concepts are not followed. The Department recognizes the validity of these concerns and has revised the regulation to provide that a constructive addition will be deemed to occur in those cases where the exercise, release or relapse of a power of appointment is subject to either the Federal estate or gift tax, with the further provision that if a nongeneral power is exercised in a manner that may result in an extension of the term of the trust more than 21 years beyond a life or lives in being at the original creation of the trust, there will be a constructive addition to the corpus of the trust. However, principally for purposes of administrative convenience, where a constructive addition occurs by reason of the exercise, release or lapse of a power which is in any part taxable under Chapter 11 or Chapter 12 the amount of the addition will be equal to the entire portion of the trust subject to the power. Rules to determine the grantor of such con-

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struction additions will be set forth in definitional regulations to be published shortly in proposed form.

Six commentors felt that the "pour-over" exception to the addition to corpus rule should be expanded beyond a "grandfathered" will or revocable trust. The regulation now provides that any "pour-over" involving two "grandfathered" instruments will not result in loss of relief under either the effective date or the transition rule.

The regulation also contains an example stating that the transition rule is inapplicable where the holder of a general power of appointment dies before January 1, 1982, but had no will in existence on June 11, 1976. The Department believes this rule is necessary to relieve the Internal Revenue Service from having to inquire whether a will was destroyed after June 11, 1976, to avoid adverse generation-skipping tax consequences.

Finally, several grammatical changes suggested by commentors were adopted.

DRAFTING INFORMATION

The principal author of these regulations is Fred E. Grundeman of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and the Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of regulations

Accordingly, a new Part 26, Generation-Skipping Transfer Tax Regulations, is added to Title 26 of the Code of Federal Regulations, and the first regulations adopted thereunder are as follows:

Sec. 26.2601-1 Effective Date.

Authority. Sections 2622 and 7805, Internal Revenue Code of 1954 (90 Stat. 1887, 68A Stat. 917, 26 USC; 2622, 7805).

§ 26.2601-1 Effective Date.

(a) *In general.* Except as provided in paragraphs (b)(1) and (b)(2) of this section, the provisions of Chapter 13 of the Code apply to any generation-skipping transfer, as defined in section 2611(a), made after June 11, 1976. For purposes of this section, any reference to a trust includes a "trust equivalent" within the meaning of section 2611(d).

(b) *Exceptions*—(1) *General rule.* The provisions of Chapter 13 of the Code will not apply to any generation-skipping transfer—

(i) under a trust which was irrevocable on June 11, 1976, but only to the extent that the transfer is not made out of corpus added to the trust after that date (the effective date rule); or

(ii) under any other trust created before June 12, 1976, or established under a will executed before June 12, 1976, which becomes irrevocable by reason of the death of a decedent before January 1, 1982, provided that the document in existence on June 11, 1976, was not amended at any time after June 11, 1976, in any respect which results in the creation of, or an increase in the amount of, a generation-skipping transfer (the transition rule).

(2) *Mental disability.* If an individual on June 11, 1976, was under a mental disability to change the disposition of his or her property, the date in the transition rule of this section (and in every reference to the transition rule) by which a document must become irrevocable shall be the later of January 1, 1982, or the date which is two years after the date on which the individual first regains his or her competence to dispose of his or her property. For purposes of this provision, the term "mental disability" means mental incompetence, in fact, to execute the instrument governing the disposition of his property, whether or not there was an adjudication of incompetence.

(3) *Examples.* The provisions of paragraphs (b)(1) and (b)(2) may be illustrated by the following examples:

Example (1). A, a resident of State X, had executed an irrevocable generation-skipping trust, but had not funded the trust as of June 11, 1976. On that date the trust was named irrevocable beneficiary of certain paid up life insurance policies on the life of *A*. Under the law of State *X* a trust is not considered a separate entity until it is funded. However, under the law of State *X* the combination of documents in existence on June 11, 1976, is considered as irrevocably disposing of the insurance proceeds, and is, therefore, an irrevocable trust equivalent for purposes of Chapter 13. Assuming that the trust is not funded (and that no further arrangements are made to add corpus to the trust or enhance the benefit payable under the policies) future generation-skipping transfers pursuant to the trust will not be subject to Chapter 13 by reason of the effective date rule.

Example (2). Assume the same facts as in example (1) except that under the law of State *X* the documents did not irrevocably determine the disposition of the insurance proceeds. Under these circumstances the combination of documents in existence on June 11, 1976, is a revocable trust equivalent. Assume further that after executing the documents but before June 12, 1976, *A* became mentally disabled and was incompetent to dispose of his property by will until his death on August 15, 1985, at which time the trust was funded with the insurance proceeds. Since the revocable trust equivalent was in existence on June 11, 1976, and the decedent was at that time mentally disabled, no generation-skipping transfers pursuant to the trust will be subject to tax under Chapter 13.

Example (3). Assume the same facts as in example (2) except that the decedent became mentally disabled after June 11, 1976. In this case, since *A* became mentally disabled after June 11, 1976, and survived beyond December 31, 1981, the transition rule is not applicable and all generation-skipping transfers pursuant to the trust will be subject to the provisions of Chapter 13.

(c) *Irrevocable trusts*—(1) *In general.* For purposes of this section, any trust in existence on June 11, 1976, will be considered an irrevocable trust except to the extent that on that date it was subject to a power that would have caused the value of the trust to be included in a decedent's gross estate for Federal estate tax purposes by reason of section 2038 (without regard to those powers relinquished during the prior 3-year period) if the decedent had died on that date. Thus, a trust will be considered subject to a power on June 11, 1976, even though the exercise of the power was subject to the precedent giving of notice, or even though the exercise could take effect only on the expiration of a stated period, whether or not on or before June 11, 1976, notice had been given or the power had been exercised. Moreover, a trust will not be considered subject to a power if the power is, by its terms, exercisable only on the occurrence of an event or contingency not subject to the possessor's control (other than the death of the possessor) and if the event or contingency had not in fact taken place on June 11, 1976.

(2) *Examples.* The provisions of paragraph (c)(1) of this section may be illustrated by the following examples:

Example (1). On June 11, 1976, *Y*, the settlor of a trust that was otherwise irrevocable on June 11, 1976, had a testamentary power to add new beneficiaries to the trust. The testamentary power held by *Y* would have caused the trust to be included in *Y's* gross estate under section 2038 if *Y* had died on June 11, 1976. Therefore the trust is not an irrevocable trust for purposes of this section.

Example (2). On June 11, 1976, *A*, the wife of the settlor of a trust in existence on that date, had the right to withdraw 15% of the corpus in each calendar year. The trust had a value of $100,000 on June 11, 1976, and was otherwise irrevocable on that date. Because the power was not held by the settlor of the trust it is not a power described in section 2038 of the Code and the trust is considered irrevocable on June 11, 1976.

Example (3). In 1972, *A* created a trust retaining the right to expand the class of remaindermen to include any of *A's* afterborn grandchildren. On June 11, 1976, there were no grandchildren who were not named remaindermen of the trust. Since *A's* power on June 11, 1976, was dependent on afterborn grandchildren being in existence, a contingency that had not occurred, the trust is not considered subject to the power on June 11, 1976, and is an irrevocable trust for purposes of this section.

(d) *Amendments to wills or revocable trusts.*—(1) *In general.* For purposes of this section, an amendment to a will or revocable trust in existence on June 11, 1976, will not be considered to result in the creation of, or an increase in the amount of, a generation-skipping transfer, where the amendment is—

(i) Basically administrative or clarifying in nature and only incidentally increases the amount transferred, or

(ii) Designed to ensure that an existing bequest or transfer qualifies for the applicable marital, charitable or minor child (orphans) deduction for estate, gift, or generating-skipping tax purposes and only incidentally increases the amount transferred.

For purposes of determining whether a particular amendment to a will (or revocable trust) creates, or increases the amount of, a generation-skipping transfer, the effect of the instrument(s) in existence on June 11, 1976, will be measured against the effect of the instrument(s) in existence on the date of death of the decedent or on the date of any prior generation-skipping transfer. If the effect of an amendment cannot be immediately determined, it will be deemed to create, or increase the amount of, a generation-skipping transfer until a determination can be made.

(2) *Wills and trusts in existence on June 11, 1976.* For purposes of this section, a will or revocable trust will be considered in existence on June 11, 1976, if (i) the will or revocable trust was in existence on June 11, 1976, (ii) the will or revocable trust was revoked in its entirety by a new will or revocable trust and (iii) prior to the death of the testator or creator the new will or revocable trust is revoked in such a manner that, under local law, the document(s) in existence on June 11, 1976, (or a conformed copy thereof) again controls the passing of property at death.

(3) *Examples.* The provisions of paragraph (d)(1) and (2) of this section may be illustrated by the following examples:

Example (1). An amendment changes the trustees of a revocable trust in existence on June 11, 1976. Although the amendment may have the effect of lowering administrative costs and thus increasing the corpus of the trust, it will be considered administrative in nature. Therefore, assuming that the generations to which the new trustees belong do not result in the creation of, or an increase in the amount of, a generation-skipping transfer, the amendment will not prevent transfers pursuant to the trust from qualifying under the transition rule.

Example (2). On September 1, 1976, *A* executes a codicil to a will in existence on June 11, 1976, removing one of the coexecutors named in the will. Although the codicil may have the effect of lowering administrative costs and thus increasing the corpus of a residuary trust, it will be considered administrative in nature and will not prevent generation-skipping transfers under the will from qualifying under the transition rule.

Example (3). A will, in existence on June 11, 1976, containing a formula marital deduction provision coming within the transition rule of section 2002(d)(1) of the Tax Reform Act of 1976, is amended to allow the estate to continue to obtain the maximum allowable estate tax marital deduction. Such an amendment does not prevent transfers under the will from qualifying under the transition rule even if the amendment incidentally produces an estate tax savings that increases the amount passing to a residuary generation-skipping trust.

Example (4). On September 1, 1976, *A* executes a codicil to his will that was in existence on June 11, 1976, revoking a bequest of $10,000 to *B* and causing that amount to be added to a residuary trust containing generation-skipping provisions. Such an amendment will be deemed to increase a generation-skipping transfer and will prevent transfers under the will from qualifying under the transition rule. If, however, *B* dies before *A* and the bequest would have lapsed under local law, the codicil will not be considered an amendment that increases a generation-skipping transfer.

Example (5). On June 11, 1976, a will provided that an amount equal to the maximum allowable marital deduction would pass to the testator's spouse. After June 11, 1976, the will is amended by codicil to provide that the amount passing to the surviving spouse will not exceed one-half of the adjusted gross estate, even though a larger deduction may be allowable by reason of certain generation-skipping transfers or the application of section 2056(c)(1)(A)(i). As the amendment merely removes a potential ambiguity created by changes in the law subsequent to execution of the will (and does not change the original distribution of the estate), it will be considered clarifying in nature and will not prevent transfers under the will from qualifying under the transition rule.

Example (6). On June 11, 1976, *D's* will provided that an amount equal to the maximum allowable marital deduction would pass to *D's* spouse with the residue of the estate passing to a testamentary generation-skipping trust. After June 11, 1976, the will is amended to provide that the marital share passing to *D's* spouse shall be the lesser of the maximum allowable marital deduction or that amount which will result in no estate tax liability for *D's* estate. The amendment is not considered clarifying in nature and may, therefore, prevent any generation-skipping transfers under the will from qualifying under the transition rule.

Example (7). On June 11, 1976, *C's* will provided for the creation of two generation-skipping trusts. On September 1, 1976, *C* executed a codicil to the will specifically increasing the amount to be used to fund one of the trusts. Since the codicil is an amendment to a will in existence on June 11, 1976, which, if effective, will increase the amount of a generation-skipping transfer, all transfers made pursuant to the will or either of the trusts created thereunder are precluded from qualifying under the transition rule.

Example (8). Assume that *C* in example (7) executed a second codicil deleting the increase to the fund. Because the provision increasing a generation-skipping transfer did not become effective it will not be considered an amendment to a will in existence on June 11, 1976.

Example (9). On June 11, 1976, *C's* revocable trust provided for certain generation-skipping transfers. Prior to his death on August 7, 1980, *C* amended his trust to provide that an amount, previously payable to *C's* child, be paid instead to charity under *C's* death. *C's* trust provided that any estate tax attributable to the trust should be paid by the trust. The effect of the charitable amendment was to decrease the estate tax attributable to the trust thereby increasing the corpus for subsequent generation-skipping transfers. Because the amendment does more than perfect an existing deductible transfer, the amendment is considered as increasing the amount of a generation-skipping transfer, and all transfers made pursuant to the trust are precluded from qualifying under the transition rule.

Example (10). Prior to June 11, 1976, *S* created a revocable trust providing that upon the death of *S* the income was to be paid to *S's* nephews *A, B* and *C* in equal shares for life, with one-third of the corpus to be distributed per stripes to each nephew's surviving issue upon the death of the nephew. *A* becomes disabled and *S* modifies the trust in 1978 to increase *A's* share of the income. Since the amendment cannot result in the creation of, or increase in the amount of, a generation-skipping transfer, transfers pursuant to the trust will not be subject to taxation under Chapter 13.

Example (11). Assume the same facts as in example (10) except that the amendment adds a fourth nephew, *D*, as an income beneficiary. Since the amendment does not create or increase the amount of, a generation-skipping transfer, transfers pursuant to the trust will not be subject to Chapter 13.

Example (12). Assume the same facts as in example (11) except that *D's* issue are to take a one-fourth share of the corpus per stirpes upon *D's* death. Because the distribution to be made upon *D's* death may involve a younger generation than would be involved if one-third shares were distributed under the original trust, the amendment will be considered an amendment that creates or increases a generation-skipping transfer until a determination can be made. Accordingly, any generation-skipping distribution of the trust corpus will be considered a taxable generation-skipping transfer until it is apparent that a younger generation has not been added to the trust. At that time a claim for refund may be filed with respect to any generation-skipping transfer tax that was paid within the period set out in section 6511.

Example (13). On June 15, 1976, *C* executed a new will revoking entirely a will in existence on June 11, 1976. The second will is considered a new will which was not in existence on June 11, 1976, and will not qualify under the transition rule even though each generation-skipping transfer under the new will is no greater than the transfer that would have occurred under the will in existence on June 11, 1976. If prior to *C's* death, *C* revokes the new will in such a manner that the document in existence on June 11, 1976, becomes subject to probate, the intervening instrument will not disqualify the original instrument for purposes of the transition rule. If *C* revokes the new will by a later will republishing the original will in its entirety the republication would not qualify transfers under the will under the transition rule unless local law would require the proof of the original document as *C's* will.

(e) ***Additions to corpus***—(1) *Irrevocable trusts.* An addition made after June 11, 1976, to the corpus of a trust that was irrevocable on June 11, 1976, will subject a proportionate amount of the transfers from such a trust to the provisions of Chapter 13 of the Code. In such a case, the portion subject to Chapter 13 is a fraction of the trust's total value. The numerator of this fraction is the amount of the addition (valued as of the date the addition was made) and the denominator is the total value of the trust immediately after the addition. Where there is more than one addition to corpus after June 11, 1976, the portion of the trust attributable to all such additions will be a similar fraction. The numerator of this fraction is the sum of:

(i) The total value of the trust immediately before the latest addition, which, because of the prior addition, is subject to Chapter 13, and

(ii) The amount of the latest addition. The denominator of the fraction is the total value of the trust immediately after the latest addition.

(2) *Revocable trusts.* Except as provided in paragraph (e)(4) of this section, an addition made after June 11, 1976, but before the death of the settlor, to the corpus of a trust described in the transition rule will subject all subsequent generation-skipping transfers involving the trust to the provisions of Chapter 13 of the Code unless the corpus of the trust as it existed on June 11, 1976, is severed from the additions thereto. The corpus will be considered severed if, before January 1, 1982, the assets transferred to the trust after June 11, 1976 (together with all income and capital gains derived therefrom and after all losses, expenses, and distributions chargeable thereto) are permanently set aside as a separate fund so that the trust will be treated as two separate trusts under local law. Under these circumstances, all distributions from the separate fund will be subject to the provisions of Chapter 13. Additions made to the corpus of a trust described in the transition rule after it becomes irrevocable by reason of the death of the settlor will be treated as additions to an irrevocable trust.

(3) *Constructive addition.* Where any portion of the corpus of an irrevocable trust remains in the trust after the post June 11, 1976, release, exercise or lapse of a power of appointment over that portion of the corpus and the release, exercise or lapse is treated to any extent as a taxable transfer under either Chapter 11 (estate tax) or Chapter 12 (gift tax) of the Code, the value of the entire portion of the corpus involved in the release, exercise or lapse of the power (and not merely the taxable portion) will be treated as an addition to the trust for purposes of this chapter. Further, where any portion of the corpus of a trust is subject to a power of appointment, that portion will be considered an addition to the corpus of the trust, if, and to the extent that, after June 11, 1976, the power is exercised in a manner that may postpone or suspend the vesting, absolute ownership or power of alienation of an interest in property for a period, measured from the date of creation of the trust, extending beyond any life in being at the date of creation of the trust plus a period of 21 years. If a power is exercised by creating another power it will be deemed to be exercised to whatever extent the second power may be exercised. In the case of a decedent dying before January 1, 1982, the provisions of this paragraph (e)(3) will not be applicable to the exercise of a power pursuant to an instrument described in the transition rule.

(4) *Exceptions.* Any addition to a trust made pursuant to a trust meeting the requirements of the effective date rule or, in the case of a decedent dying before January 1, 1982, pursuant to an instrument described in the transition rule, will not be treated as an addition to corpus for purposes of this section. Where a decedent fails to exercise a general power of appointment in a will described in the transition rule, the corpus passing in default of the exercise will be considered as passing pursuant to the will. In addition, in the case of a decedent dying before January 1, 1982, any property transferred inter vivos to a trust will not be treated as an addition to corpus if the same property or money would have been added to the trust pursuant to a will or trust described in the transition rule, or passed in the same way, but for the inter vivos transfer. However, in any case where it cannot be determined at the time of an addition to corpus if the

transition rule will apply, the property transferred will be deemed to be an addition to corpus until such time as a determination can be made.

(5) *Appreciation and income.* Except to the extent that the provisions of paragraph (e)(1) of this section allocate subsequent appreciation and accumulated income between original corpus and additions thereto, appreciation in the value of the corpus of a trust and undistributed income added thereto will not be considered an addition to the corpus of a trust.

(6) *Relation to other sections.* No provision of this section is to be construed as in any way modifying the rules to be applied in determining the identity of the grantor of a generation-skipping trust. For example, an addition to corpus occurring by reason of an exercise of a power of appointment will not cause the individual exercising the power to be considered a grantor of the trust unless the exercise is treated as a taxable transfer under Chapter 11 or Chapter 12 of the Code.

(7) *Examples.* The provisions of paragraphs (e)(1), (e)(2), (e)(3), and (e)(4) of this section may be illustrated by the following examples:

Example (1). *A*, the settlor of a generation-skipping trust that was irrevocable on June 11, 1976, added $100,000 to the trust corpus on July 30, 1976. Immediately before the addition, the corpus of the trust had a value of $900,000. Transfers pursuant to the trust after the addition on July 30, 1976, will be subject to the generation-skipping transfer provisions to the extent of 10 percent (that is, $100,000/($900,000 + $100,000)).

Example (2). Assume the same facts as in example (1) except that on August 30, 1977, when the value of the trust corpus was $2,000,000, a constructive addition of one-half the corpus is made. Since 10% of the corpus is subject to Chapter 13 by reason of the first addition, then 10% of the constructive addition is attributable to corpus already subject to Chapter 13. Therefore, the new portion of the trust subject to Chapter 13 is 55%. The numerator of the fraction set out in paragraph (e)(1) of this section is $200,000 (10% of $2,000,000) plus $900,000 (90% of ½ of $2,000,000) or $1,100,000. The denominator is $2,000,000.

Example (3). Assume the same facts as in example (1) except that the trust was revocable rather than irrevocable on June 11, 1976, and the $100,000 addition would not have passed to the trust but for the inter vivos transfer. Transfers pursuant to the trust after the addition to corpus on June 30, 1976, will be fully subject to the generation-skipping transfer provisions unless, before January 1, 1982, the additional assets (together with all increments and after all distributions) are permanently set aside in such a manner that under local law the fund traceable to the "grandfathered" corpus will be treated as a separate trust.

Example (4). Assume the same facts as in example (1) except that *A* was also the settlor of a revocable trust in existence on June 11, 1976, and that *A* died on September 30, 1979, without amending, or adding corpus to, the revocable trust. Upon the death of *A*, the trustee of the revocable trust was directed to terminate the trust, distributing the assets to the trustee of the irrevocable trust. At the time of the "pour-over" on September 30, 1979, the corpus of each trust equaled $1,500,000. To determine the percentage of each generation-skipping transfer after September 30, 1979, that is subject to tax under Chapter 13, $150,000 (10% of $1,500,000, the value of the corpus of the irrevocable trust immediately before the "pour-over") is the numerator of the fraction described in paragraph (e)(1) of this section. No other amount is treated as an addition on that date under the transition rule. Therefore, assuming no other corpus is added to the trust, 5% (that is $150,000/($1,500,000 + $1,500,000) of any generation-skipping transfer pursuant to the trust after September 30, 1979, will be subject to Chapter 13.

Example (5). Assume the same facts as in example (4) except that the $1,500,000 added to the irrevocable trust did not come within the transition rule. In that case, to determine the percentage of subsequent distributions subject to tax, $1,650,000 (10% of the $1,500,000 corpus plus the $1,500,000 addition) is the numerator of the fraction described in paragraph (e)(1) of this section. Thereafter, assuming no other corpus is added to the trust, 55% (that is $1,650,000/($1,500,000 + $1,500,000)) of future generation-skipping transfers will be subject to Chapter 13.

Example (6). On June 11, 1976, *B*, the surviving child of the settlor of a trust that was irrevocable on that date, possessed a general power of appointment over the corpus. Under the terms of the trust (created in 1970) *B's* power lapsed upon attaining age 21, an event that occurred on September 23, 1979. Under section 2514, ninety-five percent (100%—5%) of the value of the corpus was treated as a gift by *B* for federal gift tax purposes. However, because the entire trust was subject to the power of appointment, 100% (that portion of the trust subject to the power) of all generation-skipping transfers pursuant to the trust occurring after September 23, 1979, will be subject to Chapter 13.

Example (7). *H* is the grantor of an irrevocable generation-skipping trust which was in existence on June 11, 1976. *H's* will, which was executed before June 11, 1976, and not amended thereafter, provides that upon his death the entire estate will pour-over into his trust. In 1980, *H* transfers $10,000 to the trust. If *H* dies after 1981, the transfer will be treated as an addition to corpus for purposes of any distribution made after the transfer to the trust in 1980. If *H* dies before 1982, the entire trust (as well as any distribution made by the trust prior to his death) will be excluded under paragraphs (b)(1)(i) and (e)(2) of this section from the generation-skipping transfer tax provisions, because the $10,000 would have been added to the trust under a will which would have qualified under paragraph (b)(1)(ii) of this section. In either case, for any generation-skipping transfers made after the transfer to the trust in 1980 but before *H's* death the $10,000 will be treated as an addition to corpus and a proportionate amount of such transfer will be subject to the generation-skipping transfer tax provisions. If *H* dies before January 1, 1982, the person liable for any previously paid generation-skipping transfer tax may file a claim for refund of such tax within the time limit set out in section 6511.

Example (8). *A* is the settlor of a generation-skipping trust which was in existence on June 11, 1976. Under the terms of the trust, *A*, on June 11, 1976, possessed the power to withdraw one-half of the corpus for *A's* personal use. The trust was irrevocable in all other respects. If *A* dies before January 1, 1982, the entire trust will be excluded from the generation-skipping transfer tax provisions. If *A* dies after December 31, 1981, one-half of all generation-skipping transfers pursuant to the trust will be subject to Chapter 13.

Example (9). Assume the same facts as in example (8) except that on July 30, 1980, while *A* is alive, a generation-skipping distribution is made from the trust. Because, on that date, it can not be determined whether the transition rule will be applicable, the revocable portion of the trust must be treated as a constructive addition to the irrevocable portion of the trust occurring on June 11, 1976. If *A* dies before January 1, 1982, the person liable for any previously paid generation-skipping transfer tax may file a claim for refund of such tax within the time limit set out in section 6511.

Example (10). *H* and *W* are the settlors of separate revocable generation-skipping trusts which were in existence on June 11, 1976, and not amended after that date. *W* dies in 1980 and under the provisions of her trust the corpus pours over into *H's* trust. If *H* dies before January 1, 1982, the entire trust is excluded under paragraph (b)(1) of this section from the operation of Chapter 13. If *H* dies after 1981, the entire trust is subject to the generation-skipping transfer tax provisions because *H's* trust did not qualify under the transition rule. The fact that *W* died before 1982 is irrelevant, because the corpus of her trust was added to a trust that never qualified under the transition rule.

Example (11). Assume the same facts as in example (10) except that upon the death of *W* in 1980 her trust continues as an irrevocable trust and that the corpus of *H's* trust is to be paid over upon his death to *W's* trust should he survive her. Again, if *H* dies before 1982, the entire trust falls within the provisions of paragraph (b)(1) of this section. However, if *H* dies after 1981, the "pour-over" is considered an addition to the corpus of a trust which falls within the transition rule, and a proportionate part of subsequent distributions and terminations will be subject to tax under Chapter 13.

Example (12). *A*, the spouse of the settlor of an irrevocable trust that was created in 1973, had, on June 11, 1976, a general power of appointment over the trust assets. The trust provides that should *A* fail to exercise the power the trustee is to continue the trust as a generation-skipping trust. On June 11, 1976, *A* had a will in existence under which *A* failed to exercise the power of appointment. If *A* dies before January 1, 1982, without having exercised the power in a manner which results in the creation of, or increase in the amount of, a generation-skipping transfer (or amended the will in a manner that results in the creation of, or increase in the amount of, a generation-skipping transfer) transfers pursuant to the trust will not be subject to Chapter 13 because the trust qualifies under the effective date rule, the will qualifies under the transition rule, and there is no constructive addition by reason of paragraph (e) (4) of this section.

Example (13). Assume the same facts as in example (12) except that on June 11, 1976, *A* did not have a will. Upon *A's* death, or upon the prior exercise or release of the power, the value of the entire trust will be treated as a constructive addition to the corpus and all subsequent distributions or terminations pursuant to the trust will be subject to Chapter 13. It is immaterial whether *A's* death occurs before January 1, 1982, since the transition rule is only applicable where a will was in existence on June 11, 1976.

This Treasury decision is issued under the authority contained in sections 2621 and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1887, 68A Stat. 917, 26 U.S.C. 2621, 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved July 31, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on August 8, 1980, 8:45 a.m., and published in the issue of the Federal Register for August 11, 1980, 45 F.R. 53123.)

Section 4942.—Taxes on Failure to Distribute Income [Private Foundations]

26 CFR 53.4942(a)-2: Computation of undistributed income.

T.D. 7715[1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 53.—FOUNDATION EXCISE TAXES; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1975

Reduction in value for blockage or similar factors.

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the use of blockage or similar factors in determining the value of private foundations' noncharitable assets consisting of listed securities issues for purposes of determining the amount foundations must distribute annually for charitable purposes. Changes to the applicable tax law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1]. The regulations provide foundation managers with the guidance needed to comply with that Act and affect all foundations that hold listed securities issues for which reductions in value due to blockage or related factors are appropriate.

EFFECTIVE DATE: Taxable years beginning after December 31, 1975.

FOR FURTHER INFORMATION CONTACT: David E. Dickinson of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3218).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On March 12, 1980, the Federal Register published proposed amendments to the Foundation Excise Tax Regulations (26 CFR Part 53) under section 4942(e) (2) (B) of the Internal Revenue Code of 1954 (45 FR 15945). These amendments were proposed to conform the regulations to section 1303(a) of the Tax Reform Act of 1976 (90 Stat. 1715) [*supra* at 191]. No public hearing was requested or held. After consideration of the two comments received in response to the notice of proposed rulemaking, those amendments are adopted by this Treasury decision with the change de
scribed below.

EXPLANATION OF PROVISION

OLD LAW

Under section 4942(e) (2) as it e
isted prior to the Tax Reform Act
1976 and § 53.4942(a)-2(c) (4) (
(*b*) of the regulations, estate tax va
uation methods were to be used
value noncharitable assets of priva
foundations consisting of listed secur
ties issues.

NEW LAW

Section 4942(e) (2) (B) establishe
certain new, more explicit rules f
valuing a private foundation's no
charitable assets consisting of list
securities issues. In determining t
value of such securities for minimu
charitable expenditures purposes, the
fair market value (determined witho
regard to any reduction in value)
not to be reduced unless, and only
the extent that, a private foundati
establishes that as a result of a certa
factor or combination of factors en
merated in the statutory provision, t
securities could not be liquidated wit
in a reasonable period of time exce
at a price less than such fair mark
value. Any reduction in value is to
made only for one or more of the
reasons and must not in the aggrega
exceed 10 percent of the fair mark
value of the securities.

FINAL REGULATIONS

These amendments to the regul
tions explain that the new law appli
only to assets that are securities issu
described in § 53.4942(a)-2(c) (4) (
(*a*) (generally, securities issues f
which quotations are readily availab
referred to in this preamble as "list
securities issues"). See § 53.4942(a)
(c) (4) (i) (*c*).

They give as an example of
"forced or distressed sale" under se
tion 4942(e) (2) (B) (iii) of the Co
the situation where securities cann
be sold on the open market witho
first being registered under the Sec
rities Act of 1933. See § 53.4942(a)
(c) (4) (i) (*c*) (*3*).

One public comment received o
jects to this rule, which requires u

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[1] This publication of the Treasury Decision contains the complete text of the amendments to the regulations. The instructions for modifying the notice of proposed rulemaking have been omitted.

registered shares of a listed securities issue to be valued first by reference to market quotations for the listed issue and then discounted under section 4942(e)(2)(B), if applicable, to reflect the fact that the shares are unregistered. Instead, as the comment is understood, the lack of registration should first be taken into account in determining the "fair market value" of the shares before applying factors, such as blockage, listed in section 4942(e)(2)(B)(i), (ii), and (iii).

It is clear that enactment of section 4942(e)(2)(B) responded to congressional concerns that excessive discounts were being claimed in making valuations of listed securities issues. It is believed that the valuation mechanism contemplated in section 4942(e)(2)(B) must begin with undiscounted market quotations for the listed issue and then allows reductions in this beginning value to the extent, but only to the extent, permitted by section 4942(e)(2)(B)(i), (ii), or (iii) and subject to the overall discount limitation of 10 percent. Adoption of this commentator's suggestion would only continue opportunities for excessive discounts which Congress sought to prevent in enacting section 4942(e)(2)(B).

Further, the commentator's suggested formula would necessarily involve an initial calculation based solely upon lack of registration and completely ignore the size of the block of unregistered stock, the size of the block being a factor to take into account only later under section 4942(e)(2)(B)(i). It is seriously doubted that such a calculation reasonably could be made.

The regulations, as proposed, effectively provide that if a private foundation owns unlisted securities of a corporation (issuer) that owns assets comprising listed securities issues, those underlying listed securities issues are to be valued using market quotations or in accordance with the new rules, if applicable. The second commentator objected to this rule as contrary to the statute, which on its face applies to listed securities issues owned by the private foundation as opposed to an intermediate holding company. The commentator did, however, correctly suggest that the reason for this rule was to prevent a private foundation's avoiding section 4942(e)(2)(B) simply by incorporating its investment portfolio as a holding company. While the commentator had no objection to a regulatory rule which addressed this potential avoidance situation, it objected to application of the rule to cases where the private foundation held only a small minority interest in the unlisted holding company.

In response to this comment, the final regulations amending § 53.4942(a)-2(c)(iv)(*a*) provide that if a private foundation owns voting stock of an unlisted issuer and has, or together with disqualified persons or another private foundation has, effective control of the unlisted issuer within the meaning of § 53.4943-3(b)(3)(ii), then to the extent that the issuer's assets consist of listed securities issues, such assets are to be valued monthly on the basis of market quotations or in accordance with section 4942(e)(2)(B), if applicable, in determining the net worth of the issuer.

Finally, the final regulations revoke the obsolete version of section 4942 from the CFR and set forth the effective date of the new and old rules. See § 53.4942(a)-2(c)(4)(i)(*b*), new last two sentences.

DRAFTING INFORMATION

The principal author of these proposed regulations was David E. Dickinson of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to the regulations are hereby adopted:

Paragraph 1. Section 53.4942 is revoked.

Par. 2. Two sentences are added to the end of § 53.4942(a)-2(c)(4)(i)(*b*) to read as follows:

§ 53.4942(a)-2 Computation of undistributed income.

* * * * *

(c) *Minimum investment return.* * * *

(4) *Valuation of assets*—(i) *Certain securities.* * * *

(*b*) * * * This paragraph (c)(4)(i)(*b*) applies only for taxable years beginning before January 1, 1976. See section 4942(e)(2)(B) and paragraph (c)(4)(i)(*c*) of this section for special valuation rules that apply for subsequent taxable years.

* * * * *

Par. 3. Sections 53.4942(a)-2(c)(4)(i)(*c*) and 53.4942(a)-2(c)(4)(i)(*d*) are redesignated as §§ 53.4942(a)-2(c)(4)(i)(*d*) and 53.4942(a)-2(c)(4)(i)(*e*), respectively, and a new § 53.4942(a)-2(e)(4)(i)(*c*) is added to read as follows:

§ 53.4942(a)-2 Computation of undistributed income.

* * * * *

(c) *Minimum investment return.* * * *

(4) *Valuation of assets*—(i) *Certain securities.* * * *

(*c*) For purposes of this subdivision (i) and with respect to taxable years beginning after December 31, 1975, if the private foundation can show that the value of securities determined on the basis of market quotations as provided by subdivision (i)(*a*) does not reflect the fair market value thereof because—

(*1*) The securities constitute a block of securities so large in relation to the volume of actual sales on the existing market that it could not be liquidated in a reasonable time without depressing the market,

(*2*) The securities are securities in a closely held corporation and sales are few or of a sporadic nature, and/or

(*3*) The sale of the securities would result in a forced or distress sale because the securities could not be offered to the public for sale without first being registered under the Securities Act of 1933 or because of other factors, then the price at which the securities could be sold as such outside the usual market, as through an underwriter, may be a more accurate indication of value than market quotations. On the other hand, if the securities to be valued represent a controlling interest, either actual or effective, in a going business, the price at which other lots change hands may have little relation to the true value of the securities. No decrease in the fair market value of any given class of securities determined on the basis of market quotations as provided by subdivision (i) (*a*) shall be allowed except as authorized by this subdivision, and no such decrease shall in the aggregate exceed 10 percent of the fair market value of such class of securities so determined on the basis of market quotations and without regard to this subdivision.

* * * * *

Par. 4. Two sentences are inserted between the second and third sentences of § 53.4942(a)-2(c)(4)(iv)(*a*), as follows:

§ 53.4942(a)-2 Computation of undistributed income.

* * * * *

(c) *Minimum investment return.* * * *

(4) *Valuation of assets*—* * *

(iv) *Other assets.* * * *

(*a*) * * * If, however, a private foundation owns voting stock of an issuer of unlisted securities and has, or together with disqualified persons or another private foundation has, effective control of the issuer (within the meaning of § 53.4943-3(b)(3)(ii)), then to the extent that the issuer's assets consist of shares of listed securities issues, such assets shall be valued monthly on the basis of market quotations or in accordance with section 4942(e)(2)(B), if applicable. Thus, for example, if a private foundation and a disqualified person together own all of the unlisted voting stock of a holding company which in turn holds a portfolio of securities of issues which are listed on the New York Stock Exchange, in determining the net worth of the holding company, the underlying portfolio securities are to be valued monthly by reference to market quotations for their issues unless a decrease in such value is authorized in accordance with section 4942 (e)(2)(B). * * *

* * * * *

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved August 8, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on August 25, 1980, 8:45 a.m., and published in the issue of the Federal Register for August 26, 1980, 45 F.R. 56802)

Section 3221.—Rate of Tax [Railroad Retirement Tax Act]

RAILROAD RETIREMENT BOARD

Determination of Quarterly Rate of Excise Tax for Railroad Retirement Supplemental Annuity Program

In accordance with directions in section 3221(c) of the Railroad Retirement Tax Act (26 U.S.C. § 3221 (c)), the Railroad Retirement Board has determined that the excise tax imposed by such section 3221(c) on every employer, with respect to having individuals in his employ, for each work-hour for which compensation is paid by such employer for services rendered to him during the quarter beginning October 1, 1980, shall be at the rate of twelve and one-half cents.

In accordance with directions in section 15(a) of the Railroad Retirement Act of 1974, the Railroad Retirement Board has determined that for the quarter beginning October 1, 1980, 21.3 percent of the taxes collected under sections 3211(b) and 3221(c) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Account and 78.7 percent of the taxes collected under section 3211(b) and 3221(c) plus one hundred percent of the taxes collected under section 3221 (d) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Supplemental Account.

By Authority of the Board.

Dated: August 19, 1980.

R. F. BUTLER,
Secretary of the Board.

(Filed by the Office of the Federal Register on August 27, 1980, 8:45 a.m., and published in the issue of the Federal Register for August 28, 1980, 45 F.R. 57619)

Section 4945.—Taxes on Taxable Expenditures

26 CFR 53.4945-4: Grants to individuals.

Whether educational loans made by a private foundation under an employer-related loan program are taxable expenditures under section 4945 of the Code. See Rev. Proc. 80-39, page 22.

Section 7805.—Rules and Regulations

26 CFR 301.7805-1: Rules and regulations.

Whether educational loans made by a private foundation under an employer-related loan program are taxable expenditures under section 4945 of the Code. See Rev. Proc. 80-39, page 22.

26 CFR 1.9100-1: Extension of time for making certain elections.

Whether an extension of time may be granted under section 1.9100-1 of the regulations for a failure to satisfy the notification requirement of section 508(a) of the Code. See Rev. Rul. 80-259, page 7.

Part II. Treaties and Tax Legislation

Subpart B.—Legislation and Related Committee Reports

Public Law 96-320
96th Congress, S. 2492[1]
August 3, 1980

An Act to regulate commerce, promote energy self-sufficiency, and protect the environment, by establishing procedures for the location, construction, and operation of ocean thermal energy conversion facilities and plantships to produce electricity and energy-intensive products off the coasts of the United States; to amend the Merchant Marine Act, 1936, to make available certain financial assistance for construction and operation of such facilities and plantships; and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Ocean Thermal Energy Conversion Act of 1980".

* * * * *

SEC. 3. DEFINITIONS

As used in this Act, unless the context otherwise requires, the term—

* * * * *

(10) "licensee" means the holder of a valid license for the ownership, construction, and operation of an ocean thermal energy conversion facility or plantship that was issued, transferred, or renewed pursuant to this Act;

(11) "ocean thermal energy conversion facility" means any facility which is standing or moored in or beyond the territorial sea of the United States and which is designed to use temperature differences in ocean water to produce electricity or another form of energy capable of being used directly to perform work, and includes any equipment installed on such facility to use such electricity or other form of energy to produce, process, refine, or manufacture a product, and any cable or pipeline used to deliver such electricity, freshwater, or product to shore, and all other associated equipment and appurtenances of such facility, to the extent they are located seaward of the highwater mark;

(12) "ocean thermal energy conversion plantship" means any vessel which is designed to use temperature differences in ocean water while floating unmoored or moving through such water, to produce electricity or another form of energy capable of being used directly to perform work, and includes any equipment installed on such vessel to use such electricity or other form of energy to produce, process, refine, or manufacture a product, and any equipment used to transfer such product to other vessels for transportation to users, and all other associated equipment and appurtenances of such vessel;

(13) "plantship" means an ocean thermal energy conversion plantship;

* * * * *

(18) "United States citizen" means (A) any individual who is a citizen of the United States by law, birth, or naturalization; (B) any Federal, State, or local government in the United States, or any entity of any such government; or (C) any corporation, partnership, association, or other entity, organized or existing under the laws of the United States, or of any State, which has as its president or other executive officer and as its chairman of the board of directors, or holder of similar office, an individual who is a United States citizen and which has no more of its directors who are not United States citizens than constitute a minority of the number required for a quorum necessary to conduct the business of the board.

* * * * *

TITLE II—MARITIME FINANCING FOR OCEAN THERMAL ENERGY CONVERSION

SEC. 201. DETERMINATIONS UNDER THE MERCHANT MARINE ACT, 1936.

(a)(1) For the purposes of section 607 of the Merchant Marine Act, 1936 [amended by Pub. L. 91-469, 1970-2 C.B. 372] (46 U.S.C. 1177), any ocean thermal energy conversion facility or plantship licensed pursuant to this Act, and any vessel providing shipping service to or from such an ocean thermal energy conversion facility or plantship, shall be deemed to be a vessel operated in the foreign commerce of the United States.

(2) The provisions of paragraph (1) of this subsection shall apply for taxable years beginning after December 31, 1981.

(b) For the purposes of the Merchant Marine Act, 1936 (46 U.S.C. 1177 et seq.) any vessel documented under the laws of the United States and used in providing shipping service to or from any ocean thermal energy conversion facility or plantship licensed pursuant to the provisions of this Act shall be deemed to be used in, and used in an essential service in, the foreign commerce or foreign trade of the United States, as defined in section 905 (a) of the Merchant Marine Act, 1936 (46 U.S.C. 1244(a)).

* * * * *

SEC. 203. OTEC DEMONSTRATION FUND.

(a) Title XI of the Merchant Marine Act, 1936 (46 U.S.C. 1271-1279b) is further amended by adding at the end thereof a new section 1110 to read as follows:

"SEC. 1110. (a) Pursuant to the authority granted under section 1103(a) of this title, the Secretary of Commerce, upon such terms as he shall prescribe, may guarantee or make a commitment to guarantee, payment of the principal of and interest on an obligation which aids in financing, including reimbursement of an obligor for expenditures previously made for, construction, reconstruction, or reconditioning of a commercial demonstration ocean thermal energy conversion facility or plant-ship owned by citizens of the United States. Guarantees or commitments to guarantee under this subsection shall be subject to all the provisos, requirements, regulations, and procedures which apply to guarantees or commitments to guarantee made pursuant to section 1104(a)(1) of this title, except that—

"(1) no guarantees or commitments

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[1] This publication of the law and House Report No. 96-994, page 20, is restricted to excerpts involving tax matters. Senate Report No. 96-721 is not published.

to guarantee may be made by the Secretary of Commerce under this subsection before October 1, 1981;

"(2) the provisions of subsection (d) of section 1104 of this title shall apply to guarantees or commitments to guarantee for that portion of a commercial demonstration ocean thermal energy conversion facility or plantship not to be supported with appropriated Federal funds;

"(3) guarantees or commitments to guarantee made pursuant to this section may be in an aggregate principal amount which does not exceed 87½ percent of the actual cost or depreciated actual cost of the commercial demonstration ocean thermal energy conversion facility or plantship: *Provided*, That, if the commercial demonstration ocean thermal energy conversion facility or plantship is supported with appropriated Federal funds, such guarantees or commitments to guarantee may not exceed 87½ percent of the aggregate principal amount of that portion of the actual cost or depreciated actual cost for which the obligor has an obligation to secure financing in accordance with the terms of the agreement between the obligor and the Department of Energy or other Federal agency; and

"(4) the provisions of this section may be used to guarantee obligations for a total of not more than 5 separate commercial demonstration ocean thermal energy conversion facilities and plantships or a demonstrated 400 megawatt capacity, whichever comes first.

* * * * *

"(e) The interest on any obligation guaranteed under this section shall be included in gross income for purposes of chapter 1 of the Internal Revenue Code of 1954.".

* * * * *

Approved August 3, 1980.

House of Representatives
Report No. 96-994
2d Session

[Bracketed numerals indicate official report page numbers]

OCEAN THERMAL ENERGY CONVERSION ACT OF 1980

Mr. MURPHY of New York, from the Committee on Merchant Marine and Fisheries, submitted the following report to accompany H.R. 6154.[1]

* * * * *

The Committee on Merchant Marine and Fisheries, to whom was referred the bill (H.R. 6154) to regulate commerce, promote energy self-sufficiency, and protect the environment, by establishing procedures for the location, construction, and operation of ocean thermal energy conversion facilities and plantships to produce electricity and energy-intensive products off the coast of the United States; to amend the Merchant Marine Act, 1936, to make available certain financial assistance for construction and operation of such facilities and plantships; and for other purposes, having considered the same, report favorably thereon with an amendment and recommend that the bill as amended do pass.

* * * * *

[38] SECTION-BY SECTION ANALYSIS

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[39] *Section 3. Definitions*

Unless the context requires otherwise—

* * * * *

[40] (11) "Ocean thermal energy facility," or OTEC facility, means any facility which is standing or moored in or beyond the territorial sea of the United States and which is designed to use temperature differences in ocean water to produce electricity or another form of energy capable of being used directly to perform work, and includes any equipment installed on such facility to use such electricity or other form of energy to produce, process, refine, or manufacture a product, and any cable or pipeline used to deliver fresh water or such electricity or product to shore, and all other associated equipment and appurtenances of such facility, to the extent they are located seaward of the highwater mark. The Committee intends that the waters of the Atlantic, Pacific, and Arctic Oceans, the Gulf of Mexico, and the Great Lakes be considered as ocean waters for the purposes of this definition. The definition is intended to include all types of OTEC cycles. If an OTEC facility is built on land with warm and cold water pipes extending out into the ocean, the definition includes that portion of the warm and cold water pipes, and any other parts of the facility, located seaward of the highwater mark.

(12) "Ocean thermal energy conversion plantship", or OTEC plantship, means any vessel which is designed to use temperature differences in ocean water, while floating unmoored or moving through such water, to produce electricity or another form of energy capable of being used directly to perform work, and includes any equipment installed on such vessel to use such electricity or other form of energy to produce, process, refine, or manufacture a product, and any equipment used to transfer such product to other vessels for transportation to users, and all other associated equipment and appurtenances of such vessel. The Commitee intends that the waters of the Great Lakes and all Oceans, Gulfs, and other bodies of water at least part of which are included within the definition of "high seas" be considered as ocean waters for the purposes of this definition. The definition is intended to include all types of OTEC cycles, and all types of OTEC vessels, whether mobile or dynamically positioned.

* * * * *

[50] TITLE II—MARITIME FINANCING FOR OCEAN THERMAL ENERGY CONVERSION FACILITIES AND PLANTSHIPS

Section 201. Determinations under Merchant Marine Act, 1936

Subsection (a) states that for the purposes of section 607 of the Merchant Marine Act, 1936, any OTEC facility or plantship licensed under this Act, and any vessel providing shipping services to or from such an OTEC facility or plantship, is deemed to be a vessel operated [51] in the foreign commerce of the United States. This interpretation of section 607 will apply for taxable years beginning after December 31, 1981. The substantive effect of this statement in the bill is to clarify that OTEC facilities and plantships, and vessels serving them, are eligible to use the capital construction fund provisions of the 1936 Act.

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[1] Public Law 96-320, page 19.

Subsection (b) states that for the purposes of the Merchant Marine Act, 1936, any vessel documented under the laws of the United States and used in providing shipping service to or from an OTEC facility or plantship licensed under this Act shall be deemed to be used in, and used in an essential service in, the foreign commerce or foreign trade of the United States, as defined in section 905(a) of the 1936 Act. The substantive effect of this statement in the bill is to clarify that vessels serving OTEC facilities and plantships are eligible for the same financing and financial assistance programs (including construction differential subsidy and operating differential subsidy) which apply to vessels carrying cargo between United States and foreign ports under the provisions of the 1936 Act, if they meet the specific requirements for receipt of such assistance.

* * * * *

Section 203. OTEC Demonstration Fund

This section amends Title XI of the Merchant Marine Act, 1936, to set up a special subfund within the Federal Ship Financing Fund to apply to mortgage obligation guarantees for pilot or demonstration OTEC facilities and plantships which would not satisfy the "economically sound" criterion which is required for the regular Title XI program by section 1104(d). Such pilot or demonstration projects would have to be approved or participated in by the Department of Energy, and the mortgage obligation guarantee could cover no more than 87½ percent of the amount of private capital invested in the project. The limit on all mortgage obligation guarantees for OTEC pilot and demonstration plants is set at $2 billion, and the special provisions of this section could be used for not more than 5 OTEC pilot or demonstration projects. The special subfund would not be set up, and the loan guarantees could not be committed, until October 1, [52] 1981. Bonds or other obligations guaranteed under this section will be subject to regular income tax treatment, and may not be tax exempt.

* * * * *

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 80-37

Rev. Proc. 80-22, 1980-26 I.R.B. 26, sets forth areas in which advance rulings or determination letters will not be issued by the Internal Revenue Service. Section 4.018 of Rev. Proc. 80-22 states that rulings or determination letters will not ordinarily be issued on the tax effect of the transfer when part of the consideration received by the transferors consists of bonds, debentures, or any other evidences of indebtedness of the transferee. Section 4.018 is hereby amplified to read as follows:

8 Section 351—Transfers to Controlled Corporation.—

The tax effect of the transfer when part of the consideration received by the transferors consists of bonds, debentures, or any other evidence of indebtedness of the transferee and the term of the "indebtedness" is either less than ten years or a determination as to whether the "indebtedness" is properly classified as debt or equity is required in order to establish that the requirements of section 351 are met.

Rev. Proc. 80-22 is amplified.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Section 871; 1.871-1.)

Rev. Proc. 80-38

Section 1. Background

Section 4.01 of Rev. Proc. 80-22, 1980-26 I.R.B. 26, sets forth areas in which advance rulings and determination letters will not ordinarily be issued by the Internal Revenue Service.

Sec. 2. Procedure

Rev. Proc. 80-22 is amplified to include the following under section 4.01:

Section 871—Classification of alien individuals as resident or nonresident —The determination as to whether an alien individual is either a resident or nonresident of the United States will not be made with respect to situations in which the determination is dependent on factual representations that cannot be confirmed until the close of the alien individual's affected taxable year(s), that is, representations concerning an alien individual's projected stay and activities in the United States.

Sec. 3. Effective Date

This revenue procedure will apply to all ruling requests on hand in the National Office on September 29, 1980, the date of publication of this revenue procedure in the Internal Revenue Bulletin, as well as to requests received thereafter.

Sec. 4. Effect on Other Revenue Procedures

Rev. Proc. 80-22 is amplified.

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26 CFR 601.602: Forms and instructions.
(Also Part I, Sections 4945, 7805; 53.4945-4, 301.7805-1.)

Rev. Proc. 80-39

Section 1. Purpose

.01 The purpose of this revenue procedure is to provide guidelines for determining whether educational loans made by a private foundation under an employer-related loan program are taxable expenditures under section 4945 of the Internal Revenue Code.

.02 Ruling requests seeking advance approval of loan procedures are to be submitted to the Assistant Commissioner (Employee Plans and Exempt Organizations), Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: E:EO:T, and must include the statements required by section 53.4945-4(d) of the Foundation Excise Tax Regulations.

Sec. 2. Background

.01 Rev. Rul. 77-434, 1977-2 C.B. 420, holds that educational loans made by a private foundation on an objective and nondiscriminatory basis, pursuant to a procedure approved in advance by the Secretary or the Secretary's delegate, are individual grants within the meaning of section 4945(g)(3) of the Code. Thus, the loans are not taxable expenditures.

.02 Section 53.4945-4(b) of the regulations provides that a private foundation's grants are made on an objective and nondiscriminatory basis if the foundation's loan program is consistent with its exempt status under section 501(c)(3) of the Code and the allowance of deductions under section 170 for contributions to the foundation.

.03 Educational loans made by a private foundation to employees of a particular company or to their children are made for a purpose inconsistent with the foundation's exempt status under section 501(c)(3) of the Code and the allowance for deductions under section 170 for contributions to the foundation if the loans serve the private interests of the employer, rather than serving charitable purposes. A long-term, low-interest educational loan provided by a private foundation is of substantial value to students who could not obtain them from any source other than the employer-related program. The Service will assume that employer-related educational loans are made on an objective and nondiscriminatory basis, within the meaning of section 4945(g), and thus are not taxable expenditures, if they meet the guidelines contained in Sec. 4 of this revenue procedure.

Sec. 3. Application of Guidelines

.01 The guidelines in Sec. 4 apply only to educational loans made on or after January 1, 1970, by a private foundation under an employer-related program to individuals who are employees, or the children of employees, of the employer to which the program relates. Rev. Proc. 76-47, 1976-2 C.B. 670, provides guidelines for determining whether a grant made by a private foundation under an employer-related grant program to an employee or to a child of an employee of the particular employer to which the program relates is a scholarship or fellowship grant under section 117 of the Code.

.02 An employer-related program is a program that treats some or all of the employees, or the children of some or all of the employees, of a particular employer as a group from which the recipients of some or all of the foundation's loans will be selected; limits the potential loan recipients for some or all of the foundation's loans to individuals who are employees, or the children of employees, of the particular employer; or otherwise gives such individuals a preference or priority over others in being selected as loan recipients.

.03 The guidelines assume that the other applicable requirements of section 53.4945-4 of the regulations concerning loans to individuals are met.

.04 These guidelines do not determine whether loans to disqualified persons are taxable expenditures under section 4945 of the Code or would subject the disqualified persons to the tax on acts of self-dealing under section 4941.

SEC. 4. GUIDELINES

.01 *General rule.*

If a private foundation's educational loan program satisfies the seven conditions set forth in Secs. 4.03 through 4.09 below, and meets the percentage test described in Sec. 4.10, the Service will assume such loans are not taxable expenditures.

.02 *Facts and circumstances test.*

1 If a private foundation's loan program satisfies the seven conditions set forth in Secs. 4.03 through 4.09, but does not meet the percentage test of Sec. 4.10, the Service will consider, as a substitute for the percentage test of Sec. 4.10, all the relevant facts and circumstances to determine whether the primary purpose of the program is to further the private interests of the employer, or whether the primary purpose is to educate recipients in their individual capacities. The availability of loans under the program to employees of their children must be controlled and limited by substantial nonemployment-related factors so that the preferential treatment derived from employment is not of any significance beyond initial qualification for the loan. Such qualification must not lead to any significant probability that employment will make loans available for a qualified employee or his or her children interested in applying for one.

2 Such relevant facts and circumstances include, but are not limited to: the history of the program (such as the source of the program's funding), the courses of study for which the loans are available, any eligibility requirements imposed by the program (other than employment of the applicants or their parents and the age and grade level prerequisites for the studies for which the loans are available), the publicity given the loan program, the degree of independence of the selection committee, the particular standards used for selection, the specific means used to determine whether those standards have been met, the precise nature of the employee limitation or preference, the number of loans available, the number of employees or their children who would be eligible for the loans, the percentage of eligible employees or their children applying for loans who normally (*e.g.,* on an average basis) receive loans under the program, and whether and how many loans are awarded to individuals who do not qualify as employees or the children of employees.

.03 *Inducement.*

The program must not be used by the employer, the private foundation, or the creator of the foundation, to recruit employees or to induce employees to continue their employment or otherwise follow a course of action sought by the employer.

.04 *Selection committee.*

1 Selection of loan recipients must be made by a committee consisting wholly of individuals totally independent (except for participation on this committee) and separate from the private foundation, the foundation's creator, and the relevant employer. An individual who is a former employee of either the foundation or the employer concerned will not be considered totally independent. Such committees preferably should consist of individuals knowledgeable in the educational field so that they have the background and knowledge to evaluate properly the potential of the applicants.

2 The forwarding of the selections by the independent selection committee to the employer or the private foundation for the sole purpose of verifying the eligibility requirements and selection criteria used by the committee in considering the candidates and in making its selection will not disqualify the program. Any public announcement of the awards, however, must be made by the selection committee or by the foundation.

3 Loans must be awarded in the order recommended by the selection committee. The number of loans to be awarded may be reduced but may not be increased from the number recommended by the selection committee. Only the committee may vary the amounts of the loans awarded.

.05 *Eligibility requirements.*

1 The program must impose identifiable minimum requirements for loan eligibility. Such requirements must be related to the purpose of the program and must limit the independent selection committee's consideration to those employees, or children of employees, who meet the minimum standards for admission to an educational institution (as defined in section 170(b)(1)(A)(ii) of the Code) for which the loans are available. No persons will be considered eligible if they are not reasonably expected to attend such an institution, even if they meet the minimum standards.

2 If an employee must have been employed for some minimum period by the employer to which the program relates to be eligible to receive a loan, or to make that employee's children eligible to receive a loan, the minimum period of employment may not exceed three years. Moreover, eligibility must not be related to any other employer-related factors, such as the employee's position, or duties.

.06 *Objective basis of selection.*

Selection of loan recipients must be based solely upon substantial objective standards that are completely unrelated to the employment of the recipients or their parents and to the employer's line of business. Acceptable standards include, but are not limited to: prior academic performance, performance on tests designed to measure ability and aptitude for higher education, recommendations from instructors or other individuals not related to the potential loan recipients, financial need, and conclusions drawn from personal interviews as to motivation and character.

.07 *Employment.*

1 A loan may not be terminated solely because the recipient or the recipient's parent subsequently terminates employment with the employer, regardless of the reason for the termination of employment.

2 If a loan is awarded for one academic year and the recipient must reapply for an additional loan or loans to continue studies in a subsequent year, the recipient may not be considered ineligible for a subsequent loan simply because that individual or the individual's parent is no longer employed by the relevant employer. The standards for additional loans must be based solely upon nonemployment-related factors such as need and maintenance of scholastic standards.

3 At the time the loan or additional loans are awarded, there must be no requirement, condition or suggestion, express or implied, that the recipient or the recipient's parent is expected to render future employment services for the foundation or the relevant employer, or be available for such future employment, even though such future employment is at the discretion of the foundation or the employer.

.08 *Course of study.*

The courses of study for which loans are available must not be limited to those that would be of particular benefit to the relevant employer or to the foundation. If the courses of study for which loans are available include one or more that would be of such particular benefit, a loan may not be conditioned on the recipient's choosing such a course of study; the recipient must have a free choice to use the loan in the pursuit of a course of study for which the loan is otherwise available that is not of particular benefit to the employer or to the foundation.

.09 *Other objectives.*

The terms of the loan and the courses of study for which loans are available must be consistent with a disinterested purpose of enabling the recipients to obtain an education in their individual capacities solely for their personal benefit and they must not include any commitments, understandings or obligations, conditional or unconditional, suggesting that the studies are undertaken by the recipients for the benefit of the relevant employer or the foundation, or have as their objective the accomplishment of any purpose of the employer or the foundation (even though consistent with its exempt status) other than enabling the recipients to obtain an education in their individual capacities and solely for their personal benefit.

.10 *Percentage test.*

1 In the case of a program that awards loans to children of employees of a particular employer, the program meets this percentage test if the number of children receiving loans under that program in any given year does not exceed 25 percent of the number of employees' children who (i) were eligible, (ii) were applicants for such grants, and (iii) were considered by the selection committee in selecting the recipients of loans in that year, or 10 percent of the number of employees' children who can be shown to be eligible for loans (whether or not they submitted an application) in that year.

2 In the case of a program that awards loans to employees of a particular employer, the program meets this percentage test if the number of employees receiving loans under that program in any year does not exceed 10 percent of the number of employees who (i) were eligible, (ii) were applicants for such grants, and (iii) were considered by the selection committee in selecting the recipients of grants in that year.

3 For the purpose of applying these percentage tests, an employee or child of an employee will be considered eligible only if the individual meets all of the eligibility requirements imposed by the program and such requirements satisfy the conditions of Sec. 4.05 of this revenue procedure. Renewals of loans awarded in prior years will not be considered in determining the number of loans awarded in the current year. Loans awarded to children of employees and those awarded to employees will be considered as having been awarded under separate programs for purposes of all of the applicable requirements of this revenue procedure whether or not the loans are awarded under separately administered programs.

4 If a private foundation's employer-related program encompasses educational loans and scholarship or fellowship grants to the same group of eligible employees or employees' children, the percentage tests in Sec. 4.10 of this revenue procedure apply to the total number of individuals receiving combined grants of scholarships, fellowships, and educational loans.

SEC. 5. RELIANCE ON PRE-SEPTEMBER 29, 1980, RULING LETTERS

.01 A private foundation that holds a ruling letter issued before September 29, 1980, approving its employer-related educational loan program under section 4945(g)(3) of the Code, may continue to rely on the ruling letter provided its loan program fully complies with Secs. 4.01-4.10 continuously from the date on which the ruling letter was issued. Upon written request, the Service will issue a current ruling letter affirming the qualification of the loan program under the relevant portions of this revenue procedure.

.02 Pursuant to the authority contained in section 7805(b) of the Code, where a private foundation holds a ruling letter issued before September 29, 1980, approving its employer-related educational loan program, and where its loan program does not fully comply with Secs. 4.01-4.10, the private foundation may rely on the ruling letter through March 31, 1981.

.03 Educational loan programs modified to conform with Secs. 4.01-4.10 should be submitted for advance approval under section 4945(g)(3) of the Code in accordance with section 53.4945-4 of the regulations.

Part IV. Items of General Interest

Revision of Form 6199

Announcement 80-126

Form 6199, Certification of Youth Participating in a Qualified Cooperative Education Program, has been revised to reflect a provision in the Technical Corrections Act of 1979, Pub. L. 96-222, 1980-20 I.R.B. 5, 13. This law allows an individual age 19 but not yet age 20 to qualify as a member of a "targeted group" for the targeted jobs credit allowed employers under section 44B of the Internal Revenue Code. The credit is available for wages paid (or incurred) after November 26, 1979, to youths enrolled in a qualified cooperative education program. Before the enactment of the law the credit was not available for wages paid to youths reaching age 19.

The July 1980 revision of Form 6199 reflects this change in the law and can be used by a school to certify a youth age 19. The revision is now available and should be used instead of the March 1979 version.

Generation-skipping Transfer Tax; Return Requirements—Public Hearing

Announcement 80-127[1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to the filing of returns for the tax on generation-skipping transfers.

DATES: The public hearing will be held on November 5, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by October 22, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-234-79), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-2935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under section 2621 of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Tuesday, August 5, 1980 (45 FR 51771, 51840).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of the comments to be presented at the hearing and the time they wish to devote to each subject by October 22, 1980. Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive for improving government regulations appearing in the Federal Register for Wednesday, November 8, 1978.

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[1] Filed by the Office of the Federal Register on August 28, 1980, 8:45 a.m., and published in the issue of the Federal Register for August 29, 1980, 45 F.R. 57744.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individual has been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Ralph D. Lider	New Bedford, MA	Attorney	Indefinite effective August 18, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 26a.2621-1 added.	Generation-skipping transfer tax return requirements.	Aug. 5, 1980	Oct. 6, 1980
26 CFR 1.183-1, 1.212-1(h), 1.262-1(b)(3), amended; 1.280A-1 through 1.280A-3, added.	Deductions for business use or rental of dwelling unit.	Aug. 7, 1980	Oct. 6, 1980
26 CFR 301.7609-1 through 301.7610-1 added.	Administrative summonses.	Aug. 21, 1980	Oct. 20, 1980
26 CFR 1.6012-2(e), 1.6012-3(a)(5), 1.6033-2(a)(2)(i), 53.6071-1, 301.6204-1, 301.6211-1, 301.6212-1, 301.6213-1, 301.6501(c)-1, 301.6501(e)-1, 301.6503(a)-1(a), 301.6512-1, 301.6601-1(d), 301.6653-1, 301.6659-1, 301.6861-1, 301.6862-1(a), 301.6863-1(b), amended; 53.6011-1(e), 54.6011-1, 301.6501(n)-1 through 301.6501(n)-3, 301.6503(g)-1, 301.6511(f)-1, 301.7422-1, 301.7454-2, added; 301.6503(g)-1 redesignated as 301.6503(f)-1.	Procedure and administration of certain excise taxes.	Aug. 25, 1980	Oct. 24, 1980
26 CFR 53.4942(a)-3 revised.	Set-asides made by private foundations.	Aug. 26, 1980	Oct. 27, 1980
26 CFR 1.482-2, 1.483-1, amended.	Imputed interest rate on loans between related entities and on deferred payments in the case of certain sales of property.	Aug. 29, 1980	Oct. 28, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified,* above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27, dated July 7, 1980.

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1932–2	8.65
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1933–2	*3.45*
1934–1	*3.70*
1934–2	14.00
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1936–2	*14.00*
1937–1	*13.00*
1937–2	7.70
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1938–2	*13.00*
1939–1–1	8.25
1939–1–2	10.90
1939–2	9.40
1940–1	5.55
1940–2	14.00
1941–1	*$6.95*
1941–2	*3.55*
1942–1	7.25
1942–2	*5.55*
1943(*)	*9.55*
1944(*)	*7.85*
1945(*)	9.40
1946–1	*2.55*
1946–2	5.20
1947–1	*1.80*
1947–2	3.40
1948–1	*3.15*
1948–2	7.50
1949–1	*6.90*
1949–2	*2.80*
1950–1	6.35
1950–2	*4.70*
1951–1	*12.00*
1951–2	*5.05*
1952–1	*2.55*
1952–2	7.05
1953–1	*4.25*
1953–2	12.00
1954–1	12.00
1954–2	12.00
1955–1	10.25
1955–2	13.00
1956–1	15.00
1956–2	18.00
1957–1	$16.00
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1958–2	13.00
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1959–1	15.00
1959–2	9.60
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1961–2	10.00
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1962–2	13.00
1962–3	20.00
1963–1	9.00
1963–2	10.75
1964–1–1	10.00
1964–1–2	11.00
1964–2	9.80
1965–1	10.70
1965–2	12.25
1966–1	14.00
1966–2	14.05
1967–1	10.00
1967–2	14.00
1968–1	14.00
1968–2	11.75
1969–1	14.00
1969–2	6.50
1969–3	$12.50
1970–1	11.00
1970–2	14.00
1971–1	10.55
1971–2	8.50
1972–1	13.50
1972–2	13.70
1973–1	16.00
1973–2	8.30
1974–1	11.00
1974–2	9.95
1974–3	*8.20*
1974–3 Supp.	10.00
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October 6, 1980
Bulletin No. 1980-40

Internal Revenue
bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-262, page 17.

Return preparer; mathematical or clerical error. An inadvertent error made by a return preparer in either listing or totaling on Schedule B, Form 1040, the separate amounts shown on Forms 1099-INT furnished by a taxpayer that does not result in a substantial understatement of tax and is the only error on the return does not subject the preparer to the negligence penalty under section 6694(a) of the Code.

Rev. Rul. 80-263, page 17.

Return preparer; normal office practice; pattern of errors. A return preparer failed to list all income shown on a taxpayer's Forms 1099, incorrectly totaled itemized deductions, and used the wrong tax table. Even though the preparer's normal office practice was to review the taxpayer-provided information, check the return for completeness, and check the tax computation, there was a pattern of errors on the return, and the penalty under section 6694(a) of the Code applies.

Rev. Rul. 80-264, page 18.

Return preparer; normal office practice; failure to report minimum tax liability. A return preparer who failed to report a minimum tax liability showed that normal office practice, when taken together with other factors, indicated that the minimum tax error would rarely occur and that normal office practice was followed in preparing the return. The preparer was not liable for the negligence penalty under section 6694(a) of the Code. Rev. Rul. 80-28 distinguished.

Rev. Rul. 80-265, page 19.

Return preparer; failure to report income deducted on related return. A return preparer who prepared both an individual's return and the return of the individual's wholly owned corporation deducted interest paid by the corporation to the individual on the corporate return, but did not report the interest as income on the individual's return. The negligence penalty does not apply to the preparer if the information provided by the corporation did not indicate who received the interest and the information provided by the individual did not indicate receipt of such payment. However, the penalty would apply if the information provided by the corporation indicated that the individual received the interest payment.

Rev. Rul. 80-266, page 20.

Return preparer; reliance on taxpayer's assurances; entertainment expenses. A return preparer who asks a taxpayer if entertainment expense substantiation that satisfies the requirements of section 274(d) of the Code exists and receives assurances that it does will not be subject to the negligence penalty under section 6694(a) as a result of the taxpayer's failure to substantiate the expenses in an audit. A return preparer who does not ask for such assurances will be subject to the

(Continued on page 4)

Finding Lists begin on page 29.
Announcement Relating to Decisions of the Tax Court on page 5.
Announcement of Voluntary Suspension on page 26.
Announcement of Notice of Proposed Rulemaking on page 27.
Quarterly Index for July, August, and September begins on page 31.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

penalty, as will the first preparer in a subsequent year if the same assurances are received and the preparer is aware of the prior audit results.

Rev. Proc. 80-40, page 22.

Return preparer; negligence penalty. Some factors are provided that will be considered in determining whether a penalty is to be asserted under section 6694(a) of the Code for the negligent disregard of rules and regulations by an income tax return preparer.

EMPLOYEE PLANS

T.D. 7714, page 6.

Amendments to the regulations under sections 219, 408, 409, and 4974 of the Code relate to individual retirement arrangements (IRA's).

EXEMPT ORGANIZATIONS

Announcement 80-128, page 24.

A listing is given of organizations now classified as private foundations.

Announcement Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issue or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by Revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the Court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the Tax Court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Craig, Raymond A., et ux [1]	11403-78	73	1034
Dumaine Farms [2]	13428-78X	73	650
Hensler, Inc., R. R.[3]	6677-75	73	168
Industrial Aid for the Blind [4]	11387-77X	73	96

The Commissioner does NOT ACQUIESCE in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
B.H.W. Anesthesia Foundation, Inc.[5]	1316-78X	72	681
Callahan Scholarship Fund, Nellie, Trust u/w/o Nellie Callahan, Deceased, Trustees Larry Jackson, Kenneth Bassett, Clifford Scholter, Shirley A. Webster & Iowa-Des Moines National Bank [6]	9512-77X	73	626
Dumaine Farms [7]	13428-78X	73	650
Hutchinson Baseball Enterprises, Inc.[8]	13326-78X	73	144

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[1] Acquiescence in result relating to when petitioner abandoned his residence in Switzerland. Acquiescence "in result" means acceptance of the decision of the Court but disagreement with some or all the reasons assigned for the decision.

[2] Acquiescence in the issues relating to (1) whether petitioner was operated exclusively in furtherance of exempt purposes, and (2) whether petitioner served private rather than public interests.

[3] Acquiescence in result relating to whether certain expenditures made by petitioner in recovering, repairing and replacing flood damage equipment used in excavating business are deductible under section 162 in the year paid or incurred. Acquiescence "in result" means acceptance of the decision of the Court but disagreement with some or all the reasons assigned for the decision.

[4] Acquiescence relating to whether petitioner is entitled to continued tax-exempt status when it sells products made by blind individuals at a profit and remits a portion of its profits to the tax-exempt organization and to blind individuals.

[5] Nonacquiescence relating to whether petitioner, a non-profit incorporation of the Department of Anesthesiology of a section 501(c)(3) teaching hospital, which collects sums for the services of its members and disburses them to its members and the hospital, is an organization described under section 501(c)(3).

[6] Nonacquiescence relating to whether petitioner met the requirements of section 509(a)(3)(B) thereby qualifying for non-private foundation status as a supporting organization.

[7] Nonacquiescence in the issue relating to whether petitioner was organized exclusively for exempt purposes.

[8] Nonacquiescence relating to whether petitioner, whose purpose is the promotion of amateur athletics and whose principal activity is the owning and operation of an amateur baseball team that competes in a semi-professional league, is organized exclusively for charitable purposes.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 219.—Retirement Savings

26 CFR 1.219-1: Deduction for retirement savings.
(Also Sections 408, 409, 4974; 1.408-1, 1.409-1, 54.4974-1.)

T.D. 7714 [1]

TITLE 26.—INTERNAL REVENUE—CHAPTER I, SUBCHAPTER A, PART 1—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953, SUBCHAPTER D, PART 54—PENSION EXCISE TAXES

Individual retirement arrangements

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to individual retirement arrangements (IRA's—individual retirement accounts, individual retirement annuities or retirement bonds). Changes to the applicable tax law were made by the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1]. These regulations provide necessary guidance to the public for compliance with the law, and affect individuals who maintain IRA's and institutions which sponsor IRA's.

DATE: The regulations are generally effective for taxable years beginning after December 31, 1974.

FOR FURTHER INFORMATION CONTACT: William D. Gibbs of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3430) (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On February 21, 1975, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under sections 219, 402, 403 and 408 of the Internal Revenue Code of 1954 (40 F.R. 7661). A new part, containing regulations under Code sections 4973 and 4974 (26 CFR Part 54), was also proposed. A correction notice was published in the Federal Register on March 5, 1975 (40 F.R. 10187). A supplemental notice was published on November 19, 1975 (40 F.R. 53593). A notice which withdrew and reproposed part of the notice of February 21, 1975 was published in the Federal Register on March 23, 1979 (44 F.R. 17754). The amendments were proposed to conform the regulations to section 2002 of the Employee Retirement Income Security Act of 1974 (88 Stat. 958) [supra, at 127]. These final regulations, in general, do not reflect changes and additions made to the tax law by the Tax Reform Act of 1976 (90 Stat. 1520) [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1], the Revenue Act of 1978 (92 Stat. 2763) [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1], and the Act of October 14, 1978 (P.L. 95-458, 92 Stat. 1255) [1978-2 C.B. 367]. Thus, these final regulations do not deal with the extension of the period for making individual retirement plan contributions under sections 219(c)(3) and 220(c)(4), the deduction of excess contributions in a subsequent year for which there is an unused limitation under sections 219(c)(5) and 220(c)(6), the additional period to rectify certain excess contributions under section 408(d)(5), and the allowance of rollovers on a more frequent basis under section 408(d)(3)(B).

Due to numerous statutory changes made to sections 402 and 4973 since the publication of the first notice, proposed regulations under those sections have been withdrawn and will be reproposed at a later date.

SPECIAL EFFECTIVE DATE FOR ROLLOVERS

If an individual engages in a transaction described in section 408(d)(3)(A)(i) (relating to rollover contributions) on or before April 15, 1976, the first such transaction by the individual on or before April 15, 1976, will not be taken into account for purposes of applying the three year limitation rule of section 408(d)(3)(B) in effect for taxable years beginning before January 1, 1978.

TEMPORARY REGULATIONS SUPERSEDED

Section 11.408(a)(2)-1 of the Temporary Income Tax Regulations under the Employee Retirement Income Security Act of 1974 is superseded by § 1.408-2(b)(2).

DRAFTING INFORMATION

The principal author of this regulation was William D. Gibbs of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to the regulations are hereby adopted:

INCOME TAX REGULATIONS (26 CFR Part 1)

Paragraph 1. The folowing new sections are added immediately after § 1.218.0:

§ 1.219-1 Deduction for retirement savings.

(a) *In general.* Subject to the limitations and restrictions of paragraph (b) and the special rules of paragraph (c)(3) of this section, there shall be allowed a deduction under section 62 from gross income of amounts paid for the taxable year of an individual on behalf of such individual to an individual retirement account described in section 408(a), for an individual retirement annuity described in section 408(b), or for a retirement bond described in section 409. The deduction described in the preceding sentence shall be allowed only to the individual on whose behalf such individual retirement account, individual retirement annuity, or retirement bond is maintained. The first sentence of this paragraph shall apply only in the case of a contribution of cash. A contribution of property other than cash is not allowable as a deduction under this section. In the case of a retirement bond, a deduction will not be allowed if the bond is redeemed within 12 months of its issue date.

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[1] This publication of the Treasury Decision contains the complete text of the amendments to the regulations. The instructions for modifying the notices of proposed rulemaking have been omitted.

(b) *Limitations and restrictions*—(1) *Maximum deduction.* The amount allowable as a deduction under section 219(a) to an individual for any taxable year cannot exceed an amount equal to 15 percent of the compensation includible in the gross income of the individual for such taxable year, or $1,500, whichever is less.

(2) *Restrictions*—(1) *Individuals covered by certain other plans.* No deduction is allowable under section 219(a) to an individual for the taxable year if for any part of such year—

(A) He was an active participant in—

(*1*) A plan described in section 401(a) which includes a trust exempt from tax under section 501(a),

(*2*) An annuity plan described in section 403(a),

(*3*) A qualified bond purchase plan described in section 405(a), or

(*4*) A retirement plan established for its employees by the United States, by a State or political subdivision thereof, or by an agency or instrumentality of any of the foregoing, or

(B) Amounts were contributed by his employer for an annuity contract described in section 403(b) (whether or not the individual's rights in such contract are nonforfeitable).

(ii) *Contributions after age 70½.* No deduction is allowable under section 219(a) to an individual for the taxable year of the individual, if he has attained the age of 70½ before the close of such taxable year.

(iii) *Rollover contributions.* No deduction is allowable under section 219 for any taxable year of an individual with respect to a rollover contribution described in section 402(a)(5), 402(a)(7), 403(a)(4), 403(b)(8), 408(d)(3), or 409(b)(3)(C).

(3) *Amounts contributed under endowment contracts.* (i) For any taxable year, no deduction is allowable under section 219(a) for amounts paid under an endowment contract described in § 1.408-3(e) which is allocable under subdivision (ii) of this subparagraph to the cost of life insurance.

(ii) For any taxable year, the cost of current life insurance protection under an endowment contract described in paragraph (b)(3)(i) of this section is the product of the net premium cost, as determined by the Commissioner, and the excess, if any, of the death benefit payable under the contract during the policy year beginning in the taxable year over the cash value of the contract at the end of such policy year.

(iii) The provisions of this subparagraph may be illustrated by the following examples:

Example (*1*). A, an individual who is otherwise entitled to the maximum deduction allowed under section 219, purchases, at age 20, an endowment contract described in § 1.408-3(e) which provides for the payment of an annuity of $100 per month, at age 65, with a minimum death benefit of $10,000, and an annual premium of $220. The cash value at the end of the first policy year is 0. The net premium cost, as determined by the Commissioner, for A's age is $1.61 per thousand dollars of life insurance protection. The cost of current life insurance protection is $16.10 ($1.61 × 10). A's maximum deduction under section 219 with respect to amounts paid under the endowment contract for the taxable year in which the first policy year begins is $203.90 ($220 − $16.10).

Example (*2*). Assume the same facts as in example (1), except that the cash value at the end of the second policy year is $200 and the net premium cost is $1.67 per thousand for A's age. The cost of current life insurance protection is $16.37 ($1.67 × 9.8). A's maximum deduction under section 219 with respect to amounts paid under the endowment contract for the taxable year in which the second policy year begins is $203.63 ($220 — $16.37).

(c) *Definitions and special rules*—(1) *Compensation.* For purposes of this section, the term "compensation" means wages, salaries, professional fees, or other amounts derived from or received for personal service actually rendered (including, but not limited to, commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, and bonuses) and includes earned income, as defined in section 401(c)(2), but does not include amounts derived from or received as earnings or profits from property (including, but not limited to, interest and dividends) or amounts not includible in gross income.

(2) *Active participant.* For the definition of active participant, see § 1.219-2.

(3) *Special rules.* (i) The maximum deduction allowable under section 219(b)(1) is computed separately for each individual. Thus, if a husband and wife each has compensation of $10,000 for the taxable year and they are each otherwise eligible to contribute to an individual retirement account and they file a joint return, then the maximum amount allowable as a deduction under section 219 is $3,000, the sum of the individual maximums of $1,500. However, if, for example, the husband has compensation of $20,000, the wife has no compensation, each is otherwise eligible to contribute to an individual retirement account for the taxable year, and they file a joint return, the maximum amount allowable as a deduction under section 219 is $1,500.

(ii) Section 219 is to be applied without regard to any community property laws. Thus, if, for example, a husband and wife, who are otherwise eligible to contribute to an individual retirement account, live in a community property jurisdiction and the husband alone has compensation of $20,000 for the taxable year, then the maximum amount allowable as a deduction under section 219 is $1,500.

(4) *Employer contributions.* For purposes of this chapter, any amount paid by an employer to an individual retirement account or for an individual retirement annuity or retirement bond constitutes the payment of compensation to the employee (other than a self-employed individual who is an employee within the meaning of section 401(c)(1) includible in his gross income, whether or not a deduction for such payment is allowable under section 219 to such employee after the application of section 219(b). Thus, an employer will be entitled to a deduction for compensation paid to an employee for amounts the employer

contributes on the employee's behalf to an individual retirement account, for an individual retirement annuity, or for a retirement bond if such deduction is otherwise allowable under section 162.

§ 1.219-2 Definition of active participant.

(a) *In general.* This section defines the term "active participant" for individuals who participate in retirement plans described in section 219(b)(2). Any individual who is an active participant in such a plan is not allowed a deduction under section 219(a) for contributions to an individual retirement account.

(b) *Defined benefit plans*—(1) *In general.* Except as provided in subparagraphs (2), (3) and (4) of this paragraph, an individual is an active participant in the defined benefit plan if for any portion of the plan year ending with or within such individual's taxable year he is not excluded under the eligibility provisions of the plan. An individual is not an active participant in a particular taxable year merely because the individual meets the plan's eligibility requirements during a plan year beginning in that particular taxable year but ending in a later taxable year of the individual. However, for purposes of this section, an individual is deemed not to satisfy the eligibility provisions for a particular plan year if his compensation is less than the minimum amount of compensation needed under the plan to accrue a benefit. For example, assume a plan is integrated with Social Security and only those individuals whose compensation exceeds a certain amount accrue benefits under the plan. An individual whose compensation for the plan year ending with or within his taxable year is less than the amount necessary under the plan to accrue a benefit is not an active participant in such plan.

(2) *Rules for plans maintained by more than one employer.* In the case of a defined benefit plan described in section 413(a) and funded at least in part by service-related contributions, *e.g.*, so many cents-per-hour, an individual is an active participant if an employer is contributing or is required to contribute to the plan an amount based on that individual's service taken into account for the plan year ending with or within the individual's taxable year. The general rule in paragraph (b)(1) of this section applies in the case of plans described in section 413(a) and funded only on some non-service-related unit, *e.g.*, so many cents-per-ton of coal.

(3) *Plans in which accruals for all participants have ceased.* In the case of a defined benefit plan in which accruals for all participants have ceased, an individual in such a plan is not an active participant. However, any benefit that may vary with future compensation of an individual provides additional accruals. For example, a plan in which future benefit accruals have ceased, but the actual benefit depends upon final average compensation will not be considered as one in which accruals have ceased.

(4) *No accruals after specified age.* An individual in a defined benefit plan who accrues no additional benefits in a plan year ending with or within such individual's taxable year by reason of attaining a specified age is not an active participant by reason of his participation in that plan.

(c) *Money purchase plan.* An individual is an active participant in a money purchase plan if under the terms of the plan employer contributions must be allocated to the individual's account with respect to the plan year ending with or within the individual's taxable year. This rule applies even if an individual is not employed at any time during the individual's taxable year.

(d) *Profit-sharing and stock-bonus plans*—(1) *In general.* This paragraph applies to profit-sharing and stock bonus plans. An individual is an active participant in such plans in a taxable year if a forfeiture is allocated to his account as of a date in such taxable year. An individual is also an active participant in a taxable year in such plans if an employer contribution is added to the participant's account in such taxable year. A contribution is added to a participant's account as of the later of the following two dates: the date the contribution is made or the date as of which it is allocated. Thus, if a contribution is made in an individual's taxable year 2 and allocated as of a date in individual's taxable year 1, the later of the relevant dates is the date the contribution is made. Consequently, the individual is an active participant in year 2 but not in year 1 as a result of that contribution.

(2) *Special rule.* An individual is not an active participant for a particular taxable year by reason of a contribution made in such year allocated to a previous year if such individual was an active participant in such previous year by reason of a prior contribution that was allocated as of a date in such previous year.

(e) *Employee contributions.* If an employee makes a voluntary or mandatory contribution to a plan described in paragraphs (b), (c) or (d) of this section, such employee is an active participant in the plan for the taxable year in which such contribution is made.

(f) *Certain individuals not active participants.* For purposes of this section, an individual is not an active participant under a plan for any taxable year of such individual for which such individual elects, pursuant to the plan, not to participate in such plan.

(g) *Retirement savings for married individuals.* The provisions of this section apply in determining whether an individual or his spouse is an active participant in a plan for purposes of section 220 (relating to retirement savings for certain married individuals).

(h) *Examples.* The provisions of this section may be illustrated by the following examples:

Example (1). The X Corporation maintains a defined benefit plan which has the following rules on participation and accrual of benefits. Each employee who has attained the age of 25 or has completed one year of service is a participant in the plan. The plan further provides that each participant shall receive upon retirement $12 per month for each year of service in which the employee completes 1000 hours of service. The plan year is the calendar year. B, a calendar-year taxpayer, enters the plan on January 2, 1980, when he is 27 years of age. Since B has attained the age of 25, he is a participant in the plan. However, B completes less than 1000 hours of service in 1980 and 1981. Although B is not accruing any benefits under the plan in 1980 and 1981, he is an active participant under section 219(b)(2) because he is a participant in the plan. Thus, B cannot make deductible contributions to an individual retirement arrangement for his taxable years of 1980 and 1981.

Example (2). The Y Corporation maintains a profit-sharing plan for its employees. The plan year of the plan is the calendar year. C is a calendar-year taxpayer and a prticipant in the plan. On June 30, 1980, the employer makes a contribution for 1980 which is allocated on July 31, 1980. In 1981 the employer makes a second contribution for 1980, allocated as of December 31, 1980. Under the general rule stated in § 1.219-2(d)(1), C is an active participant in 1980. Under the special rule stated in § 1.219-2(d)(2), however, C is not an active participant in 1981 by reason of that contribution made in 1981.

(i) *Effective date*. The provisions set forth in this section are effective for taxable years beginning after December 31, 1978.

Par. 2. Paragraph (d)(4) of § 1.408-1 is redesignated as paragraph (d)(4) of § 1.408-6, which is added below.

Par. 3. The following new sections are added immediately after § 1.407-1:

§ 1.408-1 General rules.

(a) *In general*. Section 408 prescribes rules relating to individual retirement accounts and individual retirement annuities. In addition to the rules set forth in §§ 1.408-2 and 1.408-3, relating respectively to individual retirement accounts and individual retirement annuities, the rules set forth in this section shall also apply.

(b) *Exemption from tax*. The individual retirement account or individual retirement annuity is exempt from all taxes under subtitle A of the Code other than the taxes imposed under section 511, relating to tax on unrelated business income of charitable, etc., organizations.

(c) *Sanctions*—(1) *Excess contributions*. If an individual retirement account or individual retirement annuity accepts and retains excess contributions, the individual on whose behalf the account is established or who is the owner of the annuity will be subject to the excise tax imposed by section 4973.

(2) *Prohibited transactions by owner or beneficiary of individual retirement account*—(i) Under section 408(e)(2), if, during any taxable year of the individual for whose benefit any individual retirement account is established, that individual or the individual's beneficiary engages in any transaction prohibited by section 4975 with respect to such account, such account ceases to be an individual retirement account as of the first day of such taxable year. In any case in which any individual retirement account ceases to be an individual retirement account by reason of the preceding sentence as of the first day of any taxable year, section 408(d)(1) applies as if there were a distribution on such first day in an amount equal to the fair market value (on such first day) of all assets in the account (on such first day). The preceding sentence applies even though part of the fair market value of the individual retirement account as of the first day of the taxable year is attributable to excess contributions which may be returned tax-free under section 408(d)(4) or 408(d)(5).

(ii) If the trust with which the individual engages in any transaction described in subdivision (i) of this subparagraph is established by an employer or employee association under section 408(c), only the employee who engages in the prohibited transaction is subject to disqualification of his separate account.

(3) *Prohibited transaction by person other than owner or beneficiary of account*. If any person other than the individual on whose behalf an individual retirment account is established or the individual's beneficiary engages in any transaction prohibited by section 4975 with respect to such account, such person shall be subject to the taxes imposed by section 4975.

(4) *Pledging account as security*. Under section 408(e)(4), if, during any taxable year of the individual for whose benefit an individual retirement account is established, that individual uses the account or any portion thereof as security for a loan, the portion so used is treated as distributed to that individual.

(5) *Borrowing on annuity contract*. Under section 408(e)(3), if during any taxable year the owner of an individual retirement annuity borrows any money under or by use of such contract, the contract ceases to be an individual retirement annuity as of the first day of such taxable year. See § 1.408-3(c).

(6) *Premature distributions*. If a distribution (whether a deemed distribution or an actual distribution) is made from an individual retirement account, or individual retirement annuity, to the individual for whose benefit the account was established, or who is the owner of the annuity, before the individual attains age 59½ (unless the individual has become disabled within the meaning of section 72(m)(7)), the tax under Chapter 1 of the Code for the taxable year in which such distribution is received is increased under section 408(f)(1) or (f)(2). The increase equals 10 percent of the amount of the distribution which is includible in gross income for the taxable year. Except in the case of the credits allowable under section 31, 39, or 42, no credit can be used to offset the increased tax described in this subparagraph. See, however, § 1.408-4(c)(3).

(d) *Limitation on contributions and benefits*. An individual retirement account or individual retirement annuity is subject to the limitation on contributions and benefits imposed by section 415 for years beginning after December 31, 1975.

(e) *Community property laws*. Section 408 shall be applied without regard to any community property laws.

§ 1.408-2 Individual retirement accounts.

(a) *In general*. An individual retirement account must be a trust or a custodial account (see paragraph (d) of this section). It must satisfy the requirements of paragraph (b) of this section in order to qualify as an individual retirement account. It may be established and maintained by an individual, by an employer for the benefit of his employees (see paragraph (c) of this section), or by an employee association for the benefit of its members (see paragraph (c) of this section).

(b) *Requirements*. An individual retirement account must be a trust created or organized in the United States (as defined in section 7701(a)(9)) for the exclusive benefit of an individual or his beneficiaries. Such trust must be maintained at all times as a domestic trust in the United States. The instrument creating the trust must be in writing and the following requirements must be satisfied.

(1) *Amount of acceptable contributions.* Except in the case of a contribution to a simplified employee pension described in section 408(k) and a rollover contribution described in section 408(d)(3), 402(a)(5), 402(a)(7), 403(a)(4), 403(b)(8) or 409(b)(3)(C), the trust instrument must provide that contributions may not be accepted by the trustee for the taxable year in excess of $1,500 on behalf of any individual for whom the trust is maintained. An individual retirement account maintained as a simplified employee pension may provide for the receipt of up to $7,500 for a calendar year.

(2) *Trustee.* (i) The trustee must be a bank (as defined in section 401(d)(1) and the regulations thereunder) or another person who demonstrates, in the manner described in paragraph (b)(2)(ii) of this section, to the satisfaction of the Commissioner, that the manner in which the trust will be administered will be consistent with the requirements of section 408 and this section.

(ii) A person may demonstrate to the satisfaction of the Commissioner that the manner in which he will administer the trust will be consistent with the requirements of section 408 only upon the filing of a written application to the Commissioner of Internal Revenue, Attention: E:EP, Internal Revenue Service, Washington, D.C. 20224. Such application must meet the applicable requirements of the regulations under section 401(d)(1), relating to nonbank trustees of pension and profit-sharing trusts benefiting owner-employees.

(iii) Section 11.408(a)(2)-1 of the Temporary Income Tax Regulations under the Employee Retirement Income Security Act of 1974 is superseded by this subparagraph (2).

(3) *Life insurance contracts.* No part of the trust funds may be invested in life insurance contracts. An individual retirement account may invest in annuity contracts which provide, in the case of death prior to the time distributions commence, for a payment equal to the sum of the premiums paid or, if greater, the cash value of the contract.

(4) *Nonforfeitability.* The interest of any individual on whose behalf the trust is maintained in the balance of his account must be nonforfeitable.

(5) *Prohibition against commingling.* (i) The assets of the trust must not be commingled with other property except in a common trust fund or common investment fund.

(ii) For purposes of this subparagraph, the term "common investment fund" means a group trust created for the purpose of providing a satisfactory diversification of investments or a reduction of administrative expenses for the individual participating trusts, and which group trust satisfies the requirements of section 408(c) (except that it need not be established by an employer or an association of employees) and the requirements of section 401(a) in the case of a group trust in which one of the individual participating trusts is an employees' trust described in section 401(a) which is exempt from tax under section 501(a).

(iii) For purposes of this subparagraph, the term "individual participating trust" means an employee's trust described in section 401(a) which is exempt from tax under section 501(a) or a trust which satisfies the requirements of section 408(a) provided that in the case of such an employees' trust, such trust would be permitted to participate in such a group trust if all of the other individual participating trusts were employees' trusts described in section 401(a) which are exempt from tax under section 501(a).

(6) *Distribution of interest.* (i) The trust instrument must provide that the entire interest of the individual for whose benefit the trust is maintained must be distributed to him in accordance with paragraph (b)(6)(ii) or (iii) of this section.

(ii) Unless the provisions of paragraph (b)(6)(iii) of this section apply, the entire interest of the individual must be actually distributed to him not later than the close of his taxable year in which he attains age 70½.

(iii) In lieu of distributing the individual's entire interest as provided in paragraph (b)(6)(ii) of this section, the interest may be distributed commencing not later than the taxable year described in such paragraph (b)(6)(ii). In such case, the trust must expressly provide that the entire interest of the individual will be distributed to the individual and the individual's beneficiaries, in a manner which satisfies the requirements of paragraph (b)(6)(v) of this section, over any of the following periods (or any combination thereof)—

(A) The life of the individual,

(B) The lives of the individual and spouse,

(C) A period certain not extending beyond the life expectancy of the individual, or

(D) A period certain not extending beyond the joint life and last survivor expectancy of the individual and spouse.

(iv) The life expectancy of the individual or the joint life and last survivor expectancy of the individual and spouse cannot exceed the period computed by use of the expected return multiples in § 1.72-9, or, in the case of payments under a contract issued by an insurance company, the period computed by use of the mortality tables of such company.

(v) If an individual's entire interest is to be distributed over a period described in paragraph (b)(6)(iii) of this section, beginning in the year the individual attains 70½ the amount to be distributed each year must be not less than the lesser of the balance of the individual's entire interest or an amount equal to the quotient obtained by dividing the entire interest of the individual in the trust at the beginning of such year (including amounts not in the individual retirement account at the beginning of the year because they have been withdrawn for the purpose of making a rollover contribution to another individual retirement plan) by the life expectancy of the individual (or the joint life and last survivor expectancy of the individual and spouse (whichever is applicable)), determined in either case as of the date the individual attains age 70 in accordance with paragraph (b)(6)(iv) of this section, reduced by one for each taxable year commencing after the individual's attainment of age 70½. An annuity or endowment contract issued by an insurance company which provides for non-increasing payments over one of the periods described in paragraph (b)(6)(iii) of this section beginning not later than the close of the taxable year in which the individual attains age 70½ satisfies this provision. However, no distribution need be made in any year, or a lesser amount may be distributed, if beginning with the year the individual attains age 70½ the aggregate amounts distributed by the end of any year are at least equal to the aggregate of the minimum amounts required by this subdivision to have been distributed by the end of such year.

(vi) If an individual's entire interest is distributed in the form of an annuity contract, then the requirements of section 408(a)(6) are satisfied if the distribution of such contract takes place before the close of the taxable year described in subdivision (ii) of this subparagraph, and if the individual's interest will be paid over a period described in subdivision (iii) of this subparagraph and at a rate which satisfies the requirements of subdivision (v) of this subparagraph.

(vii) In determining whether paragraph (b)(6)(v) of this section is satisfied, all individual retirement plans maintained for an individual's benefit (except those under which he is a beneficiary described in section 408(a)(7)) at the close of the taxable year in which he reaches age 70½ must be aggregated. Thus, the total payments which such individual receives in any taxable year must be at least equal to the amount he would have been required to receive had all the plans been one plan at the close of the taxable year in which he attained age 70½.

(7) *Distribution upon death.* (i) The trust instrument must provide that if the individual for whose benefit the trust is maintained dies before the entire interest in the trust has been distributed to him, or if distribution has been commenced as provided in paragraph (b)(6) of this section to the surviving spouse and such spouse dies before the entire interest has been distributed to such spouse, the entire interest (or the remaining part of such interest if distribution thereof has commenced) must, within 5 years after the individual's death (or the death of the surviving spouse) be distributed or applied to the purchase of an immediate annuity for this beneficiary or beneficiaries (or the beneficiary or beneficiaries of the surviving spouse) which will be payable for the life of such beneficiary or beneficiaries (or for a term certain not extending beyond the life expectancy of such beneficiary or beneficiaries) and which annuity contract will be immediately distributed to such beneficiary or beneficiaries. A contract described in the preceding sentence is not includible in gross income upon distribution. Section 1.408-4(e) provides rules applicable to the taxation of such contracts. The first sentence of this paragraph (b)(7) shall have no application if distributions over a term certain commenced before the death of the individual for whose benefit the trust was maintained and the term certain is for a period permitted under paragraph (b)(6)(iii) (C) or (D) of this section.

(ii) Each such beneficiary (or beneficiary of a surviving spouse) may elect to treat the entire interest in the trust (or the remaining part of such interest if distribution thereof has commenced) as an account subject to the distribution requirements of section 408(a)(6) and paragraph (b)(6) of this section instead of those of section 408(a)(7) and paragraph (b)(7) of this section. Such an election will be deemed to have been made if such beneficiary treats the account in accordance with the requirements of section 408(a)(6) and paragraph (b)(6) of this section. An election will be considered to have been made by such beneficiary if either of the following occurs: (A) any amounts in the account (including any amounts that have been rolled over, in accordance with the requirements of section 408(d)(3)(A)(i), into an individual retirement account, individual retirement annuity, or retirement bond for the benefit of such individual) have not been distributed within the appropriate time period required by section 408(a)(7) and paragraph (b)(7) of this section; or (B) any additional amounts are contributed to the account (or to the account, annuity, or bond to which the beneficiary has rolled such amounts over, as described in (1) above) which are subject, or deemed to be subject, to the distribution requirements of section 408(a)(6) and paragraph (b)(6) of this section.

(8) *Definition of beneficiaries.* The term "beneficiaries" on whose behalf an individual retirement account is established includes (except where the context indicates otherwise) the estate of the individual, dependents of the individual, and any person designated by the individual to share in the benefits of the account after the death of the individual.

(c) *Accounts established by employers and certain association of employees*—(1) *In general.* A trust created or organized in the United States (as defined in section 7701(a)(9)) by an employer for the exclusive benefit of his employees or their beneficiaries, or by an association of employees for the exclusive benefit of its members or their beneficiaries, is treated as an individual retirement account if the requirements of paragraphs (c)(2) and (c)(3) of this section are satisfied under the written governing instrument creating the trust. A trust described in the preceding sentence is for the exclusive benefit of employees or members even though it may maintain an account for former employees or members and employees who are temporarily on leave.

(2) *General requirements.* The trust must satisfy the requirements of paragraphs (b)(1) through (7) of this section.

(3) *Special requirement.* There must be a separate accounting for the interest of each employee or member.

(4) *Definitions*—(i) *Separate accounting.* For purposes of paragraph (c)(3) of this section, the term "separate accounting" means that separate records must be maintained with

respect to the interest of each individual for whose benefit the trust is maintained. The assets of the trust may be held in a common trust fund, common investment fund, or common fund for the account of all individuals who have an interest in the trust.

(ii) *Employee association.* For purposes of this paragraph and section 408(c), the term "employee association" means any organization composed of two or more employees, including, but not limited to, an employee association described in section 501(c)(4). Such association may include employees within the meaning of section 401(c)(1). There must be, however, some nexus between the employees (*e.g.*, employees of same employer, employees in the same industry, etc.) in order to qualify as an employee association described in this subdivision (ii).

(d) *Custodial accounts.* For purposes of this section and section 408 (a), a custodial account is treated as a trust described in section 408(a) if such account satisfies the requirements of section 408(a) except that it is not a trust and if the assets of such account are held by a bank (as defined in section 401(d)(1) and the regulations thereunder) or such other person who satisfies the requirements of paragraph (b)(2)(ii) of this section. For purposes of this chapter, in the case of a custodial account treated as a trust by reason of the preceding sentence, the custodian of such account will be treated as the trustee thereof.

§ 1.408-3 Individual retirement annuities.

(a) *In general.* An individual retirement annuity is an annuity contract or endowment contract (described in paragraph (e)(1) of this section) issued by an insurance company which is qualified to do business under the law of the jurisdiction in which the contract is sold and which satisfies the requirements of paragraph (b) of this section. A participation certificate in a group contract issued by an insurance company described in this paragraph will be treated as an individual retirement annuity if the contract satisfies the requirements of paragraph (b) of this section; the certificate of participation sets forth the requirements of paragraphs (1) through (5) of section 408(b); the contract provides for a separate accounting of the benefit allocable to each participant-owner; and the group contract is for the exclusive benefit of the participant owners and their beneficiaries. For purposes of this title, a participant-owner of a group contract described in this paragraph shall be treated as the owner of an individual retirement annuity. A contract will not be treated as other than an individual retirement annuity merely because it provides for waiver of premium on disability. An individual retirement annuity contract which satisfies the requirements of section 408(b) need not be purchased under a trust if the requirements of paragraph (b) of this section are satisfied. An individual retirement endowment contract may not be held under a trust which satisfies the requirements of section 408(a). Distribution of the contract is not a taxable event. Distributions under the contract are includible in gross income in accordance with the provisions of § 1.408-4(e).

(b) *Requirements*—(1) *Transferability.* The annuity or the endowment contract must not be transferable by the owner. An annuity or endowment contract is transferable if the owner can transfer any portion of his interest in the contract to any person other than the issuer thereof. Accordingly, such a contract is transferable if the owner can sell, assign, discount, or pledge as collateral for a loan or as security for the performance of an obligation or for any other purpose his interest in the contract to any person other than the issuer thereof. On the other hand, a contract is not to be considered transferable merely because the contract contains: a provision permitting the individual to designate a beneficiary to receive the proceeds in the event of his death, a provision permitting the individual to elect a joint and survivor annuity, or other similar provisions.

(2) *Annual premium.* Except in the case of a contribution to a simplified employee pension described in section 408(k), the annual premium on behalf of any individual for the annuity or the endowment contract cannot exceed $1,500. Any refund of premiums must be applied before the close of the calendar year following the year of the refund toward the payment of future premiums or the purchase of additional benefits.

(3) *Distribution.* The entire interest of the owner must be distributed to him in the same manner and over the same period as described in § 1.408-2 (b)(6).

(4) *Distribution upon death.* If the owner dies before the entire interest has been distributed to him, or if distribution has commenced to the surviving spouse, the remaining interest must be distributed in the same manner, over the same period, and to the same beneficiaries as described in § 1.408-2(b)(7).

(5) *Nonforfeitability.* The entire interest of the owner in the annuity or endowment contract must be nonforfeitable.

(6) *Flexible premium.* (Reserved)

(c) *Disqualification.* If during any taxable year the owner of an annuity borrows any money under the annuity or endowment contract or by use of such contract (including, but not limited to, pledging the contract as security for any loan), such contract will cease to be an individual retirement annuity as of the first day of such taxable year, and will not be an individual retirement annuity at any time thereafter. If an annuity or endowment contract which constitutes an individual retirement annuity is disqualified as a result of the preceding sentence, an amount equal to the fair market value of the contract as of the first day of the taxable year of the owner in which such contract is disqualified is deemed to be distributed to the owner. Such owner shall include in gross income for such year an amount equal to the fair market value of such contract as of such first day. The preceding sentence applies even though part of the fair market value of the individual retirement annuity as of the first day of the taxable year is attributable to excess contributions which may be returned tax-free under section 408(d)(4) or 408(d)(5).

(d) *Premature distribution tax on deemed distribution.* If the individual has not attained age 59½ before the beginning of the year in which the disqualification described in paragraph (c) of this section occurs, see section 408(f)(2) for additional tax on premature distributions.

(e) *Endowment contracts*—(1) *Additional requirements for endowment contracts.* No contract providing life insurance protection issued by a company described in paragraph (a) of this section shall be treated as an endowment contract for purposes of this section if—

(i) Such contract matures later than the taxable year in which the individual in whose name the contract is purchased attains the age of 70½;

(ii) Such contract is not for the exclusive benefit of such individual or his beneficiaries;

(iii) Premiums under the contract may increase over the term of the contract;

(iv) When all premiums are paid when due, the cash value of such contract at maturity is less than the death benefit payable under the contract at any time before maturity;

(v) The death benefit does not, at some time before maturity, exceed the greater of the cash value or the sum of premiums paid under the contract;

(vi) Such contract does not provide for a cash value;

(vii) Such contract provides that the life insurance element of such contract may increase over the term of such contract, unless such increase is merely because such contract provides for the purchase of additional benefits;

(viii) Such contract provides insurance other than life insurance and waiver of premiums upon disability; or

(ix) Such contract is issued after November 6, 1978.

(2) *Treatment of proceeds under endowment contract upon death of individual.* In the case of the payment of a death benefit under an endowment contract upon the death of the individual in whose name the contract is purchased, the portion of such payment which is equal to the cash value immediately before the death of such individual is not excludable from gross income under section 101(a) and is treated as a distribution from an individual retirement annuity. The remaining portion, if any, of such payment constitutes current life insurance protection and is excludable under section 101(a). If a death benefit is paid under an endowment contract at a date or dates later than the death of the individual, section 101(d) is applicable only to the portion of the benefit which is attributable to the amount excludable under section 101(a).

§ 1.408-4 Treatment of distributions from individual retirement arrangements.

(a) *General rule*—(1) *Inclusion in income.* Except as otherwise provided in this section, any amount actually paid or distributed or deemed paid or distributed from an individual retirement account or individual retirement annuity shall be included in the gross income of the payee or distributee for the taxable year in which the payment or distribution is received.

(2) *Zero basis.* Notwithstanding section 1015(d) or any other provision of the Code, the basis (or investment in the contract) of any person in such an account or annuity is zero. For purposes of this section, an assignment of an individual's rights under an individual retirement account or an individual retirement annuity shall, except as provided in § 1.408-4(g) (relating to transfer incident to divorce), be deemed a distribution to such individual from such account or annuity of the amount assigned.

(b) *Rollover contribution*—(1) *To individual retirement arrangement.* Paragraph (a)(1) of this section shall not apply to any amount paid or distributed from an individual retirement account or individual retirement annuity to the individual for whose benefit the account was established or who is the owner of the annuity if the entire amount received (including the same amount of money or any other property) is paid into an individual retirement account, annuity (other than an endowment contract), or bond created for the benefit of such individual not later than the 60th day after the day on which he receives the payment or distribution.

(2) *To qualified plan.* Paragraph (a)(1) of this section does not apply to any amount paid or distributed from an individual retirement account or individual retirement annuity to the individual for whose benefit the account was established or who is the owner of the annuity if—

(i) No amount in the account or no part of the value of the annuity is attributable to any source other than a rollover contribution from an employees' trust destribed in section 401(a) which is exempt from tax under section 501(a) or a rollover contribution from an annuity plan described in section 403(a) and the earnings on such sums, and

(ii) The entire amount received (including the same amount of money and any other property) represents the entire amount in the account and is paid into another such trust or plan (for the benefit of such individual) not later than the 60th day after the day on which the payment or distribution is received.

This subparagraph does not apply if any portion of the rollover contribution described in paragraph (b)(2)(i) of this section is attributable to an employees' trust forming part of a plan or an annuity under which the individual was an employee within the meaning of section 401(c)(1) at the time contributions were made on his behalf under the plan.

(3) *To section 403(b) contract.* [Reserved]

(4) *Frequency limitation.* (i) For taxable years beginning on or before December 31, 1977, paragraph (b)(1) of this section does not apply to any amount received by an individual from an individual retirement account, annuity or bond if at any time during the 3-year period ending on the day of receipt, the individual received any other amount from an individual retirement account, annuity or bond which was not includible in his gross income because of the application of paragraph (b)(1) of this section.

(ii) [Reserved]

(c) *Excess contributions returned before due date of return*—(1) *Excess* *contribution.* For purposes of this paragraph, excess contributions are the excess of the amounts contributed to an individual retirement account or paid for an individual retirement annuity during the taxable year over the amount allowable as a deduction under section 219 or 220 for the taxable year.

(2) *General rule.* (i) Paragraph (a)(1) of this section does not apply to the distribution of any excess contribution paid during a taxable year to an account or annuity if: the distribution is received on or before the date prescribed by law (including extensions) for filing the individual's return for such taxable year; no deduction is allowed under section 219 or section 220 with respect to the excess contribution; and the distribution is accompanied by the amount of net income attributable to the excess contribution as of the date of the distribution as determined under subdivision (ii).

(ii) The amount of net income attributable to the excess contributions is an amount which bears the same ratio to the net income earned by the account during the computation period as the excess contribution bears to the sum of the balance of the account as of the first day of the taxable year in which the excess contribution is made and the total contribution made for such taxable year. For purposes of this paragraph, the term "computation period" means the period begining on the first day of the taxable year in which the excess contribution is made and ending on the date of the distribution from the account.

(iii) For purposes of paragraph (c)(2)(ii), the net income earned by the account during the computation period is the fair market value of the balance of the account immediately after the distribution increased by the amount of distributions from the account during the computation period, and reduced (but not below zero) by the sum of: (A) the fair market value of the balance of the account as of the first day of the taxable year in which the excess contribution is made and (B) the contributions to the account made during the computation period.

(3) *Time of inclusion.* (i) For taxable years beginning before January 1, 1977, the amount of net income determined under subparagraph (2) is includible in the gross income of the individual for the taxable year in which it is received. The amount of net income thus distributed is subject to the tax imposed by section 408(f)(1) for the year includible in gross income.

(ii) [Reserved]

(4) *Example.* The provisions of this paragraph may be illustrated by the following example:

Example. On January 1, 1975, A, age 55, who is a calendar-year taxpayer, contributes $1,500 to an individual retirement account established for his benefit. For 1975, A is entitled to a deduction of $1,400 under section 219. For 1975, A does not claim as deductions any other items listed in section 62. A's gross income for 1975 is $9,334. On April 1, 1976, $107 is distributed to A from his individual retirement account. As of such date, the balance of the account is $1,498 [$1,605 — $107]. There were no other distributions from the account as of such date. The net amount of income earned by the account is $105 [$1,498 + $107 — (0 + $1,500)]. The net income attributable to the excess contribution is $7. [$105 × ($100/$1,500)]. A's adjusted gross income for 1975 is his gross income for 1975 ($9,334) reduced by the amount allowable to A as a deduction under section 219 ($1,400), or $7,934. A will include the $7 of the $107 distributed on April 1, 1976, in his gross income for 1976. Further, A will pay an additional income tax of $.70 for 1976 under section 408(f)(1).

(d) *Deemed distribution*—(1) *General rule.* In any case in which an individual retirement account ceases to be an individual retirement account by reason of the application of section 408(e)(2), paragraph (a)(1) of this section shall apply as if there were a distribution on the first day of the taxable year in which such account ceases to be an individual retirement account of an amount equal to the fair market value on such day of all of the assets in the account on such day. In the case of a deemed distribution from an individual retirement annuity, see § 1.408-3(d).

(2) *Using account as security.* In any case in which an individual for whose benefit an individual retirement account is established uses, directly or indirectly, all or any portion of the account as security for a loan, paragraph (a)(1) of this section shall apply as if there were distributed on the first day of the taxable year in which the loan was made an amount equal to that portion of the account used as security for such loan.

(e) *Distribution of annuity contracts.* Paragraph (a)(1) of this section does not apply to any annuity contract which is distributed from an individual retirement account and which satisfies the requirements of paragraphs (b)(1), (3), (4) and (5) of section 408. Amounts distributed under such contracts will be taxable to the distributee under section 72. For purposes of applying section 72 to a distribution from such a contract, the investment in such contract is zero.

(f) *Treatment of assets distributed from an individual retirement account for the purchase of an endowment contract.* Under section 408(e)(5), if all, or any portion, of the assets of an individual retirement account are used to purchase an endowment contract described in § 1.408-3(e) for the benefit of the individual for whose benefit the account is established—

(1) The excess, if any, of the total amount of assets used to purchase such contract over the portion of the assets attributable to life insurance protection shall be treated as a rollover contribution described in section 408(d)(3), and

(2) The portion of the assets attributable to life insurance protection shall be treated as a distribution described in paragraph (a)(1) of this section, except that the provisions of section 408(f) shall not apply to such amount.

(g) *Transfer incident to divorce*—(1) *General rule.* The transfer of an individual's interest, in whole or in part, in an individual retirement account, individual retirement annuity, or a retirement bond, to his former spouse under a valid divorce decree or a written instrument incident to such divorce shall not be considered to be a distribution from such an account or annuity to such individual or his former spouse; nor shall it be considered a taxable transfer by such individual to his former spouse notwithstanding any other provision of Subtitle A of the Code.

(2) *Spousal account.* The interest described in this paragraph (g) which is transferred to the former spouse shall be treated as an individual retirement account of such spouse if the interest is an individual retirement account; an individual retirement annuity of such spouse if such interest is an individual retirement annuity; and a retirement bond of such spouse if such interest is a retirement bond.

§ 1.408-5 Annual reports by trustees or issuers.

(a) *In general.* The trustee of an individual retirement account or the issuer of an individual retirement annuity shall make annual calendar year reports concerning the status of the account or annuity. The report shall contain the information required in paragraph (b) and be furnished or filed in the manner and time specified in paragraph (c).

(b) *Information required to be included in the annual reports.* The annual calendar year report shall contain the following information for transactions occurring during the calendar year—

(1) The amount of contributions;

(2) The amount of distributions;

(3) In the case of an endowment contract, the amount of the premium paid allocable to the cost of life insurance;

(4) The name and address of the trustee or issuer; and

(5) Such other information as the Commissioner may require.

(c) *Manner and time for filing.* (1) The annual report shall be furnished to the individual on whose behalf the account is established or in whose name the annuity is purchased (or the beneficiary of the individual or owner). The report shall be furnished on or before the 30th day of June following the calendar year for which the report is required.

(2) The Commissioner may require the annual report to be filed with the Service at the time the Commissioner specifies.

(d) *Penalties.* Section 6693 prescribes penalties for failure to file the annual report.

(e) *Effective date.* This section shall apply to reports for calendar years after 1978.

(f) *Reports for years prior to 1979.* For years prior to 1979, a trustee or issuer shall make reports in the time and manner as the Commissioner requires.

Par. 4. There is inserted after § 1.408-5 a new section, § 1.408-6, and paragraph (d)(4)(x) and (xi) of this new section as redesignated by paragraph 2 of this Treasury decision is revised to read as set forth below:

§ 1.408-6 Disclosure statements for individual retirement arrangements.

(a) *In general*—(1) *General rule.* Trustees and issuers of individual retirement accounts and annuities are, under the authority of section 408(i), required to provide disclosure statements. This section sets forth these requirements.

(2) [Reserved]

(b) [Reserved]

(c) [Reserved]

(d) *Requirements.* (1) [Reserved]

(2) [Reserved]

(3) [Reserved]

(4) *Disclosure statements.* * * *

(x) This section shall be effective for disclosure statements and copies of governing instruments mailed, or delivered without mailing, after February 14, 1977.

(xi) This section does not reflect the amendments made by section 1501 of the Tax Reform Act of 1976 (90 Stat. 1734) [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 210] relating to retirement savings for certain married individuals.

Par. 5. There are added after § 1.408-6 the following new sections:

§ 1.408-7 Reports on distributions from individual retirement plans.

(a) *Requirement of report.* The trustee of an individual retirement account or the issuer of an individual retirement annuity who makes a distribution during any calendar year to an individual from such account or under such annuity shall make a report on Form W-2P (in the case of distributions that are not total distributions) or Form 1099R (in the case of total distributions), and their related transmittal forms, for such year. The return must show the name and address of the person to whom the distribution was made, the aggregate amount of such distribution, and such other information as is required by the forms.

(b) *Amount subject to this section.* The amounts subject to reporting under paragraph (a) include all amounts distributed or made available to which section 408(d) applies.

(c) *Time and place for filing.* The report required under this section for any calendar year shall be filed after the close of that year and on or before February 28 of the following year with the appropriate Internal Revenue Service Center.

(d) *Statement to recipients.* (1) Each trustee or issuer required to file Form 1099R or Form W-2P under this section shall furnish to the person whose identifying number is (or should be) shown on the forms a copy of the form.

(2) Each statement required by this paragraph to be furnished to recipients shall be furnished to such persons after November 30 of the year of the distribution and on or before January 31 of the following year.

(e) *Effective date.* This section is effective for calendar years beginning after December 31, 1977.

§ 1.409-1 Retirement bonds.

(a) *In general.* Section 409 authorizes the issuance of bonds under the Second Liberty Bond Act the purchase price of which would be deductible under section 219. Section 409 also prescribes the tax treatment of such bonds. See paragraph (b) of this section.

(b) *Income tax treatment of bonds*—(1) *General rule.* Except as provided in subparagraph (2) of this paragraph, the entire proceeds upon redemption of a retirement bond described in section 409(a) shall be included in the gross income of the taxpayer entitled to such proceeds. If a bond has not been tendered for redemption by the registered owner before the close of the taxable year in which he attains age 70½, he must include in his gross income for such taxable year the amount of the proceeds he would have received if the bond had been redeemed at age 70½. The provisions of sections 72 and 1232 do not apply to a retirement bond.

(2) *Exemptions.* (i) If a retirement bond is redeemed within 12 months after the issue date, the proceeds are excluded from gross income if no deduction is allowed under section 219 on account of the purchase of such bond. For definition of issue date, see 31 CFR § 346.1(c).

(ii) If a retirement bond is redeemed after the close of the taxable year in which the registered owner attains age 70½ the proceeds from the redemption of the bond are excludable from the gross income of the registered owner or his beneficiary to the extent that such proceeds were includible in the gross income of the registered owner for such taxable year.

(iii) If a retirement bond is surrendered for reissuance in the same or lesser face amount, the difference between current redemption value of the bond surrendered for reissuance and the current surrender value of the bond reissued is includible in the gross income of the registered owner.

(3) *Basis.* The basis of a retirement bond is zero.

(c) *Rollover.* The first sentence of paragraph (b)(1) of this section shall not apply in any case in which a retirement bond is redeemed by the registered owner before the close of the taxable year in which he attains the age of 70½ if he transfers the entire amount of the proceeds of such redemption to—

(1) An individual retirement account described in section 408(a) or an individual retirement annuity described in section 408(b) (other than an endowment contract described in § 1.408-3(e)), or

(2) An employees' trust which is described in section 401(a) which is exempt from tax under section 501(a), or an annuity plan described in section 403(a), for the benefit of the registered owner,

on or before the 60th day after the day on which he received the proceeds of such redemption. This subparagraph shall not apply in the case of a transfer to a trust or plan described in (c)(2) unless no part of the purchase price of the retirement bond redeemed is attributable to any source other than a rollover contribution from such an employees' trust or annuity plan (other than an annuity plan or employees' trust forming part of a plan under which the individual was an employee within the meaning of section 401(c)(1) at the time contributions were made on his behalf under the plan).

(d) *Additional tax.* (1) *Early redemption.* Except as provided in paragraph (2) of this paragraph, under section 409(c) if a retirement bond is redeemed by the registered owner before he attains age 59½, his tax under chapter 1 of the Code is increased by an amount equal to 10 percent of the proceeds of the redemption includible in his gross income for the taxable year. Except in the case of the credits allowable under sections 31, 39, or 42, no credit can be used to offset the tax described in the preceding sentence.

(2) *Limitations.* Subparagraph (1) of this paragraph shall not apply if—

(i) During the taxable year of the registered owner in which a retirement bond is redeemed, the registered owner becomes disabled within the meaning of section 72(m)(7), or

(ii) A retirement bond is tendered for redemption in accordance with paragraph (b)(2)(i) of this section.

MISCELLANEOUS EXCISE TAXES

(26 CFR Part 54)

Par. 6. The following regulations are added immediately before § 54.4975-6:

§ 54.4974-1 Excise tax on accumulations in individual retirement accounts or annuities.

(a) *General rule.* A tax equal to 50 percent of the amount by which the minimum amount required to be distributed from an individual retirement account or annuity described in section 408 during the taxable year of the payee under paragraph (b) of this section exceeds the amount actually distributed during the taxable year is imposed by section 4974 on the payee.

(b) *Minimum amount required to be distributed.* For purposes of this section, the minimum amount required to be distributed is the amount required under § 1.408-2(b)(6)(v) to be distributed in the taxable year described in paragraph (a) of this section.

(c) *Examples.* The application of this section may be illustrated by the following examples.

Example (1). In 1975, the minimum amount required to be distributed under § 1.408-2(b)(6)(v) to A under his individual retirement account is $100. Only $60 is actually distributed to A in 1975. Under section 4974, A would have an excise tax liability of $20 [50% of ($100 — $60)].

Example (2). Although no distribution is required under § 1.408-2(b)(6)(v) to be made in 1986, H, a married individual born on February 1, 1921, who has established and maintained an individual retirement account, decides to begin receiving distributions from the account beginning in 1986. H's wife, W, was born on March 6, 1921. H and W are calendar year taxpayers. H decides to receive his interest in the account over the joint life and last survivor expectancy of himself and his wife. On January 1, 1986, the balance in H's account is $10,000; H and W, based on their nearest birthdates, are 65; and the joint life and last survivor expectancy of H and his wife is 22.0 years (see Table II of § 1.72-9). His annual payments during the following years (none of which were required) were determined by dividing the balance in the account on the first day of each year by the joint life and last survivor expectancy reduced by the number of whole years elapsed since the distributions were to commence.

Date	Life expectancy minus whole years elapsed	Account Balance at beginning of each year	Annual payment
1-1-86	22.0	$10,000	$455
1-1-87	21.0	$10,118	$482
1-1-88	20.0	$10,214	$511
1-1-89	19.0	$10,285	$541
1-1-90	18.0	$10,329	$574
1-1-90	17.0	$10,340	$608

For 1986, 1987, 1989, and 1990, the amount required to be distributed under § 1.408-2(b)(6)(v) is zero. Thus, H would have no excise tax liability under section 4974 for these years. In 1991, the year H attains age 70½, the amount required to be distributed from the account under § 1.408-2(b)(6)(v) is $565, determined by dividing $10,340 (the account balance as of January 1, 1991) by 18.3 years (the joint life and last survivor expectancy of H and W, assuming they are both still living, as of January 1, 1991). If W should die after December 31, 1990, the joint life and last survivor expectancy determined on January 1, 1991 (18.3 years) would not be redetermined. Because the amount distributed from the account in 1991 ($608) exceeds the amount required to be distributed from the account in 1991 ($565), H has no excise tax liability under section 4974 for 1991.

Example (3). Assume the same facts as in example (2) except that W dies in 1988.

For 1988, 1989, and 1990, the amount required to be distributed under § 1.408-2 (b) (6) (v) is zero. Thus, H would have no excise tax liability under section 4974 for these years. In 1991, the amount required to be distributed under § 1.408-2(b) (6) (v) is $855, determined by dividing $10,340 (the account balance as of January 1, 1991) by 12.1 years (the life expectancy of H as of January 1, 1991). Because the amount distributed from the account in 1991 ($608) is less than the amount required to be distributed from the account in 1991 ($855), H has an excise tax liability of $123.50 under section 4974 for 1991 [50% of ($855 — $608)].

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved July 18, 1980.

EMIL M. SUNLEY,
Acting Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on August 7, 1980, 8:45 a.m., and published in the issue of the Federal Register for August 8, 1980, 45 F.R. 52782; correction notice published in the issue of the Federal Register for August 26, 1980, 45 F.R. 56802)

Section 408.—Individual Retirement Accounts

26 CFR 1.408-1: General rules.

Regulations relating to individual retirement arrangements. See T.D. 7714, page 6.

Section 409.—Retirement Bonds

26 CFR 1.409-1: Retirement bonds.

Regulations relating to individual retirement arrangements. See T.D. 7714, page 6.

Section 4974.—Excise Tax on Certain Accumulations in Individual Retirement Accounts or Annuities

26 CFR 54.4974-1: Excise tax on accumulations in individual retirement accounts or annuities.

Regulations relating to individual retirement arrangements. See T.D. 7714, page 6.

Section 6694.—Understatement of Taxpayer's Liability by Income Tax Return Preparer

26 CFR 1.6694-1: Understatement of taxpayer's liability by income tax return preparer.

Return preparer; mathematical or clerical error. An inadvertent error made by a return preparer in either listing or totaling on Schedule B, Form 1040, the separate amounts shown on Forms 1099-INT furnished by a taxpayer that does not result in substantial understatement of tax and is the only error on the return does not subject the preparer to the negligence penalty under section 6694(a) of the Code.

Rev. Rul. 80-262 [1]

ISSUE

Does the penalty for negligent disregard of rules and regulations under section 6694(a) of the Internal Revenue Code apply to a preparer in the following situations?

FACTS

Situation 1

The taxpayer furnished the income tax return preparer with all of the Forms 1099-INT, Statement for Recipients of Interest Income, that the taxpayer had received. The preparer failed to list the amount shown on one of the Forms 1099-INT on schedule B of Form 1040, U.S. Individual Income Tax Return. Upon examination of the return by the Service, it was determined that the omission resulted in an understatement of tax liability. However, the amount of the understatement was not substantial and the omission was the only error on the return.

The preparer stated that the reason for the failure to report the omitted amount was that the Form 1099-INT showing the omitted amount was overlooked.

Situation 2

The taxpayer furnished the income tax return preparer with all of the Forms 1099-INT that the taxpayer had received. The preparer correctly listed all of the amounts shown on the Forms 1099-INT on schedule B of Form 1040 but made an error in totalling the separate amounts. Upon examination of the return by the Service, it was determined that the error resulted in an understatement of tax liability. However, the amount of the understatement was not substantial and the omission was the only error on the return.

LAW AND ANALYSIS

Rev. Proc. 80-40, page 22, this Bulletin, sets forth guidelines for the application of the penalty under section 6694(a) of the Code for the negligent disregard of rules and regulations by an income tax return preparer. The revenue procedure indicates that the Service will consider the nature of the error causing the understatement, the frequency of the errors and the materiality of the errors. Rev. Proc. 80-40 specifically provides that an isolated mathematical or clerical error ordinarily reflects no more than mere inadvertence and thus will not result in the assertion of the penalty unless the error is of such magnitude or so conspicuous that it should have been discovered after its commission.

Under the facts as stated the error in situation 1 was clerical in nature and the error in situation 2 was mathematical in nature. Furthermore, in each situation, the error was the only error on the return and the amount of the understatement was not substantial.

HOLDING

The penalty for negligent disregard of rules and regulations does not apply to the preparers in either situation 1 or 2.

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26 CFR 1.6694-1: Understatement of taxpayer's liability by income tax return preparer.

Return preparer, normal office practice; pattern of errors. A return peparer failed to list all income shown on a taxpayer's Forms 1099, incorrectly totaled itemized deductions, and used the wrong tax table. Even though the preparer's

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[1] Also released as New Release IR-80-94 dated Sept. 15, 1980.

normal office practice was to review the taxpayer-provided information, check the return for completeness, and check the tax computation, there was a pattern of errors on the return, and the penalty under section 6694(a) of the Code applies.

Rev. Rul. 80-263 [1]

ISSUE

Does the penalty for negligent disregard of rules and regulations under section 6694(a) of the Internal Revenue Code apply in the following situation?

FACTS

The taxpayer furnished the income tax return preparer with all of the Forms 1099-INT, Statement for Recipients of Interest Income, and Forms 1099-DIV, Statement for Recipients of Dividends and Distributions, that the taxpayer had received. The preparer failed to list the amount shown on one of the Forms 1099-INT and on one of the Forms 1099-DIV on Schedule B, Interest and Dividend Income, of Form 1040, U.S. Individual Income Tax Return. Also, the preparer made an error in totalling the amounts of itemized deductions on Schedule A, Itemized Deductions, and used the wrong tax table in determining the tax. Upon examination of the return the Internal Revenue Service determined that these errors resulted in an understatement of liability. None of these understatements was substantial in amount.

The preparer stated that these errors were merely oversights and demonstrated that the preparer's normal practice was to review the information provided by the taxpayer, review the return to check for completeness, and check the computation of the tax.

LAW AND ANALYSIS

Section 6694(a) of the Code provides that if any part of any understatement of liability with respect to any return is due to the negligent or intentional disregard of rules and regulations by any person who is an income tax return preparer with respect to such return, such person shall pay a penalty of $100 with respect to such return.

Rev. Proc. 80-40, page 22, this Bulletin, sets forth guidelines for the application of the penalty under section 6694(a) of the Code for the negligent disregard of rules and regulations by an income tax return preparer. The revenue procedure indicates that the Service will consider the nature of the error causing the understatement, the frequency of the errors and the materiality of the errors. The revenue procedure also provides that where all the relevant facts and circumstances suggest that the return was negligently prepared, the penalty will not be asserted if (1) the preparer's normal office practice, when considered together with other facts and circumstances, indicated that the error in question would rarely occur and (2) the normal office practice was followed in preparing the return in question.

Although each error, if the sole error on the return, would not result in the imposition of the penalty, all of the errors taken together suggest that the return was negligently prepared. In addition, although the preparer alleged that the preparer's normal office practice, considered with other facts and circumstances, indicated that the errors in question would rarely occur, in this situation the normal office practice of the preparer will not relieve the preparer from the penalty because there is a pattern of errors on the return.

HOLDING

The penalty for negligent disregard of rules or regulations applies.

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26 CFR 1.6694-1: Understatement of taxpayer's liability by income tax return preparer.

Return preparer; normal office practice; failure to report minimum tax liability. A return preparer who failed to report a minimum tax liability showed that normal office practice, when taken together with other factors, indicated that the minimum tax error would rarely occur and that normal office practice was followed in preparing the return. The preparer was not liable for the negligence penalty under section 6694(a) of the Code. Rev. Rul. 80-28 distingiushed.

Rev. Rul. 80-264 [1]

ISSUE

Does the penalty for the negligent disregard of rules and regulations under section 6694(a) of the Internal Revenue Code apply to a preparer in the following situation?

FACTS

An income tax return preparer failed to report a substantial minimum tax liability resulting from a net capital gain deduction shown on the individual taxpayer's 1978 return. This was the only error on the return. The preparer agreed that there was an understatement on the return and explained that the failure to report the minimum tax was due to an oversight. To show that the preparer's normal office practice was to correctly apply the minimum tax provisions, the preparer presented a checklist that showed when the minimum tax must be considered. The workpapers of the preparer for the return in question indicated that the checklist had been reviewed. Consideration of the knowledge of the preparer, the internal procedures for review, and other facts and circumstances indicated that this error would rarely occur.

LAW AND ANALYSIS

Section 56(a) of the Code provides for the imposition of an income tax on certain items of tax preference. Section 57(a)(9)(A) treats as a tax preference item an amount equal to the net capital gain deduction for the taxable year determined under section 1202. For taxable years ending prior to January 1, 1979, such item was taxed under section 56(a). For years beginning after December 31, 1978, such item is taxed under section 55 (relating to the alternative minimum tax).

Section 6694(a) of the Code provides that if any part of any understatement of liability with respect to any return is due to the negligent or intentional disregard of rules and regulations by any person who is an income tax return preparer with respect to such return, such person shall pay a penalty of $100 with respect to such return.

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[1] Also released as New Release IR-80-94 dated Sept. 15, 1980.

[1] Also released as New Release IR-80-94 dated Sept. 15, 1980.

Rev. Rul. 80-28, 1980-4 I.R.B. 14, holds that an income tax return preparer who failed to report a minimum tax liability on an individual taxpayer's income tax return because of an oversight was required to pay a penalty for negligent or intentional disregard of rules and regulations.

Rev. Proc. 80-40, page 22, this Bulletin, sets forth guidelines for the application of the penalty under section 6694(a) of the Code for the negligent disregard of rules and regulations by an income tax preparer. This revenue procedure indicates that the Service will consider the nature of the error causing the understatement, the frequency of the errors and the materiality of the errors. The revenue procedure also provides that where the facts and circumstances suggest that the return was negligently prepared, the penalty will not be asserted if (1) the preparer's normal office practice, when considered together with other facts and circumstances, indicates that the error in question would rarely occur and (2) the normal office practice was followed in preparing the return in question.

The facts and circumstances suggested that the return was negligently prepared by the preparer. Although the failure to report the minimum tax was the only error on the return, the amount of the understatement was substantial and the error could have been discovered by reviewing the return. However, the preparer showed that the preparer's normal office practice, when taken together with other facts and circumstances, indicates that the error in question would rarely occur and that the normal office practice was followed in preparing the return in question. Furthermore, the error is not a flagrant one.

HOLDING

The preparer is not liable for a penalty for the negligent disregard of rules and regulations.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 80-28 is distinguished.

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26 CFR 1.6694-1: Understatement of taxpayer's liability by income tax return preparer.

Return preparer; failure to report income deducted on related return. A return preparer who prepared both an individual's return and the return of the individual's wholly owned corporation deducted interest paid by the corporation to the individual on the corporate return, but did not report the interest as income on the individual's return. The negligence penalty does not apply to the preparer if the information provided by the corporation did not indicate who received the interest and the information provided by the individual did not indicate receipt of such payment. However, the penalty would apply if the information provided by the corporation indicated that the individual received the interest payment.

Rev. Rul. 80-265 [1]

ISSUE

Does the penalty for negligent disregard of rules and regulations under section 6694(a) of the Internal Reve- Code apply in the following situations?

FACTS

Situation 1

An income tax return preparer prepared both *A*'s individual federal income tax return for calendar year 1978 and the corporate income tax return of *X*, *A*'s wholly-owned corporation for its taxable year ended December 31, 1978. The preparer was not the auditor of *X* and had no knowledge whatsoever of any loans by *A* to *X*. The preparer deducted interest paid by *X* to *A* on the corporation's return filed March 15, 1979. However, the preparer did not report the interest as income on *A*'s individual return filed April 15, 1979. The information provided by *X* to the preparer did not indicate who received the interest payment and the information provided by *A* to the preparer did not indicate receipt of such payment. Upon examination the Internal Revenue Service determined that the failure to report the interest income resulted in an understatement of tax liability on *A*'s individual return.

Situation 2

The facts are the same as in situation 1 except that the information provided by *X* indicated *A* received the interest payment from *X*.

LAW AND ANALYSIS

Section 6694(a) of the Code provides that if any part of any understatement of liability with respect to any return is due to the negligent or intentional disregard of rules and regulations by any person who is an income tax return preparer with respect to such return, such person shall pay a penalty of $100 with respect to such return.

Under section 61 of the Code interest received on loans are includable in gross income.

Rev. Proc. 80-40, page 22, this Bulletin, sets forth guidelines for the application of the penalty under section 6694(a) of the Code for the negligent disregard of rules and regulations by an income tax return preparer. The revenue procedure indicates that the penalty generally will not apply where a preparer in good faith relies without verification upon information furnished by the taxpayer, but the preparer may not ignore the implications of information furnished to the preparer or actually known to the preparer.

In situation 1, the preparer could rely upon the information furnished by *A* in connection with *A*'s individual return. The preparer was not required to examine or review *A*'s books and records and had no reason to believe that the information as furnished might be incorrect or incomplete.

In situation 2, the preparer, based on the information furnished by *X*, in connection with *X*'s corporate return, had reason to believe that the information furnished by *A* might be incorrect or incomplete. The preparer should have made inquiries to reconcile the information furnished by *X* with the omission by *A* of the interest income.

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[1] Also released as New Release IR-80-94 dated Sept. 15, 1980.

HOLDING

The penalty for negligent disregard of rules and regulations under section 6694(a) of the Code does not apply to the preparer in situation 1. The penalty does apply to the preparer in situation 2.

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26 CFR 1.6694-1: Understatement of taxpayer's liability by income tax return preparer.

Return preparer; reliance on taxpayer's assurances; entertainment expenses. A return preparer who asks a taxpayer if entertainment expense substantiation that satisfies the requirements of section 274(d) of the Code exists and receives assurances that it does will not be subject to the negligence penalty under section 6694(a) as a result of the taxpayer's failure to substantiate the expenses in an audit. A return preparer who does not ask for such assurances will be subject to the penalty, as will the first preparer in a subsequent year if the same assurances are received and the preparer is aware of the prior audit results.

Rev. Rul. 80-266 [1]

ISSUE

Does the penalty for negligent disregard of rules and regulations under section 6694(a) of the Internal Revenue Code apply to an income tax return preparer where the preparer relied upon incorrect information provided by the taxpayer?

FACTS

Situation 1

A preparer was engaged to prepare a tax return of a taxpayer who claimed to have incurred deductible entertainment expenses. The preparer inquired whether the taxpayer had records showing the amount, the time, the place and the business purpose of the expenses and the business relationship to the taxpayer of the persons entertained in accordance with the requirements of section 274(d) of the Code. The taxpayer represented to the preparer that it had such records. The preparer then prepared the return claiming a reduction for entertainment expenses in the amount indicated by the taxpayer.

Upon examination, the Service disallowed a portion of the claimed deductions because the taxpayer could not substantiate with respect to certain expenses either the business purpose or the business relationship of some of the persons entertained. This determination resulted in an understatement of tax liability as defined in section 6694(e) of the Code.

Situation 2

The facts are the same as in situation 1 except that the preparer did not inquire whether the taxpayer had adequate records, and the taxpayer did not make any representations that it had such records. The preparer did not adequately demonstrate that the preparer's normal office practice should prevent the assertion of the penalty.

Situation 3

The preparer in situation 1 completed the return of the same taxpayer for the year following the examination. The taxpayer again claimed to have incurred deductible entertainment expenses. The preparer inquired whether the taxpayer had records showing the amount, the time, the place, and the business purpose of the expenses, and the business relationship to the taxpayer of the persons entertained. The taxpayer again represented that it had such records. The preparer did not make a further inquiry although the preparer was aware that the taxpayer could not substantiate certain entertainment deductions during the examination in the prior year.

Upon examination the Service again disallowed a portion of the deductions claimed by the taxpayer for entertainment because the taxpayer could not substantiate with respect to certain expenses either the business purpose or the business relationship of some of the persons entertained. This determination resulted in an understatement of tax liability.

LAW AND ANALYSIS

Section 6694(a) of the Code provides that if any part of any underpayment of liability with respect to any return is due to the negligent or intentional disregard of rules and regulations by any person who is an income tax return preparer with respect to such return, such person shall pay a penalty of $100 with respect to such return.

Section 274(d) of the Code provides that no deduction will be allowed for travel and entertainment unless the taxpayer substantiates it with adequate records.

Rev. Proc. 80-40, page 22, this Bulletin, sets forth guidelines for the application of the penalty under section 6694(a) of the Code for the negligent disregard of rules and regulations by an income tax return preparer, including factors that will be taken into consideration in determining whether the penalty will be applied. The revenue procedure provides that a preparer must make appropriate inquiries to determine the existence of facts and circumstances required by a Code section or regulations as a condition to claiming a deduction.

In situation 1 the preparer made appropriate inquiries as to whether the taxpayer had records adequate to meet the requirements of section 274(d) and the regulations thereunder. Because the taxpayer represented that it had such records, it was proper for the preparer to claim the deduction.

In situation 2 the preparer failed to inquire whether the taxpayer had records adequate to meet the requirements of section 274(d) of the Code and the regulations thereunder.

In situation 3 the preparer was aware that the taxpayer could not substantiate some of the entertainment deductions in the examination during the prior year and thus had reason to believe that the taxpayer might not have adequate records for the current year. Therefore, although the inquiry made by the preparer was sufficient in situation 1, it was not sufficient in situation 3. The preparer should have made further inquiries to reconcile the inadequacy of the records in the recent examination of an earlier year with the taxpayer's representation in order to reasonably conclude that the taxpayer now has adequate records.

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[1] Also released as New Release IR-80-94 dated Sept. 15, 1980.

HOLDINGS

The penalty for negligent disregard of rules and regulations under section 6694(a) of the Code does not apply to the preparer in situation 1. The penalty does apply to the preparer in situations 2 and 3.

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26 CFR 1.6694-1: Understatement of taxpayer's liability by income tax return preparer.

Guidelines for the application of the penalty under section 6694(a) of the Code for the negligent disregard of rules and regulations by an income tax return preparer. See Rev. Proc. 80-40, page 22.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, Section 6694; 1.6694-1.)

Rev. Proc. 80-40[1]

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide guidelines for the application of the penalty under section 6694(a) of the Internal Revenue Code for the negligent disregard of rules and regulations by an income tax return preparer. The revenue procedure indicates some of the factors that will be taken into consideration in determining whether this penalty will be applied.

SEC. 2. BACKGROUND

.01 Section 6694(a) of the Code provides that if any part of any understatement with respect to any return or claim for refund is due to the negligent or intentional disregard of rules and regulations by any person who is an income tax return preparer with respect to such return or claim, such person shall pay a penalty of $100 with respect to such return or claim.

.02 Section 6694(e) of the Code provides that an "understatement of liability" means any understatement of the net amount payable with respect to any income tax.

.03 Section 1.6694-1(a)(1) of the Income Tax Regulations provides that a preparer is not considered to have negligently or intentionally disregarded a rule or regulation if the preparer exercises due diligence in an effort to apply the rules and regulations to the information given to the preparer to determine the taxpayer's correct liability for tax.

.04 Section 1.6694-1(a)(5) of the regulations provides that the preparer bears the burden of proof on the issue of whether the preparer has negligently or intentionally disregarded a rule or regulation.

.05 The Conference Report on the Revenue Act of 1978 relating to Technical Corrections to the Tax Reform Act of 1976, H.R. Rep. No. 95-1800, 95th Cong., 2d Sess. 284 (1978), 1978-3 C.B. (Vol. 1) 521, 618, states that the Service shall reasonably interpret section 6694(a) according to the standards of section 6653(a) and in light of all the facts and circumstances of each case taking into account any and all mitigating factors.

.06 The case of *Marcello v. Commissioner,* 380 F. 2d 499, 506 (5th Cir. 1967) holds that negligence is lack of due care or failure to do what a reasonable and ordinary prudent person would do under the circumstances.

SEC. 3. SCOPE

The scope of this revenue procedure is to provide guidelines for the application of the penalty under section 6694(a) of the Code for the negligent disregard of rules and regulations by an income tax return preparer. These guidelines do not apply to the penalty under section 6694(a) for the intentional disregard of rules and regulations by an income tax return preparer.

SEC. 4. APPLICATION

.01 In determining whether the penalty under section 6694(a) of the Code is to be asserted, all the relevant facts and circumstances of each case will be taken into account. In making this determination, the following factors will be taken into consideration.

1 *Nature of the Error Causing the Understatement.* Was the provision that was misapplied or not discovered so complex, uncommon, or highly technical that a competent preparer of returns of the type at issue might reasonably be unaware or mistaken as to its applicability? Should a general review of the return have disclosed the error to the preparer? For example, although an isolated mathematical or clerical error ordinarily reflects no more than mere inadvertence and thus will not result in the assertion of the penalty, such an error may be of such a magnitude or be so conspicuous that it should have been discovered after its commission.

2 *Frequency of Errors.* Is the understatement the result of an isolated error or is it the result of a number of errors? Although an isolated error may result in the assertion of the penalty if sufficiently obvious, flagrant or material, the negligence penalty generally will not be asserted for an isolated error. On the other hand, a pattern of errors on a return is presumptive of negligence and generally will result in the assertion of the penalty even though no one error occurring in isolation would have triggered the penalty.

3 *Materiality of Errors.* Is the understatement material in relation to the correct tax liability? The negligence penalty generally will not be asserted if the understatement is of a relatively immaterial amount. Nevertheless, the understatement, even though immaterial in amount, may result in the assertion of the penalty if the error or errors creating the understatement are sufficiently obvious, flagrant or numerous. An error resulting in a material understatement may be a greater indication of negligence than a similar error resulting in a less material understatement.

.02 Where all the relevant facts and circumstances suggest that the return was negligently prepared, the penalty under section 6694(a) of the Code generally will not be asserted if (1) the preparer's normal office practice, when considered together with other facts and circumstances such as the knowledge of the preparer, indicates that the error in question would rarely occur and (2) the normal office practice was followed in preparing the return in question. Examples of normal office practice include a system to promote acuracy and consistency in the preparation of returns, such as a checklist, a method for obtaining the necessary information from the taxpayer, examining the prior year's return, and review procedures. The normal office practice of the preparer will not be relevant where the error is flagrant, or there is either a pattern of errors on a particular return or an error is repeated on numerous returns.

.03 The penalty under section 6694(a) of the Code generally will not apply where a preparer in good faith relies without verification upon information furnished by the taxpayer. Thus, the preparer is not required to audit, examine or review books and records, business operations, or documents or other evidence in order to verify independently the taxpayer's information. However, the preparer may not ignore the implications of information furnished to the preparer or which was actually known by the preparer. The preparer shall make reasonable inquiries if the information as furnished appears to be incorrect or incomplete. Additionally, some sections of the Code require the existence of specific facts and circumstances, such as maintenance of specific documents, before a deduction may properly be claimed. The preparer shall make appropriate inquiries to determine the existence of facts and circumstances required by a Code section or regulations as a condition to claiming a deduction.

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[1] Also released as New Release IR-80-94 dated Sept. 15, 1980.

Part IV. Items of General Interest

Foundation Status of Certain Organizations

Announcement 80-128

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3) of the Code, eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Agape of Montgomery, Inc., Montgomery, AL
Alabama Citizens for Responsive Public Television, Inc., Birmingham, AL
Alabama Conservancy Foundation, Inc., The, Montgomery, AL
American Music Foundation, Inc., Panama City Beach, FL
American Theatre Laboratory Inc., New York, NY
Basic Trade School, Inc., St. Louis, MO
Beaubourg Foundation, New York, NY
Bedke, Andrews, Sagers, Chase Genealogical Association, The, Salt Lake City, UT
Bio Psych Center, Inc., Carmel, NY
Catholic Housing Authority of Montgomery, Inc., Montgomery, AL
Center for Attitudes, New York, NY
Childrens Day Committee, Inc., New York, NY
Choral Syndicate, Inc., New York, NY
Christian City Convalescent Center, Inc., Atlanta, GA
Collier Health Services, Inc., Immokalee, FL
Concerned Citizens of Fire Island, Inc., New York, NY
Connetquot Youth Development Corp., Bohemia, NY
Creative Productions Inc., Philadelphia, PA
Dorton Family Genealogical Association, Salt Lake City, UT
Education Economic and Christian Association for Black Unity, Inc., Birmingham, AL
Fayetteville Little League Inc., Fayetteville, NY
Film for Thought, Inc., New York, NY
Fine Entertainment with Student Talent & Arts, Inc., Tampa, FL
Friends of Arbours Association, Ltd., New York, NY
Friends of the Salvation Army of Highlands County, Inc., Sebring, FL
Garvey Memorial Black Solidarity Committee, Marcus, Rochester, NY
Hemispheric Congress for Women 76, Inc., Miami, FL
Holbrook Youth Development Corp., Holbrook, NY
Information and Volunteer Center of Olmsted County, Inc., Rochester, MN
Inside Opportunities, Inc., St. Petersburg, FL
International Piano Archives, New York, NY
Kerusso Institute, Inc., Deerfield, FL
La Porte Meals on Wheels, Inc., La Porte, IN
Lachey Plaza Committee, Inc., Niagara Falls, NY
Lilly Memorial Trust, Evan F., New York, NY
Linco Inc., Stanford, KY
Make Today Count, Inc. of Tampa, Tampa, FL
Martin County Medical Assistance Trust, The, Stuart, FL
Marywood For Girls, Monroe, NC
Mimeworkshop Inc., The, Rochester, NY
Missouri Institute for Reality Therapy, Inc., Jefferson City, MO
Mobile County Urban League, Inc., Mobile, AL
N.Y.S.A.R.C. Community Mental Retardation Services Co., Inc., New York, NY
New York Public Interest Research Center, New York, NY
Nicola Theatre Foundation, Inc., Jon, New York, NY
O.K.C. Theater Co., New York, NY
Omni-I-Care, Inc., Wetumpka, AL
Para Deys Acres, Macedon, NY
Parke Institute, The, Devon, PA
Pembroke Community Workshop, Inc., Pembroke, NC
Pennsylvania Interdisciplinary Research Group, Harrisburg, PA
Pensacola Retirement Village, Inc., Pensacola, FL
Pointe Coupee Health Care, Inc., Metairie, PA
Program for New World Anthropology, Inc., The, New York, NY
Project Joint Inc., Brooklyn, NY
Renaissance of Cultural Ideals, Inc., New York, NY
Sackets Harbor Historical Society, Sackets Harbor, NY
Sts. Joachim & Ann & John Vianney Inc., Williston Park, NY
Skipworth Sickle Cell Memorial Fund, The Glenn Allen, Muscle Shoals, AL
Soul Winning Ministries, Inc., Hollywood, FL
Southwest Association of Student Assistance Programs, Inc., San Antonio, TX
Stages for Theatrical Expansion in the Performing Arts, Inc., New York, NY
Suncoast Legal Services Corp., Clearwater, FL
Theatre South, Montrose, AL
Tompkins County Foundation, Ithaca, NY
Verismo Productions, Inc., New York, NY
Vocom, Inc., Columbus, GA
Wheelchair Club of Shalom Temple Number 77, Inc., Sunrise, FL
Whitemarsh Junior High Home and School Association, The, Plymouth Meeting, PA
Young Entrepreneurs of America Foundation, Inc., New York, NY

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individual has been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Ralph D. Lider	New Bedford, MA	Attorney	Indefinite effective August 18, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 301.7609-1 through 301.7610-1 added.	Administrative summonses.	Aug. 21, 1980	Oct. 20, 1980
26 CFR 1.6012-2(e), 1.6012-3(a)(5), 1.6033-2(a)(2)(i), 53.6071-1, 301.6204-1, 301.6211-1, 301.6212-1, 301.6213-1, 301.6501(c)-1, 301.6501(e)-1, 301.6503(a)-1(a), 301.6512-1, 301.6601-1(d), 301.6653-1, 301.6659-1, 301.6861-1, 301.6862-1(a), 301.6863-1(b), amended; 53.6011-1(e), 54.6011-1, 301.6501(n)-1 through 301.6501(n)-3, 301.6503(g)-1, 301.6511(f)-1, 301.7422-1, 301.7454-2, added; 301.6503(g)-1 redesignated as 301.6503(f)-1.	Procedure and administration of certain excise taxes.	Aug. 25, 1980	Oct. 24, 1980
26 CFR 53.4942(a)-3 revised.	Set-asides made by private foundations.	Aug. 26, 1980	Oct. 27, 1980
26 CFR 1.482-2, 1.483-1, amended.	Imputed interest rate on loans between related entities and on deferred payments in the case of certain sales of property.	Aug. 29, 1980	Oct. 28, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified,* above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

Numerical Finding List[1]

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RR	Revenue Ruling
RP	Revenue Procedure
TD	Treasury Decision
CD	Court Decision
PL	Public Law
EO	Executive Order
DO	Delegation Order
TDO	Treasury Department Order
TC	Tax Convention
SPR	Statement of Procedural Rules
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October 14, 1980
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Internal Revenue bulletin

9258

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENTS

Announcement 80-133, page 20.

A public hearing will be held on October 28, 1980, on proposed regulations relating to tax-free sales of articles to be used for, or resold for, further manufacture.

Announcement 80-134, page 20.

A public hearing will be held on November 7, 1980, on the proposed revocation of a regulation that relates to the withholding of tax on Virgin Island inhabitants.

INCOME TAX

Rev. Rul. 80-270, page 10.

Banks; bad debt reserves; additions; section 351 transfer of loans. A bank that transferred a portion of its loans outstanding to another bank in a transaction qualifying under section 351 of the Code must consider the transferred loans as a reduction in eligible loans outstanding at the begining of the year of transfer in calculating the maximum addition to its reserve for losses on loans at the end of the taxable year of transfer under section 585(b)(2)(A).

Rev. Proc. 80-41, page 18.

Areas in which advance rulings will not be issued; optional treatment of policies reinsured. The Service will not issue advance rulings under section 820 of the Code on the optional treatment of policies reinsured under modified coinsurance contracts; Rev. Proc. 80-22 amplified.

Announcement 80-130, page 20.

Various areas of the States of Ohio, Texas, and West Virginia have been declared disaster areas in which losses qualify for the special tax treatment under section 165(h) of the Code.

EMPLOYEE PLANS

Rev. Rul. 80-267, page 5.

Contributions; short taxable year. Rules are provided for determining the limitation on contributions to a qualified pension plan under section 404 of the Code for a short taxable year by an employer that has consistently determined the deductible limit for each taxable year on the basis of the plan year beginning in such taxable year; Rev. Ruls. 55-428 and 56-672 amplified.

Rev. Rul. 80-268, page 6.

Individual retirement programs; loss on total distribution. An individual received the cash surrender value of an individual retirement account (IRA) annuity, which had been purchased three months earlier, as a total distribution under section 408(d)(4) of the Code that was less than the individual's cost of the annuity. The individual may not claim an ordinary loss deduction on the difference between the cost and the cash surrender value.

Rev. Rul. 80-269, page 9.

Prohibited transaction; loan to employer-grantor; inadequate security. A qualified employees' trust

(Continued on page 4)

Finding Lists begin on page 25.
Announcement of Disbarment and Voluntary Suspensions on page 22.
Announcement of Notice of Proposed Rulemaking on page 23.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

EMPLOYEE PLANS—Cont'd

made a loan to the employer-grantor and received in return a demand note bearing a reasonable rate of interest together with a chattel mortgage on personal property then or in the future owned by the grantor. The property was not identified and the mortgage was not recorded as soon as practicable. The loan was not adequately secured and constitutes a prohibited transaction within the meaning of section 503(b)(1) of the Code. Rev. Rul. 66-324 superseded.

EXEMPT ORGANIZATIONS

Rev. Rul. 80-282, page 7.

Political activity; newsletter publication. Certain publications of congressional incumbants' voting records on selected issues in a nonpartisan newsletter do not constitute participation or intervention in any political campaign within the meaning of section 501(c)(3) of the Code; Rev. Rul. 78-248 amplified.

GIFT TAX

Rev. Rul. 80-271, page 14.

Charitable deduction; transfer in trust; trustee's power to borrow from trust. A settlor's transfer of money to a charitable trust that is a private foundation described in section 509(a) of the Code does not qualify for a gift tax charitable deduction if the trustee, an adult child of the settlor, may borrow money from the trust.

EMPLOYMENT TAXES

T.D. 7716, page 10.

Amendments to the regulations under sections 1402, 3121, 3401, 6050A, and 6652 of the Code relate to the treatment of certain crew members on boats engaged in catching fish as self-employed rather than as employees.

EXCISE TAXES

Rev. Rul. 80-272, page 16.

Windfall profit tax; recordkeeping requirements; ADP users. Punched cards, magnetic tapes, disks, and other machine-sensible data media used for recordkeeping in a taxpayer's automatic data processing system are records within the meaning of section 4997 of the Code and must be retained so long as the contents may become material in the administration of any internal revenue law. However, punched cards used merely as a means of input to the system need not be retained if the input information is duplicated on other records.

Rev. Rul. 80-273, page 15.

Constructive sale price; retail sales; no sales to wholesalers. The constructive sale price for computing the taxes imposed by sections 4061(b)(1), 4161(a), 4161(b), and 4181 of the Code on articles sold at retail by manufacturers, producers, or importers who do not sell like articles to wholesale distributors is 75 percent of the actual selling price after the adjustments provided by section 4216(a), unless it can be shown on an industry-wide basis that a lower percentage should apply; Rev. Rul. 87 modified.

Rev. Proc. 80-42, page 18.

Windfall profit tax; recordkeeping requirements; ADP users. Guidelines are set forth to comply with the recordkeeping requirements of the Crude Oil Windfall Profit Tax Act of 1980, and the regulations thereunder, for taxpayers who use automatic data processing systems.

ADMINISTRATIVE

Rev. Proc. 80-43, page 19.

Bulk quantities of forms to preparers; shipping charge. The handling and shipping charge for furnishing bulk quantities of forms to paid preparers is increased; Rev. Proc. 67-36 superseded.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 165.—Losses

26 CFR 1.165-1: Losses

Whether a taxpayer is entitled to a loss on investments in an individual retirement account (IRA) under the circumstances described. See Rev. Rul. 80-268, page 6.

Section 351.—Transfer to Corporation Controlled by Transferor

26 CFR 1.351-1: Transfer to corporation controlled by transferor.

Whether a transferor bank must consider as a reduction in eligible loans outstanding at the beginning of the year of transfer, that portion of the bank's loans transferred in a section 351 transaction in calculating the maximum addition to the reserve for losses on loans at the end of the taxable year of transfer for purposes of section 585 (b)(2)(A) of the Code and section 1.585-2(b)(1)(ii)(A) of the regulations. See Rev. Rul. 80-270, page 10.

Section 404.—Deduction for Contributions of an Employer to an Employees' Trust or Annuity Plan and Compensation Under a Deferred-Payment Plan

26 CFR 1.404(a)-1: Contributions of an employer to an employees' trust or annuity plan and compensation under a deferred payment plan; general rule.

Contributions; short taxable year. Rules are provided for determining the limitation on contributions to a qualified pension plan under section 404 of the Code for a short taxable year by an employer that has consistently determined the deductible limit for each taxable year on the basis of the plan year beginning in such taxable year; Rev. Ruls. 55-428 and 56-672 amplified.

Rev. Rul. 80-267

SECTION 1. PURPOSE

This revenue ruling provides rules for determining the deductible limit under section 404 of the Internal Revenue Code, as amended by the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 1974-3 C.B. 1, in the case of a short taxable year where the employer has consistently determined the deductible limit for each taxable year on the basis of the plan year beginning in such taxable year.

SEC. 2. BACKGROUND AND GENERAL INFORMATION

Section 404(a)(1)(A) of the Code provides general guidelines governing the deductibility of contributions to qualified pension plans.

Section 404(a)(1)(D) of the Code provides that any amount paid in a taxable year in excess of the amount deductible in such year shall be deductible in the succeeding years in order of time to the extent of the difference between the amount paid and deductible in each such succeeding year and the maximum amount deductible for such year.

Prior to the enactment of ERISA, Rev. Rul. 55-428, 1955-2 C.B. 230, together with Rev. Rul. 56-672, 1956-2 C.B. 295, provided that in the case of a short taxable year, the employer may take as a deduction a pro rata portion of both the normal cost and 10 percent of the cost of past service or supplemental benefits as of the date such benefits were provided under the plan.

Section 404(a)(1) of the Code, as amended by ERISA, changes the method for determining the deductible limits in several ways. These changes affect the deductible limit in a short taxable year.

SEC. 3. GENERAL RULE

In the case of a short taxable year, where the employer has consistently determined the deductible limit for each taxable year on the basis of the plan year beginning in the taxable year and where the plan year begins in the short taxable year, the employer may determine the deductible limit by the Weighted Average Method or the Special Allowance Method as described below.

Once a method is selected, the employer must consistently apply that method in determining the deductible limit.

SEC. 4. WEIGHTED AVERAGE METHOD

.011 Under the Weighted Average Method, where the deduction is being claimed in the short taxable year under section 404(a)(1)(A)(ii) or (iii) of the Code, the deductible limit in the short taxable year is the product of the deductible limit otherwise applicable under such section and the tax year ratio (the number of months in the short taxable year divided by 12).

.012 For subsequent taxable years, the deductible limit is the weighted average of the deductible limits for the plan year ending within the taxable year and for the plan year commencing in that taxable year. This amount is computed by adding—

(1) The deductible limit for the plan year ending within the taxable year multiplied by the difference between 1 and the tax year ratio as defined in section 4.011, and

(2) The deductible limit for the plan year commencing within the taxable year multiplied by the tax year ratio.

The deductible limits referred to in section 4.012(1) and (2) are the limits as determined under section 404 (a)(1)(A)(i), (ii), or (iii), whichever is applicable.

.021 Under the Weighted Average Method, where the deduction in the short taxable year is being claimed under section 404(a)(1)(A)(i) of the Code, the deductible limit in the short taxable year equals the sum of—

(1) The debit balance (if any) in the funding standard account as of the end of the previous plan year (without regard to the alternative minimum funding standard account) increased with interest to the end of the short taxable year, and

(2) The tax year ratio multiplied by the excess (if any) of the amount necessary to satisfy the minimum funding requirements for the plan year beginning in the short taxable year (including interest charges and credits only to the end of the short taxable year) over the amount determined in section 4.021(1).

.022 Under the Weighted Average Method, for the first taxable year after the short taxable year, where the deduction in the short taxable year was claimed under section 404(a)(1)(A)(i) of the Code, the deductible limit is the sum of—

(1) The amount which is necessary to satisfy the minimum funding requirements for the plan year beginning in the short taxable year, and which was not deductible in the short taxable year, and

(2) The tax year ratio multiplied by the deductible limit determined under section 404(a)(1)(A)(i), (ii) or (iii) of the Code (whichever is applicable) attributable to the plan year beginning in the taxable year.

.023 For subsequent taxable years, the deductible limit is the weighted average, as computed under section 4.012, of the deductible limit determined for the plan year ending within the taxable year and the deductible limit determined for the plan year commencing within the taxable year.

SEC. 5. SPECIAL ALLOWANCE METHOD

Under the Special Allowance Method the deductible limit under section 404(a)(1)(A)(i), (ii), and (iii) of the Code for a short taxable year is the same as under the Weighted Average Method. However, under the Special Allowance Method, the deductible limit in all of the taxable years following the short taxable year equals the sum of the deductible limit for the plan year beginning in such taxable year plus (if the contribution for the short year exceeded the deductible limit for such year) a special allowance. The special allowance is ten percent of the special allowance amount.

To compute the special alowance amount, subtract the deductible limit determined under the Special Allowance Method for the short taxable year from the lesser of (1) the amount necessary to satisfy the minimum funding requirement for the plan year beginning in the short taxable year or (2) the employer contribution made for the short taxable year. This special allowance can be used only for the first ten taxable years after the short taxable year.

SEC. 6. ADDITIONAL INFORMATION

With the approval of the Secretary of the Treasury as required under section 446(e) of the Code, the employer may determine the deductible limit under the End of Plan Year Method. Under this method, the employer (1) takes no deduction for plan costs in the short taxable year and (2) changes the method for determining the deductible limit so that the limit is determined for the plan year ending within the taxable year.

SEC. 7. EXAMPLE

For the taxable year beginning January 1, 1977, an employer has changed its annual accounting period from the taxable year ending December 31, creating a short taxable year ending May 31. The employer has consistently deducted amounts contributed in a taxable year for the cost attributable to the plan year beginning in such taxable year. For the short period January 1, 1977 to May 31, 1977, the employer intends to contribute the amount necessary to satisfy the minimum funding standard provided by Code section 412(a) for the plan year beginning April 1, 1977.

The minimum required contribution for the plan year beginning April 1, 1977, is $100,000, and there is no debit balance in the funding standard account as of March 31, 1977. If the taxable year were not a short year, the deductible limit determined under section 404(a)(1)(A)(ii) of the Code would be $110,000.

The deductible limit under section 404(a)(1)(A)(i) of the Code for the short taxable year January 1, 1977—May 31, 1977, is $41,667 ($0, the debit balance for the previous year + [($100,000, the minimum required contribution — $0) × 5/12]). The deductible limit under section 404(a)(1)(A)(ii) is $45,833 ($110,000 × 5/12).

If the employer contributes $100,000 and the End of Plan Year Method is not elected, the amount contributed in excess of the deductible limit in the short taxable year ($54,167) is considered a contribution carryover within the meaning of section 404(a)(1)(D) of the Code for a future taxable year.

For the plan year beginning April 1, 1978, the minimum required contribution is $110,000 and the deductible limit for the taxable year June 1, 1977—May 31, 1978, determined under section 404(a)(1)(A)(ii) of the Code (without regard to the fact that the previous taxable year was a short year) is $150,000. However, a special allowance amount is also calculated.

The special allowance amount ($54,167) is the excess of the lesser of (1) the amount necessary to satisfy the minimum funding requirement for the plan year beginning in the short taxable year ($100,000) or (2) the employer contribution in the short taxable year ($100,000), over the deductible limit determined under the Special Allowance Method for the short taxable year which is the greater of the deductible limit determined under section 404(a)(1)(A)(i) of the Code ($41,667) or the deductible limit determined under section 404(a)(1)(A)(ii) of the Code ($45,833). Therefore, the maximum deductible amount under section 404(a)(1)(A)(ii) of the Code is determined using either method below:

(1) Weighted Average Method: $126,667 [($110,000 × 7/12) + ($150,000 × 5/12)]

(2) Special Allowance Method: $155,417 [$150,000 + (10% × $54,167)]

SEC. 8. EFFECT ON OTHER REVENUE RULINGS

Rev. Ruls. 55-428 and 56-672 are amplified.

Section 408.—Individual Retirement Accounts

(Also Section 165; 26 CFR 1.165-1.)

Individual retirement programs; loss on total distribution. An individual received the cash surrender value of an individual retirement account (IRA) annuity, which had been purchased three months earlier, as a total distribution under

section 408(d)(4) of the Code that was less than the individual's cost of the annuity. The individual may not claim an ordinary loss deduction on the difference between the cost and the cash surrender value.

Rev. Rul. 80-268

Advice has been requested whether a taxpayer has a deductible loss on investments purchased with amounts contributed to an individual retirement account (IRA), as described in sections 408 and 409 of the Internal Revenue Code, under the circumstances set forth below.

A, a calendar year taxpayer under age 59½, purchased an individual retirement annuity in June of 1978 for $1,500, the maximum amount allowable as a deduction under section 219 (b)(1) of the Code. *A* revoked this annuity three months later upon joining a company and participating immediately in its qualified pension plan. *A* received a total distribution from the annuity of $1,300, the cash surrender value to which *A* was entitled under the terms of the policy. *A* did not claim a deduction for 1978 under section 219, but did deduct the excess of the investment in the contract ($1,500) over the amount received upon surrender of the contract ($1,300) as an ordinary loss.

Section 165(c)(2) of the Code provides, in part, that an individual shall be allowed to deduct any loss sustained during the taxable year in any transaction entered into for profit.

Revenue Ruling 61-201, 1961-2 C.B. 46, illustrates the circumstances under which an individual may claim a deduction on his or her federal income tax return for a loss sustained upon the cashing in of an annuity for its surrender value. This ruling states that the original purchaser of a single premium refund annuity contract may claim an ordinary loss deduction if the individual's basis in the contract, subject to certain adjustments, exceeds the amount received upon surrender of the contract.

Sections 219 and 220 of the Code set forth the restrictions on an individual's eligibility to claim a deduction on the federal income tax return for amounts contributed to an individual retirement annuity described in section 408(b).

Section 408 of the Code establishes the requirements which annuities must meet in order to maintain their status as IRA's, and section 408(d) specifies the taxability of amounts distributed from IRA's.

As provided by section 408(d)(1) of the Code, any amount paid out of an IRA (unless otherwise excepted) is to be included in an individual's gross income for the year in which received. Section 408(d)(1) also provides that, notwithstanding any other provision of Title 26 of the United States Code, the basis of an individual in an IRA is zero.

Section 408(d)(4) of the Code provides one exception to the taxability provisions of section 408(d)(1). Section 408(d)(4) states that section 408 (d)(1) shall not apply to the distribution of a contribution made during the year to an IRA, to the extent that the contribution exceeds the amount allowable as a deduction under section 219 or 220, if the following conditions are met: (1) the distribution is received on or before the day on which the individual is required to file his or her Federal income tax return for such year; (2) no deduction is allowed under section 219 or 220 for the excess contribution; and (3) the distribution is accompanied by any net income attributable to the excess contribution. Thus, an individual who utilizes the withdrawal provisions of section 408 (d)(4) is relieved from the requirement of section 408(d)(1) that all amounts distributed from an IRA be included in gross income.

A was not eligible to maintain an IRA for 1978, so no amount was allowable as a deduction under section 219 of the Code on *A*'s Federal income tax return for that year. Therefore, *A*'s contributions to the IRA were excess contributions within the meaning of section 408(d)(4). The requirement of section 408(d)(1) that all amounts be included in gross income did not apply to the distribution from the IRA because *A* utilized the provisions of section 408(d)(4) to withdraw the entire balance from the IRA before the date for filing *A*'s tax return. Thus, *A* was not required to include in gross income the distribution from the annuity.

Section 408(d)(1) of the Code, however, precluded *A* from establishing a basis in the contract. As a result, no loss was incurred when *A* cashed in the annuity for its surrender value.

Accordingly, *A* is not entitled to an ordinary loss deduction on *A*'s 1978 Federal income tax return.

Section 501.—Exemption from Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Political activity; newsletter publication. **Certain publications of congressional incumbents' voting records on selected issues in a nonpartisan newsletter do not constitute participation or intervention in any political campaign within the meaning of section 501(c)(3) of the Code; Rev. Rul. 78-248 amplified.**

Rev. Rul. 80-282

ISSUE

Would the publication of a newsletter, by an organization otherwise described in section 501(c)(3) of the Internal Revenue Code, containing the voting records of congressional incumbents on selected issues, in the manner described below, constitute participation or intervention in any political campaign within the meaning of section 501(c)(3)?

FACTS

The organization is exempt from federal income tax under section 501 (c)(3) of the Code. The organization engages in a number of different educational and charitable activities. As one of its activities, the organization maintains an office that monitors and reports on legislative, judicial, administrative, and other governmental activities and developments considered to be of important social interest. As part of the office's activities, it distributes a monthly newsletter to interested members and others, who together number only a few thousand nationwide.

The monthly newsletter contains expressions of the organization's views on a broad range of legislative, judicial, and administrative issues it considers significant. In discussing a particular issue, the reader is sometimes encouraged to contact various governmental officials to express his or her views on the issue.

As soon as practical after the close of each congressional session, the organization intends to publish in an issue of its newsletter a summary of the voting records of all incumbent Members of Congress on selected legislative issues important to it, together with an expression of the organization's position on those issues. Each member's votes will be reported in a way which illustrates whether he or she voted in accordance with the organization's position on the issue. The newsletter is politically non-partisan, and will not contain any reference to or mention of any political campaigns, elections, candidates, or any statements expressly or impliedly endorsing or rejecting any incumbent as a candidate for public office. No mention will be made of an individual's overall qualification for public office, nor will there be any comparison of candidates that might be competing with the incumbents in any political campaign. The voting records of all incumbents will be presented and candidates for reelection will not be identified. The newsletter will point out the limitations of judging the qualifications of an incumbent on the basis of a few selected votes and will note the need to consider such unrecorded matters as performance on subcommittees and constituent service.

Publication usually will occur after congressional adjournment and will not be geared to the timing of any federal election. The newsletter will be distributed to the usual subscribers, and will not be targeted toward particular areas in which elections are occurring.

LAW

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation, and which do not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

Section 1.501(c)(3)-1(c)(3)(i) of the Income Tax Regulations states that an organization is not operated exclusively for one or more exempt purposes if it is an "action" organization. Section 1.501(c)(3)-1(c)(3)(iii) defines an "action" organization as an organization that participates or intervenes, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office. The regulations further provide that activities that constitute participation or intervention in a political campaign on behalf of or in opposition to a candidate include, but are not limited to, the publication or distribution of written statements or the making of oral statements on behalf of or in opposition to such a candidate.

ANALYSIS

Whether an organization is participating or intervening, directly or indirectly, in any political campaign on behalf of or in opposition to any candidate for public office depends upon all of the facts and circumstances of each case. Certain "voter education" activities conducted in a non-partisan manner may not constitute prohibited political activities under section 501(c)(3) of the Code. Other so-called "voter education" activities, however, may be proscribed by the statute. Rev. Rul. 78-248, 1978-1 C.B. 154, sets forth several situations illustrating when an organization has or has not engaged in prohibited political activities within the meaning of section 501(c)(3).

In *Situation 3* of Rev. Rul. 78-248, the organization prepared a questionnaire to all candidates for major public offices that contained questions evidencing a bias on certain issues and made the responses generally available to the public during an election campaign. It was considered to be participating in prohibited political campaign activity. In *Situation 4* of Rev. Rul. 78-248, an organization primarily concerned with land conservation matters published a compilation of incumbents' voting records on selected land conservation issues and widely distributed it to the electorate during an election campaign. It was held that by concentrating on a narrow range of issues and widely distributing the publication among the electorate during an election campaign, the organization was participating in a prohibited political activity.

In this case the format and content of the publication are not neutral, since the organization reports each incumbent's votes and its own views on selected legislative issues and indicates whether the incumbent supported or opposed the organization's view. On the other hand, the voting records of all incumbents will be presented, candidates for reelection will not be identified, no comment will be made on an individual's overall qualifications for public office, no statements expressly or impliedly endorsing or rejecting any incumbent as a candidate for public office will be offered, no comparison of incumbents with other candidates will be made, and the organization will point out the inherent limitations of judging the qualifications of an incumbent on the basis of certain selected votes by stating the need to consider such unrecorded matters as performance on subcommittees and constituent service.

In view of the foregoing, other factors must be examined to determine whether in the final analysis the organization is participating or intervening in a political campaign.

In the instant case, the organization will not widely distribute its compilation of incumbents' voting records.

The publication will be distributed to the organization's normal readership who number only a few thousand nationwide. This will result in a very small distribution in any particular state or congressional district. No attempt will be made to target the publication toward particular areas in which elections are occurring nor to time the date of publication to coincide with an election campaign.

In view of these facts, *Situations 3 and 4* of Rev. Rul. 78-248 are distinguishable from the present case, and the organization will not be considered to be engaged in prohibited political campaign activity.

HOLDING

The publication of a newsletter, by an organization otherwise described in section 501(c)(3) of the Code, containing the voting records of Congressional incumbents on selected issues, in the manner described above, will not constitute participation or intervention in any poltical campaign within the meaning of section 501(c)(3).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 78-248 is amplified.

Section 503.—Requirements for Exemption

26 CFR 1.503(b)-1: Prohibited transactions.

Prohibited transaction; loan to employer-grantor; inadequate security. A qualified employees' trust made a loan to the employer-grantor and received in return a demand note bearing a reasonable rate of interest together with a chattel mortgage on personal property then or in the future owned by the grantor. The property was not identified and the mortgage was not recorded as soon as practicable. The loan was not adequately secured and constitutes a prohibited transaction within the meaning of section 503(b)(1) of the Code. Rev. Rul. 66-324 superseded.

Rev. Rul. 80-269

The purpose of this revenue ruling is to restate, under current law, the position in Rev. Rul. 66-324, 1966-2 C.B. 230.

The issue in Rev. Rul. 66-234 is whether a loan made by an employees' trust, under the circumstances described below, constitutes a prohibited transaction within the meaning of section 503 of the Internal Revenue Code.

An employees' trust meeting the requirements of section 401(a) of the Code and exempt from federal income tax under section 501(a) was established as part of a plan referred to in section 4975(g)(3).

The trustee of the qualified employees' trust made a loan to the employer-grantor and received in return a demand note bearing a reasonable rate of interest together with a chattel mortgage on personal property then or in the future owned by the grantor. The personal property was to have a fair market value at least equal to the amount of the loan. No identification was given of the property, and the mortgage was not recorded with the county clerk until approximately 18 months after the loan was made. Immediately after the making of this loan, the aggregate amount loaned by the trust to the employer exceeded 25 percent of the value of all assets of the trust.

Section 503(a)(1)(B) of the Code states that an organization described in section 401(a) which is referred to in section 4975(g)(2) or (3) shall not be exempt from taxation under section 501(a) if it has engaged in a prohibited transaction after March 1, 1954.

Section 503(b)(1) of the Code provides that, for purposes of that section, the term "prohibited transaction" means any transaction in which an organization subject to the provisions of that section lends any part of its income or corpus, without the receipt of adequate security and a reasonable rate of interest, to the creator of such organization (if a trust). In this case, the creator of the section 401(a) organization was the employer.

Section 1.503(b)-1(b)(1) of the Income Tax Regulations defines the term "adequate security" to mean something in addition to and supporting a promise to pay, which is so pledged to the organization that it may be sold, foreclosed upon, or otherwise disposed of in default of repayment of the loan, the value and liquidity of which security is such that it may reasonably be anticipated that loss of principal or interest will not result from the loan.

Section 503(f) of the Code provides that section 503(b)(1) shall not apply to a loan made to the employer by an employees' trust described in section 401(a) if the loan bears a reasonable rate of interest and certain conditions are met. One such condition is that immediately after the making of the loan, the aggregate amount lent by the trust to the employer, without the receipt of adequate security, must not exceed 25 percent of the value of all assets of the trust.

The provisions of local law in the employer's jurisdiction stipulate that a mortagage of personal property is void as against creditors of the mortgagor, subsequent purchasers, and encumbrancers of the property, for value, unless filed in the office of the county clerk where the property mortgaged is situated. Thus, a chattel mortgage, until filed, is enforceable only between the parties, and the rights of intervening third parties without knowledge of the unrecorded mortgage may weaken the value of such security.

In view of the foregoing circumstances it is necessary, in order to satisfy the requirements of the regulations, that the chattel mortgage be recorded as soon as practicable, and the personal property be specifically identifiable.

The chattel mortgage was not recorded as soon as practicable, and the personal property was not specifically identifiable. Therefore, the loan was not adequately secured and the circumstances of the loan made it ineligible for the exception provisions of section 503(f) of the Code.

Accordingly, the loan constitutes a prohibited transaction within the meaning of section 503(b)(1) of the Code.

Rev. Rul. 66-324 is superseded because the position stated therein is updated and restated in this revenue ruling.

Section 585.—Reserves for Losses on Loans of Banks

26 CFR 1.585-2: Addition to reserve.
(Also Section 351; 1.351-1.)

Banks; bad debt reserves; additions; section 351 transfer of loans. A bank that transferred a portion of its loans outstanding to another bank in a transaction qualifying under section 351 of the Code must consider the transferred loans as a reduction in eligible loans outstanding at the beginning of the year of transfer in calculating the maximum addition to its reserve for losses on loans at the end of the taxable year of transfer under section 585(b)(2)(A).

Rev. Rul. 80-270

ISSUE

What adjustment must be made by a transferor bank to the amount of its eligible loans outstanding for purposes of computing the maximum addition to the reserve for bad debts under section 585(b)(2)(A) of the Internal Revenue Code for a taxable year in which a section 351 transfer of loans outstanding has occurred?

FACTS

On April 1, 1978, *Y*, a commercial bank that uses the accrual method of accounting, transferred a portion of its loans outstanding ($100x$ dollars) to *Z* (also a commercial bank) in exchange for stock of *Z* in a tax free transfer qualifying under section 351 of the Code. *Y* also reduced its related reserve for losses on these loans ($5x$ dollars). Thus, pursuant to section 358, *Y*'s basis in the stock received is equal to the face amount of the loans transferred to *Z* less the reserve relating to the loans transferred ($100x - 5x = 95x$). *Y* accomplished the reduction in the reserve for losses on loans by reducing its initial reserve for losses for the taxable year by an amount equal to the amount of the reserve transferred ($5x$ dollars). *Z* established a reserve for losses on loans in the amount of $5x$ dollars with respect to the loans it received. This amount was not considered as an addition to the reserve for losses on loans by *Z* for the taxable year 1978, or for any taxable year thereafter.

Y and *Z* compute their reserves for losses on loans under section 585 of the Code and the regulations thereunder. *Y* and *Z* used the "percentage method" for computing the maximum reasonable reserve addition for 1978, as set forth in section 585(b)(2)(A) and section 1.585-2(b)(1)(ii) of the Income Tax Regulations. In addition, *Y* has consistently taken the maximum addition allowable in computing all prior additions to its reserve for losses on loans.

LAW AND ANALYSIS

In *Nash v. United States,* 398 U.S. 1 (1970), Ct. D. 1941, 1970-1 C.B. 72, the Supreme Court held that a reserve for bad debts is not includible in income when accounts receivable are transferred to a controlled corporation in exchange for securities equal in value to the accounts receivable less the bad debt reserve. As a result of the *Nash* decision, Rev. Rul. 78-280, 1978-2 C.B. 139, sets forth the method for determining the transferor's basis in the accounts receivable. An accrual basis transferor using the reserve method must reduce the basis of the transferred accounts receivable and the amount of the reserve. However, Rev. Rul. 78-280 does not describe the method by which a transferor bank computes its maximum addition to its reserve under section 585 of the Code.

Section 585 of the Code sets forth the rules for calculating the reasonable reserve addition for a bank, as defined in section 581. Section 585(b)(2) describes the "percentage method" of calculating the reasonable reserve addition. Pursuant to this method, the proper amount necessary to increase the balance of the reserve is the amount necessary to increase the balance of the reserve for losses on loans (at the close of the taxable year) to the allowable percentage of eligible loans outstanding at such time. For 1978 the allowable percentage was 1.2 percent, pursuant to section 585(b).

Section 1.585-2(b)(1)(ii)(A) of the regulations sets forth the manner for determining the amount of the maximum reasonable addition to the reserve for losses on loans under the "percentage method" for a taxable year when a bank's reserve for losses on loans at the close of its base year, as defined in section 585(b)(2), is less than the allowable percentage for the taxable year (here 1.2 percent) multiplied by the eligible loans outstanding at the close of the base year. One factor making up the annual reserve addition is "an amount attributable to an increase in the amounts of eligible loans outstanding." Section 1.585-2(b)(1)(ii)(A)(3).

The purpose of section 585 of the Code is to allow an addition to the reserve for bad debts for the increase in eligible loans at the end of the taxable year. In the instant case, *Y* may transfer the accounts receivable ($100x$ dollars) and reduce its reserve ($5x$ dollars), and *Z* may set up outstanding loans ($100x$ dollars) and set up a reserve for losses ($5x$ dollars). When the reserves of *Y* and *Z* are considered together the proper tax result is obtained for this transaction. However, for *Y* to compute its maximum addition to the reserve under section 1.585-2(b)(1)(ii) of the regulations correctly at the end of the year in which these loans were transferred, it must reduce the amount of loans outstanding at the beginning of the year by the amount of such loans transferred in the section 351 transfer in order to make the proper computation under section 1.585-2(b)(1)(ii)(A).

HOLDING

A transferor bank must consider as a reduction in eligible loans outstanding at the beginning of the year of transfer, that portion of the bank's loans transferred in a section 351 transaction in calculating the maximum addition to the reserve for losses on loans at the end of the taxable year of transfer for purposes of section 585(b)(2)(A) of the Code and section 1.585-2(b)(1)(ii)(A) of the regulations.

Section 1402.—Definitions [Tax on Self-employment Income]

26 CFR 1.1402(c)-3: Employees.

(Also Sections 3121, 3401, 6050A, 6652; 1.6050A-1, 31.3121(b)(20)-1, 31.3401(a)(17)-1, 301.6652-1.)

T.D. 7716

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; SUBCHAPTER C, PART 31. — EMPLOYMENT TAXES; APPLICABLE ON AND AFTER JANUARY 1, 1955; SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Withholding on certain crewmen engaged in fishing

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final Regulations.

SUMMARY: This document provides final regulations relating to the treatment of certain crewmen on boats engaged in catching fish as self-employed rather than as employees. Changes to the applicable tax law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1] and the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1]. These regulations provide operators and crewmen of fishing boats with guidance necessary for compliance with the Acts.

DATES: The amendments to the regulations relating to income tax withholding and self-employment taxes are effective for taxable years ending after December 31, 1954. The amendments to the regulations relating to social security taxes are effective with respect to services performed after December 31, 1954, except for services performed after December 31, 1954, but before October 4, 1976, in cases in which the owner or operator of a boat treated a share of the boat's catch as being subject to such taxes. The amendments to the regulations relating to reporting requirements are effective for calendar years beginning after October 4, 1976.

FOR FURTHER INFORMATION CONTACT: Claudine Ausness of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3459).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On April 9, 1980, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1), the Employment Tax Regulations (26 CFR Part 31), and the Regulations on Procedure and Administration (26 CFR Part 301) under sections 1402, 3121, 3401, and 6050A of the Internal Revenue Code of 1954. These amendments were proposed to conform the regulations to section 1207(e) and (f)(4) of the Tax Reform Act of 1976 (90 Stat. 1706) [*supra,* at 182, 184], as amended by section 701(z) of the Revenue Act of 1978 (92 Stat. 2921) [*supra,* at 155]. No public hearing was requested. After consideration of comments regarding the proposed amendments, those amendments are adopted by this Treasury decision as proposed.

EXPLANATION OF PROVISIONS

Under the Tax Reform Act of 1976, as amended, if certain conditions are met, after 1954 crewmen on boats engaged in catching fish and other aquatic animals are generally considered self-employed, rather than employees, for purposes of income tax withholding, self-employment tax, and the social security laws.

In order for a crewman to be considered self-employed, all of the following conditions must be met:

(1) The crew member must receive in payment for his services a fixed share of the boat's catch or of the proceeds from the sale of the catch and he must be entitled to no other cash or property independent of the size of the catch;

(2) The amount of the crew member's share must depend solely on the amount of the boat's catch, and therefore the amount of the share cannot be fixed at any minimum (in dollars or weight); and

(3) The crew of the boat on which the individual performed these services must normally be made up of fewer than 10 individuals.

Even if the criteria under the new provision are satisfied, for purposes of the social security tax a crewman is nevertheless deemed an employee, with regard to any services performed after December 31, 1954, but before October 4, 1976, if the boat operator treated a share of the boat's catch received by the crewman as subject to social security taxes.

If the new criteria are satisfied, the boat operator must file an information return on Form 1099-F (Copy A) by February 28 of the calendar year following the year in which service is performed, and, if the crewman has made his address known, the operator must furnish Copy B of the same form to the crewman. The operator must report on Form 1099-F the identity of each individual performing services, the individual's percentage share of the catch, and the amount of the proceeds received or the type and weight of the catch each crewman received as compensation for his services.

The regulation explicitly states that a crewman's share is not dependent solely on the amount of the boat's catch if the crewman is entitled under any individual or collective agreement to any fee, hourly wage, minimum for services, or any other amount unrelated to the size of the catch. Further, the operating crew includes the captain for purposes of determining the number of persons who normally make up the crew of the boat.

Two comments made with respect to the proposed rules expressed some confusion as to whether the same individual could be considered self-employed for one voyage and an employee for the next voyage as a result of how remuneration for the crewman was calculated. The regulation clearly provides that services performed by a crewman on one voyage may be excepted from employment but may not be so excepted on a subsequent voyage on the same or on a different boat, and that services of some crewman on a voyage may be excepted from employment while services of other crewmen on the same voyage may not be so excepted. For example, a crewman on a

5-man crab fishing boat, if paid solely on a share basis, might be considered self-employed for that trip, but the same crewman on a subsequent salmon tendering trip, if compensated on a per-diem basis, would be considered an employee.

The regulation specifies certain events which result in a boat operator's "treating" a share of the boat's catch as subject to social security taxes for purposes of the exception to the 1955 effective date in the case of such taxes. For example, the operator is generally deemed to have treated the share of the catch as subject to social security taxes (1) if the operator voluntarily filed Form 941, (2) if he made full or partial payment of FICA tax (unless he made such payment only in order to file a court claim for a refund), or (3) if the operator withheld FICA tax from the crewman's share (regardless of whether the tax was paid over to the Service).

The regulation makes clear that, if a share of the catch has been "treated" as subject to social security taxes, in the case of services performed after December 31, 1954, but before October 4, 1976, even though the crewman otherwise satisfied the criteria necessary for being considered self-employed, he is not required to pay tax on self-employment income with respect to such services, but is required to pay income tax on income received for such services. The fact that a boat operator has treated a share of the catch as being subject to the social security tax does not mean that the operator is required to withhold income tax with respect to that share. However, in such cases the boat operator is required to pay over both the employee and employer portions of FICA tax.

The final regulations adopted by this Treasury decision impose no significant new reporting or recordkeeping requirements. The principal effect of the final regulations is to conform existing regulations to statutory changes. Evaluation of the effectiveness of these regulations after issuance will be based upon comments received from offices within Treasury and the Internal Revenue Service, other governmental agencies, and the public.

DRAFTING INFORMATION

The principal author of these regulations is Claudine Ausness of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to 26 CFR Parts 1, 31, and 301 are hereby adopted:

INCOME TAX REGULATIONS
(26 CFR Part 1)

Paragraph 1. Section 1.1402(c)-3 is amended by revising the second sentence of paragraph (a) and by adding a new paragraph (g) to read as follows:

§ 1.1402(c)-3 Employees.

(a) *General rule.* * * * However, in six cases set forth in paragraphs (b) to (g), inclusive, of this section, the performance of service by an individual is considered to constitute a trade or business within the meaning of section 1402(c) and § 1.1402(c)-1. * * *

* * * * *

(g) *Individuals engaged in fishing.* For taxable years ending after December 31, 1954, service performed by an individual on a boat engaged in catching fish or other forms of aquatic animal life (hereinafter "fish") constitutes a trade or business within the meaning of section 1402(c) and § 1.1402(c)-1 if the service is excepted from the definition of employment by section 3121(b)(20) and § 31.3121(b)(20)-1(a). However, the preceding sentence does not apply to services performed after December 31, 1954, and before October 4, 1976, on a boat engaged in catching fish if the owner or operator of the boat treated the individual as an employee in the manner described in § 31.3121(b)(20)-1(b).

Par. 2. Section 1.6050A-1 is added immediately after § 1.6050-1, to read as follows:

§ 1.6050A-1 Reporting requirements of certain fishing boat operators.

(a) *Requirement of reporting.* The operator of a boat on which one or more individuals during a calendar year performed services described in § 31.3121(b)(20)-1(a) shall make an information return on Form 1099-F for that calendar year. The return shall include the following information:

(1) The name and taxpayer identification number of each individual performing the services;

(2) The percentage of each individual's share of the catch of fish or other forms of aquatic life (hereinafter "fish");

(3) The percentage of the operator's share of the catch of fish;

(4) If the individual receives all or part of his share of the catch in kind, the type and weight of the share and, if it can be ascertained, the fair market value of his share;

(5) If the individual receives a share of the proceeds of the catch, the dollar amount received; and

(6) Any other information that is required by the form.

For purposes of this section, the term "boat operator" means an employer (as defined in § 31.3121(d)-(2)) of an employee whose services are excepted from employment by section 3121(b)(20) and § 31.3121(b)(20)-1. The boat operator may make separate returns on Form 1099-F for each crew member for each voyage, or he may aggregate the information required by this paragraph for an individual for all or any part of a return period in which the type of catch (if required) and the percentage due the crew member remain the same.

(b) *Time and place for filing.* Returns required to be made under this section on Form 1099-F shall be filed with the Internal Revenue Service Center, designated in the instructions for Form 1099-F, on or before February 28 of the year following the year in which the relevant services were performed.

(c) *Requirement of and time for furnishing statement*—(1) *Requirement of furnishing statement.* Every person filing a Form 1099-F under this section shall furnish to the individual whose identifying number is (or should be) shown on the form a written statement showing the information required by paragraph (a) of this section. The requirement of the preceding sentence may be met by furnishing to the individual copy B of Form 1099-F or a reasonable facsimile of Form 1099-F that was filed pursuant to this section.

(2) *Time for furnishing statement.* Each statement required by this paragraph to be furnished to any individual for a calendar year shall be furnished on or before January 31 of the year following the calendar year for which the return was made.

EMPLOYMENT TAX REGULATIONS

(26 CFR Part 31)

Par. 3. Section 31.3121(b)(20)-1 is added immediately after § 31.3121(b)(19)-1, to read as follows:

§ 31.3121(b)(20)-1 Service performed on a boat engaged in catching fish.

(a) *In general.* (1) Service performed on or after December 31, 1954, by an individual on a boat engaged in catching fish or other forms of aquatic animal life (hereinafter "fish") are excepted from employment if—

(i) The individual receives a share of the boat's (or boats' for a fishing operation involving more than one boat) catch of fish or a share of the proceeds from the sale of the catch,

(ii) The amount of the individual's share depends solely on the amount of the boat's (or boats' for a fishing operation involving more than one boat) catch of fish,

(iii) The individual does not receive, and is not entitled to receive, any cash remuneration, other than remuneration that is described in subdivision (i) of this subparagraph, and

(iv) The crew of the boat (or of each boat from which the individual receives a share of the catch) normally is made up of fewer than 10 individuals.

(2) The requirement of subdivision (ii) of subparagraph (1) is not satisfied if there exists an agreement with the boat's (or boats') owner or operator by which the individual's remuneration is determined partially or fully by a factor not dependent on the size of the catch. For example, if a boat is operated under a remuneration arrangement, *e.g.,* a collective agreement which specifies that crew members, in addition to receiving a share of the catch, are entitled to an hourly wage for repairing nets, regardless of whether this wage is actually paid, then all the crew members covered by the arrangement are entitled to receive cash remuneration other than a share of the catch and their services are not excepted from employment by section 3121(b)(20).

(3) The operating crew of a boat includes all persons on the boat (including the captain) who receive any form of remuneration in exchange for services rendered while on a boat engaged in catching fish. See § 1.6050A-1 for reporting requirements for the operator of a boat engaged in catching fish with respect to individuals performing services described in this section.

(4) During the same return period, service performed by a crew member may be excepted from employment by section 3121(b)(20) and this section for one voyage and not so excepted on a subsequent voyage on the same or on a different boat.

(5) During the same voyage, service performed by one crew member may be excepted from employment by section 3121(b)(20) and this section but service performed by another crew member may not be so excepted.

(b) *Special rule.* Services performed after December 31, 1954, and before October 4, 1976, on a boat by an individual engaged in catching fish are not excepted from employment for any voyage (for purposes of section 3121(b) and the corresponding regulations), even though the individual satisfies the requirements of subdivisions (i) through (iv) of paragraph (a)(1) of this section, if the owner or operator of the boat engaged in catching fish treated the individual as an employee. For purposes of this subparagraph, the individual was treated as an employee if—

(1) Form 941 was voluntarily filed by the boat operator or owner, regardless of whether the tax imposed by chapter 21 was withheld. For purposes of this subdivision, the filing of Form 941 is not voluntary if the filing was the result of action taken by the Service pursuant to section 6651(a) (relating to addition to the tax for failure to file tax return or to pay tax);

(2) The boat owner or operator withheld from the individual's share the tax imposed by chapter 21, regardless of whether the tax was paid over to the Service; or

(3) The boat owner or operator made full or partial payment of the tax imposed by chapter 21, unless the payment was made pursuant to section 7422(a) (relating to no civil actions for refund prior to filing claim for refund).

However, for purposes of this paragraph, crew members whose services, but for subdivisions (i) through (iii), would have been excepted from employment by section 3121(b)(20) are not required to pay self-employment tax on income earned in performing those services. See § 1.1402(c)-3(g). Moreover, in such cases the employer is not entitled to a refund of the employer's share of any tax imposed by chapter 21 that was paid.

Par. 4. Section 31.3401(a)(17)-1 is added after § 31.3401(a)(16)-1, to read as follows:

§ 31.3401(a)(17)-1 Remuneration for services performed on a boat engaged in catching fish.

(a) Remuneration for services performed on or after December 31, 1954, by an individual on a boat engaged in catching fish or other forms of aquatic animal life (hereinafter "fish") is excepted from wages and hence is not subject to withholding if—

(1) The individual receives a share of the boat's (or boats' for a fishing operation involving more than one

boat) catch of fish or a share of the proceeds from the sale of the catch,

(2) The amount of the individual's share depends solely on the amount of the boat's (or boats' for a fishing operation involving more than one boat) catch of fish,

(3) The individual does not receive, and is not entitled to receive, any cash remuneration, other than remuneration that is described in subparagraph (1) of this paragraph, and

(4) The crew of the boat (or of each boat from which the individual receives a share of the catch) normally is made up of fewer than 10 individuals.

(b) The requirement of subparagraph (2) of paragraph (a) is not satisfied if there exists an agreement with the boat's (or boats') owner or operator by which the individual's remuneration is determined partially or fully by a factor not dependent on the size of the catch. For example, if a boat is operated under a remuneration arrangement, *e.g.*, a union contract, which specifies that crew members, in addition to receiving a share of the catch, are entitled to an hourly wage for repairing nets, regardless of whether this wage is actually paid, then all the crew members covered by the arrangement are entitled to receive cash remuneration other than as a share of the catch and are not excepted from employment by section 3121(b)(20).

(c) The operating crew of a boat includes all persons on the boat (including the captain) who receive any form of remuneration in exchange for services rendered while on a boat engaged in catching fish. See § 1.6050A-1 for reporting requirements for the operator of a boat engaged in catching fish with respect to individuals performing services described in this section.

(d) During the same return period, service performed by a crew member may be excepted from employment by section 3121(b)(20) and this section for one voyage and not so excepted on a subsequent voyage on the same or on a different boat.

REGULATIONS ON PROCEDURE AND ADMINISTRATION

(26 CFR Part 301)

Par. 5. Section 301.6050A-1 is added immediately after § 301.6050-1, to read as follows:

§ 301.6050A-1 Information returns regarding services performed by certain crewmen on fishing boats.

For provisions relating to the requirement of returns of information regarding services performed by certain crewmen on fishing boats, see § 1.6050A-1 of this chapter (Income Tax Regulations) and § 301.6652-1 of this chapter (Regulations on Procedure and Administration).

Par. 6. Section 301.6652-1(a)(2) is amended to read as follows:

§ 301.6652-1 Failure to file certain information returns.

(a) *Returns with respect to payments made in calendar years after 1962.* * * *

(2) *Other payments; statements with respect to tips.* In the case of each failure—

(i) To file a statement of a payment made to another person required under authority of section 6041, relating to information returns with respect to certain information at source, or section 6051(d), relating to information returns with respect to payments of wages as defined in section 3401(a), or section 6050A(a), relating to information returns with respect to remuneration of certain crew members defined in section 3121(b)(20), or

(ii) To furnish a statement required under authority of section 6053(b), relating to statements furnished by employers with respect to tips, or section 6050A(b), relating to statements furnished by fishing boat operators with respect to remuneration of certain crew members, within the time prescribed by regulations under those sections for filing such statements (determined with regard to any extension of time for filing),

there shall be paid by the person failing to so file the statement $1 for each such statement not so filed. However, the total amount imposed on the delinquent person for all such failures during any calendar year shall not exceed $1,000.

* * * * *

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of Internal Revenue.

Approved: August 18, 1980.

DONALD C. LUBICK,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on August 26, 1980, 8:45 a.m., and published in the issue of the Federal Register for August 27, 1980, 45 F.R. 57122)

Section 2522.—Charitable and Similar Gifts

26 CFR 25.2522(c)-2: Disallowance of charitable, etc., deductions in the case of gifts made after December 31, 1969.

Charitable deduction; transfer in trust; trustee's power to borrow from trust. A settlor's transfer of money to a charitable trust that is a private foundation described in section 509(a) of the Code does not qualify for a gift tax charitable deduction if the trustee, an adult child of the settlor, may borrow money from the trust.

Rev. Rul. 80-271

ISSUE

Under the circumstances described below, does the settlor's transfer to a charitable trust qualify for the gift tax charitable deduction under section 2522(a) of the Code if the trustee, a member of the settlor's family, may borrow funds from the trust?

FACTS

On December 1, 1978, *G*, the settlor, transferred 10*x* dollars to be held in trust by *G*'s adult child, *A*, as trustee. The trust is a private foundation within the meaning of section 509(a).

The trust instrument provides that income is to be paid anually to *X* Charity for 25 years. At the end of the 25 year period, the principal is to be distributed to *X* Charity. During the trust term, *A* may borrow a maximum of 2*x* dollars from the trust. The borrowed money is to be repaid, along with interest at the prevailing rate, upon the termination of the trust, if not previously repaid.

Under applicable local law the right of an individual to borrow money from a trust is not regarded as a beneficial interest in the trust since the borrowed funds must be repaid to the trust. In addition, the trustee is not prevented from exercising a power to borrow trust money.

LAW AND ANALYSIS

Section 2511(a) of the Code provides that the gift tax applies whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 2522(a) of the Code allows a federal gift tax deduction for transfers to or for the use of a charitable organization. Section 2522(c), however, provides that certain charitable transfers will not qualify for a deduction under section 2522(a).

Under section 2522(c)(1), no deduction is allowed for a gift to an organization or trust described in section 508(d). Section 508(d) describes, among other things, a private foundation that fails to meet the requirements of section 508(e). Under section 508(e), a private foundation is not exempt from taxation unless its governing instrument prohibits the foundation from engaging in, among others, any act of self-dealing, which includes the lending of money or other extension of credit by a trust to a trustee or to a member of the family of a substantial contributor to the trust. See sections 4941(d)(1)(B) and 4946(a)(1). Consequently, under section 2522(c)(1), a transfer to a trust from which a trustee or a member of the settlor's family may borrow money will not qualify for a federal gift tax deduction allowed by section 2522(a), notwithstanding that all of the interests are transferred for the benefit of a charity.

In the present situation, since the trust instrument authorizes an act of self-dealing, the trust fails to meet the requirements of section 508(e). Therefore, it is a trust described in section 508(d).

HOLDING

Since *A* can borrow funds from the trust, the trust is described in section 508(d) and, therefore, does not satisfy the requirements of section 2522(c)(1). Consequently, *G*'s transfer does not qualify for a gift tax charitable deduction under section 2522(a).

Section 3121.—Definitions

26 CFR 31.3121(b)(20)-1: Service performed on a boat engaged in catching fish.

Treatment of certain crewmen on boats engaged in catching fish as self-employed rather than as employees. See T.D. 7716, page 10.

Section 3401.—Definitions

26 CFR 31.3401(a)(17)-1: Remuneration for services performed on a boat engaged in catching fish.

Treatment of certain crewmen on boats engaged in catching fish as self-employed rather than as employees. See T.D. 7716, page 10.

Section 4061.—Imposition of Tax

26 CFR 48.4061(b)-1: Imposition of tax.

Constructive sale price for automotive parts or accessories sold at retail. See Rev. Rul. 80-273, this page.

Section 4161.—Imposition of Tax

26 CFR 48.4161(a)-1: Imposition and rate of tax; fishing equipment.

Constructive sale price for fishing equipment sold at retail. See Rev. Rul. 80-273, this page.

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26 CFR 48.4161(b)-1: Imposition and rates of tax; bows and arrows.

Constructive sale price for bows and arrows sold at retail. See Rev. Rul. 80-273, this page.

Section 4181.—Imposition of Tax

26 CFR 48.4181-1: Imposition and rates of tax.

Constructive sale price for firearms sold at retail. See Rev. Rul. 80-273, below.

Section 4216.—Definition of Price [Special Provisions Applicable to Manufacturers Tax]

26 CFR 48.4216(b)-2: Constructive sale price; basic rules.
(Also Sections 4061, 4161, 4181, 7805; 48.4061(b)-1, 48.4161(a)-1, 48.4161(b)-1, 48.4181-1, 301.7805-1.)

Constructive sale price; retail sales; no sales to wholesalers. The constructive sale price for computing the taxes imposed by sections 4061(b)(1), 4161(a), 4161(b), and 4181 of the Code on articles sold at retail by manufacturers, producers, or importers who do not sell like articles to wholesale distributors is 75 percent of the actual selling price after the adjustments provided by section 4216(a), unless it can be shown on an industry-wide basis that a lower percentage should apply; Rev. Rul. 87 modified.

Rev. Rul. 80-273

FACTS

The Internal Revenue Service has established a new basis for computing the manufacturers excise tax on the sale at retail of automotive parts or accessories, fishing equipment, bows and arrows, and firearms in situations where the manufacturers, producers, or importers do not sell like articles to wholesale distributors.

LAW AND ANALYSIS

Sections 4061(b)(1), 4161(a), 4161(b), and 4181 of the Internal Revenue Code impose manufacturers excise taxes on the sale of automotive parts or accessories, fishing equipment, bows and arrows, and firearms, respectively.

Section 4216(a) of the Code relates to the allowance of certain adjustments to the sale price for purposes of computing manufacturers excise tax liability.

Section 4216(b)(1)(A) of the Code provides that if an article is sold at retail, the manufacturers excise tax shall (if based on the price for which the article is sold) be computed on whichever of the following prices is the lower: (i) the price for which such article is sold, or (ii) the highest price for which such articles are sold to wholesale distributors, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Secretary.

Section 48.4216(b)-2(b) of the Manufacturers and Retailers Excise Tax Regulations provides that in determining the highest price for which articles are sold by manufacturers to wholesale distributors (the constructive sale price) there must be taken into consideration the normal industry practices with respect to section 4216 (a) inclusions and exclusions. However, once a constructive sale price has been determined by the Secretary, no further adjustment of such price shall be made.

Rev. Ruls. 79-32 and 79-33, 1979-1 C.B. 355 and 356, provide that the basis for computing manufacturers excise tax where truck trailer and semitrailer chassis and bodies, and truck chassis and bodies and truck-tractors, respectively, are sold at retail is 90 percent of the actual selling price after taking into account the adjustments provided by section 4216 (a) of the Code unless it can be shown that a lower percentage should apply to a particular segment of the industry. Under section 4216(b)(1)(A), the manufacturer's cost is no longer a factor with respect to articles taxable under section 4061(a).

HOLDING

The constructive sale price for computing the taxes imposed by sections 4061(b)(1), 4161(a), 4161(b), and 4181 of the Code, where the articles are sold at retail by manufacturers, producers, or importers who do not sell like articles to wholesale distributors, is 75 percent of the actual selling price after taking into account the adjustments provided by section 4216 (a) unless it can be shown on an industry-wide basis that a lower percentage should apply. No further adjustments under section 4216 are allowable. The manufacturer's cost is not to be a factor in determining the constructive sale price.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 87, 1953-1 C.B. 464, which holds that certain custom-made racks for delivery trucks are taxable automotive parts or accessories, is modified to indicate that the constructive sale price for such articles sold only at retail is 75 percent of the actual selling price after taking into account the allowable adjustments.

PROSPECTIVE APPLICATION

Under the authority granted by section 7805(b) of the Code, this revenue ruling is effective with respect to sales of the aforementioned articles by manufacturers, producers, and importers on and after January 1, 1981.

Section 4997.—Records and Information; Regulations

26 CFR 150.4997-1: Returns and recordkeeping.

Windfall profit tax; recordkeeping requirements; ADP users. Punched cards, magnetic tapes, disks, and other machine-sensible data media used for recordkeeping in a taxpayer's automatic data processing system are records within the meaning of section 4997 of the Code and must be retained so long as the contents may become material in the administration of any internal revenue law. However, punched cards used merely as a means of input to the system need not be retained if the input information is duplicated on other records.

Rev. Rul. 80-272 [1]

ISSUE

Do punched cards, magnetic tapes, disks, and other machine-sensible data media used in the automatic data processing of accounting transactions constitute records within the meaning of section 4997 of the Internal Revenue Code?

FACTS

In the typical situation the taxpayer maintains records within his automatic data processing (ADP) system. Daily transactions are recorded on punched cards and processed by the taxpayer's computer, which prints daily listings and accumulates the individual transaction records for a month's business on magnetic tapes. At the month's end the tapes are used to print out monthly journals, registers, and subsidiary ledgers and to prepare account summary totals entered on punch cards. The summary data from these cards is posted to the general ledger, and a monthly printout is generated to reflect opening balances, summary total postings, and closing balances. At the year's end several closing ledger runs are made to record adjusting entries. In other situations taxpayers use punched cards, disks, or other machine-sensible data media to store accounting information.

LAW AND ANALYSIS

Section 4986(a) of the Code imposes an excise tax on the windfall profit from taxable crude oil removed from the premises during each taxable period. Section 4986(b) provides that this tax shall be paid by the producer of the crude oil.

Section 4997 of the Code provides that each taxpayer liable for tax under section 4986, each partnership, trust, or estate producing domestic crude oil, each purchaser of domestic crude oil, and each operator of a well from which domestic crude oil was produced, shall keep such records, make such returns and furnish such information with respect to such oil as the Secretary may by regulations prescribe.

Under section 150.4997-1(b) of the Temporary Excise Tax Regulations under the Crude Oil Windfall Profit Tax Act of 1980, each of the parties described in section 4997 of the Code shall keep records of all documents, material, and information necessary to the determination of the windfall profit tax or that affect his or her administrative obligations under the Act or regulations, including material furnished to other persons, as well as information received from other persons. The records shall be kept at all times available for inspection by authorized internal revenue officers or employees and shall be retained so long as the contents thereof may become material in the administration of any internal revenue law.

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[1] Also released in News Release IR-80-96 dated September 23, 1980.

HOLDING

Punched cards, magnetic tapes, disks, and other machine-sensible data media used for recording, consolidating, and summarizing accounting transactions and records within a taxpayer's automatic data processing system are records within the meaning of section 4997 of the Code and section 150.4997-1(b) of the regulations and are required to be retained so long as the contents may become material in the administration of any internal revenue law. However, where punched cards are used merely as a means of input to the system and the information is duplicated on magnetic tapes, disks, or other machine-sensible records, such punched cards need not be retained.

It is recognized that ADP accounting systems will vary from taxpayer to taxpayer and, usually, will be designed to fit the specific needs of the taxpayer. Accordingly, taxpayers who are in doubt as to which records are to be retained or who desire further information should contact their district director for assistance.

See Rev. Proc. 80-42, page 18, this Bulletin, which sets forth guidelines for keeping records with an ADP system.

26 CFR 150.4997-1: Returns and recordkeeping.

Basic recordkeeping requirements essential in meeting the requirements set forth by the Crude Oil Windfall Profit Tax Act of 1980, for a taxpayer using an automatic data processing system. See Rev. Proc. 80-42, page 18.

Section 6050A.—Reporting Requirements of Certain Fishing Boat Operators

26 CFR 1.6050A-1: Reporting requirements of certain fishing boat operators.

Treatment of certain crewmen on boats engaged in catching fish as self-employed rather than as employees. See T.D. 7716, page 10.

Section 6652.—Failure to File Certain Information Returns, Registration Statements, Etc.

26 CFR 301.6652-1: Failure to file certain information returns.

Treatment of certain crewmen on boats engaged in catching fish as self-employed rather than as employees. See T.D. 7716, page 10.

Section 7805.—Rules and Regulations

26 CFR 301.7805-1: Rules and regulations.

Prospective application of revenue ruling relating to the constructive sale price for computing manufacturers excise tax on certain articles sold at retail. See Rev. Rul. 80-273, page 15.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 80-41

Rev. Proc. 80-22, 1980-26 I.R.B. 26, sets forth areas in which advance rulings or determination letters will not be issued by the Internal Revenue Service. Section 5 of Rev. Proc. 80-22 lists areas under extensive study in which rulings or determination letters will not be issued until the Service resolves the issue through publication of a revenue ruling, revenue procedure, regulations, or otherwise. Section 5 is amplified to include the following:

Section 820.—Optional Treatment of Policies Reinsured Under Modified Coinsurance Contracts. The tax consequences of modified coinsurance contracts to which section 820 of the Code may apply, including whether taxpayers who have entered into a modified coinsurance contract may allocate between the reinsured and reinsurer certain items to which section 820(c) applies.

Rev. Proc. 80-22 is amplified.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, Section 4997; 150.4997-1.)

Rev. Proc. 80-42 [1]

SECTION 1. PURPOSE

.01 The purpose of this revenue procedure is to set forth guidelines specifying the basic record requirements that the Internal Revenue Service considers to be essential in cases where a taxpayer's records are maintained within an automatic data processing (ADP) system. References here to ADP systems include all accounting systems which process all or part of a taxpayer's transactions, records, or data by other than manual methods.

.02 The technology of ADP is evolving rapidly; new methods and techniques are constantly being devised and adopted. Accordingly, the five points set forth in section 4 of this revenue procedure are not intended to restrict or prevent taxpayers from obtaining the maximum benefits of ADP provided the appropriate information is present or can be produced by the system. These guidelines will be modified and admended as the need indicates to keep pace with developments in ADP.

SEC. 2. BACKGROUND

The inherent nature of ADP is such that it may not be possible to trace transactions from source documents to end results or to reconstruct a given account unless the system is designed to provide audit trails. Taxpayers already using ADP or contemplating its use have requested information concerning the types of records that should be developed and maintained in order to meet the requirements of section 4997 of the Internal Revenue Code and the corresponding regulations. This section of the Code reads in part as follows:

> Each taxpayer liable for the windfall profit tax, each partnership, trust, or estate producing domestic crude oil, each purchaser of domestic crude oil, and each operator of a well from which domestic crude oil was produced shall keep such records, make such returns, and furnish such information with respect to such oil as the Secretary may by regulations prescribe.

SEC. 3. OBJECTIVES

Modern machine accounting systems are capable of recording business transactions much more rapidly and with greater accuracy than manual systems, and they are capable of retaining and producing vast amounts of data. The ability to produce in legible form the data necessary to determine, at a later date, whether or not the correct tax liability has been reported must be carefully considered in designing and programming a machine system. This factor may add to the complexity of the system and require additional cost, but this cost may be negligible in comparision to the expense that may be incurred at a later date if the system cannot practically and readily provide the information needed to support and substantiate the accuracy of the previously reported tax liability.

SEC. 4. ADP RECORD GUIDELINES

.01 ADP accounting systems will vary, just as manual systems vary, from taxpayer to taxpayer. However, the procedures built into a computer's accounting program must include a method of producing from the punched cards or tapes visible and legible records which will provide the necessary information for the verification of the taxpayer's tax liability.

.02 In determining the adequacy of records maintained with an ADP system, the Service will consider as acceptable those systems that comply with the guidelines for record requirements as follows:

1 *General and subsidiary books of account.* A general ledger, with source references, should be written out to coincide with financial reports for tax reporting periods. In cases where subsidiary ledgers are used to support the general ledger accounts, the subsidiary ledgers should also be written out periodically.

2 *Supporting documents and audit trail.* The audit trail should be designed so that the details underlying the summary accounting data, such as invoices and vouchers, may be identified and made available to the Service upon request.

3 *Recorded or reconstructible data.* The records must provide the opportunity to trace any transaction back to the original source or forward to a final total. If printouts are not made of transactions at the time they are processed, then the system must have the ability to reconstruct these transactions.

4 *Data storage media.* Adequate record retention facilities must be available for storing tapes and printouts as well as all applicable supporting documents. These records must be retained in accordance with the provisions of the Code and the regulations prescribed thereunder.

5 *Program documentation.* A description of the ADP portion of the

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[1] Also released in News Release IR-80-96 dated September 23, 1980.

accounting system should be available. The statements and illustrations as to the scope of operations should be sufficiently detailed to indicate (a) the application being performed, (b) the procedures employed in each application (which, for example, might be supported by flow charts, block diagrams or other satisfactory descriptions of input or output procedures), and (c) the controls used to insure accurate and reliable processing. Important changes, together with their effective dates, should be noted in order to preserve an accurate chronological record.

SEC. 5. COMMENTS OR INQUIRIES

Comments or inquiries relating to this revenue procedure should be addressed to the Assistant Commissioner (Compliance), Attention: CP:E, Washington, D.C., 20224.

SEC. 6. EFFECTIVE DATE

This revenue procedure is effective October 14, 1980, the date of its publication.

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26 CFR 601.602: Forms and instructions.

Rev. Proc. 80-43

SECTION 1. PURPOSE

This revenue procedure establishes a handling and shipping charge for processing requests for bulk quantities of tax forms. This charge only applies to those engaged in the preparation of tax returns for private gain.

SEC. 2. CHARGES

.01 Charges for tax forms and instructions will be established on the basis of each 1,000 printed units ordered, or fraction thereof, in excess of the first 500 printed units requested during any 12 month period. The schedule of charges for handling and shipping bulk quantities of tax forms and instructions is:

Up to but not exceeding 500 printed units	No Charge
Each 1,000 units or fraction thereof in excess of the first 500 units	$5.00

A $1.00 discount per 1,000 units will be applied to any bulk order postmarked on or before the discount deadline date published in Publication 1045.

.02 No charge will be made: (a) to an individual or organization for the first 500 printed units requested; (b) to individuals picking up tax forms or instructions at Internal Revenue Service offices; or (c) to a bank, post office or other organization for any quantity of forms and instructions for the convenience and use of the taxpayer, so long as such organization is not engaged in the preparation of tax returns for private gain.

.03 Single copies of Publications 17 and 334 will be provided without charge. Multiple copies of either publication shall not be provided to individuals or organizations except where the Regional Commissioner or District Director determines that such distribution will further the interest of taxpayer service or education. A user charge will apply to all such approved multiple copy requests; however, Regional Commissioners, District Directors and appropriate National Office officials may continue to provide multiple copies without charge for use in Service sponsored programs (e.g. Understanding Taxes and VITA). Priority must be given to filling single copy requests for Publications 17 and 334; requests for bulk quantities of either publication which jeopardize the Service's ability to respond timely to such single copy demand should not be honored. For individuals who wish, for their own purposes, to print bulk quantities of Publications 17 and 334, the Service will provide page negatives of either publication for a user charge. The schedule of charges is:

Publications 17 and 334
$.50 per copy for each approved request
$3.00 per page negative

.04 All user charges will be commensurate with the prevailing postage and handling costs and will be established by the Commissioner.

.05 Publication 1045 will contain Form 2333, Request for Blank Income Tax Forms. The instructions on Form 2333 outline the handling and shipping charge for processing orders of bulk quantities of tax forms.

.06 Checks, made payable to the Internal Revenue Service, should be submitted with Form 2333.

SEC. 3. EFFECT ON OTHER DOCUMENTS

This revenue procedure supersedes Rev. Proc. 67-36, 1967-2 C.B. 666.

Part IV. Items of General Interest

Disaster Areas

Announcement 80-130

The President of the United States has determined that the areas listed below were adversely affected by disasters of sufficient severity and magnitude to warrant federal disaster assistance.

Taxpayers who suffered losses in these areas as a result of these disasters may elect the special tax treatment provided under section 165(h) of the Internal Revenue Code. Section 1.165-11 of the Income Tax Regulations sets forth the procedure for making this election. Losses not incurred with respect to a trade or business or any transaction entered into for profit will not qualify for treatment under section 165(h) unless such losses qualify as casualty losses.

State: Ohio
Counties affected: Belmont, Columbiana, Guernsey, Jefferson, Monroe, Muskingum, Noble
Type of disaster: Severe storms and flooding
Begun on or about: August 11, 1980

State: Texas
Counties affected: Aransas, Brooks, Cameron, Duval, Hidalgo, Jim Hogg, Jim Wells, Kenedy, Kleberg, Nueces, San Patricio, Willacy
Type of disaster: Hurricane Allen
Begun on or about: August 10, 1980

State: West Virginia
Counties affected: Fayette, Hancock, Harrison, Jackson, Kanawha, Marion, Marshall, Monongalia, Nicholas, Ohio, Preston, Putnam, Raleigh, Taylor, Webster
Type of disaster: Severe storms and flooding
Begun on or about: August 4, 1980

Tax-Free Sales of Articles To Be Used for, or Resold for, Further Manufacture—Public Hearing

Announcement 80-133 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to tax-free sales of articles to be used for, or resold for, further manufacture.

DATES: The public hearing will be held on October 28, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by October 14, 1980.

ADDRESSES: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-58-79), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under section 4221 of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Wednesday, July 2, 1980 (45 FR 44965).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of oral comments to be presented at the hearing and the time they wish to devote to each subject by October 14, 1980.

Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive on improving government regulations appearing in the Federal Register for Wednesday, November 8, 1978.

Withholding; Virgin Island Inhabitants—Public Hearing

Announcement 80-134 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed revocation of regulation.

SUMMARY: This document provides notice of a public hearing relating to the proposed revocation of a regulation providing an exemption from withholding of tax under chapter 3 of the Internal Revenue Code of 1954.

DATES: The public hearing will be held on November 7, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by October 24, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-2139), Washington, D.C. 20224.

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[1] Filed by the Office of the Federal Register on Sept. 23, 1980, 8:45 a.m., and published in the issue of the Federal Register for Sept. 24, 1980, 45 F.R. 63296.

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FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is a proposed revocation of a regulation pertaining to sections 1441 and 1442 of the Internal Revenue Code of 1954. The proposed revocation of the regulation appeared in the Federal Register for Tuesday, July 8, 1980 (45 FR 45924).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed revocation and who also desire to present oral comments at the hearing on the proposed revocation should submit an outline of the comments to be presented at the hearing and the time they wish to devote to each subject by October 24, 1980. Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive for improving government regulations appearing in the Federal Register for Wednesday, November 8, 1978.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing, the following individual has been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
J. Franklin Moore	Lenoir, NC	Certified Public Accountant	August 18, 1980

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Ralph D. Lider	New Bedford, MA	Attorney	Indefinite effective August 18, 1980
Anthony G. Bellas	Littleton, CO	Enrolled Agent	Twelve months effective September 1, 1980
Roy W. Lynch	New Bedford, MA	Enrolled Agent	Indefinite effective August 28, 1980
Roger C. Hennings	Stillwater, MN	Attorney	Indefinite effective August 28, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 301.7609-1 through 301.7610-1 added.	Administrative summonses.	Aug. 21, 1980	Oct. 20, 1980
26 CFR 1.6012-2(e), 1.6012-3(a)(5), 1.6033-2(a)(2)(i), 53.6071-1, 301.6204-1, 301.6211-1, 301.6212-1, 301.6213-1, 301.6501(c)-1, 301.6501(e)-1, 301.6503(a)-1(a), 301.6512-1, 301.6601-1(d), 301.6653-1, 301.6659-1, 301.6861-1, 301.6862-1(a), 301.6863-1(b), amended; 53.6011-1(e), 54.6011-1, 301.6501(n)-1 through 301.6501(n)-3, 301.6503(g)-1, 301.6511(f)-1, 301.7422-1, 301.7454-2, added; 301.6503(g)-1 redesignated as 301.6503(f)-1.	Procedure and administration of certain excise taxes.	Aug. 25, 1980	Oct. 24, 1980
26 CFR 53.4942(a)-3 revised.	Set-asides made by private foundations.	Aug. 26, 1980	Oct. 27, 1980
26 CFR 1.482-2, 1.483-1, amended.	Imputed interest rate on loans between related entities and on deferred payments in the case of certain sales of property.	Aug. 29, 1980	Oct. 28, 1980
26 CFR 1.6013-6(a)(2)(v) amended.	Relationship of election by nonresident alien to be treated as a resident and income tax treaties.	Sept. 12, 1980	Nov. 11, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27, dated July 7, 1980.

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_____ 1928-1	6.95	_____ 1942-1	7.25	_____ 1958-1	9.60	_____ 1970-2	14.00
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_____ 1929-1	12.00	_____ *1943*(*)	*9.55*	_____ 1958-3	15.00	_____ 1971-2	8.50
_____ *1929-2*	*3.15*	_____ *1944*(*)	*7.85*	_____ 1959-1	15.00	_____ 1972-1	13.50
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_____ 1930-2	9.50	_____ *1946-1*	*2.55*	_____ 1960-1	19.00	_____ 1973-1	16.00
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_____ *1932-1*	*2.80*	_____ 1947-2	3.40	_____ 1961-2	10.00	_____ 1974-2	9.95
_____ 1932-2	8.65	_____ *1948-1*	*3.15*	_____ 1962-1	14.00	_____ *1974-3*	*8.20*
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_____ *1934-1*	*3.70*	_____ *1949-2*	*2.80*	_____ 1963-1	9.00	_____ 1975-2	13.00
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_____ *1936-2*	*14.00*	_____ *1952-1*	*2.55*	_____ 1965-1	10.70	_____ 1976-3-3	10.00
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_____ 1937-2	7.70	_____ *1953-1*	*4.25*	_____ 1966-1	14.00	_____ 1977-2	11.75
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_____ 1939-1-2	10.90	_____ 1955-1	10.25	_____ 1968-1	14.00	_____ 1978-3-2	9.00
_____ 1939-2	9.40	_____ 1955-2	13.00	_____ 1968-2	11.75	_____ 1979-1	14.00
_____ 1940-1	5.55	_____ 1956-1	15.00	_____ 1969-1	14.00	_____ 1979-2	15.00
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October 20, 1980
Bulletin No. 1980-42

Internal Revenue bulletin

9258

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENTS

Announcement 80-129, page 23.
Comments are invited on proposed amendments to the regulations under 31 CFR Part 10 that govern practice before the Service with respect to opinions used in the promotion of tax shelters. Comments should be submitted by November 3, 1980.

Announcement 80-137, page 30.
A public hearing will be held on November 18, 1980, concerning proposed amendments to the Estate and Gift Tax Regulations relating to the disclaimer of property conferred by gift or inheritance.

INCOME TAX

Rev. Rul. 80-274, page 5.
Gross income; interest; wrap-around annuity contracts. Under an agreement between a life insurance company and a federally insured savings and loan association, depositors in the savings and loan association purchase group single premium retirement annuity contracts from the insurer, and the insurer invests the proceeds, less certain expenses, in separate accounts with the savings and loan association until the annuity starting dates. The policyholders, and not the insurer, are the owners of the accounts for federal income tax purposes prior to the annuity starting dates, and the interest earned on the accounts is includible in the policyholders' gross incomes.

Rev. Rul. 80-275, page 6.
Charitable contribution; influencing legislation. A deduction is not allowable under section 170 of the Code for amounts paid to an organization exempt from tax under section 501(c)(3) and described in section 170(c)(2) that are earmarked for use in, or in connection with, influencing specific legislation.

Rev. Rul. 80-280, page 10.
Real estate investment trust; hypothecation loans. An otherwise qualifying real estate investment trust makes nonrecourse "hypothecation loans" to developers of commercial real estate. The loans are secured by first mortgage notes on commercial real property owned by third parties that are assigned to the trust. Until maturity of the hypothecation loans, the trust collects all payments on the mortgage notes, retains interest due from the hypothecation borrower, and remits the balance to such borrower. The interest received by the trust meets the requirements of section 856(c)(3)(B) of the Code, and the hypothecation loans held by the trust are "real estate assets" under section 856(c)(5) and (6)(B).

Pub. L. 96-294, page 19.
The Energy Security Act (1) provides for the tax treatment of the United States Synthetic Fuels Corporation, (2) provides that interest paid on loans or debt obligations for the construction of municipal waste energy projects is includible in gross income, (3) provides that individuals re-

(Continued on page 4)

Finding List on page 34.
Announcement of Disbarment and Suspensions on page 31.
Announcement Relating to Notice of Proposed Rulemaking on page 32.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

ceiving financial assistance from the Solar Energy and Energy Conservation Bank are not allowed a credit against taxes for the same expenditures under section 38 or 44C of the Code; and (4) amends section 216 of the National Energy Conservation Policy Act.

Announcement 80-131, page 27.
Contributions to Westchester Academy, Ltd., Baltimore, MD, are not deductible under section 170 of the Code.

EMPLOYEE PLANS

Rev. Rul. 80-276, page 6.
Normal retirement age; distribution before or at retirement. A profit-sharing plan will not fail to qualify merely because it provides for a normal retirement age of less than 65 years and for distribution of benefits at the time of that lesser age, whether or not the participant retires at that time; Rev. Ruls. 69-414 and 71-147 superseded.

Rev. Rul. 80-277, page 7.
Qualification; employer contributions suspended; nonforfeiture of rights deferred. A profit-sharing plan that provides that nonforfeitability of participants' accounts during a period in which employer contributions are suspended will occur only when the aggregate contributions drop below an amount equal to three percent of aggregate covered compensation since the inception of the plan does not meet the requirements of section 411(d)(3) of the Code; Rev. Rul. 71-94 superseded.

EXEMPT ORGANIZATIONS

Rev. Rul. 80-278, page 8.
Litigation of environmental issues. An otherwise qualifying organization that was formed to protect and restore environmental quality and whose principal activity consists of instituting litigation as a party plaintiff to enforce environmental legislation is operated exclusively for charitable purposes and qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 80-279, page 9.
Mediation of international environmental disputes. An otherwise qualifying organization that engages in legal research concerning various means of adjusting and resolving international environmental disputes and arranges for, and participates in, the resolution of such disputes through mediation is exempt under section 501 (c)(3) of the Code.

Announcement 80-132, page 27.
A listing is given of organizations now classified as private foundations.

GIFT TAX

Rev. Rul. 80-281, page 11.
Annuity purchased from charitable organization; deduction. A taxpayer purchased from a charitable organization an annuity that is payable for the taxpayer's life from the general funds of the charity. A gift tax charitable deduction is allowable for the amount paid to the charity that exceeds the present value of the annuity.

EXCISE TAXES

T.D. 7720, page 12.
Amendments to the temporary regulations under the Crude Oil Windfall Profit Tax Act of 1980 relate to the interim rule for determining base prices of tier 2 and tier 3 oil.

T.D. 7721, page 13.
Amendments to the temporary regulations under the Crude Oil Windfall Profit Tax Act of 1980 relate to base prices of tier 2 and tier 3 oil and withholding in the absence of a complete and current operator's certifiate.

TAX CONVENTIONS

Announcement 80-135, page 30.
The U.S. and Australia will resume discussions on a new income tax treaty in November. Persons wishing to submit comments about the treaty should do so by October 31, 1980.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-1: Gross income.
(Also Section 72; 1.72-1.)

Gross income; interest; wrap-around annuity contracts. Under an agreement between a life insurance company and a federally insured saving and loan association, depositors in the savings and loan association purchase group single premium retirement annuity contracts from the insurer, and the insurer invests the proceeds, less certain expenses, in separate accounts with the savings and loan association until the annuity starting dates. The policyholders, and not the insurer, are the owners of the accounts for federal income tax purposes prior to the annuity starting dates, and the interest earned on the accounts is includible in the policyholders' gross incomes.

Rev. Rul. 80-274 [1]

ISSUE

Is the life insurance company or the depositor the owner for federal income tax purposes of the savings and loan accounts established in accordance with the annuity plans described below?

FACTS

L, a life insurance company taxable under section 802 of the Internal Revenue Code, has developed so-called group single premium retirement annuity contracts ("annuity plans") that have been approved in several states by their respective regulatory departments. The terms "annuity" and "policyholder" as used in this revenue ruling are for descriptive convenience only and are not intended to have any substantive legal significance.

L has entered into agreements with participating federally insured savings and loan associations. Under each agreement, the participating association is designated as the group contract-holder under an annuity plan. *L* sells annuity contracts under the plan to existing depositors of the participating association and others wishing to establish accounts with the association ("depositors").

Under a plan, a depositor transfers cash, an existing passbook savings and loan account, or certificate of deposit to *L* in exchange for an annuity contract. The amount paid by the depositor to *L* is reduced by *L* from 2 to 5 percent for sales expenses, administrative expenses, and any premium tax imposed on *L*. This reduced amount is segregated by *L* and deposited into a separate account of the savings and loan association of the depositor. The amounts deposited are invested in a certificate of deposit for a term designated by the depositor. When the certificate of deposit expires, *L* is required under the contract to reinvest the proceeds in a certificate of deposit for the same duration unless an investment of the same duration would extend beyond the annuity starting date. In that event, a certificate of deposit with a maturity not extending beyond the annuity starting date will be purchased. If no such certificate of deposit is available, the funds will be invested in a passbook savings account.

At the option of the depositor (referred to in the contract as the "policyholder") additional amounts may be transferred to *L* that become part of the consideration for the contract.

Pursuant to the agreement between *L* and the participating savings and loan association, *L* may not dispose of the deposit, or convert it into a different asset, other than in accordance with the reinvestment provisions described above. *L* may not use the deposit for any purpose other than to benefit the particular policyholder. This arrangement is intended to afford each policyholder's deposit the maximum federal insurance coverage of $100,000 per account under federal regulations.

L does, however, retain the right to withdraw the deposits from a failing savings and loan association or from an association that terminates the plan. In the event of withdrawal, *L* must deposit the withdrawn amounts in another federally-insured savings and loan association.

Interest earned on the investments is credited annually to each anuity account by *L* after payment to *L* of an annual management fee of one percent of the accumulated value of the account. *L* guarantees that the deposit will earn interest at 4 percent per year compounded annually from the date of deposit. The current yields for certificates of deposit offered by the association range from 7% to 11% depending upon the term of the certificate. The policyholders have no contractual relationship with the association. Their rights are derived solely from their annuity contracts, and *L* may satisfy its obligations to the policyholders under these contracts using funds derived from sources other than the accounts held pursuant to the plans.

A policyholder may withdraw all or a portion of the cash surrender value of the contract at any time prior to the annuity starting date upon written request to *L*. The cash surrender value of the contract is the amount deposited plus interest credited less a charge for withdrawal. The withdrawal charge is the early withdrawal penalty charged by the savings and loan association plus any premium tax resulting from the withdrawal. The association does not have the right to distribute any assets from the savings and loan account directly to any policyholder or to any beneficiary or assignee.

The annuity contract allows the policyholder to elect one of a variety of settlement options including a lump-sum payment, a life income option, installment options for a specified period, and installment payments for a period certain and for life thereafter.

If a policyholder dies prior to the annuity starting date, a lump-sum is payable to the beneficiary in an amount equal to the cash surrender value on the date of death. The beneficiary, however, may instead elect to receive either an annuity for a term certain or a lifetime annuity, subject to a guaranteed minimum number of monthly installments.

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[1] Also released as News Release IR-80-97, dated September 24, 1980.

LAW AND ANALYSIS

Section 61(a) of the Internal Revenue Code provides that gross income means all income from whatever source derived, including interest.

To the extent that a policyholder under an annuity contract with a life insurance company possesses substantial incidents of ownership in an account established by the insurance company at the direction of the policyholder, the policyholder may be considered the owner of the account for federal income tax purposes. See Rev. Rul. 77-85, 1977-1 C.B. 12.

Under the annuity contract, the policyholder's position is substantially identical to what the policyholder's position would have been had the investment been directly maintained or established with the savings and loan association. Prior to the annuity starting date, *L* is little more than a conduit between the policyholder and the savings and loan association.

HOLDING

Prior to the annuity starting date, the policyholder, and not *L,* is the owner of the savings and loan account for federal income tax purposes and the interest on the account is thus includible in the policyholder's gross income under section 61(a) of the Code.

Section 72.—Annuities; Certain Proceeds of Endowment and Life Insurance Contracts

26 CFR 1.72-1: Introduction.

Whether the life insurance company or the individual depositor is the owner for federal income tax purposes of funds placed in federal savings and loan associations in connection with the purchase of retirement "annuity" contracts. See Rev. Rul. 80-274, page 5.

Section 170.—Charitable, Etc., Contributions and Gifts

26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance of deduction. (Also Section 501; 1.501(a)-1.)

Charitable contribution; influencing legislation. A deduction is not allowable under section 170 of the Code for amounts paid to an organization exempt from tax under section 501(c)(3) and described in section 170(c)(2) that are earmarked for use in, or in connection with, influencing specific legislation.

Rev. Rul. 80-275

ISSUE

Is a charitable contribution deduction under section 170 of the Internal Revenue Code allowable for amounts paid to an organization exempt from federal income tax under section 501(c)(3) and described in section 170(c)(2), but which are earmarked for use in influencing specific legislation?

FACTS

X, a non-profit corporation, is exempt from federal income tax under section 501(a) of the Code as an organization described in section 501(c)(3). Section 501(c)(3) provides such exemption for entities organized and operated for educational and other charitable purposes. *X* is also an organization described in section 170(c)(2).

X became concerned with proposed legislation under consideration in the Congress of the United States. In order to obtain funds to enable it to influence specific legislation, *X* mailed to its members and the general public literature that described the pending legislation and requested contributions to be used to lobby members of the Congress to help defeat the specific proposed legislation.

HOLDING

No deduction is allowed under section 170 of the Code for contributions to *X* earmarked for use in, or in connection with, attempting to influence the legislation. See Rev. Rul. 79-81, 1979-1 C.B. 107; Rev. Rul. 68-484, 1968-2 C.B. 105; Rev. Rul. 62-113, 1962-2 C.B. 10; and Rev. Rul. 56-329, 1956-2 C.B. 125.

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401-1: Qualified pension, profit-sharing, and stock bonus plans.

Normal retirement age; distribution before or at retirement. A profit-sharing plan will not fail to qualify merely because it provides for a normal retirement age of less than 65 years and for distribution of benefits at the time of that lesser age, whether or not the participant retires at that time; Rev. Ruls. 69-414 and 71-147 superseded.

Rev. Rul. 80-276

The purpose of this revenue ruling is to restate the position of Rev. Rul. 69-414, 1969-2 C.B. 59 and Rev. Rul. 71-147, 1971-1 C.B. 116, in view of enactment of the Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 1974-3 C.B. 1.

The issue in Rev. Rul. 69-414 and Rev. Rul. 71-147 is whether a profit-sharing plan will fail to qualify under section 401(a) of the Internal Revenue Code because of the provisions described below.

The plan, which otherwise meets the requirements for qualification under section 401(a) of the Code, provides that the normal retirement age is 55 and that each participant retiring at age 55 will receive a complete distribution of his or her interest under the plan. Employees in the particular industry involved customarily retire at age 65.

The plan also provides that a participant who does not plan to retire at age 55 may irrevocably elect, before age 55, to receive a complete distribution of his or her interest under the plan at age 55. If an employee continues in the employment of the employer after age 55, the plan provides that the employee will continue to share in the contributions to the plan in the same manner as before age 55.

Section 1.401-1(b)(1)(ii) of the Income Tax Regulations states that a qualified profit-sharing plan must provide for distributing the funds accumulated under the plan after a fixed number of years, the attainment of a stated age, or upon the prior occurrence of some event such as layoff, illness, disability, retirement, death or severance of employment.

Section 411(a)(8) of the Code provides that, for purposes of section 411, "normal retirement age" means the earlier of (1) the time a plan participant attains normal retirement age under the plan, or (2) the later of (a) the time a plan participant attains age 65, or (b) the 10th anniversary of the time a plan participant commenced participation in the plan.

The attainment of a stated age in a profit-sharing plan is merely one of several events that may be designated as fixing the time for making distributions from the plan. In view of the definition of normal retirement age found in section 411(a)(8) of the Code, and in the absence of any statutory prohibition or limitation, a profit-sharing plan may specify any age for distribution of benefits and, also, any age for normal retirement if it is less than the later of age 65 or the completion of 10 years of participation. See Rev. Rul. 78-120, 1978-1 C.B. 117, for the rules applicable to a pension plan. There is no requirement that the attainment of the stated age coincide with retirement or severance of employment in order to entitle a participant to a distribution from a profit-sharing plan.

Accordingly, this profit-sharing plan will not fail to qualify under section 401(a) of the Code because it provides for a normal retirement age of less than 65 and for distribution of benefits at the normal retirement age, whether or not the participant retires at that time.

Rev. Rul. 69-414 and Rev. Rul. 71-147 are superseded because the positions set forth therein are restated under current law in this Revenue Ruling.

Section 411.—Minimum Vesting Standards

26 CFR 1.411(d)-2: Termination or partial termination; discontinuance of contributions.

Qualification; employer contributions suspended; nonforfeiture of rights deferred. **A profit-sharing plan that provides that nonforfeitability of participants' accounts during a period in which employer contributions are suspended will occur only when the aggregate contributions drop below an amount equal to three percent of aggregate covered compensation since the inception of the plan does not meet the requirements of section 411(d)(3) of the Code; Rev. Rul. 71-94 superseded.**

Rev. Rul. 80-277

The purpose of this revenue ruling is to restate the position in Rev. Rul. 71-94, 1971-1 C.B. 125 in view of the enactment of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 1974-3 C.B. 1.

The issue in Rev. Rul. 71-94 is whether a profit-sharing plan that contains the provisions described below meets the requirements concerning discontinuance of contributions under section 401(a)(7) of the Internal Revenue Code. The relevant portion of that section is now contained in section 411(d)(3) of the Internal Revenue Code as amended by ERISA.

The plan provides as follows: (a) the board of directors of the employer-corporation shall determine each year the amount of employer contributions to be made for such year; (b) if such board shall fail to make a determination, a contribution shall be made by the employer in accordance with a schedule of percentages which vary in proportion to the net-profit bracket into which the employer's profits fall for the year; (c) employer contributions will be considered completely discontinued if (and only if) at any time the aggregate of all contributions previously made drops below an amount equal to three percent of the aggregate of the covered compensation of participants since the inception of the plan; and (d) if a complete discontinuance, as defined in (c), is found to exist and the board fails to authorize a contribution sufficient to satisfy the minimum limitation of three percent of covered compensation, then the amounts credited to the participants' accounts are to become nonforfeitable.

Section 411(d)(3) of the Code provides that a trust shall not constitute a qualified trust unless the plan of which such trust is a part provides that, upon the termination or partial termination, or, in the case of a plan to which section 412 of the Code (relating to minimum funding standards) does not apply, upon the complete discontinuance of contributions under the plan, the rights of all affected employees to the benefits accrued to the date of such event, to the extent then funded, are nonforfeitable.

As pointed out in section 1.411(d)-2(d)(1) of the Income Tax Regulations a complete discontinuance of contributions may occur although some amounts are contributed by the employer under the plan if such amounts are not substantial enough to reflect the intent on the part of the employer to continue to maintain the plan. On the other hand, a suspension of contributions under the plan is a temporary cessation of contributions that may, or may not, ripen into a discontinuance. The determination of whether a discontinuance of contributions has occurred under a profit-sharing plan should be made with regard to all the facts and circumstances. This section also states that among the factors to be considered in determining whether a suspension constitutes a discontinuance are: (1) whether the employer may merely be calling an actual discontinuance of contributions a suspension of such contributions in order to avoid the requirement of full vesting as in the case of a discontinuance, or for any other reason; (2) whether contributions are recurring and substantial; and (3) whether there is any reasonable probability that the lack of contributions will continue indefinitely.

In determining whether a suspension of contributions has ripened into a complete discontinuance for the purpose of requiring nonforfeitability of rights as required by section 411(d)(3) of the Code, a conclusion cannot be based solely on the relationship between aggregate employer contributions and aggregate covered compensation during the prior operation of the plan. The factors to be considered under the regulations may not be ruled out in advance by the plan provisions.

Under the plan in this case, nonforfeitability will occur only when the aggregate contributions drop below an amount equal to three percent of aggregate covered compensation. Such conditions might not arise for a period of years after contributions have actually been completely discontinued if, for example, contributions made prior to suspension have been made at a substantially higher rate.

Accordingly, this profit-sharing plan does not meet the requirements of section 411(d)(3) of the Code.

Rev. Rul. 71-94 is superseded because the position stated therein has been restated in this revenue ruling.

Section 501.—Exemption from Tax on Corporation, Certain Trusts, Etc.

26 CFR 1.501(a)-1: Exemption from taxation.

Whether amounts paid to a section 501(c)(3) organization that are earmarked for use in influencing legislation can be deducted under section 170 of the Code as a charitable contribution. See Rev. Rul. 80-275, page 6.

26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Litigation of environmental issues. An otherwise qualifying organization that was formed to protect and restore environmental quality and whose principal activity consists of instituting litigation as a party plaintiff to enforce environmental legislation is operated exclusively for charitable purposes and qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 80-278

ISSUE

Is an organization that institutes and maintains environmental litigation as a party plaintiff, under the circumstances described below, operated exclusively for charitable purposes within the meaning of section 501(c)(3) of the Internal Revenue Code?

FACTS

The organization, which otherwise qualifies for exemption under section 501(c)(3) of the Code, was organized for the purpose of protecting and restoring environmental quality. Its activities include educational activities within the meaning of section 501(c)(3). Its principal activity, however, consists of instituting litigation as a party plaintiff under state and federal environmental legislation. Typical of its litigation is a suit it filed against a local manufacturer and the state environmental protection agency. The organization sought thereby to enjoin the manufacturer from emitting certain air contaminants from its plant in violation of the state air-quality legislation and to require the state agency to enforce that legislation.

The organization does not have its own staff of attorneys and does not provide legal representation to others. Instead, it employs private attorneys to represent it in bringing and maintaining environmental litigation. Such lawsuits are not brought in cases where a substantial purpose is to benefit a private party or interest. The organization's litigation program is financed through membership dues and contributions from the public.

LAW AND ANALYSIS

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual, no substantial part of the activities of which is carrying on propaganda, or otherwise attempting to influence legislation (except as otherwise provided in section 501(h)), and which does not participate in, or intervene in (including the publishing or distributing of statements), any political campaign on behalf of any candidate for public office.

Section 1.501(c)(3)-1(a) of the Income Tax Regulations provides that an organization cannot be exempt under section 501(c)(3) of the Code unless it meets both an organizational and operational test. That is, the organization must be both organized and operated exclusively for charitable purposes.

In determining whether an organization meets the operational test, the issue is whether the particular activity undertaken by the organization is appropriately in furtherance of the organization's exempt purpose, not whether that particular activity in and of itself would be considered charitable. Moreover, the fact that the activity reflects a particular viewpoint or opinion on a controversial issue does not preclude the organization from qualifying for exemption under section 501(c)(3) of the Code. See section 1.501(c)(3)-1(d)(2) of the regulations. Two organizations having the same charitable purpose may both be recognized as exempt even though their viewpoints on the subject may differ, and they may be undertaking differing, even conflicting, means to accomplish that charitable objective. See *Restatement (Second) of Trusts*, section 374, comment 1 (1959). The law of charity provides no basis for weighing or evaluating the objective merits of specific activities carried on in furtherance of a charitable purpose, if those activities are reasonably related to the accomplishment of the charitable purpose, and are not illegal or contrary to public policy.

Therefore, in making the determination of whether an organization's activities are consistent with exemption under section 501(c)(3) of the Code, the Service will rely on a three-part test. The organization's activities will be considered permissible under section 501(c)(3) if:

(1) The purpose of the organization is charitable;

(2) the activities are not illegal, contrary to a clearly defined and established public policy, or in conflict with express statutory restrictions; and

(3) the activities are in furtherance of the organization's exempt purpose and are reasonably related to the accomplishment of that purpose.

It is generally recognized that efforts to preserve and protect the natural environment for the benefit of the public constitute a charitable purpose within the meaning of section 1.501(c)(3)-1(d)(2) of the regulations. The promotion of conservation and protection of natural resources has been recognized by Congress as serving a broad public benefit. See, *e.g.*, the National Environmental Policy Act of 1969, 42 U.S.C. section 4321 (1976). See also Rev. Rul. 76-204, 1976-1 C.B. 152, and the authorities cited therein. Thus, the organization's overall purpose is charitable.

Second, the organization's program of environmental litigation as party plaintiff clearly is not illegal, contrary to a clearly defined and established public policy, or violative of express statutory limitations, including the restrictions contained in section 501 (c) (3) of the Code prohibiting inurement of net earnings, substantial legislative activities, and participation or intervention in political campaigns.

In fact, Congress has provided for private litigation to enforce federal laws in numerous environmental statutes. See, *e.g.*, the authorization for private suits to enforce the Clean Air Act, 42 U.S.C.A. section 7604 (1979); see also the citizen suit provision of the Federal Water Pollution Control Act Amendments of 1972, 33 U.S.C. section 1365 (1976). These provisions indicate Congressional approval of private litigation as a desirable and appropriate means of enforcing environmental statutes. Many state statutes contain similar provisions. In some instances, litigation under such a statute serves to assist the government in enforcing the statute. In other cases, the litigation facilitates judicial review of important issues and ensures that the statute is correctly interpreted and administered. See also *Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240, 271 (1975).

In view of the above authorities, it is also clear that the organization's litigation activities are a reasonable means of accomplishing its exempt purposes. Accordingly, the organization's activities meet the third part of the test; that is, its program of litigation as party plaintiff under state and federal environmental statues furthers the organization's exempt purposes and is reasonably related to the accomplishment of the charitable purposes for which the organization was formed.

Compare the facts of this ruling with the three situations in which the Service has previously recognized organizations that engage in litigation as being described in section 501(c)(3): (1) legal aid societies providing legal assistance to indigents (Rev. Rul. 69-161, 1969-1 C.B. 149); (2) organizations operated to defend human and civil rights secured by law (Rev. Rul. 73-285, 1973-2 C.B. 171); and (3) public interest law firms providing legal representation on issues of significant public interest (Rev. Rul. 75-74, 1975-1 C.B. 152, Rev. Rul. 75-75, 1975-1 C.B. 154, Rev. Rul. 75-76, 1975-1 C.B. 154, Rev. Rul. 76-5, 1976-1 C.B. 146, Rev. Proc. 71-39, 1971-2 C.B. 575, and Rev. Proc. 75-13, 1975-1 C.B. 662). These types of organizations generally have staff attorneys providing legal representation to outside clients or groups, as distinguished from the organization itself being the plaintiff in litigation.

HOLDING

An organization that institutes and maintains environmental litigation as party plaintiff, under the circumstances described above, is operated exclusively for charitable purposes and qualifies for exemption from federal income tax under section 501(c)(3) of the Code.

APPLICATION INSTRUCTIONS

Even though an organization considers itself within the scope of this revenue ruling, it must file an application on Form 1023, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. See sections 1.501(a)-1 and 1.508-1(a) of the regulations. In accordance with the instructions to Form 1023, the application should be filed with the District Director of Internal Revenue for the key district indicated therein.

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26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Mediation of international environmental disputes. **An otherwise qualifying organization that engages in legal research concerning various means of adjusting and resolving international environmental disputes and arranges for, and participates in, the resolution of such disputes through mediation is exempt under section 501(c)(3) of the Code.**

Rev. Rul. 80-279

ISSUE

Does an organization that conducts mediation of international environmental disputes, under the circumstances described below, qualify for exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code?

FACTS

The organization, which otherwise qualifies for exemption under section 501(c)(3) of the Code, was formed for the purposes of engaging in legal research concerning various means of adjusting and resolving international environmental disputes, and arranging for and participating in the resolution of such disputes through the use of mediation. An international environmental dispute might arise, for example, in a situation where undesirable environmental conditions in one country are caused by industrial emissions originating in a neighboring country. Such disputes cannot generally be dealt with satisfactorily under the laws of any one country or under existing international law.

The organization conducts research to ascertain the potential for mediation to resolve certain international environmental disputes. Their research includes the identification of the issues under dispute, the assessment of the willingness of the parties to submit the dispute to mediation, and the making of an offer to conduct the mediation using its own staff of mediators and technical experts or to seek mediators acceptable to both parties.

The results of the organization's research and mediation activities are made known to the public by means of lectures and published articles and interviews. The organization's primary sources of income are grants from foundations and U.S. government agencies. The organization also receives fees for its mediation services from the parties involved, but these fees are set at or below cost.

LAW AND ANALYSIS

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(a) of the Income Tax Regulations provides that an organization cannot be exempt under section 501(c)(3) of the Code unless it meets both an organizational and operational test. That is, the organization must be both organized and operated exclusively for charitable purposes.

In determining whether an organization meets the operational test, the issue is whether the particular activity undertaken by the organization is appropriately in furtherance of the organization's exempt purpose, not whether that particular activity in and of itself would be considered charitable. Moreover, the fact that the activity reflects a particular viewpoint or opinion on a controversial issue does not preclude the organization from qualifying for exemption under section 501(c)(3) of the Code. See section 1.501(c)(3)-1(d)(2) of the regulations. Two organizations having the same charitable purpose may both be recognized as exempt even though their viewpoints on the subject may differ, and they may be undertaking differing, even conflicting, means to accomplish that charitable objective. See *Restatement (Second) of Trusts*, section 374, comment 1 (1959). The law of charity provides no basis for weighing or evaluating the objective merits of specific activities carried on in furtherance of a charitable purpose, if those activities are reasonably related to the accomplishment of the charitable purpose, and are not illegal or contrary to public policy.

Therefore, in making the determination of whether an organization's activities are consistent with exemption under section 501(c)(3) of the Code, the Service will rely on a three-part test. The organization's activities will be considered permissible under section 501(c)(3) if:

(1) The purpose of the organization is charitable;

(2) the activities are not illegal, contrary to a clearly defined and established public policy, or in conflict with express statutory restrictions; and

(3) the activities are in furtherance of the organization's exempt purpose and are reasonably related to the accomplishment of that purpose.

See Rev. Rul. 80-278, page 8, this Bulletin.

It is generally recognized that efforts to preserve and protect the natural environment for the benefit of the public constitute a charitable purpose within the meaning of section 1.501(c)(3)-1(d)(2) of the regulations. The promotion of conservation and protection of natural resources has been recognized by Congress as serving a broad public benefit. See, *e.g.*, the National Environmental Policy Act of 1969, 42 U.S.C. section 4321 (1976). See also Rev. Rul. 76-204, 1976-1 C.B. 152, and the authorities cited therein. Thus, the organization's overall purpose is charitable.

In addition, the organization's program of environmental mediation clearly is not illegal, contrary to a clearly defined and established public policy, or violative of express statutory limitations. Further, it is a form of private action that is clearly desirable in terms of the implementation of the existing public policy regarding preservation and protection of the environment. See *Alyeska Pipeline Service Co. v. Wilderness Society*, 421 U.S. 240, 271 (1975). Thus, the organization's program of arranging for and participating in environmental mediation on the international level is an appropriate means of implementing environmental policy and is reasonably related to the accomplishment of the charitable purpose for which the organization was formed.

HOLDING

An organization that conducts mediation of international environmental disputes, under the circumstances described above, qualifies for exemption from federal income tax under section 501(c)(3) of the Code.

APPLICATION INSTRUCTIONS

Even though an organization considers itself within the scope of this revenue ruling, it must file an application on Form 1023, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. See sections 1.501(a)-1 and 1.508-1(a) of the regulations. In accordance with the instructions to Form 1023, the application should be filed with the District Director of Internal Revenue for the key district indicated therein.

Section 856.—Definition of Real Estate Investment Trust

26 CFR 1.856-2: Limitations.

Real estate investment trust; hypothecation loans. An otherwise qualifying real estate investment trust makes nonrecourse "hypothecation loans" to developers of commercial real estate. The loans are secured by first mortgage notes on commercial real property owned by third parties that are assigned to the trust. Until maturity of the hypothecation loans, the trust collects all payments on the mortgage notes, retains interest due from the hypothecation borrower, and remits the balance to such borrower. The interest received by the trust meets the requirements of section 856(c)(3)(B) of the Code, and the hypothecation loans held by the trust are "real estate assets" under section 856(c)(5) and (6)(B).

Rev. Rul. 80-280

ISSUES

1. Is interest received, under the circumstances described below, "interest on obligations secured by mortgages on real property" within the meaning of section 856(c)(3)(B) of the Internal Revenue Code?

2. Are the hypothecation loans described below, "real estate assets" within the meaning of section 856 (c)(5) and (6)(B)?

FACTS

M, an unincorporated trust, otherwise qualifying as a real estate investment trust under section 856 of the Code, engages in lending activities, including the making of "hypothecation loans" to developers of commercial real estate. The terms of the hypothecation loans made by *M* range between one and seven years with interest payable monthly and principal due upon maturity. Repayment of such loans is secured by assignment to *M* of first mortgage notes owned by the hypothecation borrowers. The first mortgage notes are secured by commercial real property owned by unrelated third parties and have terms of from 15 to 40 years.

The mortgage notes given as security for *M*'s loans are endorsed by *M*'s borrowers in *M*'s favor without recourse and delivered to *M*. The hypothecation loans are also nonrecourse except for the security of the mortgage notes assigned as collateral. *M* requires sufficient collateral to assure that the balances of the hypothecation loans never exceed 80 percent of the unpaid balance of the notes assigned as security. Under the agreement with *M*'s hypothecation borrowers, *M* collects all amounts payable by the original mortgagors, retains interest due from the hypothecation borrower out of the payments, and remits the balance to the hypothecation borrower. *M* reendorses the mortgage notes (without recourse) and redelivers them to the hypothecation borrowers following full repayment of principal and interest due on the hypothecation loans.

As holder of the mortgage notes, *M* is able to enforce payment in its own name if an original mortgagor should default. *M*'s only security for the hypothecation loans is the mortgaged property if an original mortgagor defaults. In the event of such a default, *M* has the same rights as the original mortgagee to force a sale of the mortgaged property and satisfy the obligation of the hypothecation borrower out of the sales proceeds.

LAW AND ANALYSIS

Section 856(c)(3)(B) of the Code provides that a corporation, trust, or association shall not be considered a real estate investment trust for any taxable year unless at least 75 percent of its gross income (excluding gross income from prohibited transactions) is derived from certain sources, including interest on obligations secured by mortgages on real property or on interests in real property.

Section 856(c)(5) of the Code requires that at the close of each quarter of a real estate investment trust's taxable year, at least 75 percent of the trust's assets must be represented by certain assets including real estate assets.

Section 856(c)(6)(B) of the Code provides that the term "real estate assets" means real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interest) in other real estate investment trusts that meet the requirements of sections 856 through 860.

The security for the hypothecation loans made by *M* is the mortgage notes of the unrelated third parties. Therefore, the hypothecation loans are obligations secured by mortgages on real property and are interests in mortgages on real property.

HOLDINGS

1. The interest received by *M* from the hypothecation loans is "interest on obligations secured by mortgages on real property or on interests in real property" with the meaning of section 856(c)(3)(B) of the Code.

2. The hypothecation loans held by *M* are "real estate assets" within the meaning of section 856(c)(5) and (6)(B) of the Code.

Section 2522.—Charitable and Similar Gifts

26 CFR 25.2522(a)-1: Charitable and similar gifts; citizens or residents.

Annuity purchased from charitable organization; deduction. A taxpayer purchased from a charitable organization an annuity that is payable for the taxpayer's life from the general funds of the charity. A gift tax charitable deduction is allowable for the amount paid to the charity that exceeds the present value of the annuity.

Rev. Rul. 80-281

ISSUE

Is a gift tax charitable deduction allowable under section 2522 of the Internal Revenue Code, where a donor purchases an annuity from a charitable organization under the circumstances described below?

FACTS

On January 1, 1980, *A* purchased an annuity from *N*, a charitable organization described in sections 170(c) and 2522(a) of the Internal Revenue Code. Under the agreement *A* paid 100*x* dollars in return for an annuity of 5*x* dollars, payable in equal quarterly installments for *A*'s life. The annuity is payable out of the general funds of *N* charity. The value of the annuity received was less than 100*x* dollars.

LAW AND ANALYSIS

Section 2511 of the Internal Revenue Code provides that the gift tax applies whether the transfer is in trust or otherwise, and whether the gift is direct or indirect.

Section 2512(b) of the Code provides that where property is transferred for less than adequate and full consideration in money or money's worth, the amount by which the value of the property exceeds the value of the consideration received shall be deemed a gift.

Section 2522 of the Code provides a gift tax charitable deduction for the value of property transferred to charities described in section 2522(a).

Section 2522(c)(2) of the Code provides that where a donor transfers a remainder interest in property to a charitable organization and has retained an interest in the *same* property, no deduction is allowed for the interest passing to charity unless it is in a qualified form (charitable remainder annuity trust, charitable remainder unitrust or a pooled income fund).

In the instant case, *A* has made a gift to *N* charity, to the extent that the value of the property transferred by *A* exceeds the present value of the annuity received. The annuity rates to be used in determining the present value of *A*'s annuity are set forth in Rev. Rul. 72-438, 1972-2 C.B. 38.

Here, the annuity is payable out of the general funds of *N* charity, rather than the specific 100*x* dollars transferred by *A*. Thus, *A* has not retained any interest in the 100*x* dollars transferred to *N*. Therefore, the provisions of section 2522(c) are not applicable, and a deduction is allowable under section 2522(a) of the Code. See also section 1.170A-1(d) of the Income Tax Regulations.

HOLDING

Under section 2522(a) of the Code, a gift tax charitable deduction is allowable. The deduction is equal to the amount by which the value of the property transferred by *A* (100*x* dollars) exceeds the present value of the annuity received by *A*.

Section 4989.—Adjusted Base Price [Windfall Profit Tax on Domestic Crude Oil]

26 CFR 150.4989-1: Adjusted base price.

T.D. 7720

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 150.—TEMPORARY EXCISE TAX REGULATIONS UNDER THE CRUDE OIL WINDFALL PROFIT TAX ACT OF 1980

Interim rule for determining base prices for tier 2 and tier 3 oil

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides temporary excise tax regulations relating to the windfall profit tax on domestic crude oil imposed by title I of the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B. 2]. The temporary regulations provide rules to be followed by producers and purchasers of domestic crude oil. In addition, the text contained in the temporary regulations set forth in this document serves as the text of the proposed regulations cross-referenced in the notice of proposed rulemaking in the Proposed Rules section of the issue of the Federal Register for September 24, 1980, 45 F.R. 63297.

DATES: These temporary regulations are effective with respect to oil removed after February 29, 1980.

FOR FURTHER INFORMATION CONTACT: David B. Cubeta of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3297).

SUPPLEMENTARY INFORMATION

BACKGROUND

On April 4, 1980, the Federal Register published temporary regulations (45 F.R. 23384) under sections 4986, 4987, 4988, 4989, 4991, 4992, 4993, 4994, 4995, 4996, 4997, 6050C, 6076, and 6402 of the Internal Revenue Code of 1954. The temporary regulations were required to implement various sections of the Crude Oil Windfall Profit Tax Act of 1980. This document contains an amendment to § 150.4989-1(c)(2) of those temporary regulations (relating to the interim rule for determining tier 2 and tier 3 base prices).

The regulations promulgated in this document are also proposed to be prescribed as final Excise Tax Regulations (26 CFR Part 51).

EXPLANATION OF PROVISIONS

Numerous commentators on the proposed windfall profit tax regulations published on April 4, 1980 requested that further guidance be provided as to what constitutes a valid posted price for purposes of the interim base price rule for tier 2 and tier 3 oil. Several commentators suggested that the concepts contained in FEA Ruling 1977-1, which sets forth the criteria for a valid posted price in determining ceiling prices, be adopted for the purpose of determining which prices should be used in computing the interim base prices for tier 2 and tier 3 oil. That suggestion has been accepted, and these regulations adopt the principles contained in FEA Ruling 1977-1 with the modifications necessary to conform those rules to the windfall profit tax.

Because these regulations are effective with respect to oil removed after February 29, 1980, purchasers will be required to make withholding adjustments if it is determined that an improper base price has been used in computing windfall profit tax withholding.

WAIVER OF PROCEDURAL REQUIREMENTS OF TREASURY DIRECTIVE

The expeditious adoption of the provisions contained in this document is necessary because of the need for immediate guidance to taxpayers liable for the windfall profit tax on domestic crude oil and to other persons required to withhold and deposit tax, file returns, provide information, etc. For this reason, Jerome Kurtz, Commissioner of Internal Revenue, has determined that the provisions of paragraphs 8 through 14 of the Treasury Department directive implementing Executive Order 12044 must be waived.

DRAFTING INFORMATION

The principal author of these regulations is David B. Cubeta of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, Part 150, Temporary Excise Tax Regulations under the Crude Oil Windfall Profit Tax Act of 1980, is amended as follows:

Paragraph 1. Paragraph (c) of § 150.4989-1 is amended by revising the flush language following subparagraph (2)(ii)(B). Amended paragraph (c) reads as follows:

§ 150.4989-1 Adjusted base price.

* * * * *

(c) *Base prices for tier 2 and tier 3 oil*—(1) *General rule.* [Reserved]

(2) *Interim rule.* This subparagraph and subparagraph (3) apply to oil removed during a month beginning before October 1980 (or such earlier date as may be provided in regulations taking effect before such earlier date). Except as provided in subparagraph (3), the base prices for tier 2 oil and tier 3 oil, respectively, shall be the product of—

(i)(A) The highest posted price for December 31, 1979, for uncontrolled crude oil of the same grade, quality, and field, or

(B) If there is no posted price described in inferior subdivision (A), the highest posted price for such date for uncontrolled crude oil at the nearest domestic field for which prices for oil of the same grade and quality were posted for such date, multiplied by

(ii) A fraction the denominator of which is $35, and the numerator of which is—

(A) $15.20 for purposes of determining base prices of tier 2 oil, and

(B) $16.55 for purposes of determining base prices of tier 3 oil.

In determining the base price for tier 2 or tier 3 oil, the grade and quality of the oil produced in December 1979 shall be used. For purposes of determining the highest posted price for December 31, 1979, "posted price" means a written statement of crude oil prices constituting an offer to purchase oil at that price circulated publicly among sellers and buyers of crude oil in a particular field in accordance with historic practices. Although the formality of a printed price bulletin such as is published by major purchasers is not necessary for a price to be a valid posted price, the formality of a publicly circulated written offer is necessary. The requirement that the offer be in writing and publicly circulated eliminates oral offers and offers made only to specified producers. Accordingly, other than the published price bulletins of the type traditionally issued by major oil companies, written offers to purchase constitute a "posted price" only if they are bona.fide public offers of general applicability to crude oil producers in the field. For example, a letter from a purchaser to all crude oil producers in a field or in an area would constitute a posted price if the letter was a bona fide offer to purchase from all producers in that field or area. A written contract, of course, would not qualify as a posted price because it represents an agreement between a buyer and specific producer, not a bona fide offer to purchase from all producers. Accordingly, in determining the "highest posted price," a producer should first determine which offers qualify as posted prices for December 31, 1979. Because a posted price must constitute an offer to purchase, an offer does not constitute a posted price for December 31, 1979, unless the offer was initially made on or before December 31, 1979, and was in effect for oil purchased on that date. However, in determining the highest posted price for December 31, 1979, a valid posted price that was adjusted in a subsequent posted price circulated on or before January 14, 1980, shall be considered to be an offer made at the price as adjusted so long as the adjusted price applies to all oil purchased pursuant to the initial offer. In determining which posted prices were applicable to a particular field on December 31, 1979, the term "field" means a general area underlain by one or more reservoirs. Historical field designations commonly used by regulatory agencies and the oil industry will generally be used in the determination of a given field. Price bulletins which specify only a geographical area and crude oil grade (*e.g.*, "West Texas Sour") are presumed to be applicable to every field within the named area, unless a particular field is specifically excluded. However, the existence of a price bulletin stating a higher price for specifically named fields within the same area supersedes the area-wide price bulletin for the named field only. Finally, posted prices do not include either offers to buy at a price not specified in a sum certain (*e.g.*, a price "determined by the purchaser to be competitive") or premiums above posted prices which may have been paid for crude oil purchased on December 31, 1979.

(3) *Minimum interim base price.* The base price determined under paragraph (c)(2) of this section for tier 2 oil or tier 3 oil shall not be less than the sum of—

(i) The ceiling price which would have applied to such oil under the March 1979 energy regulations if it had been produced and sold in May 1979 as upper tier oil, plus

(ii)(A) $1 in the case of tier 2 oil, or

(B) $2 in the case of tier 3 oil.

For purposes of this determination, the grade and quality of the oil produced from the property in May 1979 shall be used.

* * * * *

There is need for the immediate guidance provided by the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in sections 4997 and 7805 of title 26 of the United States Code.

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved September 17, 1980.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on September 19, 1980, 4:34 p.m., and published in the issue of the Federal Register for September 24, 1980, 45 F.R. 63263)

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26 CFR 150.4989-1: Adjusted base price.
(Also Section 4995; 150.4995-1.)

T.D. 7721

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 150.—TEMPORARY EXCISE TAX REGULA-

TIONS UNDER THE CRUDE OIL WINDFALL PROFIT TAX ACT OF 1980

Base prices of tier 2 and tier 3 oil

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides temporary excise tax regulations relating to base prices of tier 2 and tier 3 oil for purposes of the windfall profit tax on oil imposed by title I of the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B. 2]. These base prices are generally determined under a formula calculated by reference to the actual removal price of oil rather than posted prices, which are used only for oil removed before October 1, 1980. The prices are those for oil removed during the base period, December 1979. The regulations also establish minimum base prices calculated by multiplying a property's May 1979 upper tier ceiling price by 1.1 (for tier 2 oil) or 1.2 (for tier 3 oil).

This document also amends the rules relating to withholding of the windfall profit tax in the absence of current data on an effective operator's certificate.

In addition, the text of the temporary regulations set forth in this document serves as the text of proposed regulations cross-referenced in the Proposed Rules section of the issue of the Federal Register for September 30, 1980, FR 64603.

DATES: The temporary regulations relating to base prices are effective with respect to liability for windfall profit tax upon crude oil removed from the premises after September 30, 1980. However, persons required to withhold or deposit the windfall profit tax may, at their option, continue to withhold or deposit under the old base price rules through November 30, 1980. Similarly, the amendment to the rules relating to operators' certificates is effective on the latter date unless the purchaser chooses an earlier date.

FOR FURTHER INFORMATION CONTACT: Eileen Murphy of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3297).

SUPPLEMENTARY INFORMATION:

BACKGROUND

This document contains temporary regulations under section 4989(d) of the Internal Revenue Code of 1954, relating to base prices for tier 2 and tier 3 oil. On April 4, 1980, temporary and proposed regulations under the Crude Oil Windfall Profit Tax Act of 1980 were published in the Federal Register (45 FR 23384). The original temporary regulations (Treasury Decision 7690 [1980-16 I.R.B. 11, 15]), in paragraph (c)(2) of § 150.4989-1, provided an interim rule for determining those base prices. That interim rule was amended in Treasury Decision 7720 (published in the Federal Register for September 24, 1980) [page 12, this Bulletin] to clarify what constitutes a valid posted price. The interim rule expires on October 1, 1980 (or on an earlier date if a permanent rule is provided by regulations effective before that date). The new temporary regulations in this document provide a permanent rule for determining base prices, effective with respect to tax liability for crude oil removed from the premises after September 30, 1980. However, persons required to withhold or deposit the tax may, at their option, use the interim rule through November 30, 1980. Adjustments to withholding for prior inaccuracies in withholding, taking into account the new rules in the case of oil removed after September 30, 1980, shall be made pursuant to paragraph (c) of § 150.4995-1.

The temporary regulations prescribed in this document are also proposed to be prescribed as final excise tax regulations (26 CFR Part 51) under sections 4989(d) and 4995 of the Internal Revenue Code of 1954.

BASE PRICES

These temporary regulations provide new excise tax regulations under Code section 4989(d), relating to base prices of tier 2 and tier 3 crude oil for purposes of the windfall profit tax. The windfall profit tax is imposed upon the windfall profit, defined as the difference between the removal price of the barrel of crude oil and the sum of the adjusted base price of the barrel of oil plus a severance tax adjustment. The adjusted base price is the base price adjusted by an inflation adjustment formula provided in section 4989(b).

Under section 4989(d)(1), the permanent base prices for tier 2 and tier 3 oil are prices determined pursuant to the method prescribed by regulations. The method prescribed by the regulations must be designed so as to yield, with respect to oil of any grade, quality, and field, a base price approximating the price at which such oil would have sold in December 1979 if it is assumed that all domestic crude oil was uncontrolled and the average removal price for all domestic crude oil (excluding Sadlerochit oil) was $15.20 a barrel (for tier 2 oil) and $16.55 a barrel (for tier 3 oil). The regulations provide a formula for determining base prices for tier 2 and tier 3 crude oil. The formula assumes that the same grade, quality, and location factors that caused a certain uncontrolled domestic crude oil to sell for more or less than the actual average uncontrolled price of all domestic crude oil (excluding Sadlerochit oil) in the base period would cause similar crude oil to sell for proportionately more or less than the applicable statutory average uncontrolled price of $15.20 or $16.55. For purposes of the formula, the temporary regulations establish that the actual average removal price for uncontrolled domestic crude oil during the base period was $35.80.

BASE PERIOD UNCONTROLLED SALES

The temporary regulations, in § 150.4989-1(c)(4), provide rules relating to uncontrolled base period sales, which produce the variable price factor to be used in the formula for determining base prices for tier 2 and tier 3 oil. The term "base period" is defined as December 1979, pursuant to the statutory mandate in section 4989 (d)(1).

CONSTRUCTIVE UNCONTROLLED BASE PERIOD BASE

The temporary regulations, in § 150.4989-1(c)(3), provide rules for determining the base price for tier 2 and tier 3 oil produced from a reservoir that did not produce oil sold by or for the taxpayer in uncontrolled base period sales. In the case of a transfer of a property after November 30, 1979, the taxpayer takes the base price of the taxpayer's transferor. The taxpayer must obtain a statement of such base price from the transferor, the operator, or the first purchaser. In a case where no such transfer took place, the taxpayer's constructive uncontrolled base period sales price is determined by reference to the following prices (stated in the order of priority): The representative market or field price of oil of similar grade and quality produced from the same reservoir during the base period; or base period prices of oil of similar grade and quality purchased or sold by the taxpayer from the nearest reservoir that produced such oil during the base period; or the representative market or field price of such oil from the nearest reservoir (from which no oil was purchased or sold by the taxpayer in uncontrolled base period sales). If none of these rules apply, the tax shall be computed on the basis of the minimum base price under § 150.4989-1(c)(6) of the temporary regulations. Similarly, if under the taxpayer's particular facts and circumstances the taxpayer is required to make a determination under one of these rules and fails to do so, the tax shall be computed on the basis of the minimum base price and not under any other rule.

MINIMUM BASE PRICES

The temporary regulations, in § 150.4989-1(c)(6), provide a rule under which minimum base prices are established. This rule is similar to the minimum base price rule under the interim rule in section 4989(d)(3). However, multipliers rather than dollar amounts are used in computing the minimum. The minimum base price rule is prescribed because the Treasury Department has determined that the actual selling price of certain oil during the base period did not reflect its value relative to other oil. The minimum base price rule is prescribed in response to a clear Congressional intention reflected in the legislative history of the windfall profit tax. The Conference Report (*H.R. Rep. No. 96-817,* 96th Cong., 2d Sess. 97 (March 7, 1980) [1980-3 C.B. 245, 257]) states: "[T]he interim rule may lead to inequities in the case of oil produced in California and certain other areas because its December 1979 price was much lower, relative to the national average, than it had been in prior years and is likely to be in the future." The conferees noted that they had given "the Secretary enough flexibility to devise a permanent solution to this problem."

ABSENCE OF COMPLETE AND CURRENT OPERATOR'S CERTIFICATE

The temporary regulations also amend the withholding rules under § 150.4995-1(b)(2) that apply when the purchaser has not received the operator's certification under section 6050C or when the purchaser has reason to believe that certain information provided by the operator is not correct. The new rules provide that the purchaser may continue to rely on the portion of the certified information that there is no reason to believe is not correct. The rules also set forth assumptions that are to be substituted for the item of information that is missing or that the purchaser has reason to believe is not correct. These rules would apply, for example, when the effective date for the new rules for withholding on the permanent base price rule has passed and the purchaser has not yet received a revised base price certification.

WAIVER OF PROCEDURAL REQUIREMENTS OF TREASURY DIRECTIVE

There is need for expeditious adoption of the provisions contained in this document because of the need to provide a permanent base price rule before the expiration of the interim base price rules on September 30, 1980, and because of the necessity of allowing sufficient time for those who must compute or withhold the windfall profit tax to ascertain the applicable base price. For this reason, Jerome Kurtz, Commissioner of Internal Revenue, has determined that the provisions of paragraphs 8 through 14 of the Treasury Department directive implementing Executive Order 12044 must be waived.

DRAFTING INFORMATION

The principal author of these regulations was Eileen Murphy of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing these regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, Part 150, Temporary Excise Tax Regulations under the Crude Oil Windfall Profit Tax Act of 1980, is amended as follows:

Paragraph 1. Paragraph (c) of § 150.4989-1 is revised to read as follows:

§ 150.4989-1 Adjusted base price.

* * * * *

(c) *Base prices for tier 2 and tier 3 oil*—(1) *In general.* Except as otherwise provided in the minimum base price and interim rules set forth in paragraph (c)(6) and (8) of this section, the base prices for tier 2 oil and tier 3 oil shall be determined under paragraph (c)(2) or (3). Paragraph (c)(2) and (3) provides rules designed to approximate the price at which oil would have sold in December 1979, taking into account quality, grade, and field, if it is assumed that all domestic crude oil was uncontrolled and the average removal price of all domestic crude oil (other than Sadlerochit oil was $15.20 a barrel for tier 2 oil and $16.55 a barrel for tier 3 oil. The rules of paragraph (c)(2) apply to oil produced from a reservoir that produced oil sold by or for the taxpayer in uncontrolled base period sales.

The rules of paragraph (c)(3) generally apply to all other tier 2 or tier 3 oil. For definitions relating to uncontrolled base period sales, see paragraph (c)(4). For effective date provisions, see paragraph (c)(7).

(2) *Oil produced from a reservoir that produced oil sold by or for the taxpayer in uncontrolled base period sales.* The base price for tier 2 or tier 3 oil produced from a reservoir that produced oil sold by or for the taxpayer in uncontrolled base period sales (see paragraph (c)(4)) is determined by multiplying the uncontrolled base period price per barrel by the tier 2 multiplier in the case of tier 2 oil or by the tier 3 multiplier in the case of tier 3 oil. See paragraph (c)(5) for the definitions of the tier 2 multiplier and the tier 3 multiplier. The uncontrolled base period price per barrel of oil from a reservoir is the weighted average removal price per barrel of oil from the reservoir sold by or for the taxpayer in uncontrolled sales during the base period, determined without regard to any price adjustments made after February 29, 1980. The weighted average is obtained by multiplying the number of barrels sold at each price by the price at which the barrels were sold, adding the products, and dividing by the total number of barrels sold in such sales.

(3) *Oil produced from a reservoir that did not produce oil sold by or for the taxpayer in uncontrolled base period sales*—(i) *In general.* The base price for tier 2 or tier 3 oil produced from a reservoir that did not produce oil sold by or for the taxpayer in uncontrolled base period sales is determined by multiplying the constructive uncontrolled base period price by the tier 2 multiplier in the case of tier 2 oil or by the tier 3 multiplier in the case of tier 3 oil. However, in the case of a transfer of a property to the taxpayer after November 30, 1979, if the taxpayer's transferor sold production from the reservoir from which the taxpayer's oil is produced in uncontrolled base period sales, the taxpayer's base price shall be—

(A) If the taxpayer obtains a written statement under the penalties of perjury from the transferor, or the transferor's operator or first purchaser, setting forth the transferor's base price for tier 2 or tier 3 oil and all facts bearing on the correctness of that base price, the base price of the taxpayer's transferor; and

(B) If the taxpayer does not obtain such a statement, the minimum base price provided in paragraph (c)(6) of this section.

(ii) *Constructive uncontrolled base period price.* For purposes of paragraph (c)(3)(i), the constructive uncontrolled base period price is the price that would have been obtained for the oil if it had been sold in uncontrolled sales by or for the taxpayer during the base period. In making this determination of constructive uncontrolled base period price:

(A) If oil of similar grade and quality was produced from the same reservoir and sold in uncontrolled sales during the base period, then the taxpayer's constructive uncontrolled base period price is the representative market or field price of such oil.

(B) If paragraph (c)(3)(ii)(A) does not apply and oil of similar grade and quality (*1*) was sold or purchased by or for the taxpayer in uncontrolled sales or purchases during the base period, and (*2*) was produced from the nearest reservoir from which oil of similar grade and quality was sold by or for any producer in uncontrolled sales during the base period, then the taxpayer's constructive uncontrolled base period price is the weighted average removal price per barrel of such oil.

(C) If paragraph (c)(3)(ii)(A) and (B) does not apply, then the taxpayer's constructive uncontrolled base period price is the representative market or field price of oil of similar grade and quality from the nearest reservoir from which such oil was produced and sold (by or for a producer other than the taxpayer) in uncontrolled sales during the base period.

If the taxpayer does not make the determination required by paragraph (c)(3)(ii)(A), (B), or (C) of this section (whichever is applicable under the circumstances of the taxpayer) the tax shall be computed on the basis of a base price that is the minimum base price determined under paragraph (c)(6) of this section. For purposes of this subdivision, the term "representative market or field price" has the same meaning as the meaning with which that term is used in the regulations under section 613. Also, prices shall be determined without regard to any price adjustment made after February 29, 1980.

(4) *Uncontrolled base period sales.* For purposes of paragraph (c)(1), (2), and (3) of this section, the term "uncontrolled sales" means sales in arms-length transactions at prices not subject to price controls imposed by the energy regulations. The term "base period" means December 1979.

(5) *Tier 2 multiplier and tier 3 multiplier.* For purposes of this section—

(i) The tier 2 multiplier is 0.42458 (the number representing the ratio of $15.20, the statutory average removal price for uncontrolled domestic crude oil to be used in the case of tier 2 oil, to $35.80, the actual average removal price for all uncontrolled domestic crude oil (except Sadlerochit oil) sold during the base period), and

(ii) The tier 3 multiplier is 0.46229 (the number representing the ratio of $16.55 to $35.80).

(6) *Minimum base prices for tier 2 and tier 3 oil.* The base price determined under paragraph (c)(1) through (5) of this section for tier 2 or tier 3 crude oil shall not be less than the product of—

(i) The ceiling price which would have applied to such oil under the March 1979 energy regulations if it had been produced and sold in May 1979 as upper tier oil, multiplied by

(ii)(A) 1.1 in the case of tier 2 oil, or

(B) 1.2 in the case of tier 3 oil.

For purposes of this determination, the grade and quality of the oil produced from the property in May 1979 shall be used.

(7) *Effective dates.* The rules of paragraph (c)(1) through (6) of this section are effective with respect to tax liability for crude oil removed from the premises after September 30, 1980. However, persons required by § 150.4995-1 to withhold windfall

profit tax or by § 150.4995-3 to deposit payments of that tax may, at their option, continue to use through November 30, 1980, the interim rule set forth in paragraph (c)(8) of this section for purposes of determining the amount to be withheld or deposited. After November 30, 1980, withholding and depositing under the new rules are mandatory and adjustments to withholding for prior inaccuracies in withholding, taking account of the new rules in the case of oil removed after September 30, 1980, shall be made pursuant to paragraph (c) of § 150.4995-1.

(8) *Interim rule.* (i) This subparagraph applies to oil removed during a month before October 1980. Except as provided in paragraph (c)(8)(ii) of this section, the base prices for tier 2 oil and tier 3 oil, respectively, shall be the product of—

(A) The highest posted price for December 31, 1979, for uncontrolled crude oil of the same grade, quality, and field, or, if there is no such posted price, the highest posted price for such date for uncontrolled crude oil at the nearest domestic field for which prices for oil of the same grade and quality were posted for such date, multiplied by

(B) A fraction the denominator of which is $35, and the numerator of which is $15.20 for purposes of determining base prices of tier 2 oil and $16.55 for purposes of determining base prices of tier 3 oil.

In determining the base price for tier 2 or tier 3 oil, the grade and quality of the oil produced in December 1979 shall be used. For purpose of determining the highest posted price for December 31, 1979, "posted price" means a written statement of crude oil prices constituting an offer to purchase oil at that price circulated publicly among sellers and buyers of crude oil in a particular field in accordance with historic practices. Although the formality of a printed price bulletin such as is published by major purchasers is not necessary for a price to be a valid posted price, the formality of a publicly circulated written offer is necessary. The requirement that the offer be in writing and publicly circulated eliminates oral offers and offers made only to specified producers. Accordingly, other than the published price bulletins of the type traditionally issued by major oil companies, written offers to purchase constitute a "posted price" only if they are bona fide public offers of general applicability to crude oil producers in the field. For example, a letter from a purchaser to all crude oil producers in a field or in an area would constitute a posted price if the letter was a bona fide offer to purchase from all producers in that field or area. A written contract, of course, would not qualify as a posted price because it represents an agreement between a buyer and specific producer, not a bona fide offer to purchase from all producers. Accordingly, in determining the "highest posted price," a producer should first determine which offers qualify as posted prices for December 31, 1979. Because a posted price must constitute an offer to purchase, an offer does not constitute a posted price for December 31, 1979, unless the offer was initially made on or before December 31, 1979, and was in effect for oil purchased on that date. However, in determining the highest posted price for December 31, 1979, a valid posted price that was adjusted in a subsequent posted price circulated on or before January 14, 1980, shall be considered to be an offer made at the price as adjusted so long as the adjusted price applies to all oil purchased pursuant to the initial offer. In determining which posted prices were applicable to a particular field on December 31, 1979, the term "field" means a general area underlain by one or more reservoirs. Historical field designations commonly used by regulatory agencies and the oil industry will generally be used in the determination of a given field. Price bulletins which specify only a geographical area and crude oil grade (*e.g.*, "West Texas Sour") are presumed to be applicable to every field within the named area, unless a particular field is specifically excluded. However, the existence of a price bulletin stating a higher price for specifically named fields within the same area supersedes the area-wide price bulletin for the named field only. Finally, posted prices do not include either offers to buy at a price not specified in a sum certain (*e.g.*, a price "determined by the purchaser to be competitive") or premiums above posted prices which may have been paid for crude oil purchased on December 31, 1979.

(ii) *Minimum interim base price.* The base price determined under paragraph (c)(8)(i) of this section for tier 2 oil or tier 3 oil shall not be less than the sum of—

(A) The ceiling price which would have applied to such oil under the March 1979 energy regulations if it had been produced and sold in May 1979 as upper tier oil, plus

(B) $1 in the case of tier 2 oil or $2 in the case of tier 3 oil.

For purposes of this determination, the grade and quality of the oil produced from the property in May 1979 shall be used.

* * * * *

Par. 2. Paragraph (b)(2) of § 150.4995-1 is revised to read as follows:

§ 150.4995-1 Requirement of withholding.

* * * * *

(b) *Amount to be deducted and withheld.* * * *

(2) *Absence of completed and current operator's certification.* (i) *In general.* This subparagraph applies if the purchaser has not received the certification required to be furnished by the operator pursuant to section 6050C and § 150.6050C-1, or if the certification does not contain all the information necessary for the purchaser to compute the amount to be withheld under paragraph (b)(1) of this section, or if the purchaser has reason to believe that any information contained in that certification that affects the tax computation is not correct (including information that was correct when provided but that has become incorrect, such as a base price that was correct under the interim rule of § 150.4989-1(c)(8) after that rule ceases to apply). In such a case, the amount of tax to be deducted and withheld under paragraph (a) of this section is the amount of tax imposed by section 4986 (without regard to the

net income limitation provided in section 4988(b)) based on the information, if any, provided in the operator's certification that the purchaser has no reason to believe is not correct, and on the substitution of the following assumptions for any item of information that is absent from the certification or that the purchaser has reason to believe is not correct:

(A) If the item that is absent or that the purchaser has reason to believe is not correct is the tax tier of the oil, the oil shall be assumed to be in tier 1 subject to the 70 percent rate of tax;

(B) If the item is the adjusted base price, the adjusted base price shall be assumed to be—

(*1*) In the case of tier 1 oil, $11.01 plus the amount equal to $11.01 multiplied by the inflation adjustment provided under section 4989(b)(1) for the calendar quarter in which the oil was removed,

(*2*) In the case of tier 2 oil, $12.11 (the amount equal to $11.01 multiplied by 1.1, the amount specified in § 150.4989-1(c)(6)(ii)(A)) plus the amount equal to $12.11 multiplied by the inflation adjustment provided under section 4989(b)(1) for the calendar quarter in which the oil was removed, and

(*3*) In the case of tier 3 oil, $13.21 (the amount equal to $11.01 multiplied by 1.2, the amount specified in § 150.4989-1(c)(6)(ii)(B)) plus the amount equal to $13.21 multiplied by the inflation adjustment provided under section 4989(b)(2) for the calendar quarter in which the oil was removed;

(C) If the item is the severance tax adjustment provided by section 4996(c), the severance tax adjustment shall be assumed to be inapplicable unless the amount of that adjustment is known by the purchaser.

(ii) *Effective date.* Notwithstanding paragraph (f) of this section, this subparagraph is effective with respect to payments made after November 30, 1980, for oil removed on or after March 1, 1980, unless the purchaser chooses to apply this subparagraph at an earlier date. However, prior to the effective date of this subparagraph as provided in the preceding sentence, this subparagraph as originally promulgated in Treasury Decision 7690 (see 45 FR 23384) is effective as provided in paragraph (f) of this section.

* * * * *

There is need for the immediate guidance provided by the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in sections 4989(d)(1), 4995, 4997(b), and 7805 of title 26 of the United States Code and section 101 of the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B. 2].

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved September 24, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on September 29, 1980, 8:45 a.m., and published in the issue of the Federal Register for September 30, 1980, 45 F.R. 64574)

Section 4995.—Withholding; Depositary Requirements

26 CFR 150.4995-1: Requirement of withholding.

Temporary excise tax regulations relating to withholding the windfall profit tax in the absence of an effective operator's certificate. See T.D. 7721, page 13.

Subpart B.—Legislation and Related Committee Reports

Pub. L. 96-294 [1]
96th Congress, S. 932
June 30, 1980

An Act to extend the Defense Production Act of 1950, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Energy Security Act".

TITLE I—SYNTHETIC FUEL

* * * * *

Part B—United States Synthetic Fuels Corporation

SUBTITLE A—GENERAL PROVISIONS

SHORT TITLE

SEC. 111. This part may be cited as the "United States Synthetic Fuels Corporation Act of 1980".

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SUBTITLE F—CAPITALIZATION AND FINANCE

* * * * *

TAX STATUS

SEC. 155. (a) The Corporation, its franchise, capital, reserves, surplus, income, and intangible property shall be exempt from all taxation now or hereafter imposed by the United States, or by any State, county, municipality, or local taxing authority, except that—

(1) any real property owned in fee by the Corporation shall be subject to State, territorial, county, municipal, or other local taxation to the same extent, according to its value, as other similarly situated and used real property, without discrimination in the valuation, classification, or assessment thereof;

(2) the Corporation and its employees shall be subject to any nondiscriminatory payroll and employment taxes intended to finance benefits based upon employment (such as social security and unemployment benefits) to the same extent as any privately owned corporation; and

(3) with respect to any Corporation construction project undertaken pursuant to subtitle E, the Corporation shall be subject to any nondiscriminatory tax levied or imposed by any State, county, municipality, or local taxing authority on—

(A) the extraction or severance of minerals owned or leased by the Corporation; and

(B) the purchase or lease of tangible personal property.

(b) With respect to any loan or debt obligation which is (1) issued after the enactment of this part by, or on behalf of, any State or any political subdivision or governmental entity thereof, (2) guaranteed or otherwise secured by the Corporation prior to the approval of a comprehensive strategy under section 126(c), and (3) not supported by the full faith and credit of the issuer as a general obligation of the issuer, the interest paid on such obligation and received by the purchaser thereof (or the purchaser's successors in interest) shall be included in gross income for the purposes of chapter 1 of the Internal Revenue Code of 1954: *Provided,* That with respect to the amount of such obligations that the issuer would have been able to issue as tax exempt obligations (other than obligations secured by the full faith and credit of the issuer as a general obligation of the issuer), the Corporation is authorized to pay only to the issuer any portion of the interest on such obligations, as determined by the Secretary of the Treasury after taking into account the interest rate which would have been paid on the obligations had they been issued as tax exempt obligations without being so guaranteed or otherwise secured by the Corporation and the interest rate actually paid on the obligations when issued as taxable obligations. Such payments shall be made in amounts determined by the Corporation, and in accordance with such terms and conditions as the Secretary of the Treasury shall require.

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TITLE II—BIOMASS ENERGY AND ALCOHOL FUELS

SHORT TITLE

SEC. 201. This title may be cited as the "Biomass Energy and Alcohol Fuels Act of 1980".

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SUBTITLE B—MUNICIPAL WASTE BIOMASS ENERGY

* * * * *

GUARANTEED CONSTRUCTION LOANS

SEC. 233. * * *

* * * * *

(g)(1) With respect to any loan or debt obligation which is—

(A) issued after the date of the enactment of this Act by, or on behalf of, any State or any political subdivision or governmental entity thereof,

(B) guaranteed by the Secretary of Energy under this section, and

(C) not supported by the full faith and credit of the issuer as a general obligation of the issuer,

the interest paid on such obligation and received by the purchaser thereof (or the purchaser's successors in interest) shall be included in gross income for the purposes of chapter 1 of the Internal Revenue Code of 1954.

* * * * *

TITLE V—SOLAR ENERGY AND ENERGY CONSERVATION

SHORT TITLE

SEC. 501. This title may be cited as the "Solar Energy and Energy Conservation Act of 1980".

SUBTITLE A—SOLAR ENERGY AND ENERGY CONSERVATION BANK

SHORT TITLE

SEC. 502. This subtitle may be cited as the "Solar Energy and Energy Conservation Bank Act".

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Part 1—Establishment and Operation of the Bank

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[1] This publication of the law is restricted to excerpts involving tax matters; Senate Report No. 96-824 published in part, page 21; House Reports No. 96-165 and 96-1104 and Senate Reports No. 96-166 and 96-387 are not published.

* * * * *

BOARD OF DIRECTORS

SEC. 506. (a) The Bank shall be governed by a Board of Directors. The Board shall consist of the Secretary of Housing and Urban Development, the Secretary of Energy, the Secretary of the Treasury, the Secretary of Agriculture, and the Secretary of Commerce.

(b) Three members of the Board shall constitute a quorum.

(c) The Chairperson of the Board shall be the Secretary of Housing and Urban Development.

(d) The President of the Bank shall be the Secretary of the Board.

(e) The Board shall carry out the functions of the Bank as set forth in this subtitle and shall adopt such regulations, subject to the provisions of section 7(o) of the Department of Housing and Urban Development Act (42 U.S.C. 3535(o)), as the Board determines are necessary to carry out such functions.

(f) The Board shall provide to the Secretary of the Treasury such information as the Secretary of the Treasury determines is necessary to insure that no individual is allowed for the same expenditure both—

(1) a credit against taxes under section 38 or section 44C of the Internal Revenue Code of 1954; and

(2) financial assistance under this subtitle.

* * * * *

PROVISION OF FINANCIAL ASSISTANCE

SEC. 509. * * *

* * * * *

(b) Financial assistance may be provided under subsection (a) only if—

* * * * *

(2) the financial assistance is provided in the form described in paragraph (1) or (2) of subsection (a) and—

* * * * *

(E) the owner or tenant receiving such loan has not applied for or received any credit against taxes allowed by section 38 or section 44C of the Internal Revenue Code of 1954 for the expenditures made with the proceeds of such loan, or portion of a loan.

(c) The amount of any financial assistance provided under this subtitle shall not be included in the gross income of any person for purposes of the Internal Revenue Code of 1954, and such person shall not receive any increase in basis under the Internal Revenue Code of 1954 which is attributable to the amount of any financial assistance provided under this subtitle.

* * * * *

CONDITIONS ON FINANCIAL ASSISTANCE FOR SOLAR ENERGY SYSTEMS

SEC. 515. * * *

(b)(1) In addition to the conditions contained in section 513 and subsection (a), financial assistance may be provided by a financial institution to a builder under this subtitle for the purchase and installation of a solar energy system in a residential building only if—

(A) the Board determines that—

(i) in order to encourage the construction or substantial rehabilitation of a greater number or residential buildings containing solar energy systems it is necessary to provide financial assistance under this subtitle directly to builders;

(ii) providing any financial assistance under this subtitle directly to builders is a more effective expenditure of such assistance to encourage the construction or substantial rehabilitation of residential buildings containing solar energy systems than providing such assistance only to the purchasers of such buildings; and

(iii) the Board, in consultation with the Secretary of the Treasury, is able to establish a procedure which will prevent the purchaser (who buys the building from the builder) of a residential building for which a builder received financial assistance under this subtitle from receiving additional assistance under this subtitle for the same expenditures for which the builder received assistance and from being allowed a credit against taxes under section 38 or section 44C of the Internal Revenue Code of 1954 for such expenditures;

(B) the Board establishes a procedure which prevents the purchaser (who buys the building from the builder) of a residential building for which a builder received financial assistance under this subtitle from receiving additional assistance under this subtitle for the same expenditures for which the builder received assistance and from being allowed a credit against taxes under section 38 or section 44C of the Internal Revenue Code of 1954 for such expenditures;

(C) the builder agrees to, and does, disclose to the purchaser (who buys the building from the builder) in writing at the time of signing the sales contract for such building—

(i) the expenditures with respect to such building for which the builder received financial assistance under this subtitle; and

(ii) that the purchaser may not be allowed a credit against taxes for such expenditures under section 38 or section 44C of the Internal Revenue Code of 1954; and

(D) in addition to any other information required by this subtitle to be provided, the builder agrees to, and does, provide to the Bank such information as the Board determines, in consultation with the Secretary of the Treasury, is necessary to assure that the purchaser (who buys the building from the builder) is not allowed a credit against taxes for such expenditures under section 38, or section 44C, of the Internal Revenue Code of 1954.

(2) Any expenditures, made by a builder for the purchase and installation of a solar energy system in a building, for which the builder received financial assistance under this subtitle shall be considered expenditures from subsidized energy financing by the purchaser (who buys such building from the builder) for purposes of section 38 and section 44C of the Internal Revenue Code of 1954.

* * * * *

SUBTITLE B—UTILITY PROGRAM

* * * * *

TAX TREATMENT

SEC. 545. Section 216 of the National Energy Conservation Policy Act is amended by adding the following new subsection at the end thereof:

"(i) Tax Treatment.—The value of any subsidy provided by a utility to any residential customer for the purchase and installation of residential energy conservation measures shall not be included in the gross income of such customer for purposes of the Internal Revenue Code of 1954, and such customer shall not receive any increase in basis under the Internal Revenue Code of 1954 which is attributable to any such subsidy.".

* * * * *

Approved June 30, 1980.

Senate Report No. 96-824
2d Session

[Bracketed numerals indicate official report page numbers]

ENERGY SECURITY ACT

June 19 (legislative day, June 12), 1980.

Mr. Johnson, from the committee of conference, submitted the following conference report to accompany S. 932.[1]

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[180] JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

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[185] Title I—Synthetic Fuels

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[200] Part B—United States Synthetic Fuels Corporation

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[227] SUBTITLE F—CAPITALIZATION AND FINANCE

* * * * *

[229] *Tax Status* (*Sec. 155*)

Section 155(a) provides that the Corporation, its franchise, capital, reserve, surplus, income and intangible property shall be exempt from all Federal, State and local taxes, except that (1) any real property owned in fee by the Corporation shall be subject to nondiscriminatory State and local taxes to the same extent as other similarly situated and used property; and (2) its employees shall be subject to any non-discriminatory payroll and employment tax levied for the purpose of employee benefits and to the same extent as any privately owned corporation. In addition, the Corporation construction projects shall be subject to any non-discriminatory tax levied or imposed by any State, county, municipality, or local taxing authority on those assets of the Corporation construction project pursuant to Subtitle E, including only

(i) the extraction or severance of minerals owned or leased by the Corporation, and

(ii) on the purchase or lease of tangible personal property.

Subsection 155(b)

Section 155(b) establishes debt obligations the Federal tax policy to be followed for Federal taxation of gross income from State and local bonds, which are guaranteed by the Corporation pursuant to Section 133 or which are secured by financial assistance from the Corporation pursuant to Subtitle D during Phase I. The interest paid on any such State or local loan or debt obligations issued after the enactment of this Title is to be included in the gross income of obligation purchasers to the extent that such obligations are not supported by the full faith and credit as a general obligation of the issuer. Because it is anticipated that the taxation of this interest will impose additional costs on issuers than would otherwise be paid in connection with tax-exempt issuances, the Secretary of the Treasury is authorized to determine, and the Corporation is authorized to pay an interest differential payment to issuers for the purpose of compensation for these increased costs incurred as the consequence of taxable status of interest on the obligations. In calculating the amount of the payment which may be made respecting each specific issue of obligation, the Secretary of the Treasury shall take into account the interest which would have been paid if the obligations were issued as tax exempt obligations, and the interest rate actually paid on the taxable obligations.

A price support commitment from the Corporation may be used for a project financed tax exempt bond if, but only if, there is no pledge of the price support commitment as security for the bonds. It is the intention of the Conference Committee that a bond be considered secured by a price support and thus taxable if the bondholders are given a pledge of the price support payments which would entitle the bondholders to receive the prize support payments prior to any other creditors of the owners and/or operators of the facility subject to the price support payments. Where bondholders have rights [230] to the price support payments only as general creditors of the owners or operators of the facility, the Conference Committee does not intend that such bonds be deemed to be "otherwise secured" and thus taxable under Section 155(b).

In order that this interest differential payment authority shall not have the effect of encouraging applicants to seek project financing through State and local governments or agencies, the Conferees intend that the Corporation will exercise this payment authority only where there are clear public benefits to be derived from a project in excess of the benefits which would be derived if the pyament were not made. The Conferees do not expect the Corporation to make extensive use of this payment provision. Nor is it expected that the full amount of the interest differential will be paid in all cases. Further, the Conferees direct the Corporation to assure in each instance that the entire value of the payment will be used to reduce the debt service cost of the project.

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[278] Title V—Solar Energy and Energy Conservation

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[293] Subtitle B—Utility Program

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[1] Public Law 96-294, page 19.

[294] *Tax treatment*

Section 545 provides that any subsidy provided to a customer by a utility's financing program for residential energy conservation measures shall not be treated as income or as an increase in the basis of the customer's residence for tax purposes.

The conferees intend that any financial assistance which is provided to a customer by a utility for residential energy conservation measures and which does not include Federal, State or local governmental financial assistance (such as assistance from the Solar Energy and Energy Conservation Bank) shall not be considered subsidized energy financing for the purposes of the Internal Revenue Code, and shall not, therefore, disqualify such a customer from receiving the relevant tax credits for expenditures so financed.

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Part IV. Items of General Interest

Tax Shelters; Practice Before the Service—Comments

Announcement 80-129 [1]

TITLE 31.—MONEY AND FINANCE, PART 10.—PRACTICE BEFORE THE INTERNAL REVENUE SERVICE.

AGENCY: Department of the Treasury.

ACTION: Invitation for public comments on proposed rule.

SUMMARY: Treasury is * * * releasing for public comment a proposed rule that would amend regulations governing practice before the Internal Revenue Service * * * to set standards for the providing of opinions used in the promotion of tax shelters. The proposed rule would require a practitioner who provides an opinion for a tax shelter to exercise due diligence in representing the facts and Federal tax aspects of the transaction, and in assuring that the opinion is accurately and clearly described in any discussion of tax aspects appearing in the offering materials. The proposed rule would allow a practitioner to provide an opinion for a tax shelter only if the opinion concluded that it was more likely than not that the bulk of the tax shelter had been promoted are allowable under the tax law.

DATES: Comments must be in writing and must be received on or before November 3, 1980. No hearing is now contemplated but one may be held at a time and place to be set in a later notice in the Federal Register if requested by an interested person desiring an opportunity to comment orally and raising an issue that requires oral amplification. The effective date of the regulation will be the date of publication of final regulations in the Federal Register.

ADDRESSES: Comments should be sent in triplicate to Director of Practice, Department of the Treasury, Washington, D.C. 20220. All comments received will be available for public inspection and copying in the Treasury Library, 15th and Pennsylvania Avenue, NW, Washington, D.C.

FOR FURTHER INFORMATION CONTACT:

Mr. Leslie S. Shapiro, Director of Practice—(202) 376-0767.

SUPPLEMENTARY INFORMATION:

The proposed rule which Treasury is * * * releasing for public comment sets standards for IRS practitioners in providing opinions used in the promotion of tax shelters.

Abusive tax shelters are one of the Internal Revenue Service's most serious compliance problems. The IRS has identified approximately 25,000 abusive tax shelters promoted in recent years, involving 190,000 returns and $5.1 billion in adjustments.[1] Apart from the loss in revenue, the widespread nature of such schemes undermines the public's confidence in the fairness of the tax system and may affect the level of voluntary compliance.

A critical element in the typical promotion of an abusive tax shelter is the tax opinion generally provided by the promoter's attorney.[2] The theory of the tax shelter promoter appears to be that the tax opinion, even if qualified or simply incorrect, may provide the investor with assurance that penalties will not be assessed even if deductions and credits taken by the taxpayer are subsequently disallowed. Moreover, promoters also appear to hope that investors will view the practitioner's willingness to provide an opinion, even when the opinion is frankly pessimistic about the chances of ultimately obtaining the promised tax benefits or simply does not purport to address key tax aspects, as an endorsement of the tax shelter.

Four categories of opinions have been identified as causing problems: (1) the opinion that is intentionally false, incompetent, or knowingly or recklessly misstates the law or the facts; (2) the opinion that purports to rely upon factual representations of the promoter even where certain critical facts are questionable in light of other facts and circumstances of the transaction; (3) the opinion that never actually comes to a conclusion on the tax aspects raised by the particular offering to which it is attached. Variants on this include the opinion based on hypothetical facts and the opinion addressing some but not all key aspects; (4) the opinion which states that there is a "reasonable basis" for a taxpayer's claiming the tax benefits on the basis of which the shelter is promoted, but indicating, explicitly or implicitly, that if challenged, the taxpayer probably would ultimately lose.

The Bar has increasingly worried about the providing of these types of opinions, in part because such opinions put significant and unhealthy pressure on the careful practitioner. Such a practitioner may be faced with the unpleasant task of explaining to a client why tax benefits promised in an abusive tax shelter cannot properly be taken even though an opinion by another attorney appears to indicate that they can be taken. The careful practitioner may be offered a substantial fee for an opinion, even if elaborately qualified, which the practitioner knows another will give if he or she does not. There have been suggestions that Treasury amend Circular 230 [1966-2 C.B. 1171; 1967-1 C.B. 433; 1970-2 C.B. 644] to provide clear and effective guidance with respect to the providing of tax shelter opinions. Indeed, at its June 9, 1980 meeting the Commissioner's Advisory Group urged such an amendment.

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[1] Filed by the Office of the Federal Register on Sept. 3, 1980, 8:45 a.m., and published in the issue of the Federal Register for Sept. 4, 1980, 45 F.R. 58594.

[1] Not all tax shelters are abusive. An "abusive" tax shelter may be generally described as a transaction without any significant economic purpose other than the generation of tax benefits that typically employs exaggerated valuations and otherwise mischaracterizes critical aspects of the transaction.

[2] Although the discussion is cast in terms of attorney's opinions, much of the analysis would apply to opinions rendered by certified public accountants and others entitled to practice before the IRS. The rule covers all such practitioners.

Under the authority conferred by 31 U.S.C. 1026 and 5 U.S.C. 301 to regulate the professional conduct of those who practice before it, Treasury proposes to adopt a rule that would confront the problem of tax attorney opinions in abusive tax shelters by imposing certain duties upon a practitioner providing a tax shelter opinion.

Scope of the Rule

With one exception, the proposed rule is drawn to apply only to "tax shelter opinions." [3] These are opinions that the practitioner who provides the opinion knows or should know will be "referred to or included in offering materials distributed to parties who are not then [the practitioner's] clients in connection with the promotion of a tax shelter." The proposed rule is not directed at the advice which a tax practitioner gives his or her client. Nor is it intended to deal with the problem addressed in Formal Opinion 314 of the American Bar Association of whether an attorney who is asked to advise his or her client in the course of the preparation of the client's tax returns may freely urge the statement of positions most favorable to the client as long as there is a reasonable basis for those positions.

"Tax shelter" is defined in the proposed rule in terms of transactions "in which the claimed tax benefits are likely to be perceived by the taxpayer as the principal reason for his or her participation." Consideration was given to defining a "tax shelter" in terms of transactions "in which the claimed tax benefits are set forth in the offering materials or otherwise described as a principal reason for the taxpayer's participation," but limiting coverage of the rule to a subset of tax shelters particularly likely to be abusive. Such shelters might be defined as those in which "it is contemplated that the aggregate deductions, credits, and other allowances that a taxpayer may claim within 24 months of his or her initial cash outlay will equal or exceed the amount of such cash outlay (disregarding any cash to be obtained by borrowings, except full-recourse borrowings from financial institutions unrelated to the taxpayer, promoter, or other participants)." Treasury encourages comment on this alternative approach to the definition of tax shelter.

Due Diligence in the Providing of Tax Shelter Opinions

A. *Due Diligence as to Factual Matters*

Proposed Section 10.33(a)(1)(i) requires the practitioner who provides a tax shelter opinion to exercise "due diligence" to assure that the opinion (or offering material) adequately discloses those facts which bear significantly on each important Federal tax aspect of the shelter. A tax shelter opinion should be based upon the actual facts of the transaction. Thus a tax shelter opinion that relied on hypothetical facts in arriving at its conclusions would not be acceptable. Such an opinion too readily lends itself to abuse in a tax shelter promotion.

What constitutes "due diligence" in assuring the accuracy of facts depends on the circumstances. Due diligence ordinarily includes the duty to examine any offering materials and to be satisfied that the facts upon which the opinion is based are accurate and complete. "Due diligence" requires the practitioner to be alert to inconsistencies or implausibilities in the facts as presented to him or her and to resolve any doubts before rendering an opinion.

For example, if the offering materials refer to an appraisal of property to be acquired by an investor, the practitioner should ordinarily review the appraisal and the appraiser's credentials and consider whether the terms and conditions on which the property will be sold are consistent with the purported valuation. If doubts about valuation cannot be resolved to the practitioner's satisfaction, the practitioner should not provide an opinion.

B. *Due Diligence as to Tax Law Matters*

Proposed Section 10.33(a)(1)(ii) generally requires the practitioner who provides a tax shelter opinion to use "due diligence" to assure that the opinion adequately describes and sets forth a conclusion with respect to each important Federal tax aspect of the transaction. In the opinion the practitioner must state a conclusion as to likely legal outcomes. An opinion that merely presents opposing views or merely states that there is a "reasonable basis" for a particular view without assessing the likely legal outcome does not meet the standard of the proposed rule.

However, in rare cases, *e.g.*, an inability to predict legal results because of internal inconsistency in a statute or inconsistency between literal statutory language and the overall legislative scheme, and the absence of helpful IRS regulations or case law, good professional practice may dictate that it would be inappropriate to set forth a conclusion as to a particular Federal tax aspect. When a practitioner can demonstrate the existence of such circumstances, a conclusion as to likely legal outcome will not be required as to that tax aspect. The phrase in proposed paragraph (a)(i)(ii), "unless inappropriate under good professional practice," is intended to accomplish this result. This provision in no way modifies the requirement in proposed paragraph (a)(2) that a practitioner may provide a tax shelter opinion only if he or she concludes that it is more likely than not that the bulk of the benefits on the basis of which the shelter has been promoted are allowable under the tax law.

Under the definition of "important Federal tax aspect" proposed in paragraph (c)(4), the practitioner is required to give an opinion on all tax benefits on the basis of which the tax shelter is promoted. Moreover, there may be some Federal tax aspects which are significant in relation to the total tax benefits which may be claimed from the shelter that are not discussed or emphasized in the offering materials. For example, frequently offering materials do not discuss the consequences of recapture of tax benefits obtained, which may result in adverse tax consequences so substantial as to constitute an important Federal tax aspect. The practitioner must address such issues, as "important Federal tax aspects," in the opinion.

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[3] As a clarification of Section 10.51, the providing of an intentionally or recklessly false opinion, or a pattern of providing incompetent opinions in Federal tax matters (not just in tax shelters), is specifically identified as an instance of disreputable conduct.

In certain circumstances a practitioner may be asked or may request to provide an opinion on some but not all of the important Federal tax aspects. For example, a practitioner with a very specific speciality may not want to opine on a broad range of issues. Paragraph (b)(1) permits a practitioner to provide an opinion in such circumstances if opinions by other practitioners fill in the gaps. The other opinions must be disseminated in the same way as the practitioner's. This includes, for example, discussion in the offering materials if the practitioner's opinion is discussed there. Additionally, the practitioner, upon reviewing the other opinions, and the offering materials, must have no reason to believe that the requirements of adequate factual and legal disclosure have been violated in connection with such other opinions. The required review calls for at least a careful reading, but, in the absence of significant differences with the practitioner's view of the law or discrepancies with the practitioner's knowledge of the facts, does not entail an audit of legal or factual conclusions in the other opinions.

C. *Due Diligence as to Description in Offering Materials*

Proposed Section 10.33(a)(1)(iii) requires the practitioner who provides a tax shelter opinion to exercise "due diligence" to assure that the opinion is adequately described in any discussion of tax aspects appearing in any offering materials. A practitioner ordinarily has control over the use to which his or her opinion may be put and thus has the responsibility to take reasonable steps (such as insisting on a review of offering materials) to assure that the opinion is accurately and clearly described.

D. *Due Diligence Generally*

"Due diligence" is a concept which is defined to a substantial extent by the standards prevalent in good professional practice. Thus Treasury particularly welcomes comment by professional groups, including opinions by ethics committees, as to their views of what constitutes due diligence in a variety of circumstances. Standards of practice agreed on by recognized professional groups will be an important factor in guiding Treasury enforcement activity in this area.

"More Likely Than Not" Standard for Providing Opinions

Proposed Section 10.33(a)(2) allows the practitioner to provide a tax shelter opinion only if the opinion concludes that it is "more likely than not" that the bulk of the tax benefits on the basis of which the shelter has been promoted are allowable under the tax law. The proposed rule requires only a statement of the opinion of the practitioner as to his or her view of the law. A practitioner is entitled to disagree with the position of the Internal Revenue Service, so long as he or she honestly believes the courts would ultimately sustain the position he or she advises. It should be noted, however, that an opinion which is intentionally or recklessly misleading, or which is part of a pattern of providing incompetent opinions, will be regarded as an instance of disreputable conduct under Section 10.51. This is made clear by proposed Section 10.51(j). An opinion that reaches a conclusion with which no reasonable practitioner could concur is likely to be either intentionally or recklessly misleading.

The "bulk of the tax benefits" language is not a precise directive, but it means substantially more than 51%. The term also indicates a rejection of a possible alternative of requiring a positive conclusion for each important Federal tax aspect. What constitutes the "bulk of the tax benefits" will frequently become apparent from the substance of a particular transaction and its presentation in offering materials. For example, in a tax shelter promising deductions, credits, and other allowances in a ratio of 5 to 1 of the investor's initial cash outlay, a conclusion that it is more likely than not that a 4 to 1 ratio will be allowable meets the standards of paragraph (a)(2).

Also, in some circumstances a practitioner who has properly provided an opinion on just some of the important Federal tax aspects may not be able to determine whether the "more likely than not" test can be met for the "bulk of the tax benefits." To avoid needless duplication of work, under paragraph (b)(2) the practitioner may provide an opinion if another opinion, upon which he or she has properly relied for purposes of paragraph (b)(1), meets the test of paragraph (a)(2). The practitioner may also rely on conclusions in such other opinions to provide an opinion complying with paragraph (a)(2). Thus at least one practitioner must ultimately review all important Federal tax aspects of a tax shelter and conclude that the test of paragraph (a)(2) has been met.

Special Disclosure Alternative

The rule of paragraph (a)(2) constitutes a significant step in the regulation of tax practitioners. For example, present professional practice standards indicate that a tax practitioner can properly advise a client to take a deduction with respect to a consummated transaction so long as the practitioner in good faith believes there is a reasonable basis for such a position, even though he or she also believes that the deduction would ultimately be disallowed. ABA Opinion 314.

The theory of paragraph (a)(2) is that tax practitioners have greater responsibility when their opinions are used to help merchandise an investment proposal to persons who are not their clients.[4] The prohibition of paragraph (a)(2) also recognizes that, in contrast to the Securities and Exchange Commission's primary concern with investor protection in tax shelter promotions, the Treasury is primarily concerned about the possible defrauding of the Government. In many tax shelter promotions the true victim is the Treasury. Investors seek to evade their fair share of the taxes, and disclaimers as to the weakness of the scheme may not sufficiently deter the successful promotion of these ventures. An effective deterrent may be to forbid participation by tax practitioners because their participation suggests their endorsement of the promotion. A prohibition also eliminates use of the opinion as insurance against fraud or negligence penalties if the benefits are ultimately disallowed.

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[4] The proposed rule takes no position on a tax practitioner's responsibility in tax planning for his or her client, where the practitioner may be called on to structure a transaction to obtain certain tax benefits which he or she believes would ultimately be disallowed but as to which there is a reasonable basis.

On the other hand, some thoughtful practitioners have argued that there is nothing unprofessional or disreputable in a tax practitioner permitting the circulation of a competent opinion which sets forth the risks that the proposed tax shelter will not provide the hoped for benefits, especially if adequate disclosure is made of the negative aspects of the opinion. The following language has been suggested as a possible way of meeting this point:

"(c) *Special Disclosure*. A practitioner may provide a tax shelter opinion that does not comply with paragraph (a)(2) hereunder if the risks of not obtaining tax benefits are clearly and forcefully explained in the opinion and if he or she exercises due diligence to assure that such explanation appears in any materials used to promote the tax shelter. A clear and forceful explanation normally would include a highlighted statement on the first page of any offering materials, the first page of the practitioner's opinion, and at the head of any other discussion of tax aspects in the offering materials that it is 'unlikely that the bulk of the tax benefits on the basis of this tax shelter transaction is promoted are allowable under the tax law' ".

The proposed rule has not adopted this suggestion because tax shelter opinions not meeting the standards of paragraph (a)(2) are inherently subject to abuse. A promoter who would use a negative opinion as part of the offering materials is expecting investors either not to read the opinion, not to understand the opinion, or to view it as insurance against the imposition of penalties if the claimed tax benefits are ultimately disallowed. The disclosure alternative does not appear adequately to respond to these concerns. Comment is specifically invited on the issues raised by the disclosure alternative.

OTHER

A proposed amendment to Section 10.51 will make clear what is already implied by that section, that the providing of intentionally or recklessly false opinions, or a pattern of providing incompetent opinions in Federal tax matters (not just tax shelter matters) is an instance of disreputable conduct.

A proposed amendment to Section 10.52 will allow disbarment or suspension from practice before the Internal Revenue Service for violation of proposed Section 10.33 and Sections 10.22 and 10.50. The standard of these sections make the requirement of willfulness in present Section 10.52 inappropriate.

DRAFTING INFORMATION

The principal draftsman is Jeffrey N. Gordon, special assistant to the General Counsel of the Treasury.

AUTHORITY

These rules and amendments are proposed under authority of Sec. 3, 23 Stat. 258, secs. 2-12, 60 Stat. 237 et seq.; 5 U.S.C. 301; 31 U.S.C. 1026; Reorg. Plan No. 26 of 1950, 15 F.R. 4935, 65 Stat. 1280, 3 CFR, 1949-53 Comp., p. 1017.

PROPOSED AMENDMENTS TO THE REGULATIONS

In consideration of the foregoing, it is proposed to amend Part 10 of 31 CFR by adding a new Section 10.33, by adding a new Section 10.51(j), and by revising existing Section 10.52 as follows:

Section 10.33. Tax Shelter Opinions.

(a) *General Rule*. A practitioner who provides a tax shelter opinion

(1) shall exercise due diligence to assure that

(i) the opinion or the offering material fully and fairly discloses those facts which bear significantly on each important Federal tax aspect and

(ii) the opinion fully and fairly describes and, unless inappropriate under good professional practice, states a conclusion as to the likely legal outcome with respect to each important Federal tax aspect, and

(iii) the opinion is accurately and clearly described in any discussion of tax aspects appearing in any offering materials and

(2) shall provide the opinion only if the opinion concludes that it is more likely than not that the bulk of the tax benefits on the basis of which the shelter has been promoted are allowable under the tax law.

(b) *Reliance on Other Opinions*. (1) Notwithstanding paragraph (a)(1)(ii), a practitioner may provide an opinion on fewer than all of the important Federal tax aspects if

(i) other practitioners provide opinions on the other important Federal tax aspects which are disseminated in the same manner as the practitioner's opinion, and

(ii) the practitioner, upon reviewing such other opinions and any offering materials, has no reason to believe that the standards set forth in paragraph (a)(1) have been violated.

(2) In providing an opinion under paragraph (b)(1), the practitioner is not required to comply with paragraph (a)(2) if at least one other opinion properly relied upon for purposes of paragraph (b)(1) satisfies the standard of paragraph (a)(2).

(3) In providing an opinion under paragraph (b)(1) that also seeks to meet the standard of paragraph (a)(2), the practitioner may rely on conclusions in opinions properly relied upon for purposes of paragraph (b)(1).

(c) *Definitions*. For purposes of Section 10.33:

(1) "Practitioner" is any person authorized under Section 10.3 to practice before the Internal Revenue Service.

(2) "Tax shelter" is a sale, offering, syndication, promotion, investment or other transaction in which the claimed tax benefits are likely to be perceived by the taxpayer as the principal reason for his or her participation.

(3) "Tax shelter opinion" is written advice relating to the Federal tax law which the practitioner providing such advice knows or reasonably should know will be referred to or included in offering materials distributed to parties who are not then his or her clients in connection with the promotion of a tax shelter.

(4) "Important Federal tax aspect" is any Federal tax aspect on the basis of which the tax shelter is promoted in whole or in part or which is significant in relation to the total tax benefits which may be claimed from the tax shelter. Frequently the recapture of tax benefits obtained may result in adverse tax consequences so substantial as to constitute an important Federal tax aspect.

Section 10.51. Disreputable Conduct.

(j) Giving an intentionally or recklessly misleading opinion, or a pattern of providing incompetent opinions, on questions arising under the Federal tax laws.

Section 10.52. Violation of Regulations.

In addition to the grounds set forth in Section 10.51, any attorney, certified public accountant, or enrolled agent or other eligible individual may be disbarred or suspended from practice before the Internal Revenue Service for violation of Sections 10.22, 10.33, or 10.50 or for willful violation of any of the other regulations contained in this part.

Dated August 29, 1980.

Robert H. Mundheim,
General Counsel,
U.S .Department of
the Treasury.

Deletions from Cumulative List of Organizations Contributions to Which Are Deductible Under Section 170 of the Code

Announcement 80-131

The name of an organization that no longer qualifies as an organization contributions to which are deductible under section 170 of the Internal Revenue Code of 1954 is listed below.

Generally, the Service will not disallow deductions for contributions made to a listed organization on or before the date of announcement in the Internal Revenue Bulletin that the organization no longer qualifies. However, the Service is not precluded from disallowing a deduction for any contributions made after an organization ceases to qualify under section 170 where the contributor (1) had knowledge of the revocation of the ruling or determination letter, (2) was aware that such revocation was imminent, or (3) was in part responsible for or was aware of, the activities or deficiencies on the part of the organization which gave rise to the loss of qualification.

Moreover, if the Service has announced suspension of advance assurance of deductibility of contributions to an organization pending examination, and the qualification of the organization is subsequently terminated, contributions made after the date specified in the announcement in the Internal Revenue Bulletin are not deductible. In such a case the date of suspension will appear after the name of the organization to which it applies.

Westchester Academy, Ltd., Baltimore, MD

Foundation Status of Certain Organizations

Announcement 80-132

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3) of the Code, eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Adolescent Community Center for Education and Responsibility Training, Phoenix, AZ
Adult Center Club of Prescott, Arizona, Prescott, AZ
Adventist International Medical Society, Loma Linda, CA
Afro American Christian Culture Society, Inc., Phoenix, AZ
Alco-Dri-Fraternity, Santa Ana, CA
Ames Talented and Gifted Organization, Ames, IA
Arizona Association of Rehabilitation Facilities, Scottsdale, AZ
Arizona Congress for Action, Inc., Phoenix, AZ
Ark Coffee House, The, Marshall, TX
Art Heart, Inc., Hoboken, NJ
Asian-American Temperance League, Inc., Hawthorne, CA
Atlanta, Help Our Youth, Inc!, Atlanta, GA
Ballet Mexicapan, Inc., Los Angeles, CA
Baltimore County P.A.L., Towson, MD
Barrios Unidos Westside of Los Angeles, Inc., Venice, CA
Beacon-Belverlywood East—A Community of Neighbors, Santa Monica, CA
Beerman Foundation, Leonard I., Los Angeles, CA
Benetwood Corp., Erie, PA
Bible Memory Book Center, Los Angeles, CA
Big Brothers of Walker County, Inc., Jasper, AL
Bio-Energy Research Foundation, Los Angeles, CA
Black Charities, Los Angeles, CA
Buckeye Sheriff's Educational Foundation, Columbus, OH
California Pacific University Alumni Association, San Diego, CA
California Taido Association, Gardena, CA
California Youth Action Program, Inc., Long Beach, CA
Camp Shilon of Boyertown Inc., Boyertown, PA
Cara Trust, Palm Springs, CA
Career Center, The, Haverford, PA
Centennial Village Corp., Mesa, AZ
Central Pacific Rail Road Corp., Sacramento, CA
Child Care Expansion Systems, Upland, CA

Children's University, The, Burbank, CA
Christ Church Day Care Center, Paterson, NJ
Christian Boat Fellowship, Honolulu, HA
Christian Cyclists' Charitable Trust, San Bernardino, CA
Christian Services International, Ontario, CA
Christian Outreach Ministries of Hemet, Inc., Hemet, CA
Church Building Fund in the USA for the Sacred Order of the Church of Cherubim & Seraphim, Irvine, CA
Churches of Christ Community Involvement, Inglewood, CA
Citizens for Energy Conservation and Solar Development Corp., Los Angeles, CA
Citizens of Audubon Park, Inc., Brentwood, MD
Coastal Region Health Consortium, Los Angeles, CA
Community Arts Council, New Castle, PA
Community Cartoon Workshop, Los Angeles, CA
Community House, Inc., Erie, PA
Community Resource Development, Inc., Santa Monica, CA
Community Volunteers of Southern California (COVO), Van Nuys, CA
Council on Science and Technology for Development, Washington, DC
D.E.P.A.R.T., Jefferson City, MO
Disciples, Inc., Newport Beach, CA
Do Fix-it Shop, Inc., Phoenix, AZ
Dooly Health Care Association, Inc., Unadilla, GA
Dove Enterprises, Weatherford, TX
Elder Scholarship Fund, Inc., The, Washington, DC
Enabling Systems Institute—ESI, Honolulu, HA
Encino Women's Club Trust Fund, Encino, CA
Energy Research and Development Foundation, Inc., Washington, DC
Enterprises Unlimited, Bolivar, MO
Environmental Education Association (EEA), Tempe, AZ
Evangelism Outreach, Santa Monica, CA
Experimental Learning Fellowship, Bakersfield, CA
Federation of Feminist Women's Health Centers, Los Angeles, CA
Feingold Association of San Diego, San Diego, CA
Fellowship Club, The, Cedar Rapids, IA
Fort Yuma Inter-Tribal Health Board & Health Department, Inc., Yuma, AZ
Forty Over Employment, Encino, CA
Foundation for Responsible Efforts for Ex-Offenders, Wydmoor, PA
Friends of Newport Theatre/Art Center, Newport Beach, CA
Friends of the Eldora Public Library, Eldora, IA
Friends of the People of Gemona, Inc., Fullerton, CA
Friends of Thornwald Park, Carlisle, PA
Fronteras de las Californias, San Diego, CA
Gay Community Center of Orange County, Costa Mesa, CA
Geriatric Foundation of Franklin, The, Franklin, TN
Gospel Carriers Evangelistic Team, Inc., The, Poway, CA
Gospel Rock Ministries, Inc., Phoenix, AZ
Goss Nutrition Consultant Services, Inc., J., Altadena, CA
Greater Orange County Food Coalition, Westminster, CA
Hanmi Cultural and Educational Center, Monrovia, CA
Hawaii Public Health Association, Honolulu, HA
Health Services Information Center, Inc., Tryon, NC
Heritage and Tradition, Inc., North Hollywood, CA
High Desert Recycling Council, Ridgecrest, CA
His Men, Inc., Mason City, IA
Hollywood Historic Trust, Hollywood, CA
Holy Cross Orthodox Foundation, Los Angeles, CA
Home-Center Recreation and Park Board, Inc., Homer, PA
Hospitality House for Women, Inc., Rome, GA
Hulse Evangelistic Association, David, Tulsa, OK
I. A. Foundation, Ltd., Tucson, AZ
Immanuel Christian Center, Inglewood, CA
Independent Board for Presbyterian Home Missions Inc., The Wilmington, DE
Innergy Medical Research Foundation, Sherman Oaks, CA
Innovative Research Systems, Inc., San Diego, CA
Institute of Creative Action Realized in Unified Service, The, Santa Barbara, CA
Instudhess, Inc., Chevy Chase, MD
Intercom Publishers, The, San Jose, CA
Interlude House, Inc., The, Denver, CO
International Animated Film Society ASIFA — Hollywood, Hollywood, CA
International Youth Training Mission, Santa Ana, CA
Janus Society Corp., The, Beverly Hills, CA
Jesus Uni-Church Ministries, Vista, CA
Joaquin, Bessie Vincent Trust, Palos Verdes Estates, CA
Jojoba Research Institute, The, Carpenteria, CA
Joyful House, Rancho Palos Verdes, CA
Joyland Childcare Center, Inc., Los Angeles, CA
Junior World of Business, Inc., Plainfield, NJ
Kaleo O Ka Po'e, Hilo, HA
Kearney County Council on Aging Inc., Lakin, KS
Kennedy/Smith Family Association, Northridge, CA
Lafayette Center Preservation Foundation Corp., Lafayette, NJ
Laguna Endowment and Scholarship Society, Laguna Beach, CA
Land Air and Water, Inc., Clintwood, VA
Las Damas League, Palm Springs, CA
Legal Center for Public Representation, Inc., Panorama City, CA
Light of the World Prayer Community, Diamond Bar, CA
Lincroft Senior Citizens Housing Corp., East Orange, NJ
Little School House, Kailua, HA
Living Circle, The, Carson, CA

Logos Work, Inc., Tucson, AZ

Los Angeles Sign Co., The, Encino, CA

Los Angeles Workshop, Inc., The, Gardena, CA

Los Liones Arboretum Foundation, The, Pacific Palisades, CA

M.E.D.I.C.S. International, Inc., Glendale, CA

Mandala House Foundation, Inc., Perkasie, PA

Maranatha Mobiles, Rowland Heights, CA

Maxiom, Inc., Los Angeles, CA

Melanson Memorial Vocational Scholarship Fund, Marilyn, Yucca Valley, CA

Memory Research Center, Los Angeles, CA

Metropolitan Youth Council, Inc., Tucson, AZ

Mexican American Parent Student Organization, Colton, CA

Mexico Christian Ministry, Longview, TX

Microsurgery Instruction, Consultation and Research Organization, Inc., Downey, CA

Minority Aerospace Associates Now United People, Los Angeles, CA

Minority Affairs Institute, Inc., Costa Mesa, CA

Minority Arts Ensemble, Inc., Washington, DC

Mission of Love, Inc., La Jolla, CA

Mission of Mercy, Inc., Odessa, TX

Missions for Christ, Unlimited, Compton, CA

Mobile Ministries Association, Rialto, CA

Monday Night Bible Study, Inc., Garden Grove, CA

Mountaintop Christian Outreach, Inc., Running Springs, CA

Music on the Green, Laguna Niguel, CA

Music Society of Southern New Jersey, The, Cherry Hill, NJ

Na Koe Alii Drum and Bugle Corps, Inc., Honolulu, HA

National Community Affirmative Action Center, Los Angeles, CA

National Driver's Association, Inc., Arlington, VA

National German-Chorale Society, Easton, PA

National Institute of Human Resources Development, Laguna Beach, CA

National Motorcycle Safety Club, Washington, DC

Natures Horizon Inc., Doyestown, PA

New Horizons West, Inc., Bishop, CA

New Life Camp, Studio City, CA

New Responses, Inc., Washington, DC

New Theater, Inc., The, Clinton, NJ

Nigritian Animist Institute, Inc., Los Angeles, CA

Normandie 5 Project Area Committee, Los Angeles, CA

Nursing Education Associates, Hacienda Heights, CA

Off the Wall Theatre, Inc., Hollywood, CA

Okeechobee Council on Aging, Inc., Okeechobee, FL

Orange Acorn, Inc., Santa Ana, CA

Orange County Blue Angels Boys Track and Field Club, Huntington Beach, CA

Orange County Committee for Employment of the Handicapped, Inc., Garden Grove, CA

Our Ultimate Investment, Los Angeles, CA

Outreach Foundation, Inc., Santa Barbara, CA

P.E.P. (People For Educational Progress) Forums of America, Camarillo, CA

Pacific Asian American Center, Santa Ana, CA

Pacific Ballet Theatre Educational Corporation of Southern California, North Hollywood, CA

Pacific Forensic Institute, San Diego, CA

Palos Verdes Museum of Archaeology, Rancho Palos Verdes, CA

Parents for Action, Inc., Trenton, NJ

Pennsylvania Chamber of Commerce Education Fund, Harrisburg, PA

People for Better Housing Inc., Preston, MD

Personal Dynamics Institute, Inc., Reading, PA

Philadelphia Fund to Keep Children from Smoking, The, Philadelphia, PA

Phoenix Rising Theatre Foundation of the Performing Arts, North Hollywood, CA

Pittsburgh Legal Services Clinic for Youth, Pittsburgh, PA

Potomac Chapter, National Society for Performance and Instruction, Falls Church, VA

Professional Entertainers for Prisoners, Inc., Los Angeles, CA

Progressive Broadcasting Foundation, Beverly Hills, CA

Quest Foundation, Placentia, CA

Quiet Key, Inc., Costa Mesa, CA

Rays (Reaching Adults and Youth by Success), Long Beach, CA

Read Memorial Christian Center, Sedalia, MO

Reading Improvement Association Inc., Baltimore, MD

Reapers Foundation, Costa Mesa, CA

Regeneracion Research, Inc., Los Angeles, CA

Rhodes Foundation, E. R., San Diego, CA

Right Track Inc., Hollywood, CA

Riverside Church of Gospel, Inc., Jacksonville, FL

Rosemead Rebels Athletic Club, Rosemead, CA

Ter Marsch Foundation, Baking Ridge, NJ

Therapeutic Riding Services for the Handicapped, Inc., Downey, CA

To Help Amblyopia Treatment Eye Foundation, Los Angeles, CA

Total Learning Management, Irvine, CA

Twenty-Third District Central Steering Committee of Alcoholics Anonymous, Santa Barbara, CA

Twin City Community Development Organization, White Hall, IL

United Crusade for Christ, Inc., The, Clarkesville, GA

United Evangelism, Inc., Tucson, AZ

University of Southern California Black Alumni Association, Los Angeles, CA

Vaughn Tenant Association, St. Louis, MO

Ventura County Association for the Education of Young Children, Camarillo, CA

Ventura County Genealogical Society, Santa Paula, CA

Viva Zapatos Shoe Fund, Inc., Los Angeles, CA

Wainman Homes, Inc., Asheboro, NC

Waves: Music of the Present Day, Santa Barbara, CA

West Central Association Popwarner Football, Inc., Phoenix, AZ

White Oak Foundation, Inc., Rancho Mirage, CA
Whole Person, The, Torrance, CA
Wings of the Wind, Inc., Grand Prairie, TX
Women's Institute for International Relations, Inc., Washington, DC
Woodrow Wilson High School Scholarship Fund, Inc., Los Angeles, CA
Youth & Students for World Peace and Environmental Protection, Philadelphia, PA
6-Up Club Schools, Inc., Phoenix, AZ

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

U.S.-Australia Tax Treaty Discussions

Announcement 80-135 [1]

The Treasury Department has announced that representatives of the United States and Australia will meet in Canberra in November to resume discussions on a new income tax treaty to replace the present treaty which has been in effect since 1953.

Negotiations on a new treaty began in 1970 and continued in 1971. It was not possible at that time to resolve all of the issues, and negotiations lapsed. On the basis of several informal discussions in the last few years, full agreement now appears promising.

The new treaty will be patterned after the U.S. and OECD Model Conventions of 1977. It will deal with the taxation of business income, investment income, and personal service income and with administration of the treaty.

The Treasury invites persons wishing to submit comments or suggestions on any aspect of the proposed treaty or on U.S.-Australian tax relations generally to write, by October 31, 1980, to H. David Rosenbloom, International Tax Counsel, Department of the Treasury, Room 3064, Washington, D.C. 20220.

Dated September 15, 1980.

Donald C. Lubick,
Assistant Secretary
(Tax Policy).

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[1] Filed by the Office of the Federal Register on September 19, 1980, 8:45 a.m., and published in the issue of the Federal Register for September 19, 1980, 45 F.R. 62601.

Qualified Disclaimers—Public Hearing

Announcement 80-137 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to the disclaimer of property conferred by gift or inheritance.

DATES: The public hearing will be held on November 18, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by November 4, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-213-76), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed amendments to the Estate Tax Regulations under sections 2041, 2045, 2055 and 2056 of the Internal Revenue Code of 1954 and the Gift Tax Regulations under Code sections 2511, 2514 and 2518. The proposed regulations appeared in the Federal Register for Tuesday, July 22, 1980 (45 FR 48922).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on proposed regulations should submit an outline of the comments to be presented at the hearing and the time they wish to devote to each subject by November 4, 1980. Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive for improving Government regulations appearing in the Federal Register for Wednesday, November 8, 1978.

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[1] Filed by the Office of the Federal Register on September 29, 1980, 8:45 a.m., and published in the issue of the Federal Register for September 30, 1980, 45 F.R. 64603.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing, the following individual has been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
J. Franklin Moore	Lenoir, NC	Certified Public Accountant	August 18, 1980

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Ralph D. Lider	New Bedford, MA	Attorney	Indefinite effective August 18, 1980
Anthony G. Bellas	Littleton, CO	Enrolled Agent	Twelve months effective September 1, 1980
Roy W. Lynch	New Bedford, MA	Enrolled Agent	Indefinite effective August 28, 1980
Roger C. Hennings	Stillwater, MN	Attorney	Indefinite effective August 28, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.6012-2(e), 1.6012-3(a)(5), 1.6033-2(a)(2)(i), 53.6071-1, 301.6204-1, 301.6211-1, 301.6212-1, 301.6213-1, 301.6501(c)-1, 301.6501(e)-1, 301.6503(a)-1(a), 301.6512-1, 301.6601-1(d), 301.6653-1, 301.6659-1, 301.6861-1, 301.6862-1(a), 301.6863-1(b), amended; 53.6011-1(e), 54.6011-1, 301.6501(n)-1 through 301.6501(n)-3, 301.6503(g)-1, 301.6511(f)-1, 301.7422-1, 301.7454-2, added; 301.6503(g)-1 redesignated as 301.6503(f)-1.	Procedure and administration of certain excise taxes.	Aug. 25, 1980	Oct. 24, 1980
26 CFR 53.4942(a)-3 revised.	Set-asides made by private foundations.	Aug. 26, 1980	Oct. 27, 1980
26 CFR 1.482-2, 1.483-1, amended.	Imputed interest rate on loans between related entities and on deferred payments in the case of certain sales of property.	Aug. 29, 1980	Oct. 28, 1980
26 CFR 1.6013-6(a)(2)(v) amended.	Relationship of election by nonresident alien to be treated as a resident and income tax treaties.	Sept. 12, 1980	Nov. 11, 1980
26 CFR 1.47-1 amended, 1.48-9 added.	Business investment credit for energy property.	Sept. 19, 1980	Nov. 18, 1980
26 CFR 150.4989-1(c) amended; published as temporary regulations in T.D. 7720, page 12, this Bulletin.	Interim rule for determining base prices for tier 2 and tier 3 oil.	Sept. 24, 1980	Nov. 24, 1980
26 CFR 150.4989-1(c), 150.4995-1(b)(2) revised; published as temporary regulations in T.D. 7721, page 13, this Bulletin.	Base prices of tier 2 and tier 3 oil and withholding in the absence of effective operator's certificate.	Sept. 30, 1980	Dec. 1, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

Finding List of Current Action on Previously Published Rulings[1]

Bulletins 1980-27 through 1980-41

*** Denotes entry since last publication.**

Delegations Orders:

4 (Rev. 10)
Superseded by
4 (Rev. 11), 1980-33, I.R.B. **19**

11 (Rev. 11)
Superseded by
11 (Rev. 12), 1980-33 I.R.B. **20**

96 (Rev. 3)
Superseded by
96 (Rev. 4), 1980-29 I.R.B. **25**

112 (Rev. 5)
Superseded by
112 (Rev. 6), 1980-29 I.R.B. **26**

156 (Rev. 1)
Amended by
156 (Rev. 1), Amend. 1, 1980-28 I.R.B. **29**

I.T.

1359
Amplified & Superseded by
80-222, 1980-33 I.R.B. **10**

3061
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80-222, 1980-33 I.R.B. **10**

Revenue Procedures:

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80-43, 1980-41 I.R.B. **19***

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80-35, 1980-37 I.R.B. **17**

79-26
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80-33, 1980-33 I.R.B. **21**

79-35
Modified by
80-33, 1980-33 I.R.B. **21**

80-7
Modified by
80-32, 1980-29 I.R.B. **27**

80-22
Amplified by
80-34, 1980-36 I.R.B. **34**
80-37, 1980-39 I.R.B. **22**
80-38, 1980-39 I.R.B. **22**
80-41, 1980-41 I.R.B. **18***

Revenue Rulings:

87
Modified by
80-273, 1980-41 I.R.B. **15***

55-60
Superseded by
80-229, 1980-34 I.R.B. **8**

Rev. Ruls.—Continued

55-532
Obsoleted by
80-243, 1980-36 I.R.B. **32**

55-428
Amplified by
80-267, 1980-41 I.R.B. **5***

56-672
Amplified by
80-267, 1980-41 I.R.B. **5***

58-214
Obsoleted by
80-237, 1980-35 I.R.B. **9**

58-310
Obsoleted by
80-243, 1980-36 I.R.B. **32**

59-60
Amplified by
80-213, 1980-32 I.R.B. **7**

59-241
Superseded by
80-229, 1980-34 I.R.B. **8**

60-161
Amplified by
80-210, 1980-31 I.R.B. **14**

62-213
Distinguished and clarified by
80-173, 1980-27 I.R.B. **8**

65-234
Obsoleted by
80-243, 1980-36 I.R.B. **32**

65-294
Superseded by
80-229, 1980-34 I.R.B. **8**

66-324
Superseded by
80-269, 1980-41 I.R.B. **9***

67-165
Superseded by
80-258, 1980-39 I.R.B. **6**

69-261
Modified by
80-189, 1980-29 I.R.B. **7**

69-442
Revoked by
80-199, 1980-30 I.R.B. **11**

70-262
Amplified by
80-191, 1980-29 I.R.B. **18**

71-191
Distinguished by
80-176, 1980-27 I.R.B. **10**

71-257
Superseded by
80-252, 1980-38 I.R.B. **14**

71-315
Modified by
80-254, 1980-38 I.R.B. **15**

72-372
Revoked by
80-175, 1980-27 I.R.B. **18**

Rev. Ruls.—Continued

73-306
Distinguished by
80-206, 1980-31 I.R.B. **11**

74-577
Obsoleted by
80-256, 1980-38 I.R.B. **16**

75-403
Revoked by
80-251, 1980-37 I.R.B. **5**

76-508
Amplified by
80-231, 1980-34 I.R.B. **14**

77-395
Modified and clarified by
80-176, 1980-27 I.R.B. **10**

78-201
Amplified by
80-246, 1980-37 I.R.B. **7**
80-247, 1980-37 I.R.B. **9**

78-260
Distinguished by
80-227, 1980-34 I.R.B. **6**

79-189
Superseded by
80-179, 1980-27 I.R.B. **20**

79-320
Clarified by
80-227, 1980-34 I.R.B. **6**

79-394
Amplified by
80-181, 1980-28 I.R.B. **14**

80-28
Distinguished by
80-264, 1980-40 I.R.B. **18**

80-62
Modified by
80-203, 1980-29 I.R.B. **6**

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27, dated July 7, 1980.

INTERNAL REVENUE CUMULATIVE BULLETINS

______	1927–1	$6.90
______	*1927–2*	*2.95*
______	1928–1	6.95
______	1928–2	9.50
______	1929–1	12.00
______	*1929–2*	*3.15*
______	1930–1	7.30
______	1930–2	9.50
______	*1931–1*	*3.60*
______	1931–2	13.00
______	*1932–1*	*2.80*
______	1932–2	8.65
______	*1933–1*	*3.35*
______	*1933–2*	*3.45*
______	*1934–1*	*3.70*
______	1934–2	14.00
______	1935–1	6.90
______	*1935–2*	*14.00*
______	*1936–1*	*3.55*
______	*1936–2*	*14.00*
______	*1937–1*	*13.00*
______	1937–2	7.70
______	*1938–1*	*16.00*
______	*1938–2*	*13.00*
______	1939–1–1	8.25
______	1939–1–2	10.90
______	1939–2	9.40
______	1940–1	5.55
______	1940–2	14.00
______	1941–1	*$6.95*
______	*1941–2*	*3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
______	*1944*(*)	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*12.00*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$16.00
______	1957–2	13.00
______	1958–1	9.60
______	1958–2	13.00
______	1958–3	15.00
______	1959–1	15.00
______	1959–2	9.60
______	1960–1	19.00
______	1960–2	11.50
______	1961–1	14.00
______	1961–2	10.00
______	1962–1	14.00
______	1962–2	13.00
______	1962–3	20.00
______	1963–1	9.00
______	1963–2	10.75
______	1964–1–1	10.00
______	1964–1–2	11.00
______	1964–2	9.80
______	1965–1	10.70
______	1965–2	12.25
______	1966–1	14.00
______	1966–2	14.05
______	1967–1	10.00
______	1967–2	14.00
______	1968–1	14.00
______	1968–2	11.75
______	1969–1	14.00
______	1969–2	6.50
______	1969–3	$12.50
______	1970–1	11.00
______	1970–2	14.00
______	1971–1	10.55
______	1971–2	8.50
______	1972–1	13.50
______	1972–2	13.70
______	1973–1	16.00
______	1973–2	8.30
______	1974–1	11.00
______	1974–2	9.95
______	*1974–3*	*8.20*
______	1974–3 Supp.	10.00
______	1975–1	13.25
______	1975–2	13.00
______	1976–1	11.00
______	1976–2	10.25
______	1976–3–1	9.50
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October 27, 1980
Bulletin No. 1980-43

Internal Revenue
bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENT

Announcement 80-141, page 25.
A public hearing will be held on November 12, 1980, concerning proposed regulations relating to the requirement that the plan administrator of a defined benefit plan periodically file an actuarial report for the plan.

INCOME TAX

Rev. Rul. 80-283, page 7.
Stock redeemed for property; liabilities in excess of basis. Computation of gain to be recognized under section 311(c) of the Code on a corporation's distribution of property with respect to its stock is made on an individual, asset-by-asset basis rather than on an aggregate basis. This application is illustrated by various situations in which such distributions are made in complete termination of a shareholder's interest in the corporation.

Rev. Rul. 80-284, page 8.
Transfer to controlled corporation; continuity of interest. Section 351(a) of the Code does not apply to an individual's exchange of the 14 percent of the stock of a corporation owned by the individual for the preferred stock of a newly formed subsidiary of another corporation as part of a plan for the subsidiary's parent to acquire all the stock of the first corporation.

Rev. Rul. 80-285, page 9.
Transfer to controlled corporation; continuity of interest. Section 351(a) of the Code does not apply to a corporation's transfer of all its assets to a newly organized corporation for securities and all the voting preferred stock of the new corporation as part of a plan of the new corporation's parent to acquire all the assets of the first corporation.

Rev. Rul. 80-288, page 14.
Foreign tax credit limitation; allocation of expenses to income source. A domestic corporation that operates domestic oil refineries and an unrelated worldwide wholesale business purchases and refines its own crude oil and sells the refined oil products in the U.S. and abroad. For purposes of computing the foreign tax credit limitation, expenses incurred in preparing certain refinery reports required by federal law must be allocated to a class of income that consists of both U.S. and foreign source income from the sale of the refined oil products. If the corporation does not sell refined oil outside the U.S., the expenses would be allocable to a class of income that consists solely of U.S. source income from the sale of the corporation's refined oil products.

Rev. Rul. 80-286, page 11.
Charitable contribution; foreign exchange program. Fees paid by a family participating in a foreign exchange program equal to the cost of travel and insurance and the expenses incurred on behalf of the foreign child while living in the U.S. family's household are not charitable con-

(Continued on page 4)

Finding Lists begin on page 31.
Announcement Relating to Decisions of the Tax Court on page 6.
Announcement of Disbarment and Voluntary Suspensions on page 28.
Announcement of Notice of Proposed Rulemaking on page 29.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

tributions under section 170 of the Code. However, contributions from a participating family that exceed the fair market value of services received from the program are deductible.

T.D. 7719, page 18.
Amendments to the regulations under section 6073 of the Code relate to the time for filing estimated income tax by farmers, fishermen, and certain nonresident aliens.

Announcement 80-138, page 25.
The 1980 cost-of-living differential tables, used to calculate certain deductions for U.S. taxpayers living and working abroad, and a list of hardship areas for January 1 through August 31, 1980, used to determine whether income earned in a hardship area camp is eligible for exclusion or to figure the hardship area deduction, have been issued.

EXEMPT ORGANIZATIONS

Rev. Rul. 80-286, page 11.
Foreign exchange program. An otherwise qualifying organization that was formed to foster the cultural and educational development of children by arranging for and participating in the temporary exchange of children between families of a foreign country and the U.S. qualifies for exemption under section 501(c)(3) of the Code. Rev. Rul. 67-327 distinguished.

Rev. Rul. 80-287, page 12.
Lawyer referral service. A nonprofit lawyer referral service arranges at the request of any member of the public an initial half-hour appointment for a nominal charge with a lawyer whose name is on an approved list maintained by the organization. Any further contact between the lawyer and the client is arranged without the involvement of the organization. The referral service is not exempt under section 501(c)(3) of the Code, but is exempt as a business league under section 501 (c)(6). Rev. Ruls. 61-170 and 74-308 distinguished.

Rev. Proc. 80-44, page 22.
Information returns; organizations not required to file. A current list is provided of those categories of exempt organizations that are not required to file Form 990.

T.D. 7718, page 17.
Amendments to the regulations under section 4942 of the Code relate to the treatment of private foundations that maintain certain residential facilities for the care or education of disabled persons, elderly persons, needy widows, or children. Further, the regulations under section 6050 relating to the filing of Form 4629, Transfer of Property to an Exempt Organization, are deleted.

ESTATE TAX

Rev. Rul. 80-289, page 16.
Transfer within 3 years of death; life insurance; time of transfer. An employee who was insured under a group term life insurance policy, the premiums for which were paid by the employer, assigned all rights under the policy to the insured's spouse in 1971 under an agreement assigning the spouse the rights under any arrangement of the employer for life insurance coverage. The employer terminated its insurance arrangement and obtained a similar arrangement with a different insurer in 1977, less than three years before the insured's death, and the insured assigned the new policy to the spouse. The value of the policy proceeds is not includible in the insured's gross estate. Rev. Rul. 79-231 revoked.

Rev. Rul. 80-291, page 20.
Interest on deficiency; deduction subsequently allowed. A charitable deduction claimed on an estate tax return was disallowed because the deduction did not satisfy the requirements of section 2055(e) of the Code, but was subsequently allowed when the gift was made to qualify. Interest is due on the deficiency from the due date of the return to the end of a 180-day period following the filing of a claim for credit or refund.

EXCISE TAXES

Rev. Rul. 80-290, page 16.
Manufacturers; spring leaves; assembly, replacement, or renovation. Examples illustrate the manufacturers excise tax liability of a company in the business of repairing and replacing automotive springs on customer-owned highway trucks.

Announcement 80-136, page 24.
The excise tax on fuel used in commercial trans-

(Continued on page 5)

Highlights of this Issue—Continued

(Continued from page 4)

EXCISE TAXES—Cont'd

poration on inland or intracoastal waterways, as enacted by the Inland Waterways Revenue Act of 1978, is effective for fuel used after September 30, 1980. A list of inland and intracoastal waterways is provided.

ADMINISTRATIVE

Del. Order 114 (Rev. 2), page 22.
Tax treaties; "competent or taxation authority." The Assistant Commissioner (Compliance) may redelegate to a level no lower than Division Director the authority to administer the operating provisions of tax treaties of the U.S.; Del. Order 114 (Rev. 1) superseded.

E.O. 12238, page 22.
International Maritime Satellite Organization. The International Maritime Satellite Organization is designated as a public international organization entitled to the privileges, exemptions, and immunities provided by the International Organizations Immunities Act.

Announcement Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issue or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the tax court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Dobin, Darryl R., et ux [1]	12701-78	73	1121
Gentile, Alfred A., et ux [2]	509-74	65	1

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[1] Acquiescence relating to whether the petitioners' occupancy of a new principal residence before the March 12, 1975 cut-off date disqualifies the purchase from the section 44 credit.

[2] Acquiescence relating to whether petitioner's gambling activity constituted the carrying on of a trade or business.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 170.—Charitable, Etc., Contributions and Gifts

26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance of deduction.

Whether and to what extent payments to an organization that operates an exchange program for children of the United States and a foreign country qualify as charitable contributions. See Rev. Rul. 80-286, page 11.

Section 302.—Distributions in Redemption of Stock

26 CFR 1.302-4: Termination of shareholder's interest.

Whether *Y*'s distribution of *Z* securities to its public shareholders in exchange for all of their *Y* stock qualifies as a complete termination under section 302(b)(3) of the Code. See Rev. Rul. 80-285, page 9.

Section 311.—Taxability of Corporation on Distribution

26 CFR 1.311-1: General.

Stock redeemed for property; liabilities in excess of basis. Computation of gain to be recognized under section 311(c) of the Code on a corporation's distribution of property with respect to its stock is made on an individual, asset-by-asset basis rather than on an aggregate basis. This application is illustrated by various situations in which such distributions are made in complete termination of a shareholder's interest in the corporation.

Rev. Rul. 80-283

ISSUE

Does section 311(c) of the Internal Revenue Code apply to distributed assets individually or in the aggregate in the situations described below?

FACTS

Situation 1:

Individuals *A* and *B* owned equally all the outstanding stock of *X* corporation. In a redemption qualifying under section 302(b)(3) of the Code, *A*'s interest in *X* was completely terminated. As consideration for the surrender of stock, *X* distributed to *A* two items of property: property I having an adjusted basis of 200*x* dollars and a fair market value of 400*x* dollars and property II having an adjusted basis of 300*x* dollars and a fair market value of 600*x* dollars. A mortgage encumbering property I to the extent of 250*x* dollars was assumed by *A* in connection with the distribution. In light of the complete termination exception of section 311(d)(2)(A), section 311(d)(1), relating to redemptions using appreciated property, has no application here.

Situation 2:

The facts are identical to those in *Situation 1* except that the assumed liability of 250*x* dollars does not specifically encumber either of the distributed assets.

Situation 3:

The facts are identical to those in *Situation 1* except that *A* assumes, in addition to the 250*x* dollar mortgage encumbering property I, an additional liability of 250*x* dollars that does not specifically encumber either of the distributed assets.

LAW AND ANALYSIS

Section 1.311-1(d) of the Income Tax Regulations provides, in part, that if the distributed property subject to a liability is not a capital asset in the hands of the distributing corporation, the gain is taxable as gain from the sale of a noncapital asset. Because characterization of the recognized gain is thus to be done on an asset by asset basis, it is reasonable to infer that Congress intended computation of such gain to be done on that basis as well.

A similar inference can be drawn from section 357(c). That provision, like section 311(c), became law as part of the Internal Revenue Code of 1954. Furthermore, section 357(c) also provides for gain recognition when liabilities associated with transferred property exceed the basis of that property. Unlike section 311(c), however, section 357(c) confronts and resolves the question of individual or aggregate by specifying that

> [i]f the *sum* of the amount of the liabilities assumed, plus the amount of the liabilities to which the property is subject, exceeds the *total* of the adjusted basis of the property transferred . . ., then the excess shall be considered as a gain . . . (Emphasis added.)

See Treas. Reg. § 1.357-2(a). Consequently, given the simultaneous enactment and similar mechanics of the two sections, it can be inferred that Congress, in omitting such language from section 311(c), was manifesting its intention that the contrary or asset by asset approach be used.

Accordingly, the computation of gain under section 311(c) should be done on an asset by asset basis. Furthermore, so that this approach may be consistently applied, liabilities assumed in connection with section 311(c) distributions but not related to any of the distributed property should be allocated among all such property according to relative fair market value. *Compare* Rev. Rul. 55-79, 1955-1 C.B. 370.

HOLDINGS

Situation 1:

X has a recognizable gain of 50*x* dollars under section 311(c). This represents the excess of the 250*x* dollar mortgage assumed by *A* over the 200*x* dollar adjusted basis of property I in the hands of *X*.

Situation 2:

X has no recognizable gain under section 311(c). Since 400*x* dollars, or 40 percent of the total fair market value of 1,000*x* dollars, is attributable to property I, 40 percent of the unrelated liability of 250*x* dollars, or 100*x* dollars, is allocable to that property and 60 percent, or 150*x* dollars, to property II. Therefore, with respect to both properties, adjusted basis exceeds the allocated liability and no gain results.

Situation 3:

X has a recognizable gain of 150*x* dollars under section 311(c). The liability allocation under *Situation 2* is combined with the specific encumbrance of *Situation 1* to give property

I a total computation liability of 350*x* dollars (100*x* dollars plus 250*x* dollars). The distribution thus results in a 150*x* gain to *X* (350*x* dollars liability less 200*x* dollars adjusted basis) with respect to property I and no gain to *X* (300*x* dollars adjusted basis less 150*x* dollars liabiilty) with respect to property II.

Section 351.—Transfer to Corporation Controlled by Transferor

26 CFR 1.351-1: Transfer of corporation controlled by transferor.

Transfer to controlled corporation; continuity of interest. Section 351(a) of the Code does not apply to an individual's exchange of the 14 percent of the stock of a corporation owned by the individual for the preferred stock of a newly formed subsidiary of another corporation as part of a plan for the subsidiary's parent to acquire all the stock of the first corporation.

Rev. Rul. 80-284

ISSUE

Will nonrecognition treatment under section 351(a) of the Internal Revenue Code be accorded to a transfer of 14 percent of the stock of a corporation (*T*) to another corporation (*S*) in exchange for *S* stock as part of a plan whereby *S* acquires the remaining 86 percent of the *T* stock for cash?

FACTS

T, a manufacturing corporation, had outstanding 1,000*x* shares of capital stock. The fair market value of *T* was 100,000*x* dollars, and the fair market value of each share of its outstanding stock was 100*x* dollars. *T*'s president and chairman of the board, *A*, owned 140*x* shares of its capital stock (14 percent). The remaining 860*x* shares of *T*'s capital stock (86 percent) were publicly held. *P*, a large publicly traded corporation unrelated to *T*, wished to purchase the stock of *T* and thereafter to have *T*'s business continued by a wholly owned subsidiary. While the other shareholders of *T* were willing to accept cash for their *T* stock, *A*, who was of an advanced age and who had a very low basis in his 140*x* shares, was unwilling to sell the *T* stock for cash because the sale would result in recognition of taxable gain.

In order to accommodate *A*'s wish to avoid recognition of gain, *P* and *A* agreed in January, 1980, to organize a new corporation, *S*, for the purpose of acquiring and holding all of the stock of *T*. Several months later, pursuant to the agreement, *P* transferred 86,000*x* dollars in cash together with other property to *S* solely in exchange for all of *S*'s common stock, and *A* transferred his 140*x* shares of *T* stock to *S* solely in exchange for all of *S*'s preferred stock. It was intended that this transaction would be a tax-free exchange under section 351(a) of the Code. Thereafter, and as part of the overall plan, *S* organized a new corporation, *D*, by transferring the 86,000*x* dollars in cash to *D* solely in exchange for all of *D*'s stock. *D* was then merged into *T* under applicable state law, and pursuant thereto each share of *T* stock, except those shares transferred by *A* to *S*, was surrendered in exchange for 100*x* dollars in cash. The *T* stock acquired by *D* for cash was cancelled and, pursuant to state law, each share of *D* stock was converted into stock of *T*. Although *S* could theoretically have acquired the remaining 86 percent of the *T* stock directly from the *T* shareholders for cash, the acquisition was made pursuant to the state merger laws because this method was more expeditious and convenient. *T* remains in existence as an operating company, and *S* remains in existence as a holding company.

LAW AND ANALYSIS

Section 351(a) of the Code provides that no gain or loss is recognized if persons who control a corporation transfer property to the corporation solely in exchange for stock or securities. Section 351(a) is an exception to the general rule that gain or loss must be recognized on any sale or exchange of property. See section 1.1002-1(b) of the Income Tax Regulations, which states that exceptions to the general rule (including section 351(a)) "are strictly construed and do not extend either beyond the words or the underlying assumptions and purposes of the exception. Nonrecognition is accorded by the Code only if the exchange is one which satisfies both (1) the specific description in the Code of an excepted exchange, and (2) the underlying purpose for which such exchange is excepted from the general rule."

Thus, while *A*'s exchange of common stock for preferred stock may satisfy all of the literal requirements of section 351 of the Code, it does not follow that Congress meant to cover such an exchange, even though "the facts answer the dictionary definition of each term used in the statute." See *Helvering v. Gregory*, 69 F.2d 809, 810 (2nd Cir. 1934) (Hand, J.), *aff'd*, 293 U.S. 465 (1935), Ct. D. 911, XIV-1 C.B. 193 (1935).

Section 351(a) of the Code is intended to apply to "certain transactions where gain or loss may have accrued in a constitutional sense, but where in a popular and economic sense there has been a mere change in the form of ownership and the taxpayer has not really 'cashed in' on the theoretical gain, or closed out a losing venture." *Portland Oil Co. v. Commissioner*, 109 F.2d 479, 488 (1st Cir. 1940), *cert. denied*, 310 U.S. 650 (1940). See also Rev. Rul. 73-472, 1973-2 C.B. 114. On the other hand, section 351(a) is not intended to apply to transactions that sufficiently resemble a sale so that gain is recognized in a popular and economic sense. Thus, the issue presented is whether, in terms of economic substance, there has been a mere change in the form of investment or a cashing in of that investment.

A's exchange of common stock for preferred stock is an integral part of a larger transaction. In the larger transaction, *P*, acting through its subsidiary *S*, acquires all the stock of an unrelated third corporation *T*. Thus, viewed from the perspective of all the parties, the larger transaction fits a pattern common to acquisitive reorganizations. Contrast Rev. Rul. 57-190, 1957-1 C.B. 121, and Rev. Rul. 57-464, 1957-2 C.B. 244 (which describe transfers to a controlled corporation as part of a larger transaction that fits a pattern common to divisive reorganizations).

A well-established continuity of interest test applies to acquisitive reorganizations. See section 1.368-1(b) of the Regulations and Rev. Rul. 66-224, 1966-2 C.B. 114. The object of the continuity of interest test is to identify acquisitive transactions that sufficiently resemble a sale so gain is recognized in the ordinary business sense. See *Roebling v. Commissioner,* 143 F.2d 810, 812 (3rd Cir. 1944), *cert. denied,* 323 U.S. 773 (1944).

Under the continuity of interest test, a substantial portion of the consideration paid must consist of stock in the acquiring corporation. See *Southwest Natural Gas Co. v. Commissioner,* 189 F.2d 332, 334 (5th Cir. 1951), *cert. denied,* 342 U.S. 860 (1951). If an acquisitive transaction fails the continuity of interest test, then the transaction as a whole sufficiently resembles a sale so all the parties recognize gain in the ordinary business sense.

The larger acquisitive transaction in which *S* obtains the stock of *T* fails the continuity of interest test. It follows that the transaction as a whole sufficiently resembles a sale so all the parties (including *A*) recognize gain in the ordinary business sense. Because section 351 of the Code is not intended to apply where gain is recognized in the ordinary business sense, *A*'s exchange is not within the "underlying assumptions and purposes" of section 351. See section 1.1002-1(b) of the regulations.

No other conclusion would be consistent with the history and purpose of continuity of interest. In a series of decided cases, the courts have denied nonrecognition treatment to acquisitive transactions that lacked continuity of interest. See, *e.g.,* in addition to the cases cited above, *LeTulle v. Scofield,* 308 U.S. 415 (1940), Ct. D. 1432, 1940-1 C.B. 151, *Pinellas Ice & Cold Storage Co. v. Commissioner,* 287 U.S. 462 (1933), Ct. D. 630, XII-1 C.B. 161 (1933), and *Cortland Speciality Co. v. Commissioner,* 60 F.2d 937 (2d Cir. 1932), *cert. denied,* 288 U.S. 599 (1933). The defect in each case was entirely one of substance; the transaction at issue satisfied all of the technical requirements for nonrecognition under the satutory provisions that were directly relevant. A defect of this kind cannot be remedied by means that are essentially formal. In particular it cannot be remedied merely by rearranging the form of an acquisitive transaction so that the technical requirements of section 351 of the Code are satisfied, but without altering the substance of the transaction.

In this ruling, the facts reveal an acquisitive transaction which does not meet the continuity of interest test and thus is equivalent to a sale. Accordingly, although the technical requirements of section 351(a) of the Code are satisfied, the transaction is beyond the underlying assumptions and purposes of section 351(a). Therefore, its substance as a sale remains the same, and the transaction will be treated as a taxable exchange. Compare Rev. Rul. 80-285, this page, this Bulletin, which reaches the same result when assets, instead of stock, are acquired under similar circumstances.

HOLDING

A's exchange of capital stock in *T* for preferred stock in *S* does not qualify for nonrecognition treatment under section 351(a) of the Code, and gain is therefore recognized on the exchange.

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26 CFR 1.351-1: Transfer to corporation controlled by transferor.
(Also Section 302; 1.302-4.)

Transfer to controlled corporation; continuity of interest. Section 351(a) of the Code does not apply to a corporation's transfer of all its assets to a newly organized corporation for securities and all the voting preferred stock of the new corporation as part of a plan of the new corporation's parent to acquire all the assets of the first corporation.

Rev. Rul. 80-285

ISSUE

Will nonrecognition treatment under section 351(a) of the Internal Revenue Code be accorded to a transfer of all of the assets of a corporation (*Y*) to another corporation (*Z*) in exchange for *Z* stock and *Z* securities, where, as part of the plan, *Y* redeems 81 percent of its stock for the *Z* securities?

FACTS

Y, a manufacturing corporation, had outstanding 1,000*x* shares of capital stock. The fair market value of *Y* was 100,000*x* dollars, and the fair market value of each share of its outstanding stock was 100*x* dollars. *Y*'s president and chairman of the board, *A*, owned 190*x* shares of its capital stock (19 percent). The remaining 810*x* shares of *Y*'s capital stock (81 percent) were publicly held. *X*, a large publicly traded corporation unrelated to *Y*, wished to purchase all of the assets of *Y* and thereafter to have *Y*'s business continued by a wholly owned subsidiary. While the other shareholders of *Y* were willing to accept cash or securities for their *Y* stock, *A*, who was of an advanced age and who had a very low basis in his 190*x* shares, was unwilling to sell the *Y* stock for cash or securities because the sale would result in recognition of taxable gain. The public shareholders of *Y* are unrelated to *A*, within the meaning of section 318 of the Code.

In order to accommodate *A*'s wish to avoid recognition of gain, *X* and the *Y* shareholders agreed in January, 1980, to have *X* and *Y* organize a new corporation, *Z*, for the purpose of acquiring and holding all of the assets of *Y*. Several months later, pursuant to the agreement, *X* transferred 81,000*x* dollars in cash together with other property to *Z* solely in exchange for all of *Z*'s common stock, and *Y* transferred all of its assets to *Z* solely in exchange for all of *Z*'s voting preferred stock and *Z* securities. It was intended that this transaction would qualify as an exchange under section 351 of the Code. Thereafter, and as part of the overall plan, *Y* redeemed all of its stock (81 percent) held by its public shareholders for the *Z* securities. All transfers and exchanges were at fair market value. The value of the property and cash transferred by *X* to *Z* was over 80 times the value of the property transferred by *Y* to *Z*. Therefore, the *Z* common stock received by *X* in the exchange comprised over 80 percent of the total combined voting power of all classes of *Z* stock entitled to vote. *Z* remains in existence as an operating company, and *Y* remains in existence as a wholly owned holding company of *A*. After all of the exchanges occurred, *Z* owned all of the assets of *Y*, *X* owned all of the *Z* common stock, *Y* owned all of the *Z* voting preferred stock, *A* owned all of the *Y* stock, and the *Y* public shareholders received all of the *Z* securities in exchange for their *Y* stock.

LAW AND ANALYSIS

Section 351(a) of the Code provides that no gain or loss is recognized if persons who control (within the meaning of section 368(c)) a corporation transfer property to the corporation solely in exchange for stock or securities. Section 351(a) is an exception to the general rule that gain or loss must be recognized on any sale or exchange of property. See section 1.1002-1(b) of the Income Tax Regulations, which states that exceptions to the general rule (including section 351(a)) "are strictly construed and do not extend either beyond the words or the underlying assumptions and purposes of the exception. Nonrecognition is accorded by the Code only if the exchange is one which satisfies both (1) the specific description in the Code of an excepted exchange, and (2) the underlying purpose for which such exchange is excepted from the general rule."

Thus, while *Y*'s exchange of assets for voting preferred stock and *Z* securities may satisfy all of the literal requirements of section 351 of the Code, it does not follow that Congress meant to cover such an exchange, even though "the facts answer the dictionary definition of each term used in the statute." See *Helvering v. Gregory,* 69 F.2d 809, 810 (2nd Cir. 1934) (Hand, J.), *aff'd,* 293 U.S. 465 (1935), Ct. D. 911, XIV-1 C.B. 193 (1935).

Section 351(a) of the Code is intended to apply to "certain transactions where gain or loss may have accrued in a constitutional sense, but where in a popular and economic sense there has been a mere change in the form of ownership and the taxpayer has not really 'cashed in' on the theoretical gain, or closed out a losing venture." *Portland Oil Co. v. Commissioner,* 109 F.2d 479, 488 (1st Cir. 1940), *cert. denied,* 310 U.S. 650 (1940). See also Rev. Rul. 73-472, 1973-2 C.B. 114. On the other hand, section 351(a) is not intended to apply to transactions that sufficiently resemble a sale so that gain is recognized in a popular and economic sense. Thus, the issue presented is whether, in terms of economic substance, there has been a mere change in the form of investment or a cashing in of that investment.

Y's transfer of assets for voting preferred stock and *Z* securities is an integral part of a larger transaction. In the larger transaction, *X*, acting through its subsidiary, *Z*, acquires all the assets of an unrelated third corporation, *Y*. Thus, viewed from the perspective of all the parties, the larger transaction fits a pattern common to acquisitive reorganizations. Contrast Rev. Rul. 57-190, 1957-1 C.B. 121, and Rev. Rul. 57-464, 1957-2 C.B. 244 (which describe transfers to a controlled corporation as part of a larger transaction that fits a pattern common to divisive reorganizations).

A well-established continuity of interest test applies to acquisitive reorganizations. See section 1.368-1(b) of the regulations and Rev. Rul. 66-224, 1966-2 C.B. 114. The object of the continuity of interest test is to identify acquisitive transactions that sufficiently resemble a sale so gain is recognized in the ordinary business sense. See *Roebling v. Commissioner,* 143 F.2d 810, 812 (3rd Cir. 1944), *cert. denied,* 323 U.S. 773 (1944).

Under the continuity of interest test, a substantial portion of the consideration paid must consist of stock in the acquiring corporation. See *Southwest Natural Gas Co. v. Commissioner,* 189 F.2d 332, 334 (5th Cir. 1951), *cert. denied,* 342 U.S. 860 (1951). If an acquisitive transaction fails the continuity of interest test, then the transaction as a whole sufficiently resembles a sale so all the parties recognize gain in the ordinary business sense.

The larger acquisitive transaction in which *Z* obtains all of the assets of *Y*, and the public shareholders receive *Z* securities for their 81 percent interest in *Y*, fails the continuity of interest test. It follows that the transaction as a whole sufficiently resembles a sale so all of the exchanging parties (including *Y*) recognize gain in the ordinary business sense. Because section 351 of the Code is not intended to apply where gain is recognized in the ordinary business sense, *Y*'s exchange is not within the "underlying assumptions and purposes" of section 351. See section 1.1002-1(b) of the regulations.

No other conclusion would be consistent with the history and purpose of continuity of interest. In a series of decided cases, the courts have denied nonrecognition treatment to acquisitive transactions that lacked continuity of interest. See, *e.g.,* in addition to the cases cited above, *LeTulle v. Scofield,* 308 U.S. 415 (1940), Ct. D. 1432, 1940-1 C.B. 151, *Pinellas Ice & Cold Storage Co. v. Commissioner,* 287 U.S. 462 (1933), Ct. D. 630, XII-1 C.B. 161 (1933), and *Cortland Specialty Co. v. Commissioner,* 60 F.2d 937 (2nd Cir. 1932), *cert. denied,* 288 U.S. 599 (1933). The defect in each case was entirely one of substance; the transaction at issue satisfied all of the technical requirements for nonrecognition under the statutory provisions that were directly relevant. A defect of this kind cannot be remedied by means that are essentially formal. In particular it cannot be remedied merely by rearranging the form of an acquisitive transaction so that the technical requirements of section 351 of the Code are satisfied, but without altering the substance of the transaction.

In this ruling, the facts reveal an acquisitive transaction which does not meet the continuity of interest test and thus is equivalent to a sale. Accordingly, although the technical requirements of section 351(a) of the Code are satisfied, the transaction is beyond the underlying assumptions and purposes of section 351(a). Therefore, its substance as a sale remains the same, and the transaction will be treated as a taxable exchange. Compare Rev. Rul. 80-284, page 8, this Bulletin, which reaches the same result when stock, instead of assets, is acquired under similar circumstances.

Y redeemed its stock (within the meaning of section 317(b) of the Code) held by its public shareholders for *Z* securities at fair market value. Since each such shareholder's interest in *Y* was completely terminated, each exchange qualifies as a redemption within the meaning of section 302(b)(3). Therefore, section 302(a) applies to the gain realized on the exchange by each public shareholder. See Rev. Rul. 79-273, 1979-2 C.B. 125, for a similar result where a redemption and statutory merger are used to acquire stock.

HOLDING

Y's exchange of all of its assets for *Z* voting preferred stock and *Z* securities does not qualify for nonrecognition treatment under section 351(a) of the Code, and gain is therefore recognized on the exchange. *X*'s exchange of cash and property for *Z* common stock qualifies for nonrecognition of gain or loss under section 351(a), since *X* controls over 80 percent of the total combined voting power of all classes of stock of *Z* entitled to vote, and at least 80 percent of the total number of shares of all other classes of *Z* stock (since there were none), immediately after the transfer. See Rev. Rul. 68-43, 1968-1 C.B. 146.

Section 501.—Exemption from Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals. (Also Section 170; 1.170A-1.)

Foreign exchange program. An otherwise qualifying organization that was formed to foster the cultural and educational development of children by arranging for and participating in the temporary exchange of children between families of a foreign country and the U.S. qualifies for exemption under section 501(c)(3) of the Code. Fees paid by the participating families equal to the cost of travel and insurance and the expenses incurred on behalf of the foreign child while living in the U.S. family's household are not charitable contributions under section 170. However, contributions from a participating family that exceed the fair market value of services received from the program are deductible. Rev. Rul. 67-327 distinguished.

Rev. Rul. 80-286

ISSUE

Does an organization that operates an exchange program for children of the United States and a foreign country, under the circumstances described below, qualify for exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code?

FACTS

The organization, which otherwise qualifies for exemption under section 501(c)(3) of the Code, was formed in the United States to encourage and foster cultural and educational development of children by arranging for and participating in the exchange of children, on a temporary basis, between responsible families of a particular foreign country and the United States. To accomplish this purpose, the organization arranges for an American family to exchange one of its children for a child from a family that resides in the foreign country. The organization solicits applications from interested families in both countries, selects and matches qualified families, arranges for transportation to and from the respective countries, and provides a bilingual escort to travel with the children between countries. The organization interviews all applicants and selects those families for the program that can provide stable home environments and suitable cultural experiences for the children.

Families participating in the organization's exchange program are required to pay a fee equal to the cost of travel and the cost of health, accident, and baggage insurance. The organization also receives income from grants and contributions.

LAW AND ANALYSIS

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable and educational purposes.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense. Such term includes the advancement of education.

Rev. Rul. 65-191, 1965-2 C.B. 157, considers a nonprofit organization organized for the purposes of extending hospitality to foreign visitors and students, promoting cultural and educational programs, and providing an environment for social contact between American citizens and foreign visitors and students, which maintains and operates a hospitality or community center. Rev. Rul. 65-191 holds that the provision of a community center for the mingling of foreign students and visitors with one another and with American citizens is charitable within the meaning of section 501(c)(3) of the Code.

Rev. Rul. 68-165, 1968-1 C.B. 253, holds that a domestic nonprofit corporation that joins with a counterpart group in a country in Latin America to promote student and cultural exchanges and to provide technical and material assistance for self-help projects designed to improve living conditions of underprivileged people in Latin America qualifies for exemption under section 501(c)(3) of the Code. Specifically, Rev. Rul. 68-165 holds that promoting student and cultural exchanges helps improve the capabilities of the individual and, thus, is educational.

Like the organizations in Rev. Rul. 65-191 and Rev. Rul. 68-165, the organization in this case is facilitating student and cultural exchanges and, thus, is engaging in a charitable activity. Also, by promoting the exchange of children between families in the United States and families in a foreign country, which allows the children to undergo an educational experience through participation in the everyday activities of families in a foreign country, the organization is promoting education. See Rev. Rul. 69-400, 1969-2 C.B. 114.

The organization in this case is distinguishable from the one described in Rev. Rul. 67-327, 1967-2 C.B. 187, wherein an organization whose sole purpose and activity was to arrange group tours for students and faculty members of a university was held to be not exempt under section 501(c)(3) of the Code.

HOLDING

An organization that operates an exchange program for children of the United States and a foreign country, under the circumstances described above, is operated exclusively for charitable and educational purposes and thus qualifies for exemption from federal income tax under section 501(c)(3) of the Code.

APPLICATION INSTRUCTIONS

Even though an organization considers itself within the scope of this revenue ruling, it must file an application on Form 1023, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. See sections 1.501(a)-1 and 1.508-1(a) of the regulations. In accordance with the instructions to Form 1023, the application should be filed with the District Director of Internal Revenue for the key district indicated therein.

DEDUCTIBILITY OF CHARITABLE CONTRIBUTIONS

Section 170(a) of the Code provides that there shall be allowed as a deduction, subject to certain limitations, any charitable contribution, as defined in section 170(c), payment of which is made within the taxable year. Section 170(c)(2)(B) defines a charitable contribution to include a contribution or gift to or for the use of a corporation organized and operated exclusively for educational purposes.

Although the term "contribution" is not defined either in the Code or in the Income Tax Regulations, it is well established judicially that in order to be deductible under section 170 of the Code, a contribution must qualify as a gift in the common law sense of being a voluntary transfer of property without consideration. To the extent a transferor receives or can expect to receive, for the money or property he or she transfers, a financial or economic benefit, as distinguished from the incidental benefit that inures to a donor as a member of the general public, then no deduction under section 170 is allowable. *Singer v. United States*, 449 F. 2d 413 (Ct. Cl. 1971); Rev. Rul. 67-246, 1967-2 C.B. 104; Rev. Rul. 76-185, 1976-1 C.B. 60.

Accordingly, the fees paid by families participating in the exchange program are not deductible as charitable contributions under section 170 of the Code. Further, the expenses incurred by a participating United States family contributing to the support, maintenance and cultural enrichment of the foreign child while the child is a member of the United States family's household for the exchange duration are not deductible as charitable contributions under section 170.

However, contributions from members of the general public, as well as contributions from a family that exceed the fair market value of services received from the family's participation in the exchange program, will be deductible under section 170 of the Code in the manner and to the extent provided therein.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 67-327 is distinguished.

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26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary or educational purposes, or for the prevention of cruelty to children or animals.

Whether a nonprofit lawyer referral service qualifies for exemption from federal income tax under section 501(c)(3) of the Code. See Rev. Rul. 80-287, below.

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26 CFR 1.501(c)(6)-1: Business leagues, chambers of commerce, real estate boards, and boards of trade.
(Also Section 501; 1.501(c)(3)-1.)

Lawyer referral service. A nonprofit lawyer referral service arranges at the request of any member of the public an initial half-hour appointment for a nominal charge with a lawyer whose name is on an approved list maintained by the organization. Any further contact between the lawyer and the client is arranged without the involvement of the organization. The referral service is not exempt under section 501(c)(3) of the Code, but is exempt as a business league under section 501(c)(6). Rev. Ruls. 61-170 and 74-308 distinguished.

Rev. Rul. 80-287

ISSUE

Does a nonprofit lawyer referral service qualify for exemption from federal income tax under either section 501(c)(3) or section 501(c)(6) of the Internal Revenue Code?

FACTS

The organization is a nonprofit corporation created by several bar associations in a metropolitan area to provide a lawyer referral service. The lawyer referral service aids persons who do not have an attorney by helping them to select one. Any member of the public in need of an attorney may visit or call the organization. The individual's problem is screened in order to categorize the area of law involved. From a list of attorneys maintained by the organization, an attorney specializing in the appropriate area of law is selected from within the geographic area preferred by the client. The organization arranges an appointment for the individual with the attorney. This initial appointment is for a minimum of one-half hour and the individual is asked to pay a nominal fee substantially less than the normal fee charged for a half-hour appointment. The attorney subsequently remits this fee to the organization. Any additional services performed by the attorney after the initial appointment are governed by a normal lawyer-client contractual relationship with which the organization has no connection.

Any attorney who is a member of one of the local bar associations may apply to the organization to have his or her name placed on the organization's referral list. Attorneys must apply annually to be listed. Applicants are required to show how long they have been practicing law, whether they are or have been subject to disciplinary procedures, what their areas of legal competence are, and whether they are covered by malpractice insurance. They must agree to leave open a specified number of hours each month for referral clients. If an application is approved by the organization, the attorney pays a fee and is thereupon listed on the organization's attorneys' panel. About 20 percent of the members of the local bar associations appear on the organization's list each year.

In addition to the referral fee, the organization also imposes a nominal service charge of one dollar upon all those who make use of its services. Any operating deficits are defrayed by the local bar associations.

LAW AND ANALYSIS

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes.

Section 1.501(c)(3)-1(a) of the Income Tax Regulations states that to be tax exempt, an organization must be both organized and operated exclusively for one or more exempt purposes specified in section 501(c)(3) of the Code.

Section 1.501(c)(3)-1(d)(2) of the regulations states that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense. It includes relief of the poor and distressed or of the underprivileged, and promotion of social welfare by organizations designed to eliminate prejudice and discrimination or to defend human and civil rights secured by law.

Section 501(c)(6) of the Code provides for the exemption from federal income tax of business leagues not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(6)-1 of the regulations defines a business league as an association of persons having a common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. That regulation also states that a business league's activities should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.

Rev. Rul. 71-505, 1971-2 C.B. 232, holds that a city bar association is not exempt from federal income tax under section 501(c)(3) of the Code. The association conducted a number of activities primarily directed at the promotion and protection of the practice of law. These activities were found not to be in furtherance of charitable or educational purposes. That ruling relied in part on the principle, expressed in *Better Business Bureau of Washington, D.C., Inc. v. United States*, 326 U.S. 279 (1945), Ct. D. 1650, 1945 C.B. 375, that the presence of a single nonexempt purpose, if substantial in nature, will preclude exemption regardless of the number or importance of statutorily exempt purposes. The same result was reached in Rev. Rul. 71-504, 1971-2 C.B. 231, which involved a city medical society carrying on substantial activities directed at promotion of the medical profession.

It is a clearly established principle of the law of charity that a purpose is not charitable unless it is directed to the public benefit. Not every purpose which is beneficial to the community, however, is deemed charitable. As a general rule, providing services of an ordinary commercial nature in a community, even though the undertaking is conducted on a nonprofit basis, is not regarded as conferring a charitable benefit on the community unless the service directly accomplishes one of the established categories of charitable purposes.

In this case, the lawyer referral service does not directly accomplish any of the established categories of charitable purposes. The program is open to all members of the community and, thus, is not operated exclusively for the relief of the poor, distressed, or underprivileged. The organization's activities are directed toward assisting individuals in obtaining preventive or remedial legal services covering the gamut of everyday legal problems and, as such, are not specifically designed to eliminate prejudice or discrimination or to defend human and civil rights secured by law. Therefore, the lawyer referral service does not confer a charitable benefit on the community.

Although the lawyer referral service provides some public benefit, a substantial purpose of the program is promotion of the legal profession. This is a noncharitable purpose, and, in accordance with section 1.501(c)(3)-1(a) of the regulations and the *Better Business Bureau* case, it precludes exemption under section 501(c)(3) of the Code. Thus, the organization is not exempt from federal income tax under section 501(c)(3).

Operation of the lawyer referral service in the manner described does, however, promote the common business interest of the legal profession within the metropolitan area. The principal purpose of the program is to introduce individuals to the use of the legal profession in the hope that they will enter into lawyer-client relationships on a paying basis as a result of the experience. To achieve this purpose, individuals pay only a nominal fee, substantially below the normal rates for a half-hour appointment. The program encourages people unfamiliar with lawyers to form the habit of seeking professional help, provides middle income persons an opportunity to present their legal problems to a reputable attorney for a modest fixed fee, and combats the notion that only certain persons can afford legal assistance. Thus, the organization's activities are designed to improve conditions within the legal profession as a whole as distinguished from performing particular services for individuals within the meaning of section 1.501(c)(6)-1 of the regulations. Therefore, the organization qualifies for exemption from federal income tax under section 501(c)(6) of the Code.

Rev. Rul. 61-170, 1961-2 C.B. 112, and Rev. Rul. 74-308, 1974-2 C.B. 168, which hold that organizations referring persons to nurses and to tow truck operators, respectively, are not exempt under section 501(c)(6) of the Code are distinguishable. Unlike those organizations, which serve primarily to locate customers for their members, this organization provides more than a mere business referral service that is simply a convenience and economy to members of the legal profession. Rather, in the manner described above, this organization serves to improve the image and functioning of the legal profession as a whole.

HOLDING

The separately incorporated nonprofit lawyer referral service qualifies for exemption from federal income tax as a business league described in section 501(c)(6) of the Code. It does not, however, qualify for exemption as a charitable organization described in section 501(c)(3).

APPLICATION PROCEDURES

Even though an organization considers itself within the scope of this revenue ruling, it must file an application on Form 1024, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(6) of the Code. See section 1.501(a)-1 of the regulations. In accordance with the instruction to Form 1024, the application should be filed with the District Director of Internal Revenue for the key district indicated therein.

EFFECT ON PRIOR REVENUE RULINGS

Rev. Ruls. 61-170 and 74-308 are distinguished.

Section 861.—Income from Sources within the United States

26 CFR 1.861-8: Computation of taxable income from sources within the United States and from other sources and activities. (Also Sections 904, 907; 1.904-1.)

Foreign tax credit limitation; allocation of expenses to income source. A domestic corporation that operates domestic oil refineries and an unrelated worldwide wholesale business purchases and refines its own crude oil and sells the refined oil products in the U.S. and abroad. For purposes of computing the foreign tax credit limitation, expenses incurred in preparing certain refinery reports required by federal law must be allocated to a class of income that consists of both U.S. and foreign source income from the sale of the refined oil products. If the corporation does not sell refined oil outside the U.S., the expenses would be allocable to a class of income that consists solely of U.S. source income from the sale of the corporation's refined oil products.

Rev. Rul. 80-288

ISSUE

In computing the limitation under section 904(a) of the Internal Revenue Code in the situations described below, are expenses incurred by the taxpayer in preparing reports required by a federal agency allocable to a class of gross income consisting solely of gross income from sources within the United States under section 861(b) of the Code?

FACTS

Situation (1). Taxpayer is a domestic corporation that owns and operates domestic oil refineries and an unrelated worldwide, non-oil wholesale business. Taxpayer purchases and refines its own crude oil and then sells the refined oil products both in the United States and abroad. Taxpayer does not purchase or refine any crude oil within a United States possession.

For the current taxable year taxpayer has United States source gross income of $8,000x from the sale of its refined oil products in the United States, foreign source gross income of $2,000x from the sale of such products abroad, United States source gross income of $2,000x from its wholesale business, and foreign source gross income from the wholesale business of $1,200x.

In the process of refining crude oil, taxpayer's refineries discharge processed waste water and non-contact cooling water. Federal law requires taxpayer to file periodic reports with a government agency on the steps taken by taxpayer to control the amount of pollutants in these discharges. In preparing these reports taxpayer incurs technical expenses (biological, chemical, and engineering), general and administrative expenses, and supervisory expenses, in the amount of $50x. The amount of these expenses is not affected by whether taxpayer has any foreign source gross income. Taxpayer does not incur any legal or accounting expenses in preparing these reports. *See* section 1.861-8(e)(5) of the Income Tax Regulations for the allocation rules for legal and accounting expenses.

For purposes of computing its foreign tax credit limitation under section 904 of the Code, taxpayer allocates all of the $50x to its gross income from the sale of refined oil products within the United States.

Situation (2). The facts are the same as in Situation (1), except that taxpayer is not engaged in the business of selling refined oil products outside the United States and thus will not have any gross income from foreign sources currently from the sale of such products.

LAW AND ANALYSIS

Section 904(a) of the Code limits the amount of the foreign tax credit to the same proportion of United States income tax against which credit is taken that the taxpayer's taxable income from sources without the United States bears to its entire income for the same taxable year.

Section 907(b) of the Code provides that section 904 shall be applied separately with respect to foreign oil related income (FORI). FORI includes income derived from sales of refined oil products outside the United States or its possessions.

Section 861(b) of the Code states that there shall be deducted from certain specified items of gross income from sources within the United States the expenses properly apportioned or allocated thereto and a ratable part of any expenses which cannot definitely be allocated to some item or class of gross income.

Section 1.861-8(a)(2) of the regulations requires a taxpayer to allocate deductions to a class of gross income.

Section 1.861-8(b)(1) of the regulations states that the gross income to which a specific deduction is definitely related is the "class of gross income." Classes of gross income are not predetermined but must be determined on the basis of the deductions to be allocated.

Section 1.861-8(b)(2) of the regulations states the general rule that a deduction shall be considered definitely related to a class of gross income and therefore allocable to such class if it is incurred as a result of, or incident to, an activity or in connection with property from which such class of gross income is derived.

Section 1.861-8(b)(3) of the regulations permits a taxpayer to allocate deductions that are supportive in nature (such as overhead, general and administrative, and supervisory expenses) under an alternative allocation rule. The alternative rule provides that deductions that are supportive in nature may relate to other deductions that can more readily be allocated to gross income. In such instances, these supportive deductions may be allocated and apportioned along with the deductions to which they relate.

Section 1.861-8(b)(3) of the regulations also provides that supportive deductions may be allocated to a class of gross income under the general rule of section 1.861-8(b)(2), by stating that it would be equally acceptable to attribute supportive deductions on some reasonable basis directly to the activities or property that generate, have generated, or could reasonably have been expected to generate the gross income.

Section 1.861-8(c)(1) of the regulations provides that when a deduction has been allocated to a class of gross income that is included in one statutory grouping and the residual grouping, the deduction must be apportioned between the statutory grouping and the residual grouping. One of the methods described for apportioning expenses is comparing the amount of gross income in the statutory grouping with the amount in the residual grouping. If, however, the class of gross income to which a deduction has been allocated is included in its entirety in either a single statutory grouping or the residual grouping, there is no need to apportion that deduction.

A statutory grouping is gross income from a specific source or activity that must first be determined in order to arrive at taxable income from this specific source or activity under an operative section such as section 904(a) of the Code. Gross income from other activities or sources represent the residual grouping of gross income. *See* section 1.861-8(a)(4) of the regulations.

Section 1.861-8(f)(1)(iv)(D) of the regulations provides that the rules of section 1.861-8 apply in determining the amount of foreign oil related income.

Under section 904(a) of the Code as applied separately under section 907(b), the statutory grouping is foreign source gross income from the sale of refined oil products and the residual grouping is United States source gross income from the sale of refined oil products. *See* sections 1.861-8(a)(4) and (f)(1)(i) of the regulations.

Situation (1). The $50*x* of reporting expenses are incurred solely as a result of taxpayer's operation of refineries in the United States and not as a result of taxpayer's wholesale business. Thus, under section 1.861-8(b)(2) of the regulations, these reporting expenses are definitely related and therefore allocable to all of taxpayer's gross income from the sale of taxpayer's refined oil products. It would not be acceptable for taxpayer to allocate these expenses to a class of gross income under the alternative rule of section 1.861-8(b)(3) of the regulations.

Since the class "gross income from the sale of taxpayer's refined oil products" consists of gross income from the sale of such products in both the United States and in foreign countries, taxpayer must apportion the $50*x* of reporting expenses within the class between the statutory grouping, gross income from sources without the United States, and the residual grouping, gross income from sources within the United States, in computing its foreign tax credit limitation under section 904 of the Code as applied separately under section 907(b). An acceptable method for taxpayer to apportion its reporting expenses under the facts in this situation is by comparing the amount of gross income in the statutory grouping ($2,000*x*) with the amount on the residual grouping ($8,000*x*). *See* section 1.861-8(c)(1)(vi) of the regulations. Under this method $10*x* of reporting expenses will be apportioned to the statutory grouping, foreign source gross income from the sale of refined oil products, and the remaining $40*x* will be apportioned to the residual grouping, gross income from United States sources from the sale of such products, computed as follows:

$$\$50x \times \frac{\$2{,}000x}{(\$2{,}000x + \$8{,}000x)} = \$10x$$

$$\$50x \times \frac{\$8{,}000x}{(\$2{,}000x + \$8{,}000x)} = \$40x$$

Situation (2). The result is the same as in situation (1), except that taxpayer will have no foreign source gross income from the sale of its refined oil products. Thus, under section 1.861-8(c)(1) of the regulations, no apportionment of the $50*x* of reporting expenses is necessary since the entire expense is attributable to the residual grouping, gross income from United States sources from sale of taxpayer's refined oil products.

HOLDING

In computing the limitation under section 904(a) of the Code, expenses incurred by the taxpayer in preparing reports required by a federal agency are in situation (1) allocable under section 861(b) of the Code to a class of gross income that consists of both United States source gross income and foreign source gross income from the sale of taxpayer's refined oil products, and in situation (2) allocable under section 861(b) to a class of gross income that consists solely of United States source gross income from the sale of taxpayer's refined oil products.

Section 904.—Limitation on Credit

26 CFR 1.904-1: Limitation on credit for foreign taxes.

Whether, in computing the limitation under section 904(a) of the Code, as applied separately under section 907(b), the expenses incurred in preparing reports required by a federal agency are allocable to a class of gross income consisting solely of gross income from sources within the United States under section 861(b). See Rev. Rul. 80-288, page 14.

Section 907.—Special Rules in Case of Foreign Oil and Gas Income

Whether, in computing the limitation under section 904(a) of the Code, as applied separately under section 907(b), the expenses incurred in preparing reports required by a federal agency are allocable to a class of gross income consisting solely of gross income from sources within the United States under section 861(b). See Rev. Rul. 80-288, page 14.

Section 2035.—Adjustments for Gifts Made Within 3 Years of Decedent's Death

Transfer within 3 years of death; life insurance; time of transfer. An employee who was insured under a group term life insurance policy, the premiums for which were paid by the employer, assigned all rights under the policy to the insured's spouse in 1971 under an agreement assigning the spouse the rights under any arrangement of the employer for life insurance coverage. The employer terminated its insurance arrangement and obtained a similar arrangement with a different insurer in 1977, less than three years before the insured's death, and the insured assigned the new policy to the spouse. The value of the policy proceeds is not includible in the insured's gross estate. Rev. Rul. 79-231 revoked.

Rev. Rul. 80-289 [1]

The decedent, *D* was an active employee of the *X* corporation until the date of death on November 16, 1977.

In 1970, *X* corporation entered into a group term life insurance arrangement with the *Y* insurance company. Under the plan, a master insurance policy was issued to the *X* corporation and individual insurance certificates were issued to the *X* corporation employees. All premiums were paid by the *X* corporation. The *Y* insurance company master policy provides, among other things, that an insured employee may assign all rights in the insurance policy to any person with such an assignment to be effective upon written notification to, and acceptance by, the *Y* insurance company.

In 1971, *D* assigned all rights under the insurance policy issued by the *Y* insurance company to *D*'s spouse. The employer was duly notified of the assignment, and the *Y* insurance company received and accepted the assignment. Before making the assignment, *D* executed a written agreement with *D*'s spouse stating that the assignment would vest in the assignee-spouse not only *D*'s rights under the current policy issued by the *Y* insurance company, but also *D*'s rights under any arrangement for life insurance coverage of the employees of *X* corporation.

On January 17, 1977, less than 3 years before *D*'s death, the *X* corporation terminated the insurance arrangement with the *Y* insurance company and obtained a new master contract from the *Z* insurance company. Notice of the termination of coverage under the master policy of the *Y* insurance company was properly given to the employees and their assignees. Upon termination, the new master policy of the *Z* insurance company came into effect. The terms of the new master policy and the individual employees' certificates of insurance were, in all relevant aspects, identical to the terms of the previous arrangement with the *Y* insurance company. Two weeks after the *Z* insurance company coverage came into effect, the decedent executed an assignment of all rights under the new policy to the decedent's spouse.

Rev. Rul. 79-231, 1979-2 C.B. 323, concluded under identical facts that the anticipatory assignment in 1971 was not effective as a present transfer of the decedent's rights in the group term life insurance policy issued by the *Z* insurance company and that the time of transfer for purposes of section 2035 was in 1977. The Internal Revenue Service maintains the view that the anticipatory assignment was not technically effective as a present transfer of the decedent's rights in the policy issued by *Z*. Nevertheless, the Service believes that the assignment in 1977 to *D*'s spouse, the object of the anticipatory assignment in 1971, should not cause the value of the proceeds to be includible in the gross estate of the decedent under section 2035 where the assignment was necessitated by the change of the employer's master insurance plan carrier and the new arrangement is identical in all relevant aspects to the previous arrangement with *Y*.

HOLDING

The value of the proceeds from the group term life insurance policy is not includible in the gross estate of the decedent under section 2035 of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 79-231 is revoked.

Section 2055.—Transfers for Public, Charitable, and Religious Uses

26 CFR 20.2055-1: Deduction for transfers for public, charitable, and religious uses; in general.

Whether interest is due on an estate tax deficiency where the estate claimed on its return a charitable deduction for which it did not qualify at the time the return was filed, but which was later allowed when the deduction qualified. See Rev. Rul. 80-291, page 20.

Section 4061.—Imposition of Tax

26 CFR 48.4061(b)-1: Imposition of tax. (Also Sections 4063, 4218, 6416; 48.4218-1, 146.1-1.)

Manufacturers; spring leaves; assembly, replacement, or renovation. Examples illustrate the manufacturers excise tax liability of a company in the business of repairing and replacing automotive springs on customer-owned highway trucks.

Rev. Rul. 80-290

ISSUE

Does the fabrication or repair of truck springs, as described below, result in manufacturers excise tax liability?

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[1] Also released as News Release IR-80-103, dated October 7, 1980.

FACTS

A company performs three types of operations on springs of customer-owned highway trucks:

Operation (1). It assembles a spring from parts in inventory such as main and wrap leaves, bushings, clips, center bolts, and U-bolts to replace a damaged spring.

Operation (2). It restores one or more leaves in a damaged spring by heating them and reshaping the arches to original specification. This operation is not performed if more than 40 percent of the leaves need restoration; instead, a new spring is needed.

Operation (3). It replaces one or more of the leaves in a damaged spring. This operation is not performed if more than 40 percent of the leaves need replacement; instead a new spring is needed.

In Operations (1) and (3) the company will ordinarily use a leaf it has purchased but will, when necessary, manufacture its own leaves.

LAW AND ANALYSIS

Section 4061(b)(1) of the Internal Revenue Code imposes a tax upon parts or accessories (other than tires and inner tubes) for any article enumerated in section 4061(a)(1) when sold by the manufacturer, producer, or importer. Among the articles enumerated in section 4061(a)(1) are chassis and bodies for trucks.

Section 4063(c) of the Code excludes rebuilt parts or accessories from the tax.

Section 48.4061(b)-2(a) of the Manufacturers and Retailers Excise Tax Regulations provides that, in general, the term "parts or accessories" includes (1) any article the primary use of which is to improve, repair, replace, or serve as a component part of an automobile truck or bus chassis or body, or taxable tractor, (2) any article designed to be attached to or used in connection with such chassis, body, or tractor, to add to its utility or ornamentation, and (3) any article the primary use of which is in connection with such chassis, body, or tractor, whether or not essential to its operation or use.

Section 48.0-2(a)(4)(i) of the regulations defines a "manufacturer" as including any person who produces a taxable article from scrap, salvage or junk material, or from new or raw material by processing, manipulating, or changing the form of an article or by combining or assembling two or more articles.

Section 146.1-1 of the temporary regulations provides that the rebuilder of a part or accessory shall not be treated as the manufacturer of that part or accessory. However, the section further provides that the rebuilder must pay tax under section 4218(b) of the Code on all new parts or accessories it manufactures and that are used in the rebuilding of the parts or accessories.

The assembly of a replacement spring from various parts is an act of manufacture whether the spring is from scrap, salvage or junk material, or from new or raw material. A new spring has therefore been produced for manufacturers excise tax purposes.

The company's reshaping of up to 40 percent of the leaves of a damaged spring by heating and retempering does not constitute the manufacture of a new spring.

The company's replacement of up to 40 percent of the broken leaves in a damaged spring does not constitute the manufacture of a new spring.

HOLDING

In Operation (1) the assembly by the company of a replacement spring from various parts is the manufacture of a taxable part or accessory within the meaning of section 4061(b)(1) of the Code. The company is liable for the tax imposed by that section on its sale of the spring. The company is entitled to a credit under section 6416(b)(3) for any parts, such as leaves, it purchased tax paid and used in assembling the spring.

In Operation (2) the restoration of the damaged spring leaves by reshaping them does not result in manufacturers excise tax liability.

In Operation (3) the replacement of the broken leaves does not result in manufacturers excise tax liability. However, the company is liable for tax under section 4218 for any leaves it manufactures and uses in this operation.

Section 4063.—Exemptions

26 CFR 146.1-1: Tax-exempt sales of rebuilt automotive parts or accessories.

Whether a company in the business of repairing automotive springs incurs manufacturers excise tax liability in three described operations. See Rev. Rul. 80-290, page 16.

Section 4218.—Use by Manufacturer or Importer Considered Sale

26 CFR 48.4218-1: Tax on use by manufacturer, producer, or importer.

Whether a company in the business of repairing automotive springs incurs manufacturers excise tax liability for leaves it manufactures and uses to replace broken leaves. See Rev. Rul. 80-290, page 16.

Section 4942.—Taxes on Failure to Distribute Income [Private Foundations]

26 CFR 53.4942(b)-1: Operating foundations.

T.D. 7718

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953, SUBCHAPTER D, PART 53.—FOUNDATION AND SIMILAR EXCISE TAXES, SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Treatment of certain elderly care facilities

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the treatment of private foundations that maintain certain elderly care facilities. Changes to the applicable tax law were made by the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1]. The regulations provide private foundations with the guidance needed to comply with that Act and affect private foundations that provide long-term care facilities for disabled persons, elderly persons, needy widows, and children.

DATES: The regulations are effective for taxable years beginning after December 31, 1969.

FOR FURTHER INFORMATION CONTACT: Charles Kerby of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:EE-2-79 (202-566-3422) (not a toll-free number).

SUPPLEMENTARY INFORMATION:

On March 24, 1980, the Federal Register published proposed amendments to the Regulations on Foundation and Similar Excise Taxes (26 CFR Part 53) under section 4942 (j)(6) of the Internal Revenue Code of 1954 (45 F.R. 18973). The amendments were proposed to conform existing regulations to section 522 of the Revenue Act of 1978 (92 Stat. 2885) [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, 119]. In the same document deletions were proposed to the Income Tax Regulations (26 CFR Part 1) and the Regulations on Procedure and Administration (26 CFR Part 301) to reflect the repeal of section 6050 of the Code by section 5 of the Act of December 29, 1979 (Pub. L. No. 96-167; 93 Stat. 1275) [1980-5 I.R.B. 12]. The only comment received from the public on the proposed regulations supported the issuance of the regulations in final form.

DRAFTING INFORMATION

The principal author of this regulation is Charles Kerby of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to the regulations are hereby adopted under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917, 26 U.S.C. 7805):

Paragraph 1. Section 1.6050-1 is deleted.

Par. 2. Section 53.4942(b)-1(a) is revised to read as follows:

§ 53.4942(b)-1 Operating foundations.

(a) *Operating foundation defined*—(1) *In general.* For purposes of section 4942 and the regulations thereunder, the term "operating foundation" means any private foundation which makes qualifying distributions (within the meaning of § 53.4942(a)-3(a)(2)) directly for the active conduct of activities constituting its charitable, educational, or other similar exempt purpose equal in value to substantially all of its adjusted net income (as defined in § 53.4942(a)-2(d)) and which, in addition, satisfies the assets test, the endowment test or the support test set forth in § 53.4942(b)-2 (a), (b) and (c).

(2) *Certain elderly care facilities described in section 4942(j)(6)*—(i) *In general.* For purposes of the distribution requirements of section 4942 (but no other provision of the Internal Revenue Code) and for taxable years beginning after December 31, 1969, the term "operating foundation" includes a private foundation which—

(A) On or before May 26, 1969, and continuously thereafter to the close of the taxable year, operates and maintains, as its principal functional purpose, residential facilities for the long-term care, comfort, maintenance, or education of permanently and totally disabled persons, elderly persons, needy widows, or children, and

(B) Satisfies the endowment test set forth in § 53.4942(b)-2(b).

(ii) *Principal functional purpose.* For purposes of section 4942(j)(6) and this subparagraph (2), an organization's "principal functional purpose" is operating and maintaining residential facilities for the long-term care, comfort, maintenance, or education of permanently and totally disabled persons, elderly persons, needy widows, or children, if it is organized for the principal purpose of operating and maintaining such residential facilities and is primarily engaged directly in the operation and maintenance of those facilities. An organization will be treated as being primarily engaged directly in the operation and maintenance of the described residential facilities if at least 50% of the qualifying distributions (as defined in § 53.4942(a)-3(a)(2)) normally made by the organization are expended for the operation and maintenance of the facilities.

* * * * *

Par. 3. Section 301.6050-1 is deleted.

Jerome Kurtz,
Commissioner of Internal Revenue.

Approved August 25, 1980.

Emil M. Sunley,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on September 3, 1980, 8:45 a.m., and published in the issue of the Federal Register for September 4, 1980, 45 F.R. 58520)

Section 6033.—Returns by Exempt Organizations

26 CFR 1.6033-2: Returns by exempt organizations; taxable years beginning after December 31, 1969.

Exempt organizations that are not required to file Form 990. See Rev. Proc. 80-44, page 22.

Section 6073.—Time for Filing Declarations of Estimated Income Tax by Individuals

26 CFR 1.6073-1: Time and place for filing declarations of estimated income tax by individuals.

T.D. 7719

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Time for filing declarations of estimated income tax by farmers, fishermen, and certain nonresident aliens

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the time for filing estimated income tax by farmers, fishermen, and certain nonresident aliens. Changes to the applicable tax law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1] and the Act of November 10, 1978 [Pub. L. 95-628, 1978-2 C.B. 435]. These amendments to the regulations specify the dates for filing declarations of tax in a timely manner and thereby provide the public with needed guidance to comply with the Acts.

DATES: The amendment relating to the time for farmers and fishermen to file declarations of estimated tax is effective for taxable years beginning after November 10, 1978. The amendment relating to the time for nonresident aliens to file declarations of estimated tax is effective for taxable years beginning after December 31, 1976.

FOR FURTHER INFORMATION CONTACT: Claudine Ausness of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3459).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On May 21, 1980, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 6073 of the Internal Revenue Code of 1954. These amendments were proposed to conform the regulations to section 1012(c) of the Tax Reform Act of 1976 (90 Stat. 1614) [*supra* at 90] and section 7 of the Act of November 10, 1978 (Pub. L. 95-628, 92 Stat. 3630) [*supra* at 437]. The one written comment received raised an issue unrelated to the proposed regulation changes and no public hearing was requested or held. The proposed amendment is adopted by this Treasury decision without change.

EXPLANATION OF PROVISIONS

The amendment made by the Tax Reform Act provides that, in the case of nonresident aliens who are not subject to wage withholding, the due date for filing a declaration of estimated tax for the current taxable year is not earlier than the due date for filing an income tax return for the preceding taxable year. The amendment made by the Act of November 10, 1978, provides an additional exception for farmers and fishermen to the quarterly requirements relating to declarations of estimated tax. The regulations adopted by this Treasury decision reflect these statutory changes.

The regulations adopted by this Treasury decision impose no new reporting burdens or recordkeeping requirements. Evaluation of the effectiveness of these regulations will be based upon comments received from members of Congress, offices within Treasury and the Internal Revenue Service, other governmental services, and the public.

DRAFTING INFORMATION

The principal author of this regulation is Claudine Ausness of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to 26 CFR Part 1 are hereby adopted:

Paragraph 1. Section 1.6073-1 is amended by revising subparagraph (1) of paragraph (b), by redesignating paragraphs (c) and (d) as paragraphs (d) and (e), respectively, and by adding a new paragraph (c). These revised and added provisions read as follows:

§ 1.6073-1 Time and place for filing declarations of estimated [income] tax by individuals.

* * * * *

(b) *Farmers or fishermen*—(1) *In general.* In the case of an individual on a calendar year basis—

(i) If at least two-thirds of the individual's total estimated gross income from all sources for the calendar year is from farming or fishing (including oyster farming), or

(ii) If at least two-thirds of the individual's total gross income from all sources shown on the return for the preceding taxable year was from farming or fishing (including oyster farming) (with respect to declarations of estimated tax for taxable years beginning after November 10, 1978),

he may file a declaration of estimated tax on or before the 15th day of January of the succeeding calendar year in lieu of the time prescribed in paragraph (a) of this section. For the filing of a return in lieu of a declaration, see paragraph (a) of § 1.6015-1.

* * * * *

(c) *Nonresident aliens.* Notwithstanding the provisions of paragraph (a) of this section, for taxable years beginning after December 31, 1976, in the case of a nonresident alien described in section 6072(c) (relating to returns of nonresident aliens whose wages are not subject to withholding) whose estimated gross income for the calendar year meets the requirements of section 6015(a), a declaration of estimated tax for the calendar year need not be made before June 15th of such calendar year.

* * * * *

Par. 2. Section 1.6073-2 is amended by revising paragraphs (b) and (c) to read as follows:

§ 1.6073-2 Fiscal years.

* * * * *

(b) *Farmers or fishermen.* In the case of an individual on a fiscal year basis—

(1) If at least two-thirds of the individual's total estimated gross income from all sources for the fiscal year is from farming or fishing (including oyster farming), or

(2) If at least two-thirds of the individual's total gross income from all sources shown on the return for the preceding taxable year was from farm-

ing or fishing (including oyster farming) (with respect to declarations of estimated tax for taxable years beginning after November 10, 1978),

he may file a declaration on or before the 15th day of the month immediately following the close of his taxable year, in lieu of the time prescribed in paragraph (a) of this section.

(c) *Nonresident aliens.* Notwithstanding the provisions of paragraph (a) of this section, in the case of a nonresident alien described in section 6072(c) (relating to returns of nonresident aliens whose wages are not subject to withholding) whose anticipated income for the fiscal year meets the requirements of section 6015(a), § 1.6015(a)-1, and § 1.6015(i)-1, the declaration of estimated tax for the fiscal year need not be filed before the 15th day of the 6th month of such fiscal year.

Par. 3. Section 1.6073-3 is amended by revising paragraphs (b) and (c) to read as follows:

§ 1.6073-3 Short taxable years.

* * * * *

(b) *Farmers or fishermen.* In the case of an individual—

(1) Whose current taxable year is a short taxable year and whose estimated gross income from farming or fishing (including oyster farming) is at least two-thirds of his total estimated gross income from all sources for such current taxable year, or

(2) Whose taxable year preceding the current taxable year was a short taxable year and whose gross income from farming or fishing (including oyster farming) was at least two-thirds of the total gross income from all sources shown on the return for such preceding short taxable year (with respect to declarations of estimated tax for taxable years beginning after November 10, 1978),

he may file a declaration of estimated tax on or before the 15th day of the month immediately following the close of the current taxable year, in lieu of the time prescribed in paragraph (a) of this section.

(c) *Nonresident aliens.* Notwithstanding the provisions of paragraph (a) of this section, in the case of a short taxable year, a nonresident alien described in section 6072(c) (relating to returns of nonresident aliens whose wages are not subject to withholding) whose anticipated income for the short taxable year meets the requirements of section 6015(a), § 1.6015(a)-1, § 1.6015(g)-1, and § 1.6015(i)-1 on or before the 1st day of the 6th month following the beginning of such year need not file a declaration of estimated tax before the 15th day of the 6th month following the beginning of such year.

This Treasury decision is issued under the authority contained in section 6073(d) and 7805 of the Internal Revenue Code of 1954 (68A Stat. 750, 917; 26 U.S.C. 6073(d) and 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved August 27, 1980.

Emil M. Sunley,
Acting Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on September 12, 1980, 8:45 a.m., and published in the issue of the Federal Register for September 15, 1980, 45 F.R. 60902)

Section 6416.—Certain Taxes on Sales and Services

Whether a company in the business of repairing automotive springs is entitled to a credit for parts purchased tax paid and used in assembling a spring. See Rev. Rul. 80-290, page 16.

Section 6601.—Interest on Underpayment, Nonpayment, or Extensions of Time for Payment of Tax

26 CFR 301.6601-1: Interest on underpayments.
(Also Section 2055; 20.2055-1.)

Interest on deficiency; deduction subsequently allowed. A charitable deduction claimed on an estate tax return was disallowed because the deduction did not satisfy the requirements of section 2055(e) of the Code, but was subsequently allowed when the gift was made to qualify. Interest is due on the deficiency from the due date of the return to the end of a 180-day period following the filing of a claim for credit or refund.

Rev. Rul. 80-291

ISSUE

For what period is interest due when a charitable deduction claimed on an estate tax return was disallowed because the deduction did not satisfy the requirements of section 2055 of the Internal Revenue Code at the time the return was filed, but which was later allowed when the gift qualified?

FACTS

The decedent died on April 12, 1977. The estate tax return was timely filed on the due date, January 12, 1978. A charitable deduction was claimed on the return for a bequest that did not satisfy the requirements of section 2055(e) of the Code. Upon examination of the estate tax return the deduction was disallowed by the Internal Revenue Service. On December 19, 1978, the estate petitioned the state court for a reformation of the testamentary trust created by the decedent's will and for relief from certain provisions of the state law so that the remainder devised to charity would qualify for the deduction under section 2055. On February 27, 1979, while the examination of the estate was still pending, the state court entered a judgment granting the relief that the estate requested. On February 28, 1979, the estate filed a claim for credit or refund based on the fact that the testamentary trust had been amended in order to satisfy the requirements of section 2055(e). The examiner secured two waivers, one agreeing to a deficiency based on the disallowed original deduction and the other agreeing to an overassessment based on the subsequently filed claim.

LAW AND ANALYSIS

Section 2055(e)(3) of the Code provides that if the amendment of the governing instrument is made after the due date for filing of the estate tax return, the deduction shall be allowed upon the filing of a timely claim for credit or refund (as provided for in section 6511) of an overpayment resulting from the application of this paragraph. In the case of a credit or refund resulting from an amendment made pursuant to section 2055(e), no interest is allowable for the period before the expiration of the 180th day after the date on which the claim for credit or refund is filed.

Section 6601(a) of the Code provides that if any amount of tax imposed by the Code is not paid on or before the last date prescribed for payment, interest shall be paid on such amount for the period from such last date to the date paid.

Section 2.01 of Rev. Proc. 60-17, 1960-2 C.B. 942, provides that interest generally is paid on a tax overpayment for the time the government has the use of the taxpayer's money. Similarly, interest is collected for the time the taxpayer has the use of the government's money. Section 3.02(5)d of Rev. Proc. 60-17 states that the date of overpayment in a restricted interest case is the date from which interest is allowable on the overpayment, and that this same date is the terminating date for charging interest on a deficiency satisfied by credit of an overpayment.

In *Manning v. Seeley Tube and Box Co.*, 338 U.S. 561 (1950), Ct. D. 1729, 1950-1 C.B. 113, the Supreme Court held that a net operating loss carryback that eliminates a deficiency does not abate the interest previously assessed on that deficiency.

Since the estate is not entitled to the use of the money resulting from taking this deduction from the due date of the return to the end of the 180-day period beginning after the date on which the estate filed the claim for refund, interest is due for this period.

HOLDING

Interest is due on the estate tax deficiency from January 12, 1978, the due date of the estate tax return, to August 27, 1979, the end of the 180-day period.

Part III. Administrative, Procedural, and Miscellaneous

Delegation Order No. 114 (Rev. 2)
(Effective August 28, 1980)

Designation to Act as "Competent or Taxation Authority" Under Tax Treaties

1. Pursuant to the authority delegated to me by Treasury Department Order No. 150-83 [1973-2 C.B. 508], there is hereby delegated to the Assistant Commissioner (Compliance) the authority to act as "competent or taxation authority" under tax treaties of the United States. This authority includes the administration of the operating provisions of tax treaties as well as the interpretation or application of such treaties. With respect to the interpretation or application of tax treaties, the Assistant Commissioner (Compliance) shall act in all such matters only after the concurrence of the Assistant Commissioner (Technical).

2. The authority delegated herein to administer the operating provisions of tax treaties may be redelegated, but not lower than Division Director.

3. The authority delegated herein relating to the interpretation or application of tax treaties may not be redelegated.

4. Delegation Order No. 114 (Rev. 1) [1976-2 C.B. 623], issued November 3, 1976, is superseded.

JEROME KURTZ,
Commissioner.

Executive Order 12238

Public International Organization Entitled to Enjoy Privileges, Exemptions, and Immunities

By the authority vested in me by Section 1 of the International Organizations Immunities Act (59 Stat. 669; 22 U.S.C. 288) [Pub. L. 291, 1946-1 C.B. 323], and having found that the United States participates in the International Maritime Satellite Organization pursuant to Title V of the Communications Satellite Act of 1962, as amended (47 U.S.C. 751 *et seq.*), the International Maritime Satellite Organization is hereby designated as a public international organization entitled to enjoy the privileges, exemptions, and immunities conferred by the International Organizations Immunities Act.

JIMMY CARTER

THE WHITE HOUSE
September 12, 1980.

(Filed by the Office of the Federal Register on September 12, 1980, 10:50 a.m., and published in the issue of the Federal Register on September 15, 1980, 45 F.R. 60877)

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26 CFR 601.602: Forms and instructions.
(Also Part I, Section 6033; 1.6033-2.)

Rev. Proc. 80-44

SECTION 1. PURPOSE

The purpose of this revenue procedure is to establish and maintain for reference purposes a current list of those organizations exempt from federal income tax because they are described in section 501(c) of the Internal Revenue Code that are not required to file an annual information return on Form 990. This list does not include organizations, such as private foundations, that are required to file (under an annual information return) on forms other than the Form 990.

SEC. 2. BACKGROUND

.01 Section 6033(a)(1) of the Code, as amended by the Tax Reform Act of 1969, Pub. L. 91-172, 1969-3 C.B. 10, 27, generally requires the filing of annual information returns by exempt organizations.

.02 Section 6033(a)(2)(A) of the Code provides certain mandatory exceptions to this filing requirement.

.03 In addition, section 6033(a)(2)(B) of the Code provides discretionary exceptions from filing such returns where the Secretary "determines such filing is not necessary to the efficient administration of the internal revenue laws." Section 1.6033-2(g)(6) of the Income Tax Regulations delegates authority to the Commissioner to excuse organizations from the filing requirement. It provides that, "the Commissioner may relieve any organization or class of organizations from filing, in whole or in part, the annual return required by section 6033 where he determines that such returns are not necessary for the efficient administration of the internal revenue laws."

.04 Section 1.6033-2(g)(1) of the regulations provides a partial list of organizations that are not required to file annual returns either because they are excepted by statute or because the Commissioner has exercised the authority referred to above in Sec. 2.03.

.05 In Announcement 77-62, 1977-17 I.R.B. 22, the Commissioner announced that he had exercised his discretionary authority to excuse an additional category of exempt organizations from filing Form 990. This category consisted of exempt organizations described in section 501(c) of the Code (other than private foundations) the gross receipts of which in each taxable year are normally not more than $10,000. These organizations are excused from filing the annual information return for tax years ending on or after December 31, 1976.

.06 From time to time, the Commissioner may excuse additional organizations from filing such returns by publishing an announcement in the Internal Revenue Bulletin, revising the instructions accompanying Form 990, amending the regulations, or other appropriate publication. As these changes to the filing requirements may occur, subsequent revisions to this procedure will be made.

SEC. 3. ORGANIZATIONS CURRENTLY NOT REQUIRED TO FILE ANNUAL RETURNS

.01 The list of organizations described in section 501(c) of the Code that are not required to file annual returns by reason of section 6033(a)(2) is as follows:

1 A church, an interchurch organization of local units of a church, a convention or association of churches, or an integrated auxiliary of a church (such as a men's or women's organization, religious school (such as a seminary), mission society, or youth group).

2 A school (described in section 170(b)(1)(A)(ii) of the Code) below

college level affiliated with a church or operated by a religious order, even though it is not an integrated auxiliary of a church.

3 A mission society sponsored by or affiliated with one or more churches or church denominations, more than one-half of the activities of which society are conducted in, or directed at persons in, foreign countries.

4 An exclusively religious activity of any religious order.

5 For tax years ending on or after December 31, 1976, an organization (other than a private foundation) that normally has gross receipts in each taxable year of not more than $10,000. (See Sec. 4.)

6 A state institution, whose income is excluded from gross income under section 115.

7 An organization described in section 501(c)(1).

.02 This list does not include organizations, such as private foundations, that are required to file annual information returns on forms other than Form 990.

SEC. 4. DEFINITIONS — NORMALLY NOT MORE THAN $10,000

For purposes of Sec. 3 above, the annual gross receipts of an organization are normally not more than $10,000 if:

1 in the case of an organization which has been in existence for one year or less, the organization has received, or donors have pledged to give, gross receipts of $15,000 or less during the first taxable year of the organization;

2 in the case of an organization which has been in existence for more than one, but less than three years, the average of the gross receipts received by the organization in the first two taxable years is $12,000 or less; and,

3 in the case of an organization which has been in existence for three years or more, the average of the gross receipts received by the organization in the immediately preceding three years, including the year for which the return would be filed, is $10,000 or less.

Part IV. Items of General Interest

Excise Tax on Fuel Used in Commercial Transportation on Inland Waterways

Announcement 80-136 [1]

A federal excise tax of four cents per gallon will be imposed on the purchaser of any liquid fuel used after September 30, 1980, in vessels for commercial transportation on United States inland or intracoastal waterways. The new excise tax, which is in addition to all other taxes imposed on the sale or use of the fuel, was enacted as part of the Inland Waterways Revenue Act of 1978, Pub. L. 95-502, 1978-2 C.B. 393.

"Commercial waterway transportation" means using a vessel to transport property either for compensation or in the business of the vessel's owner, lessee or operator. Fish or aquatic animal life caught on the voyage, however, are not considered property for this tax.

Liquid fuel for vessels used by a state or local government, passenger vessels and oceangoing vessels with a draft of more than 12 feet is exempt from the excise tax. Liquid fuel for tugs used exclusively to pull oceangoing LASH and SEABEE barges picking up or delivering international cargoes also is exempt from the excise tax.

The four-cents-per-gallon tax is scheduled to increase by two cents per gallon on October 1 of 1981, 1983 and 1985, but will stay at the maximum 10-cents-per-gallon rate after October 1, 1985. The tax is to be reported on Form 720, Quarterly Federal Excise Tax Return. Since each taxpayer is required to include an employer identification number on Form 720, any taxpayer who does not have one should file Form SS-4, Application for Employer Identification Number, with the appropriate Internal Revenue Service Center.

The following is a list of inland and intracoastal waterways for purposes of this tax.

1. Alabama-Coosa River: From junction with the Tombigbee River at river mile (RM) 0 to junction with Coosa River at RM 314.

2. Allegheny River: From confluence with the Monongahela River to form the Ohio River at RM 0 to the head of the existing project at East Brady, Pennsylvania, RM 72.

3. Apalachicola-Chattahoochee and Flint Rivers: Apalachicola River from mouth at Apalachicola Bay (intersection with the Gulf Intracoastal Waterway) RM 0 to junction with Chattahoochee and Flint Rivers at RM 107.8. Chattahoochee River from junction with Apalachicola and Flint Rivers at RM 0 to Columbus, Georgia, at RM 155 and Flint River, from junction with Apalachicola and Chattahoochee Rivers at RM 0 to Bainbridge, Georgia, at RM 28.

4. Arkansas River (McClellan-Kerr Arkansas River Navigation System): From junction with Mississippi River at RM 0 to port of Catoosa, Oklahoma, at RM 448.2.

5. Atchafalaya River: From RM 0 at its intersection with the Gulf Intracoastal Waterway at Morgan City, Louisiana, upstream to junction with Red River at RM 116.8.

6. Atlantic Intracoastal Waterway: Two inland water routes approximately paralleling the Atlantic coast between Norfolk, Virginia, and Miami, Florida, for 1,192 miles via both the Albermarle and Chesapeake Canal and Great Dismal Swamp Canal routes.

7. Black Warrior-Tombigbee-Mobile Rivers: Black Warrior River System from RM 2.9, Mobile River (at Chickasaw Creek) to confluence with Tombigbee River at RM 45. Tombigbee River (to Demopolis at RM 215.4) to port of Birmingham, RM's 374-411 and upstream to head of navigation on Mulberry Fork (RM 429.6), Locust Fork (RM 407.8), and Sipsey Fork (RM 430.4).

8. Columbia River (Columbia-Snake Rivers Inland Waterways): From The Dalles at RM 191.5 to Pasco, Washington (McNary Pool), at RM 330, Snake River from RM 0 at the mouth to RM 231.5 at Johnson Bar Landing, Idaho.

9. Cumberland River: Junction with Ohio River at RM 0 to head of navigation, upstream to Carthage, Tennessee, at RM 313.5.

10. Green and Barren Rivers: Green River from junction with the Ohio River at RM 0 to head of navigation at RM 149.1.

11. Gulf Intracoastal Waterway: From St. Mark's River, Florida, to Brownsville, Texas, 1,134.5 miles.

12. Illinois Waterway (Calumet-Sag Channel): From the junction of the Illinois River with the Mississippi River RM 0 to Chicago Harbor at Lake Michigan, approximately RM 350.

13. Kanawha River: From junction with Ohio River at RM 0 to RM 90.6 at Deepwater, West Virginia.

14. Kaskaskia River: From junction with the Mississippi River at RM 0 to RM 36.2 at Fayetteville, Illinois.

15. Kentucky River: From junction with Ohio River at RM 0 to confluence of Middle and North Forks at RM 258.6.

16. Lower Mississippi River: From Baton Rouge, Louisiana, RM 233.9 to Cairo, Illinois, RM 953.8.

17. Upper Mississippi River: From Cairo, Illinois, RM 953.8 to Minneapolis, Minnesota, RM 1,811.4.

18. Missouri River: From junction with Mississippi River at RM 0 to Sioux City, Iowa, at RM 734.8.

19. Monongahela River: From junction with Allegheny River to form the Ohio River at RM 0 to junction of the Tygart and West Fork Rivers, Fairmont, West Virginia, at RM 128.7.

20. Ohio River: From junction with the Mississippi River at RM 0 to junction of the Allegheny and Monongahela Rivers at Pittsburgh, Pennsylvania, at RM 981.

21. Ouachita-Black Rivers: From the mouth of the Black River at its junction with the Red River at RM 0 to RM 351 at Camden, Arkansas.

22. Pearl River: From junction of West Pearl River with the Rigolets at RM 0 to Bogalusa, Louisiana, RM 58.

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[1] Based on News Release IR-80-95, dated September 18, 1980.

23. Red River: From RM 0 to the mouth of Cypress Bayou at RM 236.

24. Tennessee River: From junction with Ohio River at RM 0 to confluence with Holstein and French Rivers at RM 652.

25. White River: From RM 9.8 to RM 255 at Newport, Arkansas.

26. Willamette River: From RM 21 upstream of Portland, Oregon, to Harrisburg, Oregon, at RM 194.

Periodic Report of Actuary—Public Hearing

Announcement 80-141 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Public hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to the requirement that the plan administrator of a defined benefit plan periodically file an actuarial report for the plan.

DATES: The public hearing will be held on November 12, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by October 29, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (EE-27-78), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under sections 6059 and 6692 of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Tuesday, July 8, 1980 (45 FR 45926).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of oral comments to be presented at the hearing and the time they wish to devote to each subject by October 29, 1980. Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive for improving Government Regulations appearing in the Federal Register for Wednesday, November 8, 1978.

By direction of the Commissioner of Internal Revenue.

Hardship Areas and Cost-of-Living Differential Tables

Announcement 80-138 [1]

The 1980 cost-of-living differential tables used to calculate certain deductions for U.S. taxpayers living and working outside the United States and a list of hardship areas for January 1, 1980, through August 31, 1980, used to determine whether income earned in a hardship area camp is eligible for exclusion or figure the hardship area deduction have been issued. The final list of 1980 hardship areas will be available at the end of the year and included in the instructions for Form 2555, Deduction from, or Exclusion of, Income Earned Abroad, and in Publication 54, Tax Guide for U.S. Citizens Abroad.

Taxpayers should check the new cost-of-living tables and hardship area list and, if necessary, adjust their withholding or estimated tax payments to avoid a possible estimated tax penalty for 1980. Although the hardship list issued today may be used to estimate 1981 deductions or exclusions, taxpayers are cautioned that this list is not final and adjustments may have to be made later.

Those taxpayers who wish to change the amount of withholding because their estimated deduction for excess foreign living costs has changed should file a statement with their employers showing the anticipated amount of the deduction. A sample of this statement can be found in Publication 54, which is available at U.S. consulates and embassies or from the Office of International Operations, Internal Revenue Service, P.O. Box 384, Benjamin Franklin Station, Washington, D.C. 20044.

Other taxpayers who wish to change the amount of withholding because their estimated exclusion of income earned in a hardship area has changed should notify their employers of the corrected amount of the exclusion as soon as possible.

A hardship area is any place where because of extraordinarily difficult living conditions, notably unhealthful conditions, or excessive physical hardships a U.S. government employee would qualify for a hardship cost differential of 15 percent or more of salary.

Taxpayers can provide the necessary information to establish a hardship area by filling out Form OF 267, Post Differential Questionnaire, which can be obtained by writing the Director, Allowance Staff, Department of State, Washington, D.C. 20520 or by calling (202) 235-9466.

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[1] Filed by the Office of the Federal Register on October 2, 1980, 8:45 a.m., and published in the issue of the Federal Register for October 3, 1980, 45 F.R. 65625.

[1] Based on News Release IR-80-102, dated October 7, 1980.

1980 Qualified Cost-of-Living Differential Tables

TABLE A.—Geographic Areas

(Find the group code that applies to your geographic area and refer to Table B for the cost-of-living differential for that group code, except group code X where no index is available from the State Department.)

Country	Group code
Afghanistan	A
Albania	X
Algeria	H
Andorra	J
Angola	B
Antigua	B
Argentina	K
Australia	F
Austria	L
Bahamas	G
Bahrain	J
Bangladesh	C
Barbados	D
Belgium	L
Belize	A
Benin	K
Bermuda	F
Bhutan	A
Bolivia	C
Botswana	B
Brazil	A
British Virgin Is.	B
Brunei	D
Bulgaria	H
Burma	E
Burundi	K
Cameroon	L
Canada	B
Cape Verde	F
Cayman Is.	F
Central Afr. Rep.	M
Chad	X
Chile	H
China	B
Colombia	A
Comoros	H
Congo	K
Costa Rica	C
Cuba	E
Cyprus	C
Czechoslovakia	D
Denmark	L
Djibouti	H
Dominica	B
Dominican Republic	A
Ecuador	A
Egypt	B
El Salvador	B
Equatorial Guinea	B
Ethiopia	F
Fiji	D
Finland	K
France	M
French West Indies	K
Gabon	N
Gambia	J
Germany E.	L
Germany W.	L
Ghana	L
Greece	A
Grenada	B
Guatemala	B
Guinea	I
Guinea-Bissau	H
Guyana	C
Haiti	E
Honduras	A
Hong Kong	D
Hungary	A
Iceland	K
India	A
Indonesia	E
Iran	X
Iraq	E
Ireland	F
Israel	F
Italy	F
Ivory Coast	N
Jamaica	C
Japan	L
Jordan	G
Kampuchea	X
Kenya	E
Kiribati	A
Korea N.	X
Korea S.	J
Kuwait	I
Laos	A
Lebanon	C
Lesotho	A
Liberia	I
Libya	I
Liechtenstein	M
Luxembourg	K
Macao	D
Madagascar	J
Malawi	F
Malaysia	F
Maldives	A
Mali	L
Malta	D
Mauritania	N
Mauritius	D
Mexico	A
Monaco	L
Mongolia	A
Montserrat	C
Morocco	H
Mozambique	C
Namibia	A
Nauru	X
Nepal	A
Netherlands	K
Neth. Antilles	D
New Caledonia	I
New Hebrides	A
New Zealand	D
Nicaragua	A
Niger	N
Nigeria	M
Norway	L
Oman	J
Pakistan	A
Panama	B
Papua N. Guinea	I
Paraguay	E
Peru	A
Philippines	A
Poland	A
Portugal	C
Qatar	K
Romania	A
Rwanda	I
St. Kitts-Nevis	A
St. Lucia	A
St. Vincent and the Grenadines	A
San Marino	F
Sao Tome & Principe	H
Saudi Arabia	J
Senegal	K
Seychelles	G
Sierra Leone	I
Singapore	D
Solomon Islands	A
Somalia	J
South Africa	A
Spain	E
Sri Lanka	A
Sudan	F
Surinam	F
Swaziland	B
Sweden	M
Switzerland	M
Syria	C
Taiwan	B
Tanzania	E
Thailand	B
Togo	K
Tonga	A
Trinidad & Tobago	D
Tr. Terr. of Pac. Is.	A
Tunisia	G
Turkey	A
Turks & Caicos Is.	A
Tuvalu	A
Uganda	K
United Arab Emirates	J
United Kingdom	K
Upper Volta	L
Uruguay	G
U.S.S.R.	I
Vatican City	F
Venezuela	I
Vietnam	X
Western Samoa	A
Yemen (Aden)	A
Yemen (Sana)	H
Yugoslavia	A
Zaire	R
Zambia	J
Zimbabwe	X

TABLE B.—Cost-of-Living Differentials

Group code	Family Size (Number of Persons)					
	1	2	3	4	5	6 or more
A and B	No cost-of-living differential allowed.					
C	400	500	600	700	700	800
D	900	1,100	1,300	1,400	1,500	1,600
E	1,400	1,600	2,000	2,200	2,200	2,400
F	1,800	2,200	2,600	2,900	3,000	3,200
G	2,300	2,700	3,300	3,600	3,700	4,000
H	2,700	3,300	4,000	4,300	4,500	4,800
I	3,400	4,000	4,900	5,300	5,500	5,900
J	4,100	4,900	5,900	6,500	6,700	7,200
K	5,000	6,000	7,300	7,900	8,200	8,800
L	5,900	7,100	8,600	9,400	9,700	10,400
M	6,900	8,100	9,900	10,800	11,300	12,000
N	7,800	9,200	11,200	12,300	12,800	13,500
O	8,700	10,300	12,500	13,700	14,300	15,100
P	9,600	11,400	13,900	15,200	15,800	16,700
Q	10,500	12,500	15,200	16,600	17,300	18,300
R	11,400	13,600	16,500	18,100	18,800	19,900

1980 (1/1/80 to 8/31/80) Qualified Hardship Areas—Countries and Locations

(Unless a beginning or ending date is shown for your area, the location qualified as a hardship area for the entire year. Only the locations listed below qualify as hardship areas.)

- **Afghanistan**—All locations
- **Algeria**—All locations
- **Angola**—All locations
- **Ascension Island**—All locations
- **Australia**
  - Alexandria Station
- **Bahamas**
  - Andros Island except Nicolls Town
  - Hard Bargain, Long Island
  - Carter Cay
  - Eleuthera Station
  - Great Stirrup Cay
  - Treasure Cay & Marsh Harbor
- **Bahrain**—All locations
- **Bangladesh**—All locations
- **Belize**—All locations
- **Benin**—All locations
- **Bolivia**
  - All locations except Cochabamba and Santa Cruz
- **Brazil**
  - All locations within the States of:
    - Acre
    - Amapa
    - Amazonas
    - Cuiaba
    - Goias
    - Maranhao
    - Mato Grosso
    - Para
    - Piaui
    - Rio Branco
  - Camamu, Bahia
  - Rio Guarani, Parana
- **British West Indies**
  - Antigua Air Station
- **Bulgaria**
  - All locations except Sofia
- **Burma**—All locations
- **Burundi**—All locations
- **Cameroon**—All locations
- **Canada**
  - Northwest Territories
- **Cape Verde**—All locations
- **Central African Republic**—All locations
- **Chad**—All locations
- **Chagos Archipelago**—All locations
- **China**—All locations
- **Colombia**
  - All locations within the provinces of:
    - Amazonas
    - Arauca
    - Boyaca
    - Caqueta
    - Guainia
    - Meta
    - Putumayo
    - Vaupes
    - Vichada
  - Barranquilla after 2/23/80
  - Gigante
  - Montelibano
- **Congo**—All locations
- **Costa Rica**
  - All locations except San Jose
- **Cuba**
  - Havana
- **Djibouti**—All locations
- **Dominican Republic**
  - All locations except Santo Domingo
- **Easter Island**—All locations
- **Ecuador**—All locations
- **Egypt**
  - All locations except Alexandria and Cairo after 6/28/80
- **El Salvador**
  - El Ronco
  - San Salvador
  - San Lorenzo
  - All other locations after 1/27/80
- **Ethiopia**—All locations
- **French West Indies**—All locations
- **Gabon**—All locations
- **Gambia**—All locations
- **Ghana**—All locations
- **Greenland**—All locations
- **Guatemala**
  - All locations except Guatemala City and Quezaltenango
- **Guinea**—All locations
- **Guinea-Bissau**—All locations
- **Guyana**—All locations
- **Haiti**—All locations
- **Honduras**—All locations
- **India**—All locations
- **Indonesia**—All locations
- **Iran**—All locations
- **Iraq**—All locations
- **Israel**
  - Negev Region Construction Sites
- **Ivory Coast**—All locations
- **Jamaica**
  - Kingston after 8/6/80
- **Jordan**
  - All locations except Amman
- **Kenya**
  - Garissa
  - Kitale
  - Marsabit
  - Ngomeni
  - Wajir
- **Korea**
  - All locations except Osan AB (including Pyongtaek), Pusan, Seoul (including ASCOM, Suwom, Kimpo Airfields, Camps Eiler, Mercer and Thompson), and Chanyan-Myon
- **Kuwait**—All locations
- **Laos**—All locations
- **Lebanon**—All locations
- **Liberia**—All locations
- **Libya**—All locations
- **Madagascar**—All locations
- **Malaysia**
  - All locations except Kuala Lumpur and Penang
- **Maldives**—All locations
- **Mali**—All locations
- **Mauritania**—All locations
- **Mexico**
  - Chiapas
    - Chamula
    - Chenalho
    - Francisco de Leon
    - Lacanja
  - Chihuahua
    - Barboregame
    - Rocorroibo
    - Samachique
  - Coahuila
    - Nacimiento
  - Duranco
    - Ocotan
  - Guerrero
    - Alacatlazala
    - Atliaca
    - Ayutla
    - Malinaltepec
    - Xochislahuaca
  - Hidalgo
    - Huasteca
    - Huehuetla
    - Mexquital
    - San Antonio
    - Tenango
  - Mexico
    - San Felipe
    - Santa Maria
  - Michoacan
    - Pomaro
  - Morelos
    - Tetelcingo
  - Nayarit
    - Jesus Maria
    - Nayar
  - Oaxaca
    - All locations except Oaxaca City
  - Puebla
    - Naupan
    - San Felipe
    - San Juan Atzingo
    - San Luis
    - San Marcos
    - Sierra de Puebla
    - Xayacatlan
  - Queretaro
    - Almealco
  - San Luis Potosi
    - Santa Maria Acapulco
  - Sonora
    - Desemboque
    - La Junta
    - Nacozari de Garcia
    - Navajoa
    - Vicam
  - Tabasco
    - Nacapuca
  - Veracruz
    - Campamento Farallon
    - Isthmus
    - Orizaba
    - Papantla
    - Sierra
    - Tantoyuca
    - Tlachichilco
    - Xicotepec
- **Morocco**
  - Ben Guria
  - Phos Boucra
- **Mozambique**—All locations
- **Nepal**—All locations
- **New Caledonia**
  - Noumea
- **Nicaragua**—All locations
- **Niger**—All locations
- **Nigeria**—All locations
- **Oman**—All locations
- **Pakistan**—All locations
- **Panama**
  - All locations except Panama City, Santiago and Canal Area (Pre-Treaty)
- **Papua New Guinea**—All locations
- **Paraguay**
  - All locations except Asuncion
- **Peru**
  - All locations except Arequipa and Lima
- **Philippines**
  - All locations except Baguio City, Cagayan de Oro, Los Banos, Manila (including Cavite), San Fernando, La Union, and San Pablo
  - Cebu after 5/17/80
  - Angeles before 6/1/80
  - Camp O'Donnell before 6/1/80
  - San Miguel before 6/1/80
  - Subic Bay before 6/1/80
- **Qatar**—All locations
- **Romania**
  - All locations except Bucharest
- **Rwanda**—All locations
- **Saudi Arabia**—All locations
- **Senegal**—All locations
- **Seychelles**—All locations
- **Sierra Leone**—All locations
- **Sinai Field Mission**
- **Somalia**—All locations
- **South Africa**
  - Aggeneys
- **Sri Lanka**—All locations
- **Sudan**—All locations
- **Surinam**
  - All locations except Paramaribo
- **Syria**—All locations
- **Taiwan**
  - All locations except Kaohsiung (incl. Tsoying), Tainan and Taipei
- **Tanzania**—All locations
- **Thailand**
  - All locations except Bangkok
- **Togo**—All locations
- **Trust Territory of the Pacific Islands**—All locations
- **Turks and Caicos Island**
  - Grand Turk Auxiliary Airfield
- **Turkey**—All locations
- **Uganda**—All locations
- **United Arab Emirates**—All locations
- **United Kingdom**
  - Belfast
- **Upper Volta**—All locations
- **U.S.S.R.**—All locations
- **Venezuela**
  - All locations within the states of:
    - Apure
    - Barinas
    - Bolivar
    - Cojides
    - Guarico
    - Mongas
    - Portuguesa
  - Amacuro Delta Territory
  - Amazonas Territory
  - Campamento Siberia
  - Turimiquire Dam
- **Yemen Arab Republic**—All locations
- **Zaire**—All locations
- **Zambia**—All locations
- **Zimbabwe**—All locations
- **Other**
  - MV Seismic Surveyor (North Sea)

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing, the following individual has been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
J. Franklin Moore	Lenoir, NC	Certified Public Accountant	August 18, 1980

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Anthony G. Bellas	Littleton, CO	Enrolled Agent	Twelve months effective September 1, 1980
Roy W. Lynch	New Bedford, MA	Enrolled Agent	Indefinite effective August 28, 1980
Roger C. Hennings	Stillwater, MN	Attorney	Indefinite effective August 28, 1980
Vincent E. Heyworth	Hagerstown, MD	Enrolled Agent	Six months effective September 30, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.482-2, 1.483-1, amended.	Imputed interest rate on loans between related entities and on deferred payments in the case of certain sales of property.	Aug. 29, 1980	Oct. 28, 1980
26 CFR 1.6013-6(a)(2)(v) amended.	Relationship of election by nonresident alien to be treated as a resident and income tax treaties.	Sept. 12, 1980	Nov. 11, 1980
26 CFR 1.47-1 amended, 1.48-9 added.	Business investment credit for energy property.	Sept. 19, 1980	Nov. 18, 1980
26 CFR 150.4989-1(c) amended; published as temporary regulations in T.D. 7720, 1980-42 I.R.B. 12.	Interim rule for determining base prices for tier 2 and tier 3 oil.	Sept. 24, 1980	Nov. 24, 1980
26 CFR 150.4989-1(c), 150.4995-1(b)(2) revised; published as temporary regulations in T.D. 7721, 1980-42 I.R.B. 13.	Base prices of tier 2 and tier 3 oil and withholding in the absence of effective operator's certificate.	Sept. 30, 1980	Dec. 1, 1980
26 CFR 1.584-1 through 1.584-4, 1.6032-1 amended.	Common trust funds.	Sept. 22, 1980	Nov. 21, 1980
26 CFR 31.6205-1(b)(2) amended.	Interest-free adjustment with respect to erroneous filing of FICA and RRTA returns.	Sept. 26, 1980	Nov. 25, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] See footnote at end of list.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27, dated July 7, 1980.

NOTES

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1937–2	7.70	*1953–1*	*4.25*	1966–1	14.00	1977–2	11.75
1938–1	*16.00*	1953–2	12.00	1966–2	14.05	1978–1	11.75
1938–2	*13.00*	1954–1	12.00	1967–1	10.00	1978–2	13.00
1939–1–1	8.25	1954–2	12.00	1967–2	14.00	1978–3–1	12.25
1939–1–2	10.90	1955–1	10.25	1968–1	14.00	1978–3–2	9.00
1939–2	9.40	1955–2	13.00	1968–2	11.75	1979–1	14.00
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November 3, 1980
Bulletin No. 1980-44

9258

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENTS

Announcement 80-139, page 36.
A public hearing will be held on December 4, 1980, concerning proposed regulations relating to business investment credit for energy property.

Announcement 80-145, page 37.
The date for submitting comments on proposed amendments to the regulations under 31 CFR Part 10 that govern practice before the Service with respect to opinions used in the promotion of tax shelters has been extended to November 14, 1980. A public hearing on the proposed amendments will be held on November 25, 1980.

Announcement 80-146, page 38.
The date for filing 1979 income tax returns has been extended to December 15, 1980, for certain overseas employees of charitable organizations who resided in lesser developed countries while employed by such organizations during any part of their 1979 taxable year.

INCOME TAX

Rev. Rul. 80-292, page 5.
Distribution of stock rights from subsidiary to parent's shareholders. A wholly owned subsidiary issued nontransferable subscription rights to purchase stock in the subsidiary to the shareholders of its parent. As the parent expected, an active "when-issued" market developed for the stock of the subsidiary at a market price in excess of the subscription price. The transaction is treated as a nontaxable distribution from the subsidiary to the parent under section 305(a) of the Code that is followed by a distribution of property from the parent to its shareholders. The constructive distribution by the parent is taxable to the shareholders, subject to the provisions of section 301, on the date of distribution, rather than on the date the rights are exercised.

Rev. Rul. 80-293, page 8.
Incorporation of foreign partnership; losses; U.S. partners; section 367 ruling. The amount of ordinary foreign source income that domestic partners are required to include in their income upon the incorporation of their foreign partnership is limited to the amount of losses incurred by the partnership after the domestic partners acquired their partnership interests; Rev. Rul. 78-201 amplified.

T.D. 7722, page 6.
Final regulations under section 337 of the Code relate to the election to treat the disposition of involuntarily converted property that occurred within 60 days before the date a plan of liquidation is adopted as a sale or exchange occurring within the 12-month period beginning on that date.

EXEMPT ORGANIZATIONS

Rev. Rul. 80-294, page 9.
Broadcasting rights; professional tournaments.

(Continued on page 4)

Finding Lists begin on page 41.
Announcement of Disbarment and Voluntary Suspensions on page 39.
Announcement of Notice of Proposed Rulemaking on page 40.
Monthly Index for October begins on page 44.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

EXEMPT ORGANIZATIONS—Cont'd

The status of an organization exempt under section 501(c)(6) of the Code created to promote interest in, elevate the standards of, and conduct tournaments in, a certain professional sport will not be adversely affected merely because its primary support is derived from the sale of television broadcasting rights to the tournaments it conducts; Rev. Rul. 58-502 clarified.

Rev. Rul. 80-295, page 10.
Unrelated trade or business; broadcasting rights; amateur athletic events. The sale of television and radio broadcasting rights to an independent producer by an exempt organization created as a national governing body for amateur athletics is not unrelated trade or business under section 513 of the Code.

Rev. Rul. 80-296, page 10.
Unrelated trade or business; broadcasting rights; athletic event. The sale of broadcasting rights to a national radio and television network by an organization created by a regional collegiate athletic conference made up of universities to hold an annual athletic event is not unrelated trade or business under section 513 of the Code.

Rev. Rul. 80-297, page 11.
Unrelated trade or business; school leasing tennis facilities. An exempt school that uses its tennis facilities for ten weeks in the summer as a public tennis club operated by employees of the school's athletic department is engaged in unrelated trade or business, and the income earned is not excludable from unrelated business taxable income as rent from real property. If the school leases the tennis facilities for a fixed fee to an unrelated individual who operates a tennis club for the public, the school is still engaged in unrelated trade or business, but the lease income is excluded from unrelated business taxable income as rent from real property. Rev. Rul. 76-402 amplified.

Rev. Rul. 80-298, page 13.
Unrelated trade or business; university leasing stadium. An exempt university that leases its stadium to a professional football team for several months of the year and provides the utilities, grounds maintenance, and dressing room, linen, and stadium security services is engaged in unrelated trade or business. Further, the university's income from the lease is not excluded from unrelated business taxable income as rent from real property.

Announcement 80-140, page 36.
A listing is given of organizations now classified as private foundations.

TAX CONVENTIONS

France, page 15.
The convention between the United States and the French Republic with respect to taxes on estates, inheritances, and gifts is reproduced.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 301.—Distributions of Property

26 CFR 1.301-1: Rules applicable with respect to distributions of money and other property.
(Also Section 305; 1.305-1.)

Distribution of stock rights from subsidiary to parent's shareholders. A wholly owned subsidiary issued nontransferable subscription rights to purchase stock in the subsidiary to the shareholders of its parent. As the parent expected, an active "when-issued" market developed for the stock of the subsidiary at a market price in excess of the subscription price. The transaction is treated as a nontaxable distribution from the subsidiary to the parent under section 305(a) of the Code that is followed by a distribution of property from the parent to its shareholders. The constructive distribution by the parent is taxable to the shareholders, subject to the provisions of section 301, on the date of distribution, rather than on the date the rights are exercised.

Rev. Rul. 80-292

ISSUE (1). Whether a direct issuance by a subsidiary corporation (*S*) of nontransferable rights to acquire *S* stock to the shareholders of its parent corporation (*P*) should be treated, for federal income tax purposes, as a nontaxable distribution of stock rights by *S* to *P* under section 305(a) of the Internal Revenue Code followed by a distribution of property by *P* to its shareholders under section 301.

ISSUE (2). If the transaction is so viewed, whether the constructive distribution by *P* to its shareholders is taxable under section 301 of the Code on the date the nontransferable rights to purchase stock are constructively distributed by *P*, or on the date that the shareholder of *P* exercises the rights to purchase the subsidiary's stock.

FACTS

P corporation is engaged in manufacturing and *P*'s stock is traded on a national securities exchange. *P* owns all of the stock of *S* corporation. *S* was recently created to engage in a new and relatively speculative business enterprise that was unrelated to *P*'s manufacturing business except that *P*'s manufactured end-product goods will be utilized in *S*'s operations. The management of *P* and *S* desired to obtain additional equity capital for *S*'s operations by offering to the shareholders of *P* an oportunity to obtain 17 percent of the outstanding stock of *S* with *P* retaining the remaining 83 percent of *S*'s stock. The plan was declared effective on January 3, 1978, and called for *S* to directly issue nontransferable subscription rights to subscribe to its stock to the *P* shareholders on a pro rata basis. One right to purchase one share of *S* common stock was to be issued for each seven shares of *P* common stock held by a shareholder at the close of business on the record date of January 20, 1978. Each right was exercisable at a price of 15 dollars. The rights were mailed by *S* to the *P* shareholders after close of business on the record date, and were exercisable by the payment of the 15 dollar subscription price by close of business on February 10, 1979.

When the plan for the issuance of the rights became effective on January 3, 1978, as was expected by *P*, shares of *S* stock started trading on a "when-issued" basis on the over-the-counter market, and 3 days later, on January 6, 1978, shares of *S* started trading on a "when-issued" basis at an average price of 35 dollars on a national stock exchange. On this market and exchange, a *P* shareholder could, and some did, enter into a contract with another person to sell, at the 35 dollar per share market price, to that person shares of *S* that the *P* shareholder would receive upon exercise of the right to acquire such stock by payment of the 15 dollar subscription price.

LAW

Section 305(a) of the Code provides the general rule that gross income does not include the amount of any distribution of the stock of a corporation made by such corporation with respect to its stock. Section 305(d)(1) provides that for purposes of section 305(a) the term "stock" includes rights to acquire stock.

Section 301(a) of the Code provides that a distribution of property (as defined in section 317(a)) with respect to a corporation's stock shall be treated as provided in section 301(c). Section 317(a) provides that the term "property" means money, securities, and any other property; except that such term does not include stock in the corporation making the distribution (or rights to acquire such stock). Section 301(c) provides that the portion of the distribution that constitutes a dividend (as defined in section 316) shall be included in gross income; section 301(b) provides that the amount of such a distribution, to a noncorporate distributee, is the fair market value of the property received.

ANALYSIS

ISSUE (1). The subscription rights issued by *S* appear to represent merely an offer by *S* to the *P* shareholders to purchase *S* stock that was made because those shareholders are likely purchasers of *S* stock since they own *P* stock. However, because of the corporate-shareholder relationship of the parties, a question arises as to whether the form of the transaction should determine its characterization for federal income tax purposes. In *Baumer v. United States*, 580 F.2d 863 (5th Cir. 1978) a corporation granted, without business purpose and for nominal consideration, a valuable option to purchase corporate property to the son of the corporation's sole shareholder. The United States Court of Appeals held that the form of the transaction would not control and that the transaction resulted in a constructive dividend to the father and a gift by the father to the son in the amount of the constructive dividend.

Similarly, in the present transaction the value of the rights to purchase *S* stock received only by the *P* shareholders, without any consideration, was significant. The value of the right was evidenced by the fact that the *S* stock was trading at an average price, during the exercise period, which substantially exceeded the 15 dollar subscription price. If *S* had distributed rights to purchase its stock to *P* and *P* in turn distributed those rights, without consideration, to the *P* shareholders, the distribution to the *P* shareholders would be a taxable distribution of property, within the meaning of section 317(a), under section 301. See Rev. Rul. 70-521, 1970-2 C.B. 72. Consequently, considering *P*'s control over *S* it is appropriate to view the transaction, for federal income tax purposes, as a distribution of stock rights by *S* to *P* under section 305(a) of the Code followed by a distribution of property, within the meaning of section 317(a), in the form of stock rights to purchase *S* stock by *P* to its shareholders subject to the provisions of section 301, especially since this view is consistent with the economic realities of the transaction.

HOLDING

ISSUE (1). The transaction will be viewed, for federal income tax purposes, as a nontaxable distribution of stock rights, within the meaning of section 305(d)(1) of the Code, by *S* to *P* under section 305(a), followed by a distribution of property by *P*, within the meaning of section 317(a), to its shareholders subject to the provisions of section 301.

ANALYSIS

ISSUE (2). Prior to enactment of the 1954 Code, the Supreme Court of the United States held that a corporation's issuance of rights to purchase stock of another corporation did not constitute a dividend, and instead amounted to an offer that could result in dividend treatment only when the offer was accepted by exercise. *Palmer v. Commissioner,* 302 U.S. 63 (1937), 1937-2 C.B. 251. Following enactment of the 1954 Code, the Supreme Court indicated that it has not been authoritatively settled whether an issue of rights to acquire stock of another corporation at less than fair market value itself constitutes a dividend, or whether the dividend occurs only on the exercise of the right. *Commissioner v. Gordon,* 391 U.S. 83 (1968), 1968-2 C.B. 148.

In Rev. Rul. 70-521, the Service concluded that since under the revised 1954 Code treatment of corporate distributions, rights to acquire stock in a corporation other than the distributing corporation are "property" within the meaning of section 317(a) of the Code, a distribution of such rights is taxable as provided under section 301(c) as of the time of distribution. Thus, the *Palmer* doctrine would not be applied so as to avoid ordinary dividend taxation on the distribution of transferable rights to acquire stock of another corporation on the date of distribution. *Redding v. Commissioner,* Docket Nos. 79-1775, 79-1776 (7th Cir., Aug. 25, 1980). Similarly, while the rights to acquire *S* stock in the instant case were nontransferable, as was expected by the management of *P*, a trading market for these rights developed immediately on the "when-issued" market upon the effective date of the plan. Further, under the facts and circumstances of the instant transaction the "nontransferable" nature of the rights has no effect on the conclusion that the rights to acquire *S* stock are property.

Since the constructive issuance by *P* of the stock rights to purchase *S* stock involves a distribution of property other than cash, the fair market value of the rights distribution in the instant case is determined, pursuant to section 1.301-1(b) of the Income Tax Regulations, as of the date that the rights were actually distributed on January 20, 1978. Section 1.301-1(b) further provides that the date of distribution of property other than cash is determined without regard to whether such date is the same as that on which the distribution is includible in the shareholder's gross income. Thus, January 20, 1978, the date on which *P* distributed the stock rights, is the date on which the fair market value of these rights is determined even if they are not includible in the gross income of a *P* shareholder on that date.

HOLDING

ISSUE (2). The constructive distribution by *P* to its shareholders of nontransferable rights to purchase *S* stock is a distribution of property on the date of distribution (January 20, 1978), taxable as provided in section 301(c) of the Code. The amount distributed to an individual shareholder of *P* upon receipt of each right to purchase a share of *S* stock is the fair market value of each right on the date of distribution. See section 301(b)(1)(A). The amount distributed to a domestic corporate shareholder of *P* is the lesser of the fair market value of the rights distributed or the adjusted basis of the property in the hands of *P*. See section 301(b)(1)(B).

Section 305.—Distributions of Stock and Stock Rights

26 CFR 1.305-1: Stock dividends.

Whether a subsidiary corporation's direct issuance to the shareholders of its parent corporation of rights to acquire a portion of the subsidiary corporation's stock should, in part, be treated as a distribution of stock rights from the subsidiary to the parent, which is nontaxable under section 305(a), followed by a distribution of these rights by the parent to its shareholders under section 301. See Rev. Rul. 80-292, page 5.

Section 337.—Gain or Loss on Sales or Exchanges in Connection With Certain Liquidations

26 CFR 1.337-6: Information to be filed.

T.D. 7722

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Election in certain liquidation
for involuntary conversions

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the election to extend the 12-month period for certain corporate liquidations where there is an involuntary conversion. Changes to the applicable tax law were made by the Act of November 10, 1978, Pub. L. 95-628, 1978-2 C.B. 435. The regulations provide necessary guidance to the public as to the time and manner for making the election.

DATE: The regulations are effective for dispositions of involuntarily converted property occurring after November 10, 1978.

FOR FURTHER INFORMATION CONTACT: Lawrence M. Axelrod of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T) (202-566-3458) (not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On January 30, 1980, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 337 of the Internal Revenue Code of 1954 (45 FR 6800). The amendments were proposed to conform the regulations to section 4 of the Act of November 10, 1978 (92 Stat. 3628). A public hearing was neither requested nor held. After consideration of the one comment received regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision.

Under section 337(e) of the Code, a liquidating corporation that qualifies under section 337(a) may elect to treat the disposition of involuntarily converted property, that occurred within 60 days preceding the date a plan of liquidation is adopted, as a sale or exchange occurring within the 12-month period beginning on that date. If the election is made, no gain or loss from any involuntary conversion during the 60-day period is recognized. H.R. Rep. No. 95-645, 95th Cong., 2d Sess. 7 (1978). Under section 337(e)(3), the Secretary is authorized to prescribe regulations specifying the time and manner in which the election is made.

The notice proposed that a corporation could elect the application of section 337(e) by adding a sentence to a statement, presently required under § 1.337-6, expressly electing to apply section 337(e). The notice further proposed that the statement would have to be filed with a timely filed original return of the electing corporation.

After considering the comment received, it was determined that the election should not be made with the statement presently required under § 1.337-6. The Service has ruled that a corporation will not be denied the benefit of section 337(a), for failure to report the information required by § 1.337-6, because section 337(a) is not an elective provision but is mandatory for transactions that meet the statutory requirements (Rev. Rul. 65-30, 1965-1 C.B. 155). On the other hand, section 337(e) is elective. If the corporation fails to make an election under that section, it will not receive the benefit. Furthermore, the return of the liquidating corporation, for the taxable year for which certain information is required under § 1.337-6, may not be the return for the taxable year for which gain (or loss) is reportable for property involuntarily converted during the 60-day period described in section 337(e)(2). Lastly, since section 337(e) was enacted as a relief provision, it seemed harsh to deny a liquidating corporation the benefit of that provision simply because the corporation failed to make the election with the original return.

Accordingly, the final regulations provide that a corporation must file with its return or amended return, for the earliest taxable year for which income (or loss) attributable to involuntarily converted property would otherwise be reportable, a statement that it elects the application of section 337(e) to such property converted during the 60-day period described in section 337(e)(2). The statement must include a general description of all property involuntarily converted during that period.

DRAFTING INFORMATION

The principal author of this regulation is Lawrence M. Axelrod of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 1 is amended as follows:

Section 1.337-6 is amended by adding a new paragraph (c) at the end to read as follows:

§ 1.337-6 Information to be filed.

* * * * *

(c) *Election under section 337(e).* (1) Section 337(e) applies to a disposition of converted property (within the meaning of section 1033(a)(2)(E)(ii)) occurring after November 10, 1978, but only if a proper election is made.

(2) To make the election—

(i) A liquidating corporation must file a statement that it elects 337(e) for all of its property involuntarily converted during the 60-day period described in section 337(e)(2).

(ii) The statement must be filed with its return or amended return for the earliest taxable year for which income (or loss) would otherwise be reportable for such conversions.

(iii) The statement must include the name of the liquidating corporation, its taxpayer identification number, a general description of the property, and the date or dates of the conversions. The general description of the property should be sufficient to apprise the Commissioner as to which business and which assets were involuntarily converted. The requirement that a general description of the property be provided is not intended to impose on the taxpayer the burden of listing each item of property destroyed. For example, assume a fire, which destroys a men's clothing store and all the contents therein, precipitates the adoption of a plan of liquidation. A satisfactory statement would set forth the date of the fire, the location of the store, and that furniture, fixtures, inventory, and records of a men's clothing store were destroyed.

(3) If, following the filing of an election under section 337(e), a liquidating corporation fails to satisfy the requirements for a complete liquidation under section 337(a), the corporation must file an amended return reporting any gain or loss that was not recognized by reason of its election under section 337(e).

This Treasury decision is issued under the authority contained in sections 337(e) and 7805 of the Internal Revenue Code of 1954 (92 Stat. 3628, 68A Stat. 917; 26 U.S.C. 337(e), 7805).

JEROME KURTZ,
Commissioner of Internal Revenue.

Approved September 16, 1980.

DONALD C. LUBICK,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on September 30, 1980, 8:45 a.m., and published in the issue of the Federal Register for October 1, 1980, 45 F.R. 64906)

Section 367.—Foreign Corporations

26 CFR 7.367(a)-1: Ruling requests under section 367 relating to certain transfers involving a foreign corporation.

Incorporation of foreign partnership; losses; U.S. partners; section 367 ruling. The amount of ordinary foreign source income that domestic partners are required to include in their income upon the incorporation of their foreign partnership is limited to the amount of losses incurred by the partnership after the domestic partners acquired their partnership interests; Rev. Rul. 78-201 amplified.

Rev. Rul. 80-293

ISSUE

Upon a foreign partnership's incorporation of its business, is the amount of ordinary foreign source income that United States persons are required to include in their income in accordance with Rev. Rul. 78-201, 1978-1 C.B. 91, limited to the amount of losses incurred by the partnership after United States persons purchased their partnership interests?

FACTS

P, a foreign partnership that was organized 10 years ago, was engaged in the farming business on land in foreign country *Z*. *A*, *B*, *C*, and *X* own percentage interests in *P* of 63, 7, 10, and 20, respectively, the percentage interests being in both capital and profits. *A* and *B* are individuals and are United States residents, *C* is a nonresident alien individual, and *X* is a domestic corporation. *A* and *B* acquired their partnership interests in 1977, in a bona fide purchase, from unrelated parties who were United States residents. *X* and *C* acquired their partnership interests when *P* was originally formed.

P decided to incorporate its farming business in country *Z* to benefit from certain tax incentives in country *Z*. Accordingly, in 1978, *P* transferred all of the assets associated with its farming business to *Y*, a newly-formed country *Z* corporation, solely in exchange for all of the stock of *Y* and *Y*'s assumption of all of the liabilities associated with the farming business. The fair market value of, and *P*'s basis in, its assets transferred to *Y* exceeded the sum of the liabilities assumed by *Y*. *P* remained in existence and retained certain export licenses and the stock of *Y*.

Prior to 1977, *P* incurred net losses that were passed through as deductions to the partners and reduced their basis in the partnership and their other income. For the period subsequent to the purchase of the partnership interests by *A* and *B*, *P* had net profits which were included in income by *A*, *B*, and *X* in proportion to their respective interests.

The transfer of assets in exchange for stock would have fulfilled all of the requirements of section 351 of the Code had the transferee been a domestic corporation. The transfer met the requirements of section 3.02(1) of Rev. Proc. 68-23, 1968-1 C.B. 821. Further, within 183 days of the beginning of the transfer *P* requested a ruling from the Internal Revenue Service that the transaction was not in pursuance of a plan of tax avoidance within the meaning of section 367.

LAW AND ANALYSIS

The applicable Code sections are section 351(a), relating to the nonrecognition of gain or loss on the transfer of property to a corporation controlled by the transferor, and section 367(a)(1), relating to the requirement that a ruling be obtained that an exchange described in section 351 is not in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes in order for a foreign corporation to be considered a corporation for purposes of determining gain on the transfer.

The applicable sections of the Temporary Income Tax Regulations are section 7.367(a)-1(b)(3)(i), which provides that a "transfer described in section 367(a)(1)" of the Code is a transfer of property made by a United States person, directly or indirectly, to a foreign corporation in connection with an exchange described in section 351, and section 7.367(a)-1(b)(3)(iii), which provides that a transfer by a foreign partnership in which a United States person holds an interest shall be considered to have been made by any such United States person who realizes gain or other income (whether or not recognized) on account of the transfer.

Pursuant to section 7.367(a)-1(b)(3)(iii) of the Temporary Regulations, *A*, *B*, and *X* are considered to have made the transfer of property to *Y* that *P* made. Since the transfer is described in section 351 of the Code and the transfer of property was made indirectly by a United States person (*A*, *B*, and *X*) to a foreign corporation (*Y*), the transfer is described in section 367(a)(1). Unless it is established that the transfer to *Y* was not in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes, then, pursuant to section 367(a)(1), *Y* will not be considered to be a corporation for purposes of determining gain recognized on the transfer. The transfer of property to *Y* qualifies for nonrecognition of gain to *P* under section 351 (thus no gain is passed through to the partners) if *Y* is considered to be a corporation.

Rev. Rul. 78-201 required the United States transferor to include in income an amount of ordinary foreign source income (the sum of branch losses previously incurred) as a condition for obtaining a ruling that the exchange was not in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes within the meaning of section 367(a)(1) of the Code. In the instant situation, the acquisition by *A* and *B* in 1977, through a taxable sale, of their 70 percent interest in *P*'s capital and profits created a new partnership for federal income tax purposes. See section 708(b)(1)(B) of the Code. Since *P* had only net profits during the period subsequent to the purchase of their partnership interests by *A* and *B*, those partners did not have any partnership losses from *P* prior to the incorporation.

X acquired its partnership interest in *P* 10 years ago. The losses incurred by the foreign farming business of *P* prior to 1977, and prior to its incorporation, were taken into account by *X* in proportion to its partnership interest and reduced the amount of *X*'s worldwide income subject to federal income tax. As a result of the incorporation of the foreign farming business of *P*, the income to be produced by these operations will not be taken into account by *X*, and thus will not increase the amount of *X*'s worldwide income subject to federal income tax. Accordingly, the transfer by *P* of all of the assets associated with its farming business to *Y* will be deemed not to be in pursuance of a plan having as one of its principal purposes the avoidance of federal income taxes within the meaning of section 367(a)(1) of the Code only if *X* (who is considered to be a transferor by application of section 7.367(a)-1(b)(3)(iii) of the Temporary Regulations), pursuant to Rev. Rul. 78-201, recognizes as gain on the transfer an amount of ordinary foreign source income equal to its proportionate share of the sum of the foreign country *Z* losses previously incurred by *P*.

HOLDING

Since *P* incurred only net profits after *A* and *B* became partners in a taxable sale or exchange, and thus *A* and *B* were unable to utilize *P*'s net losses, Rev. Rul. 78-201 does not require *A* and *B* to include the sum of *P*'s prior losses in their income as ordinary foreign source income. However, since *X* utilized *P*'s net losses, Rev. Rul. 78-201 requires *X* to recognize as gain on the transfer an amount of ordinary foreign source income equal to *X*'s proportionate share of the sum of the foreign country *Z* losses previously incurred by *P* as a condition for obtaining a ruling under section 367(a)(1) of the Code. In addition, *X*'s basis in *P*, *P*'s basis in the *Y* stock, and *Y*'s basis in the assets received are increased by the amount of gain that *X* recognizes, pursuant to Rev. Rul. 78-201, on the transfer.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 78-201 is amplified.

Section 501.—Exemption From Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(c)(6)-1: Business leagues, chambers of commerce, real estate boards, and boards of trade.

Broadcasting rights; professional tournaments. The status of an organization exempt under section 501(c)(6) of the Code created to promote interest in, elevate the standards of, and conduct tournaments in, a certain professional sport will not be adversely affected merely because its primary support is derived from the sale of television broadcasting rights to the tournaments it conducts; Rev. Rul. 58-502 clarified.

Rev. Rul. 80-294

ISSUE

Is the exempt status of an organization described in section 501(c)(6) of the Internal Revenue Code adversely affected when its primary source of support is income derived from the sale of broadcasting rights?

FACTS

The organization was formed to promote interest in a particular sport, to elevate the standards of the sport as a profession, and to sponsor and conduct tournaments for the encouragement of its members. The organization's membership is open to all professional players of the sport in the United States. The organization has been recognized as exempt from federal income tax under section 501(c)(6) of the Code.

Among its activities, the organization conducts apprentice programs, annual conventions and merchandise shows, and tournaments. Its support is derived primarily from the sale of television broadcasting rights to its tournaments. Other support is from membership dues, penalties, and apprentice fees. Its expenses are for salaries, administrative costs of its programs, and tournament costs, including prizes and awards.

LAW AND ANALYSIS

Section 1.501(c)(6)-1 of the Income Tax Regulations provides that a business league is an association of persons having some common business interest, the purpose of which is to promote such common interest and not to engage in a regular business of a kind ordinarily carried on for profit. It also provides that the activities of the organization should be directed to the improvement of business conditions of one or more lines of business as distinguished from the performance of particular services for individual persons.

Rev. Rul. 58-502, 1958-2 C.B. 271, describes an association, exempt under section 501(c)(6) of the Code, which was formed to promote and conserve the best interest and true spirit of a game and which accomplishes its exempt purposes by the sponsoring and conducting of championship tournaments and the incidental sale of radio and television broadcasting rights. Rev. Rul. 58-502 implies that unless the amount of income received by the association from the sale of broadcasting rights is relatively insignificant, the sale of broadcasting rights would not serve the association's exempt purposes.

Here, the organization's tournament activities are similar to those of an organization described in Rev. Rul. 58-502, with the exception that the organization's primary source of support is the sale of broadcasting rights.

The sponsorship of tournaments and the sale of broadcasting rights with respect thereto by the organization directly promotes the interests of those engaged in the sport by encouraging participation in the sport and by enhancing awareness by the general public of the sport as a profession. The amount of income derived from the sale of broadcasting rights is not, by itself, determinative of whether the activity furthers the purposes specified in section 501(c)(6) of the Code. Thus, under the circumstances described above, sponsoring tournaments and selling broadcasting rights are activities directly related to exempt purposes, notwithstanding the amount of income received.

HOLDING

An organization exempt from federal income taxes under section 501(c)(6) of the Code will not adversely affect its exempt status if its primary source of support is derived from the sale of broadcasting rights to the sports tournaments it conducts.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 58-502 is clarified to remove the implication that the sale of television broadcasting rights to an organization's tournaments furthers exempt purposes within the meaning of section 501(c)(6) of the Code only when the amount of income derived therefrom is insignificant in amount.

Also, see Rev. Rul. 80-295, this page, and Rev. Rul. 80-296, this page, this Bulletin.

Section 512.—Unrelated Business Taxable Income

26 CFR 1.512(b)-1: Modifications.

Whether an exempt school's furnishing of its tennis facilities in two described situations is unrelated trade or business under section 513 and if so, whether income from these activities is excluded from unrelated business taxable income as rent from real property under section 512(b)(3). See Rev. Rul. 80-297, page 11.

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26 CFR 1.512(b)-1: Modifications.

Whether an exempt university's leasing of its stadium to a professional football team is unrelated trade or business under section 513 and, if so, whether amounts from this activity are excluded from unrelated business taxable income as rent from real property under section 512(b)(3). See Rev. Rul. 80-298, page 13.

Section 513.—Unrelated Trade or Business

26 CFR 1.513-1: Definition of unrelated trade or business.

Unrelated trade or business; broadcasting rights; amateur athletic events. The sale of television and radio broadcasting rights to an independent producer by an exempt organization created as a national governing body for amateur athletics is not unrelated trade or business under section 513 of the Code.

Rev. Rul. 80-295

ISSUE

Under the circumstances described below, is the sale of exclusive broadcasting rights to athletic events by an organization exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code unrelated trade or business within the meaning of section 513?

FACTS

The organization was created as a national governing body for amateur athletics to promote systematic physical exercise and education, to foster interest in amateur sports among the public at large, and to encourage widespread public participation in athletics and recreational sports.

The organization sponsors, supervises, and regulates programs in a number of different amateur sports. It also arranges for and coordinates open competition for amateur athletes at the local, state, regional, and national levels.

The organization receives income each year from the sale of exclusive television and radio broadcasting rights to an independent producer, who contracts with a commercial network to broadcast many of the athletic events sponsored, supervised, and regulated by the organization.

LAW AND ANALYSIS

Section 513(a) of the Code defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of an organization for income or funds or the use it makes of the profits derived) to the exercise or performance by an organization of its exempt function.

Section 1.513-1(d)(2) of the Income Tax Regulations provides that a trade or business is "substantially related" only if the production or distribution of the goods or the performance of the service from which the gross income is derived contributes importantly to the accomplishment of the purposes for which exemption is granted.

The broadcasting of the organization's sponsored, supervised, and regulated athletic events promotes the various amateur sports, fosters widespread public interest in the benefits of its nationwide amateur athletic program, and encourages public participation. Therefore, the organization's sale of broadcasting rights and the resultant broadcasting of its athletic events contributes importantly to the accomplishment of its exempt purposes.

HOLDING

The sale of exclusive broadcasting rights, under the circumstances described above, is substantially related to the purpose constituting the basis for the organization's exemption and, therefore, is not unrelated trade or business within the meaning of section 513 of the Code.

See Rev. Rul. 80-294, page 9, and Rev. Rul. 80-296, this page, this Bulletin.

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26 CFR 1.513-1: Definition of unrelated trade or business.

Unrelated trade or business; broadcasting rights; athletic event. The sale of broadcasting rights to a national radio and television network by an organization created by a regional collegiate athletic conference made up of universities to hold an annual athletic event is not unrelated trade or business under section 513 of the Code.

Rev. Rul. 80-296

ISSUE

Is the sale of broadcasting rights to an annual intercollegiate athletic event by an organization exempt from federal income tax under section 501(c)(3) of the Internal Revenue Code unrelated trade or business within the meaning of section 513?

FACTS

The organization was created by a regional collegiate athletic conference, made up of universities exempt under section 501(c)(3) of the Code, for the purpose of conducting an annual competitive athletic game between the champion of the conference and another collegiate team. The annual game generates income from various sources including admission charges and the sale of exclusive broadcasting rights to a national radio and television network.

LAW AND ANALYSIS

Section 513(a) of the Code defines the term "unrelated trade or business" as any trade or business the conduct of which is not substantially related (aside from the need of an organization for income or funds or the use it makes of the profits derived) to the exercise or performance by an organization of its exempt function.

Section 1.513-1(d)(2) of the Income Tax Regulations provides that a trade or business is "substantially related" only if the production or distribution of the goods or the performance of the service from which the gross income is derived contributes importantly to the accomplishment of the purposes for which exemption is granted. Whether activities productive of gross income contribute importantly to the accomplishment of any purpose for which an organization is granted exemption depends in each case upon the facts and circumstances involved.

College and university athletic organizations that promote certain aspects of athletic competition have generally been held to be educational and thus exempt from federal income tax. An athletic program is considered to be an integral part of the educational process of a university, and activities providing necessary services to student athletes and coaches further the educational purposes of the university. See Rev. Rul. 67-291, 1967-2 C.B. 184. See also Rev. Rul. 64-275, 1964-2 C.B. 142.

The Service has traditionally taken the position that income from paid admissions to college and university athletic events, regardless of the number of persons in attendance or the amount of paid admissions, is not taxable as income from unrelated trade or business because the events themselves are related to the educational purposes of the colleges and universities. This position is consistent with the following language contained in the Committee Reports on the Revenue Act of 1950, in which the predecessor to section 513 of the Code was enacted.

Athletic activities of schools are substantially related to their educational functions. For example, a university would not be taxable on income derived from a basketball tournament sponsored by it, even where the teams were composed of students from other schools. (H.R. Rep. No. 2319, 81st Cong., 2d Sess. 37, 109 (1950), 1950-2 C.B. 380, 458.)

Of course, income of an educational organization from charges for admissions to football games would not be deemed to be income from an unrelated business, since its athletic activities are substantially related to its athletic program. (S. Rep. No. 2375, 81st Cong., 2d Sess. 29, 107 (1950), 1950-2 C.B. 483, 505.)

On the basis of the facts and circumstances presented in this case the educational purposes served by intercollegiate athletic activities are identical whether conducted directly by individual universities or by their regional athletic conference. Also, the educational purposes served by exhibiting a game before an audience that is physically present and exhibiting the game on television or radio before a much larger audience are substantially similar. Therefore, the sale of the broadcasting rights and the resultant broadcasting of the game contributes importantly to the accomplishment of the organization's exempt purposes.

HOLDING

The sale of broadcasting rights, under the circumstances described, is substantially related to the purpose constituting the basis for the organization's exemption and is not unrelated trade or business within the meaning of section 513 of the Code.

See Rev. Rul. 80-294, page 9, and Rev. Rul. 80-295, page 10, this Bulletin.

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26 CFR 1.513-1: Definition of unrelated trade or business.
(Also Section 512; 1.512(b)-1.)

Unrelated trade or business; school leasing tennis facilities. An exempt school that uses its tennis facilities for ten weeks in the summer as a public tennis club operated by employees of the school's athletic department is engaged in unrelated trade or business, and the income earned is not excludable from unrelated business taxable income as rent from real property. If the school leases the tennis facilities for a fixed fee to an unrelated individual who operates a tennis club for the public, the school is still engaged in unrelated trade or business, but the lease income is excluded from unrelated business taxable income as rent from real property. Rev. Rul. 76-402 amplified.

Rev. Rul. 80-297

ISSUE

In the two situations described below, is a school's furnishing of its tennis facilities unrelated trade or business under section 513 of the Internal Revenue Code and, if so, is income from these activities excluded from unrelated business taxable income as rent from real property under section 512(b)(3)?

FACTS

SITUATION 1.—TENNIS CLUB RUN BY A SCHOOL'S EMPLOYEES

A school is exempt from federal income tax under section 501(c)(3) of the Code and is classified as an educational organization described in section

170(b)(1)(A)(ii). The school's purposes are limited to those involving the advancement of education. The school's facilities include tennis courts and dressing rooms, which are employed during the regular academic year in the school's educational programs. For ten weeks during the summer the school operates a tennis club. For a fee, the general public is invited to join the club and thereby use the school's tennis courts and dressing rooms during designated periods. Two employees of the school's athletic department conduct the affairs of the club, including collecting membership fees and scheduling court time. The net income of the club is used for the exempt purposes of the school.

SITUATION 2.—TENNIS CLUB RUN BY A PROFESSIONAL USING SCHOOL FACILITIES

This Situation is the same as *Situation 1*, except that the school merely makes the facilities available to an unrelated individual for ten weeks at a fixed fee which does not depend, in whole or in part, on the income or profits derived from the leased property. The individual forms a tennis club and hires employees to administer the affairs of the club. Under a contract with the school, the individual must repair any damage to the facilities beyond normal wear and tear at the end of the ten weeks.

LAW

Section 511 of the Code imposes a tax on the unrelated business taxable income of organizations exempt under section 501(c)(3).

Section 512(a) of the Code defines "unrelated business taxable income" as the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less certain deductions, but with modifications provided in section 512(b). For purposes of determining unrelated business taxable income, section 512(b)(3) excludes rents from real property.

Section 513(a) of the Code defines "unrelated trade or business" of an exempt organization as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational or other purpose or function constituting the basis for its exemption under section 501.

Section 513(c) of the Code provides that the term "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services.

Section 1.512(b)-1(c)(5) of the Income Tax Regulations provides that rents from real property, for purposes of the exclusion from unrelated business taxable income, do not include payments for the use or occupancy of rooms or other space where services are also rendered to the occupant, such as for the use or occupancy of rooms in hotels, boarding houses, or apartment houses furnishing hotel services, or for the use or occupancy of space in parking lots or warehouses. Generally, services are considered rendered to the occupant if they are for his or her convenience and are not those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only. The regulation further provides that supplying maid service constitutes such service, whereas the furnishing of heat and light, the cleaning of public entrances, exits, stairways, and lobbies, and the collection of trash, are not considered services rendered to the occupant.

Section 1.513-1(d)(2) of the Income Tax Regulations provides that a trade or business is "related" to exempt purposes, in the relevant sense, only when the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income); and it is "substantially related," for purposes of section 513 of the Code only if the causal relationship is a substantial one. Section 1.513-1(d)(2) further provides that for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

Rev. Rul. 76-402, 1976-2 C.B. 177, considered an exempt school that provides tennis courts, furnished dormitory rooms, linens, maid service, meals, and dining facilities to an individual for use by the individual in conducting a summer tennis camp. Rev. Rul. 76-402 assumed that the income was taxable as income from an unrelated trade or business under section 513 of the Code and was not excludable from unrelated business taxable income under section 512(b)(3) and section 1.512(b)-1(c)(5) of the regulations as rent from real property.

ANALYSIS AND HOLDINGS

In this case, by furnishing tennis facilities in the above described situations, the school is performing services for the production of income, which constitutes a trade or business under section 513 of the Code. Since the school furnishes its tennis facilities during ten weeks of the year, it is engaging in a trade or business regularly carried on within the meaning of section 512. The exempt purposes of the school are limited to those involving the advancement of education. Furnishing tennis facilities in the manner described is not an activity that furthers the educational purposes of a school. Thus, this activity does not have a substantial causal relationship to the achievement of the school's exempt purposes, as required by section 1.513-1(d)(2) of the regulations. Accordingly, the school's furnishing of its tennis facilities in the above described situations is unrelated trade or business under section 513.

In *Situation 1*, as in Rev. Rul. 76-402, the school furnishes more than just its facilities. It operates the tennis club through its own employees, who perform substantial services for the participants in the tennis club. Accordingly, income from the school's furnishing of its tennis facilities through the operation of a tennis club in the manner described is not excluded from unrelated business taxable income as rent from real property under section

512(b)(3) of the Code and section 1.512(b)-1(c)(5) of the regulations.

In *Situation 2*, the school furnishes its tennis facilities to an unrelated individual without services and for a fixed fee which does not depend in whole or in part on the income or profits derived from the leased property. Unlike *Situation 1*, where the school itself provided services, the unrelated club operator hires employees to administer the affairs of the club. Accordingly, income from the school's furnishing of its tennis facilities through an individual operator is excluded from unrelated business taxable income as rent from real property under section 512(b)(3) of the Code and section 1.512(b)-1(c)(5) of the regulations.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 76-402 is amplified.

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26 CFR 1.513-1: Definition of unrelated trade or business.
(Also Section 512; 1.512(b)-1.)

Unrelated trade or business; university leasing stadium. An exempt university that leases its stadium to a professional football team for several months of the year and provides the utilities, grounds maintenance, and dressing room, linen, and stadium security services is engaged in unrelated trade or business. Further, the university's income from the lease is not excluded from unrelated business taxable income as rent from real property.

Rev. Rul. 80-298

ISSUE

Under the circumstances described below, is a university's leasing of its stadium to a professional football team unrelated trade or business under section 513 of the Internal Revenue Code and, if so, is income from this activity excluded from unrelated business taxable income as rent from real property under section 512(b)(3)?

FACTS

The university is exempt from federal income tax under section 501(c)(3) of the Code, and has been classified as an educational organization described in section 170(b)(1)(A)(ii). The university's facilities include a stadium, which it uses in its physical education program and intramural and intercollegiate sports program. In addition to the stadium's use in connection with the university's educational activities, for a fixed fee, the university permits a professional football team to use the stadium for practice during several months of the year. Under a lease agreement, in addition to heat, light, and water, the university is responsible for maintaining the playing surface and all other grounds maintenance. It also provides dressing room, linen, and stadium security services for the professional team. Security services include crowd and traffic control, guarding the stadium and maintaining the privacy of practice sessions.

LAW

Section 511 of the Code imposes a tax on the unrelated business taxable income of organizations exempt under section 501(c)(3).

Section 512(a) of the Code defines "unrelated business taxable income" as the gross income derived by an organization from any unrelated trade or business regularly carried on by it, less certain deductions, but with modifications provided in section 512(b). For purposes of determining unrelated business taxable income, section 512(b)(3) excludes rents from real property.

Section 513(a) of the Code defines "unrelated trade or business" of an exempt organization as any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational or other purpose or function constituting the basis for its exemption under section 501.

Section 513(c) of the Code provides that the term "trade or business" includes any activity which is carried on for the production of income from the sale of goods or the performance of services.

Section 1.512(b)-1(c)(5) of the Income Tax Regulations provides that rents from real property, for purposes of the exclusion from unrelated business taxable income, do not include payments for the use or occupancy of rooms or other space where services are also rendered to the occupant, such as for the use or occupancy of rooms in hotels, boarding houses, or apartment houses furnishing hotel services, or for the use or occupancy of space in parking lots or warehouses. Generally, services are considered rendered to the occupant if they are for his or her convenience and are not those usually or customarily rendered in connection with the rental of rooms or other space for occupancy only. The regulation further provides that supplying maid service constitutes such service, whereas the furnishing of heat and light, the cleaning of public entrances, exits, stairways, and lobbies, and the collection of trash, are not considered services rendered to the occupant.

Section 1.513-1(d)(2) of the regulations provides that a trade or business is "related" to exempt purposes, in the relevant sense, only when the conduct of the business activities has causal relationship to the achievement of exempt purposes (other than through the production of income); and it is "substantially related," for purposes of section 513 of the Code only if the causal relationship is a substantial one. Section 1.513-1(d)(2) further provides that for the conduct of trade or business from which a particular amount of gross income is derived to be substantially related to purposes for which exemption is granted, the production or distribution of the goods or the performance of the services from which the gross income is derived must contribute importantly to the accomplishment of those purposes.

Rev. Rul. 76-402, 1976-2 C.B. 177, considered an exempt school that provides tennis courts, furnished dormitory rooms, linens, maid service, meals, and dining facilities to an individual for use by the individual in conducting a summer tennis camp. Rev. Rul. 76-402 assumed that the income was taxable as income from an unrelated trade or business under section 513 of the Code and was not excludable from unrelated business taxable income under section 512(b)(3) and section 1.512 (b)-1(c)(5) of the regulations as rent from real property.

ANALYSIS AND HOLDINGS

In this case, by leasing its stadium in the manner described, the university is performing services for the production of income, which constitutes a trade or business under section 513(c) of the Code. Since the university leases its stadium during several months of the year, it is engaging in a trade or business regularly carried on within the meaning of section 512. The exempt purposes of the university are limited to those involving the advancement of education. Leasing a stadium to a professional football team in the manner described is not an activity that furthers the educational purposes of a university. Thus, this activity does not have a substantial causal relationship to the achievement of the university's exempt purposes, as required by section 1.513-1(d)(2) of the regulations. Accordingly, the university's leasing of its stadium is unrelated trade or business under section 513.

Additionally, providing extensive grounds and playing field maintenance, dressing room linens, and stadium and dressing rooms, pursuant to the lease, the university, like the school in Rev. Rul. 76-402, is furnishing substantial services for the convenience of the lessee that go beyond those usually rendered in connection with the rental of space for occupancy only. Accordingly, income from the university's leasing of its stadium to a professional football team is not excluded from unrelated business taxable income as rent from real property under section 512 (b)(3) of the Code and section 1.512 (b)-1(c)(5) of the regulations.

See Rev. Rul. 76-402, for another example of the computation of unrelated business taxable income where amounts are from dual use of facilities and personnel.

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions

United States-France Estate, Inheritance, and Gift Tax Convention [1]

Convention signed at Washington November 24, 1978;
Ratification advised by the Senate of the United States of America July 9, 1979;
Ratified by the President of the United States of America July 30, 1979;
Ratified by the French Republic July 24, 1980;
Ratifications exchanged at Paris August 7, 1980;
Proclaimed by the President of the United States of America September 9, 1980;
Entered into force October 1, 1980.

BY THE PRESIDENT OF THE UNITED STATES OF AMERICA
A PROCLAMATION

CONSIDERING THAT:

The Convention between the United States of America and the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Estates, Inheritances, and Gifts was signed at Washington on November 24, 1978, the texts of which are hereto annexed;

The Senate of the United States of America by its resolution of July 9, 1979, two-thirds of the Senators present concurring therein, gave its advice and consent to ratification of the Convention;

The Convention was ratified by the President of the United States of America on July 30, 1979, in pursuance of the advice and consent of the Senate, and was ratified on the part of the French Republic on July 24, 1980;

It is provided in Article 19 of the Convention that the Convention shall enter into force the first day of the second month following the month in which the exchange of the instruments of ratification takes place;

The instruments of ratification of the Convention were exchanged at Paris on August 7, 1980, and accordingly the Convention enters into force on October 1, 1980;

NOW, THEREFORE, I, Jimmy Carter, President of the United States of America, proclaim and make public the Convention to the end that it shall be observed and fulfilled with good faith on and after October 1, 1980, by the United States of America and by the citizens of the United States of America and all other persons subject to the jurisdiction thereof.

IN TESTIMONY WHEREOF, I have signed this proclamation and caused the Seal of the United States of America to be affixed.

DONE at the city of Washington
this ninth day of
September in the
year of our Lord
one thousand
nine hundred
eighty and of the
Independence
of the United
States of
America the two
hundred fifth.

By the President:

JIMMY CARTER

Secretary of State:

EDMUND S. MUSKIE

CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND THE FRENCH REPUBLIC FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON ESTATES, INHERITANCES, AND GIFTS

The President of the United States of America and the President of the French Republic, desiring to conclude a convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on estates, inheritances, and gifts, have appointed for that purpose as their respective plenipotentiaries:

The President of the United States of America: The Honorable George S. Vest, Assistant Secretary of State for European Affairs, the President of the French Republic: His Excellency François de Laboulaye, Ambassador of France, who having communicated to each other their full powers, found in good and due form, have agreed upon the following provisions.

CHAPTER I.—SCOPE OF THE CONVENTION

ARTICLE 1.—ESTATES AND GIFTS COVERED

(1) This Convention shall apply to estates of decedents whose domicile at death was in France and to estates of decedents which are subject to the taxing jurisdiction of the United States by reason of the decedent's domicile therein or citizenship thereof at death.

(2) This Convention shall also apply to gifts of donors whose domicile at the time of making a gift was in France, and to gifts which are subject to the taxing jurisdiction of the United States by reason of the donor's domicile therein or citizenship thereof at the time of making of a gift.

(3) A person who at the time of death or the making of a gift was a resident of a possession of the United States and who acquired United States citizenship solely by reason of (a) his being a citizen of such possession, or (b) his birth or residence within such possession, shall be considered as having been neither domiciled in nor a citizen of the United States for purposes of this Convention.

ARTICLE 2.—TAXES COVERED

(1) This Convention shall apply to:

(a) In the case of the United States: the Federal gift tax and the Federal estate tax, including the tax on generation-skipping transfers; and

(b) In the case of France: the duty on gifts and the duty levied on succession.

(2) This Convention shall also apply to any identical or substantially

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[1] The text of the convention is contained in the pamphlet of the Treaties and Other International Act Series (TIAS) and is designated TIAS 9812. Pertinent excerpts from Senate Report No. 96-3, page 21; Treasury Department Technical Explanation, page 28; Senate Executive J is not published.

similar taxes on estates, inheritances, and gifts which are subsequently imposed by a Contracting State in addition to, or in place of, the existing taxes.

(3) The competent authorities of the Contracting States shall notify each other of any substantial changes which have been made in their respective laws relating to taxes on estates, inheritances, and gifts.

Chapter II.—Definitions

ARTICLE 3.—GENERAL DEFINITIONS

(1) In this Convention:

(a) The terms "Contracting State" and "other Contracting State" mean the United States or France, as the context requires.

(b) The term "United States" means the United States of America and, when used in a geographical sense, means the states thereof and the District of Columbia. Such term also includes any area outside the States and the District of Columbia which is, in accordance with international law, an area within which the United States may exercise rights with respect to the natural resources of the seabed and sub-soil.

(c) The term "France" means the French Republic and, when used in a geographical sense, means the European and Overseas departments of the French Republic. Such term also includes any area outside those departments which is, in accordance with international law, an area within which France may exercise rights with respect to the natural resources of the seabed and sub-soil.

(d) The term "enterprise" means a commercial or industrial enterprise carried on by an individual domiciled in a Contracting State.

(e) Except where expressly stated to the contrary, the term "tax" means the tax or taxes referred to in Article 2 which are imposed by the Contracting State (or Contracting States) as indicated by the context of the term's usage.

(f) The term "competent authority" means:

(i) In the case of the United States, the Secretary of the Treasury or his delegate, and

(ii) In the case of France, the Minister of Budget or his delegate.

(2) Any term not otherwise defined in this Convention shall, unless the context otherwise requires, have the meaning which it has under the tax laws of the Contracting State whose tax is being determined. However, if the meaning of such a term under the laws of one of the Contracting States is different from the meaning of the term under the laws of the other Contracting State, the Contracting State may, in order to prevent double taxation or to further any other purposes of this Convention, establish a common meaning of the term for purposes of this Convention.

ARTICLE 4.—FISCAL DOMICILE

(1) For the purpose of this Convention, the question whether an individual was domiciled in one of the Contracting States shall be determined according to the law of that State.

(2) Where by reason of the provisions of paragraph (1) an individual was domiciled in both Contracting States, then this case shall be determined in accordance with the following rules:

(a) He shall be deemed to have been domiciled in the Contracting State in which he maintained his permanent home;

(b) If he had a permanent home in both Contracting States or in neither of the Contracting States, his domicile shall be deemed to be in the Contracting State with which his personal relations were closest (center of vital interests);

(c) If the Contracting State in which he had his center of vital interests cannot be determined, his domicile shall be deemed to be in the Contracting State in which he had an habitual abode;

(d) If he had an habitual abode in both Contracting States or in neither of the Contracting States, his domicile shall be deemed to be in the Contracting State of which he was a citizen; or

(e) If he was a citizen of both Contracting States or of neither of them, the competent authorities of the Contracting States shall determine the Contracting State of his domicile by mutual agreement.

(3)(a) Notwithstanding the provisions of paragraph (2), an individual who at the time of his death or the making of a gift was a citizen of one of the Contracting States without being a citizen of the other Contracting State, and who would be considered under paragraph (1) as having been domiciled in both Contracting States, shall be deemed to have been domiciled only in the Contracting State of which he was a citizen, if he had a clear intention to retain his domicile in that Contracting State and if he was domiciled in the other Contracting State in the aggregate less than 5 years during the 7-year period ending with the year of his death or the making of a gift.

(b) Notwithstanding the provisions of paragraph (2) or of subparagraph (a) of this paragraph, an individual who at the time of his death or the making of a gift was a citizen of one of the Contracting States without being a citizen of the other Contracting State, and who would be considered under paragraph (1) as having been domiciled in both Contracting States, shall be deemed to have been domiciled only in the Contracting State of which he was a citizen if:

(i) He was domiciled in the other Contracting State in the aggregate less than 5 years during the 7-year period ending with the year of his death or the making of a gift, provided that he was in that other Contracting State by reason of an assignment of employment or as the spouse or other dependent (personne à charge) of a person present in that other Contracting State for such a purpose; or

(ii) He was domiciled in the other Contracting State in the aggregate less than 7 years during the 10-year period ending with the year of his death or the making of a gift, provided that he was in that other Contracting State by reason of a renewal of an assignment of employment or as the spouse or other dependent (personne à charge) of a person present in that other Contracting State for such a purpose.

Chapter III.—Taxing Rules

ARTICLE 5.—IMMOVABLE (REAL) PROPERTY

(1) Immovable (real) property may be taxed by a Contracting State if such property is situated in that State.

(2) The term "immovable (real) property" shall be defined in accordance with the tax laws of the Contracting State in which such property is situated. Mortgages or other claims secured by immovable (real) property shall not be regarded as immovable (real) property.

(3) The provisions of paragraphs (1) and (2) shall also apply to immovable (real) property which forms part of the business property of a permanent establishment or is used for the performance of professional services or other independent activities of a similar character.

ARTICLE 6.—BUSINESS PROPERTY OF A PERMANENT ESTABLISHMENT AND ASSETS PERTAINING TO A FIXED BASE USED FOR THE PERFORMANCE OF PROFESSIONAL SERVICES

(1) Except as provided in Article 5, assets (other than ships and aircraft operated in international traffic and movable property pertaining to the operation of such ships and aircraft) used in or held for use in the conduct of the business of a permanent establishment may be taxed by a Contracting State if the permanent establishment is situated therein.

(2) For purposes of this Convention, the term "permanent establishment" means a fixed place of business through which the business of an enterprise is wholly or partly carried on. If an individual is a member of a partnership or other association that is not a corporation which is engaged in industrial or commercial activity through a fixed place of business, he shall be deemed to have been so engaged to the extent of his interest therein.

(3) The term "permanent establishment" shall include especially:

(a) A seat of management;

(b) A branch;

(c) An office;

(d) A factory;

(e) A workshop;

(f) A warehouse;

(g) A mine, quarry, or other place of extraction of natural resources; and

(h) A building site or a construction or assembly project which exists for more than 12 months.

(4) Notwithstanding the provisions of paragraphs (2) and (3), the term "permanent establishment" shall not be deemed to include:

(a) The use of facilities solely for the purpose of storage, display, or delivery of goods or merchandise belonging to the enterprise;

(b) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage, display, or delivery;

(c) The maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another person;

(d) The maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or the collection of information, for the enterprise;

(e) The maintenance of a fixed place of business solely for the purpose of advertising, supplying information, conducting scientific research, or similar activities which have a preparatory or auxiliary character, for the enterprise; or

(f) The maintenance of a fixed place of business solely for investment purposes (and not for purposes of engaging in industrial or commercial activity) of an individual, whether by the individual or his employees or through a broker or other agent.

(5) A person who was acting in a Contracting State on behalf of an enterprise—other than agent to whom paragraph (4)(f) or (6) applies—shall be deemed to have been a permanent establishment of the enterprise in that State if such person had, and habitually exercised in that State, an authority to conclude contracts in the name of the enterprise, unless the exercise of such authority was limited to the purchase of goods or merchandise for the enterprise.

(6) An enterprise shall not be deemed to have had a permanent establishment in a Contracting State merely because the enterprise engaged in industrial or commercial activity in that State through a broker, general commission agent, or any other agent of an independent status acting in the ordinary course of his business.

(7) The fact that an enterprise controlled a corporation which engaged in industrial or commercial activity in a Contracting State (whether through a permanent establishment or otherwise) shall not be taken into account in determining whether the enterprise had a permanent establishment in that State.

(8) Except as provided in Article 5, assets pertaining to a fixed base used for the performance of professional services or other independent activities of a similar character may be taxed by a Contracting State if the fixed base is situated in that State.

ARTICLE 7.—TANGIBLE MOVABLE PROPERTY

(1) Tangible movable property other than currency may be taxed by a Contracting State if such property is situated in that State and is not taxable by the other Contracting State pursuant to Article 6. For this purpose, tangible movable property which is in transit shall be considered situated at the place of destination.

(2) Notwithstanding the provisions of paragraph (1), tangible movable property owned by an individual referred to in paragraph (3) of Article 4 and used for his normal personal use or that of his family may be taxed only by the Contracting State in which the individual was domiciled.

(3) Notwithstanding the provisions of paragraph (1), ships and aircraft operated in international traffic, and movable property pertaining to the operation of such ships and aircraft, may be taxed by a Contracting State if such ships and aircraft are registered in that Contracting State. Other ships and aircraft may be taxed by a Contracting State if the harbors and airports most frequently used by such ships and aircraft are situated in that State.

ARTICLE 8.—TAXATION OTHER THAN PURSUANT TO ARTICLES 5, 6, AND 7

Except as provided in Articles 5, 6, and 7, property, including shares or stock in a corporation, debt obligations (whether or not there is written evidence thereof), other intangible property, and currency may be taxed by a Contracting State only if the decedent or donor was a citizen of or was domiciled in that State at the time of death or the making of a gift, and if taxable by that State under its laws.

ARTICLE 9.—DEDUCTIONS OF DEBTS

(1) Debts, to the extent they would be deductible according to the internal law of a Contracting State, shall be deducted from the gross value of the property which may be taxed by that State in the proportion that such gross value bears to the gross value of the entire property wherever situated.

(2) Notwithstanding the provisions of paragraph (1), for purposes of determining the French tax:

(a) Debts pertaining to a permanent establishment or to a fixed base used for the performance of professional services or other independent activities of a similar character shall be deducted from the value of assets referred to in Article 6.

(b) Debts pertaining to ships and aircraft operated in international traffic and to movable property related to the operation of such ships and aircraft shall be deducted from the value of these assets.

ARTICLE 10.—CHARITABLE EXEMPTIONS AND DEDUCTIONS

(1) A transfer to a legal entity created or organized in a Contracting State shall be exempt from tax, or fully deductible from the gross value liable to tax, in the other Contracting State with respect to its taxes referred to in Article 2, provided the transfer would be eligible for such exemption or deduction if the legal entity had been created or organized in that other Contracting State.

(2) The provisions of paragraph (1) shall apply only if the legal entity:

(a) Has a tax-exempt status in the first Contracting State by reason of which transfers to such legal entity are exempt or fully deductible;

(b) Is organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes; and

(c) Receives a substantial part of its support from contributions from the public or governmental funds.

(3) This Article shall not apply to transfers to a Contracting State or a political or administrative subdivision thereof unless specifically limited to a purpose described in paragraph (2) (b).

ARTICLE 11.—COMMUNITY PROPERTY AND MARITAL DEDUCTION

(1) Property (other than community property) which was acquired during marriage for consideration by an individual who at the time of death or the making of a gift was domiciled in, or a citizen of, the United States and which passes to the spouse of such individual shall, for the purposes of determining the French tax, be treated as if it were community property, unless the spouses expressly elected to have a treatment other than community property treatment provided by French civil law.

(2) In the case of an individual who was domiciled in France there shall, for purpose of determining the United States tax, be allowed the same marital deduction in effect on the date of signature of this Convention, as if such individual were domiciled in the United States, and in such a case the tax rates applicable if the decedent or donor had been domiciled in the United States shall apply. If the tax determined without regard to the preceding provision of this paragraph is lower than that computed under the preceding provision, the lower tax shall apply.

(3) In the event the laws of either Contracting State are changed substantially to reduce the tax benefits of the marital deduction or community property, the competent authorities of the Contracting States shall consult to determine whether this Article shall be modified or shall cease to have effect.

CHAPTER IV.—RELIEF FROM DOUBLE TAXATION

ARTICLE 12.—EXEMPTIONS AND CREDITS

(1) Except as otherwise provided in this Convention, each Contracting State shall impose its tax, and shall allow exemptions, deductions, credits, and other allowances, in accordance with its laws.

(2) Double taxation shall be avoided in the following manner:

(a) In determining the French tax where property may be taxed by the United States in accordance with Article 5, 6, or 7, such property shall be exempt from the French tax. However, French tax with respect to property which is taxable by France in accordance with this Convention shall be computed at the rate appropriate to the total of property taxable under French law.

(b) In determining the United States tax:

(i) Where both Contracting States impose tax with respect to property which is taxable by France in accordance with Article 5, 6, or 7, the United States shall allow a credit equal to the amount of the tax imposed by France with respect to such property.

(ii) Notwithstanding the provisions of subparagraph (i), the total amount of all credits allowed by the United States pursuant to this Article or pursuant to its laws or other conventions with respect to all property in respect of which a credit is allowable under subparagraph (i) shall not exceed that part of the tax of the United States which is attributable to such property.

(iii) Any credits for tax imposed by France allowable under this Article are in lieu of, and not in addition to, any such credits allowed by the laws of the United States.

(3) If the decedent or donor was a citizen of the United States at the time of death or the making of a gift and would be considered under Article 4 as having been domiciled in France at such time, the United States shall allow a credit equal to the amount of the tax imposed by France.

(4) Exemption and credits under this Article shall be tentatively allowed by the United States on the basis of statements made in the tax return as to the amount of any tax paid or payable to France. However, such exemptions and credits shall not be finally allowed until any such tax for which

the exemption or credit is allowable has been paid.

(5) The provisions of this Convention shall not result in an increase in the amount of the tax imposed by either Contracting State under its domestic laws. A reduction in the credit allowed against United States tax for the tax paid to France which results from the application of this Convention shall not be considered as an increase in tax.

CHAPTER V.—SPECIAL PROVISIONS

ARTICLE 13.—TIME LIMITATIONS ON CLAIMS FOR CREDIT OR REFUND

(1) Any claim for credit or for refund of tax founded on the provisions of this Convention shall be made before the expiration of the latest of:

(a) The time for the making of a claim for refund of tax under the laws of the Contracting State to which the claim for credit or refund is made;

(b) Five years from the date of death of the decedent, or from the making of a gift with respect to which the claim is made; or

(c) One year after final determination (administrative or judicial) and payment of tax for which any credit under Article 12 is claimed, provided that the determination and payment are made within 10 years of the date of death of the decedent or of the making of a gift.

(2) Any refund based on the provisions of this Convention shall be made without payment of interest on the amount so refunded.

ARTICLE 14.—MUTUAL AGREEMENT PROCEDURE

(1) Any person who considers that the actions of one or both of the Contracting States result or will result for him in taxation not in accordance with this Convention may, notwithstanding the remedies provided by the laws of those States, present his case to the competent authority of either Contracting State. Such presentation must be made within the period of time prescribed for the filing of a claim for credit or refund under Article 13. Should the person's claim be considered to have merit by the competent authority of the Contracting State to which the claim is made, it shall seek agreement with the competent authority of the other Contracting State with a view to the avoidance of taxation contrary to the provisions of this Convention.

(2) The competent authorities of the Contracting States shall resolve by mutual agreement any difficulties or doubts arising as to the application of this Convention.

(3) The competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement in the sense of this Article. When it seems advisable for the purpose of reaching an agreement, the competent authorities may meet together for an oral exchange of opinions.

(4) When the competent authorities reach such an agreement, taxes shall be imposed, and refund or credit of taxes shall be allowed by the Contracting States in accordance with such agreement, notwithstanding any procedural rule (including the statute of limitations) applicable under the laws of either Contracting State.

(5) The competent authority of each Contracting State may prescribe such regulations and forms as may be necessary or appropriate to give effect to and implement the provisions of this Convention.

ARTICLE 15.—FILING OF RETURNS AND EXCHANGE OF INFORMATION

(1)(a) The provisions of Articles 5, 6, 7, or 8, which change the taxability or situs of property or the amount of tax which would have been due in the absence of this Convention, shall not change:

(i) The requirements of the respective tax laws of the Contracting States relating to information or tax returns or notices, transfer certificates or maintenance of records, and

(ii) The applicability and amount of any sanctions of such laws with respect to the requirements referred to to in subparagraph (i).

(b) As concerns the United States, notwithstanding the provisions of paragraph (a), the requirements or sanctions found to be unnecessary for the prevention of fraud or fiscal evasion with respect to taxes to which this Convention applies may be eliminated or modified (but not made more burdensome) by regulations prescribed pursuant to paragraph (5) of Article 14.

(2) The competent authority of each Contracting State shall furnish the competent authority of the other Contracting State such information as is pertinent to:

(a) Carrying out the provisions of this Convention or the laws of such other Contracting State concerning its tax insofar as the taxation thereunder is in accordance with this Convention, or

(b) Preventing fraud or fiscal evasion in relation to the taxes which are the subject of this Convention (including information with respect to property exempted from the tax of the first-mentioned Contracting State by reason of Article 8).

However, this paragraph shall not require the competent authority of a Contracting State to furnish information not in the possession of that Contracting State with respect to property exempted from its tax by reason of Article 8. Any information furnished shall be treated as secret and shall not be disclosed to any persons other than those (including a court or administrative body) concerned with assessment, collection, enforcement, or prosecution in respect of the taxes which are the subject of this Convention.

(3) In no case shall the provisions of paragraph (2) be construed so as to impose on one of the Contracting States the obligation:

(a) To carry out administrative measures at variance with the laws or the administrative practice of that or of the other Contracting State;

(b) To supply particulars which are not obtainable under the laws or in the normal course of the administration of that or of the other Contracting State;

(c) To supply information which would disclose any trade, business, industrial, commercial, or professional secret or trade process, or information the disclosure of which would be contrary to public policy.

(4) The furnishing of information shall be either on a routine basis or on request with reference to particular cases. The competent authorities of the Contracting States shall agree on the list of information which shall be furnished on a routine basis.

ARTICLE 16.—ASSISTANCE IN COLLECTION

(1) The two Contracting States undertake to lend assistance and support to each other in the collection of the taxes to which this Convention relates, together with interest, costs, and additions to the taxes and fines not being of a penal character according to the laws of the State requested, in cases where the taxes are definitively due according to the laws of the State making the application.

(2) In the case of an application for enforcement of taxes, revenue claims of each of the Contracting States which have been finally determined will be accepted for enforcement by the State to which application is made and collected in that State in accordance with the laws applicable to the enforcement and collection of its own taxes.

(3) The application will be accompanied by such documents as are required by the laws of the State making the application to establish that the taxes have been finally determined.

(4) If the revenue claim has not been finally determined, the State to which application is made will take such measures of conservancy (including measures with respect to transfer of property belonging to nonresident aliens) as are authorized by its laws for the enforcement of its own taxes.

(5) The assistance provided for in this Article shall not be accorded with respect to estates of citizens of the Contracting States to which application is made.

ARTICLE 17.—DIPLOMATIC AND CONSULAR OFFICIALS

(1) Nothing in this Convention shall affect the fiscal privileges of diplomatic or consular officials under the general rules of international law or under the provisions of special agreements.

(2) Insofar as such privileges prevent the imposition of tax in the receiving Contracting State, the right to tax shall be reserved to the Contracting State in whose service the persons concerned exercised their functions and, notwithstanding any other provisions of this Convention, such persons shall not be deemed to have been domiciled in the receiving Contracting State.

ARTICLE 18.—TERRITORIAL EXTENSION

(1) This Convention may be extended, either in its entirety or with necessary modifications, to all or any of the Overseas Territories of the French Republic or the territories for whose international relations the United States is responsible, if such territories impose taxes substantially similar in character to those referred to in Article 2. Any such extension shall take effect from such date and subject to such modifications and conditions as may be specified and agreed between the Contracting States in notes to be exchanged through diplomatic channels or in any other manner in accordance with their constitutional procedure. In the case of the United States, such procedure shall be that set forth in Article II, Section 2, of the Constitution of the United States (advice and consent of the Senate).

(2) At any time after the expiration of a period of one year from the effective date of an extension made by virtue of paragraph (1) either of the Contracting States may, by a written notice of termination given to the other Contracting State through diplomatic channels, terminate the application of the provisions in respect of any territory to which this Convention has been extended, in which case the provisions of the Convention shall cease to be applicable to such territory on and after the first day of January following the date of such notice.

(3) Unless otherwise agreed by both Contracting States, the termination of the Convention by one of the Contracting States under Article 20 shall also terminate the application of the Convention to any territory to which it has been extended under this Article.

CHAPTER VI.—FINAL PROVISIONS

ARTICLE 19.—ENTRY INTO FORCE

(1) This Convention shall be ratified and the instruments of ratification shall be exchanged at Paris as soon as possible.

(2) This Convention shall enter into force the first day of the second month following the month in which the exchange of the instruments of ratification takes place. Its provisions shall apply to estates of persons dying and to gifts made on or after that date.

(3) The Convention of October 18, 1946, as modified by the Protocol of May 17, 1948, and the Convention of June 22, 1956, shall be terminated on, and shall cease to have effect from, the date on which the present Convention enters into force according to paragraph (2).

ARTICLE 20.—TERMINATION

(1) This Convention shall remain in force until terminated by one of the Contracting States. However, not earlier than the fifth year following the year in which this Convention entered into force, either Contracting State may, between the first of January and the thirtieth of June, give written notice of termination through diplomatic channels, with effect from the end of the calendar year in which such notice is given. In such an event, its provisions shall not apply to estates of persons dying or to gifts made after the end of the calendar year with respect to the end of which this Convention has been terminated.

(2) Notwithstanding the provisions of paragraph (1), if the effects of this Convention are substantially altered as a result of changes made in the tax law of either Contracting State, either Contracting State may, through diplomatic channels, give a written notice of termination with effect not earlier than 6 months after such notice is given. In such an event, its provisions shall not apply to estates of persons dying or to gifts made on or after the effective date of the termination.

In witness whereof, the plenipotentiaries of the two Contracting States have signed this Convention and affixed thereto their seals.

Done at Washington, in duplicate, in the English and French languages, each text being equally authentic, this 24th day of November 1978.

For the President of the United States of America: George S. Vest

For the President of the French Republic: Francois de Laboulaye

Senate Executive Report No. 96-3

[Bracketed numerals indicate official report page numbers]

ESTATE AND GIFT TAX TREATY WITH THE FRENCH REPUBLIC

June 15, 1979

Mr. Church, from the Committee on Foreign Relations, submitted the following report to accompany Ex. J, 96th Cong., 1st sess.

The Committee on Foreign Relations, to which was referred the Estate and Gift Tax Treaty with the French Republic ("France")[1] for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on estates, inheritances and gifts, having considered the same, reports favorably thereon without reservation and recommends that the Senate give its advice and consent to ratification thereof.

I. PURPOSE

The purpose of the proposed estate and gift tax treaty between the United States and France is to alleviate double taxation on estates and gifts of French and U.S. domiciliaries and U.S. citizens by modifying the jurisdictional rules of estate and gift taxation with respect to these individuals.

[2] II. BACKGROUND

The proposed treaty was signed by the United States and the French Republic on November 24, 1978, and has been submitted to the Senate for advice and consent to its ratification. The Tax Treaty was transmitted to the Senate on February 9, 1979.

The portion of the proposed treaty dealing with state taxation will replace the existing estate tax treaty and protocol between the United States and France, which have been in force since October 17, 1949 [1956-1 C.B. 837]. There is no existing gift tax treaty between the two countries.

III. SUMMARY OF TREATY

The proposed treaty will alleviate double taxation on gifts and estates of United States citizens and domiciliaries and French domiciliaries in some situations by allowing only one country to impose its tax and in others by allowing both countries to impose a tax but requiring one of the countries to allow a credit against its tax for the taxes paid to the other country.

In most situations, the treaty allows the country of domicile to assert primary tax jurisdiction. However, the situs country is given priority taxation in the case of real property, tangible personal property, and business assets which are located in that country.

The treaty provides that the domicile of an individual will be determined separately under the laws of each country. If only one of the two countries treats the individual as a domiciliary under its domestic laws, then that is the country of domicile for purposes of the treaty. However, if both countries treat the individual as a domiciliary under their domestic laws, then the treaty sets forth an extensive set of rules to determine the individual's domicile for purposes of establishing primary tax jurisdiction under the treaty. The approach used in this set of rules is to recognize that where an individual domiciled in both countries is a national of one of the two countries and has been resident for only a limited period of time in the other country, his ties with the country of residence are not sufficient to justify the assertion of primary tax jurisdiction by that country. However, where an individual has been domiciled in both countries for a substantial period of time, the country with which he has his closest ties (such as the place of his permanent home) has the greater claim to domicile and, thus, primary tax jurisdiction will generally be allowed to that country.

[3] IV. DATE OF ENTRY INTO FORCE AND TERMINATION

Entry into force

The proposed treaty will enter into force on the first day of the second month following the month in which the instruments of ratification are exchanged and will apply to estates of persons dying and to gifts made on or after that date. The existing treaty terminates at that time.

Termination

The proposed treaty will continue in force indefinitely but either country may terminate it as of the close of any calendar year which ends at least 5 years after the treaty enters into force. Termination is accomplished by delivering written notice between January 1st and June 30th of that same year.

The proposed treaty can also be terminated if changes in the tax laws of either country result in a substantial alteration of the effects of the treaty. Such termination will occur 6 months after the delivery of notice. A termination under this provision is not subject to the 5-year minimum period previously mentioned.

V. COMMITTEE ACTION

The Committee on Foreign Relations held public hearings on the proposed French estate and gift tax treaty and on other proposed tax treaties, on June 6, 1979. The Committee considered the proposed treaty on June 12, 1979 and ordered it favorably reported by a vote of 13 yeas, no nays, with the recommendation that the Senate give its advice and consent to ratification of the treaty.

VI. BUDGET IMPACT

The Committee estimates that the effect of the proposed treaty on budget receipts will be negligible.

In accordance with the objectives of section 403 of the Budget Act, the

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[1] Page 15; Technical Explanation, page 28; Senate Executive J is not published.

Committee advises that the Director of the Congressional Budget Office has examined the Committee's budget estimate and agrees that the effect on budget receipts will be negligible. In keeping with section 308(a) of the Budget Act, and after consultation with the Director of the Congressional Budget Office, the Committee states that the treaty does not provide any new budget authority or any new or increased tax expenditures.

[4] VII. EXPLANATION OF TREATY PROVISIONS

A comprehensive article-by-article explanation of the proposed estate, inheritance and gift tax treaty between the United States and France is set forth below.

Article 1. Estates and gifts covered

The proposed treaty applies to estates of decedents who were domiciled in France at the time of their death and to estates that are subject to tax in the United States because the decedent was a citizen or domiciliary of the United States at the time of his death. With respect to gifts, the treaty applies to gifts made while the donor was a domiciliary of France and to gifts which are subject to tax in the United States because the donor was a citizen or domiciliary of the United States when the gift was made. Generation-skipping transfers which are subject to tax in the United States because the transferor was a U.S. citizen or domiciliary are also covered.

The proposed treaty does not treat certain residents of U.S. possessions as U.S. citizens or domiciliaries. These are individuals who acquired U.S. citizenship solely because they were citizens of a possession or because they were born in a possession or were residents of a possession. Under U.S. law (Code sec. 2209 and sec. 2501(c)), these individuals are not taxed by the United States on their worldwide estates and gifts, so protection against double taxation is generally unnecessary. Accordingly, the proposed treaty will not apply to estates or gifts of these individuals, unless it is applicable by reason of their being domiciled in France.

Article 2. Taxes covered

The proposed treaty applies to the U.S. estate tax, gift tax, and the tax on generation-skipping transfers.

The United States imposes its estate tax on the worldwide assets of estates of persons who were citizens or domiciliaries of the United States at the time of their death, and on property belonging to non-domiciliaries of the United States which is situated in the United States at the time of their death. The U.S. gift tax is imposed on all gifts made by U.S. citizens and domiciliaries, and on gifts of property made by nondomiciliaries where the property is tangible property located in the United States at the time of the gift.

The U.S. tax on generation-skipping transfers was enacted in 1976 to prevent the transfer of the use of property among generations of the transferor's descendants without the payment of gift or estate taxes. In general, the tax on such transfers is imposed when property passes through a trust from persons of one generation to persons of another generation, and the transfer is not otherwise subject to estate or gift tax.

The proposed treaty applies to the French succession duty and the French gift duty. The succession duty is imposed on the world-wide [5] assets of persons domiciled in France at the time of their death, and on property of nondomiciliaries of France where the property is located in France at the time of their death. France imposes a gift duty on all gifts made by persons domiciled in France, and on property of nondomiciliaries that is located in France at the time of the gift.

As is generally true in the case of other U.S. estate tax treaties, the proposed treaty does not apply to death or gift taxes imposed by state or local governments. In addition, the proposed treaty provides that it will apply to any substantially similar taxes on estates, inheritances and gifts that either country may subsequently impose. The competent authorities of both countries are required to notify each other in the case of any substantial changes in their estate, inheritance or gift tax laws.

Article 3. General definitions

The standard definitions generally found in most existing U.S. estate tax treaties are contained in the proposed treaty.

The United States is defined to mean the fifty states and the District of Columbia. Thus, U.S. possessions and territories are not covered by the treaty. France is defined to mean that part of France situated in Europe and the Overseas Departments of the French Republic which include Guadaloupe, Martinique, Guyane and Reunion. The geographical definition of both countries also includes any area where either country may, under international law, exercise rights with respect to the natural resources of the seabed and subsoil.

The proposed treaty also contains the standard provision that undefined terms are to have the meaning which they have under the applicable tax laws of the country whose tax is being determined. In addition, it is further provided that where a term defined in a different manner by the two countries, the countries may establish a common meaning of the term in order to prevent double taxation or to further any other purposes of the proposed convention.

Article 4. Fiscal domicile

The concept of domicile is important under the proposed treaty because the country of domicile has, under the treaty, primary tax jurisdiction on all property other than the property subject to situs taxation. The country of domicile is initially determined by each country under its domestic laws. However, in those situations where both countries would treat an individual as a domiciliary, the treaty sets forth rules for establishing the country of domicile for purposes of the taxes covered by the treaty.

Ordinarily, the tests employed by countries to determine the domicile of an individual often are not exactly the same. Under the Internal Revenue Code an individual is considered a domiciliary of the United States for purposes of the Federal estate and gift tax if the person was residing in the United States and had the intent to remain in the United States indefinitely (or had been residing in the United States with such an intent and had subsequently left this country without an intent to remain indefinitely at his new place of residence). A person is considered domiciled in France if his main establishment is in France. In general, a person's main establishment is where he physically [6] resides and intends to live permanently. In the situation where an individual resides (or has resided) in both countries, it is possible that each country, in ascertaining where the individual intended to make his permanent home, could arrive at different conclusions from the individual's actions. Thus, each country could hold that these actions clearly demonstrate the individual's intention to make that country his permanent home and, accordingly, his domicile.

To provide relief from double taxation where each country considers the individual to be a domiciliary under its domestic laws, the proposed treaty provides a series of rules designed to establish a single country of domicile for the individual for purposes of the taxes covered by the treaty. The country so selected will then have the primary tax jurisdiction with respect to the worldwide estate of the decedent or his worldwide gifts, other than with respect to real property, business assets or tangible property situated in the other country. As described below, these rules are based on the concept that primary tax jurisdiction should be exercised either by the country of nationality, if the dual domicile individual has not been resident in the other country for a substantial period of time prior to his death or the making of the gift, or by the country in which he has his most significant contacts if the nationality test is not determinative.

In determining the domicile of an individual under the proposed treaty, each country will first determine whether the individual is considered a domiciliary under its law. If the individual is a domiciliary of only one country then that will be the individual's country of domicile for purposes of the proposed treaty. However, if both countries determine the individual to be a domiciliary, the proposed treaty provides a series of rules by which an exclusive domicile for the individual will be determined.

The first rule that is applied consists of two separate tests which apply to persons who are citizens of only one of the two countries. Under the first test, such a person will be considered domiciled in the country of which he is a citizen if he was domiciled in the other country for less than 5 years during the 7-year period which ends with the year of his death or the year the gift was made, and he was in that country because of an assignment of employment or because he was the spouse or dependent of a person who was in that country for such a purpose. Under the second test, the person will be considered a domiciliary of the country of which he is a citizen if he was domiciled in the other country for less than 7 years during the 10-year period which ends with the year of his death or the year the gift was made, and he was in that country because of a renewal of an assignment of employment or because he was the spouse or dependent of a person who was in that country for such a purpose.

A second rule, which is similar to the first in that it applies to persons who are domiciliaries of both countries and citizens of only one of the countries, applies if domicile cannot be resolved under the first rule. Under the second rule such a person will be considered a domiciliary of the country of which he is a citizen if he had a clear intention to retain his domicile in that country and he was domiciled in the other country for less than 5 years during the 7-year period which ends with the year of death or the year the gift was made.

[7] It is contemplated that these rules will resolve the great majority of dual domicile situations. However, if a dual domicile problem still remains after application of these rules, the proposed treaty provides four additional rules to determine domicile. The rules (applied in the order presented) provide that the individual will be considered domiciled in the country (1) in which he maintained his permanent home, (2) in which his personal relations were the closest (center of vital interests), (3) in which he had a habitual abode, or (4) in his country of citizenship. In cases where an individual's domicile cannot be determined under these rules, the competent authorities of the countries are to settle the question by mutual agreement.

Article 5. Immovable (real) property

Under the proposed treaty, immovable (real) property is one of the three types of property over which the situs country, rather than the country of domicile has primary tax jurisdiction. The other two are assets of a permanent establishment or fixed base (*Article 6*) and tangible movable property (*Article 7*).

The determination of whether an item of property is immovable (real) property is to be made under tax laws of the country in which the property is located. Although U.S. law does not define "immovable (real) property," that term for U.S. purposes is considered to mean real property. It is further provided that immovable (real) property does not include claims secured by real property (such as mortgages). Real property which is part of the business assets of a permanent establishment or used for the performance of professional or similar independent services is taxable under this article, rather than Article 6.

Article 6. Business property of a permanent establishment and assets pertaining to a fixed base used for the performance of professional services

Under the proposed treaty, the second type of property over which the situs country has primary tax jurisdiction is the business assets (other than ships and aircraft operated in international traffic and related personal property and other than real property) of an individual's permanent establishment which located in the situs country and the assets (other than real property) of a fixed base of an individual which is situated in the country and is used for the performance of professional services or other similar independent activities. The real property of a permanent establishment or fixed base is to be taxed by the country in which it is situated, as provided in Article 5.

The proposed treaty contains a definition of the term "permanent establishment" which is similar to the definition found in recent U.S. income tax treaties. Generally, any fixed place of business through which a person engages in a trade or business is considered a permanent establishment. For this purpose, a person is considered engaged in a trade or business regardless of whether the business is carried on as a sole proprietorship or through a partnership or as an unincorporated association which is not taxed as a corporation. In the case of a partnership or association, however, only the person's interest in the business entity will be taken into account for purposes of this provision.

A fixed place of business generally includes a branch, office, factory, workshop, warehouse, place of extraction of natural resources, and [8] any building site or construction or assembly project which exists for more than 12 months. This general rule is modified by providing that a fixed place of business which is used for certain activities specified in the treaty will not be considered a permanent establishment. These activities include, for example, the warehousing of goods for purposes of storage, display, or delivery, and the use of a fixed place of business solely for the purpose of purchasing merchandise or collecting information. An additional activity included within this exempt category is the maintenance of a fixed place of business solely for investment purposes of an individual, whether conducted by the individual, his employees, a broker or other agent.

The proposed treaty also provides that a person will be deemed to have a permanent establishment in a country if he had an agent in that country who had and habitually exercised a general contracting authority (other than for the purchase of goods or merchandise) in that country. This agency rule does not apply, however, if the agent is a broker, general commission agent, or any other agent of an independent status, provided the agent is acting in the ordinary course of his business.

A company will not be held to have a permanent establishment in one of the countries solely because it controls a company which is a resident of that country.

Article 7. Tangible movable property

With three exceptions, tangible movable (i.e., personal) property, other than currency, is subject to tax in the country in which the property is situated. The first exception is for property which is held for use by a permanent establishment or a fixed base used for the performance of professional services which is located in the other country. This property is subject to tax by the country in which the permanent establishment or fixed base is located.

A second exception is for property owned by an individual who is considered domiciled in the country of which he is a citizen (under the special 5-of-7 or 7-of-10 year rules used in Article 4(3) to determine domicile) if the property is for the normal personal use of that person or his family. Essentially, this property can only be taxed by the country of citizenship.

Finally, ships and aircraft operated in international traffic, and personal property pertaining to the operation of such ships and aircraft, may be taxed by the country in which they are registered. Other ships and aircraft may be taxed by the country whose harbors and airports are most frequently used by the ships and aircraft.

Article 8. Taxation other than pursuant to Articles 5, 6, and 7

This article sets forth the general treaty rule that the country of domicile, as determined under the treaty, has the primary tax jurisdiction over the estates or gifts of its domiciliaries other than the property specifically reserved for situs taxation.

The proposed treaty provides that property, other than real property, assets of a permanent establishment or fixed base, and tangible personal property, may be subject to tax in either of the two countries only if the individual is a citizen or domiciliary of that country and the property is otherwise subject to tax in that country. This provision is explicitly intended to cover corporate stock, debt obligations, other intangible property and currency.

[9] Since the United States does tax based upon citizenship (France does not), there is still the possibility of double taxation if an individual is a U.S. citizen and a French domiciliary. The possibility of double taxation in that situation is, however, alleviated under the tax credit structure established in Article 12.

Article 9. Deduction of debts

The proposed treaty provides that if debts are deductible from the value of property in computing the estate or gift tax of either country, these debts are to be deducted from the gross value of the property subject to tax in that country in the same proportion that such gross value bears to the total gross value of all the property. However, in computing the French tax, debts pertaining to a permanent establishment or a fixed base are to be deducted in total from the assets (other than real property) that relate to the permanent establishment or fixed base. Similarly, debts relating to ships and aircraft, and their movable property, are to be deducted in total from the value of those assets. These debts are to be allowed as a deduction in computing the French tax under the treaty even if they would not be allowed as a deduction under French internal law.

Article 10. Charitable exemptions and deductions

Essentially, this provision allows contributions made to charitable organizations in one country to be exempt from tax in the other country or to be deductible in computing the tax in that other country. This treatment is allowed only if the transfer would be eligible for an exemption or deduction if the charitable organization had been created in the taxing country. Additionally, the charitable organization must have a tax-exempt status in its home country so that payments to it are exempt or fully deductible, it must be organized and operated exclusively for religious, charitable, scientific, literary or educational purposes, and it must receive a substantial part of its support from public or governmental funds. Thus, in computing the French tax, no deduction or exemption is allowed for contributions to a private foundation, even if the contribution would be deductible under U.S. law.

Contributions to governmental organizations will not qualify for exempt or deductible status unless the contribution is specifically limited to one of the tax-exempt purposes enumerated above.

Article 11. Community property and marital deduction

The proposed treaty allows U.S. citizens and domiciliaries to elect to treat property which is subject to the French tax as being community property. Essentially, this means that France will only tax one-half of the gifts made by a person to his spouse and it will only tax one-half of the property that passes from a decedent to his spouse. In both cases, the other one-half is deemed to already belong to the spouse under the elected community property laws.

Reciprocally, French domiciliaries may, in computing their U.S. tax, take the marital deduction that would be allowed to a U.S. domiciliary on November 24, 1978, the date the proposed treaty was signed. Currently, a nondomiciliary does not get a marital deduction, but is entitled to lower tax rates than those applicable to domiciliaries and citizens. If a French domiciliary claims the marital deduction allowed by this article, he is required to compute his tax at the rates [10] applicable to U.S. citizens and domiciliaries. A French domiciliary will be taxed at the rates applicable to nondomiciliaries without a marital deduction, if the tax computed on that basis is lower than the tax computed by allowing a marital deduction and applying the higher rates.

If the laws of either country are modified substantially to reduce the benefits of the community property rules in the case of France or the marital deduction in the case of the United States, the tax authorities of the two countries will consult on whether this provision should be modified or terminated. Actual modification or termination will require termination of the entire treaty (*Article 20*) or other action in accord with the constitutional procedures of each country.

Article 12. Exemptions and credits

Except as otherwise provided in the treaty, each country shall compute its estate or gift tax in accordance with its own laws including the allowance of exemptions, deductions, credits, and other allowances allowed under the country's internal law. In general, double taxation is avoided because France exempts property from taxation that is subject to situs taxation in the United States and because the United States allows a credit for taxes paid to France on property subject to situs taxation in France.

Specifically, real property, assets of a permanent establishment or fixed base, and tangible movable property, which are subject to situs taxation in the United States, as provided for in the proposed treaty, will be completely exempt from tax in France. However, this property will be taken into account in determining the appropriate tax rate applicable to the property which is subject to French taxation (i.e., an exemption with progression).

Correspondingly, the United States will allow a credit against its estate or gift tax for taxes paid to France on property where, under the proposed treaty, the property is subject to situs taxation in France. However, the credit will only be allowed for taxes actually paid to France and the credit is not to exceed the U.S. estate or gift tax attributable to the property. In addition, the credit is in lieu of any other such credits allowed under the laws of the United States.

The United States gives France primary tax jurisdiction over U.S. citizens determined to be French domiciliaries under the treaty. The treaty provides that the United States will give a full tax credit for taxes paid to France by a U.S. citizen who is deemed to be a French domiciliary under the treaty (i.e. the amount of the credit can exceed the amount of the U.S. tax attributable to the property, but it cannot, of course, exceed the U.S. tax on the entire estate). However, if the U.S. tax exceeds the French tax, the excess will be collected by the United States.

The proposed treaty stipulates that the treaty will not increase the amount of tax due to either country under its domestic laws. However, a reduction in the amount of the foreign tax credit allowed by the United States against its estate and gift tax will not be considered to be an increase in tax. This prevents the argument that an individual would have received a higher foreign tax credit without the treaty, because he would have paid more French taxes, and thus should be [11] allowed the higher foreign tax credit even though the treaty reduced his French tax.

Article 13. Time limitations on claims for credit or refund

Under the Internal Revenue Code, a claim for credit or refund of U.S. estate and gift taxes generally must be made within 3 years from the date the return was filed. The proposed treaty provides a period of limitation during which claims for credit or refund of taxes based on the provisions of the treaty may be made which, in some cases, may be longer than that allowed by the Internal Revenue Code. It is provided that a claim for a credit or refund of taxes based on the provisions of the treaty must be made before the expiration of the latest of (1) the period of limitations prescribed under the domestic law of the country to which the claim is made, (2) 5 years from the date of the decedent's death or the date of the gift, or (3) 1 year after final determination and payment of a tax for which a credit is claimed under the treaty (provided the determination and payment occur within 10 years from the date of the decedent's death or the date of the gift).

The proposed treaty follows the approach of other U.S. estate tax treaties and provides that any refund based on the provisions of the treaty is to be made without interest.

Articles 14 and 15. Administrative provisions

The proposed treaty contains various administrative provisions which are generally found in other U.S. tax treaties. In general, the proposed treaty provides—

(1) For consultation and negotiation between the competent authorities of the two countries to resolve differences arising in the interpretation or application of the proposed treaty and also to resolve claims by taxpayers that they are being subjected to taxation contrary to the proposed treaty;

(2) For the exchange between the countries of information pertinent to carrying out the provisions of the proposed treaty or the tax laws of one of the countries, insofar as its taxation is in accordance with the proposed treaty, or to prevent fraud or fiscal evasion with respect to the taxes covered by the proposed treaty; and

(3) For continuing the tax return and recordkeeping requirements that exist under each country's domestic law, except with respect to U.S. provisions which the Treasury finds are not necessary for the prevention of fraud or fiscal evasion.

Article 16. Assistance in collection

The two countries agree to assist each other in collecting each other's estate and gift taxes. This assistance extends to enforcing assessments that have been finally determined under the law of the requesting country and taking measures of conservancy where the assessment has not been finally determined. The assistance each country is obligated to give is limited to the enforcement measures it can take in enforcing its own assessments.

The assistance provided by a country will not extend to enforcement of assessments against estates of its own citizens.

[12] *Article 17. Diplomatic and consular officials*

The proposed treaty provides that its provisions are not to affect the fiscal privileges which diplomatic and consular officials and officials of international organizations enjoy under the general rules of international law or the provisions of special agreements. It is further provided that the right to tax those persons will be reserved to the country for whom they perform their functions and that these officials are not to be considered domiciled in the country where they are employed. This provision is designed to prevent diplomatic and consular officials of a third country from claiming domicile in either the United States or France so as to bring themselves within the provisions of the convention.

Article 18. Territorial extension

The proposed treaty contains a method similar to that found in some of our other U.S. tax treaties by which the treaty may be extended to any of the Overseas Territories of the French Republic or to any territories for whose international relations the United States is responsible, if the territory imposes taxes substantially similar to those covered by the treaty. The treaty may be extended pursuant to this provision either in its entirety or with necessary modifications. The extension is to be effected in accordance with the constitutional procedures of the two countries. This requirement follows the U.S. Senate's reservation to the territorial extension provision of the income tax treaty between the United States and France.

Any extension of the treaty to an eligible territory of either country may be terminated after one year. Additionally, if the treaty between the two countries is terminated, the termination shall extend to any extensions made under the treaty.

Article 19. Entry into force

The proposed treaty will enter into force on the first day of the second month following the month in which the instruments of ratification are exchanged and will apply to estates of persons dying and to gifts made on or after that date. The existing treaty terminates at that time.

Article 20. Termination

The proposed treaty will continue in force indefinitely but either country may terminate it as of the close of any calendar year which ends at least 5 years after the treaty enters into force. Termination is accomplished by delivering written notice between January 1st and June 30th of that same year.

The proposed treaty can also be terminated if changes in the tax laws of either country result in a substantial alteration of the effects of the treaty. Such termination will occur 6 months after the delivery of notice. A termination under this provision is not subject to the 5-year minimum period previously mentioned.

[13] VIII. TEXT OF RESOLUTION OF RATIFICATION

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RESOLUTION OF RATIFICATION

Resolved (two-thirds of the Senators present concurring therein), That the Senate advise and consent to the ratification of the Convention Between the United States of America and the French Republic for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Estates, Inheritances and Gifts, done at Washington on November 24, 1978 (Ex. J, Ninety-sixth Congress, first session).

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[58] APPENDIX C

WRITTEN RESPONSES BY TREASURY TO QUESTIONS BY THE COMMITTEE STAFF

DEPARTMENT OF THE TREASURY,
Washington, D.C., June 8, 1979.

Hon. FRANK CHURCH,
Chairman, Committee on Foreign Relations,
U.S. Senate
Washington, D.C.

DEAR MR. CHAIRMAN: To follow-up my testimony at the June 6 hearings concerning the six tax conventions or protocols involving the United Kingdom, France, Hungary and Korea, I want to assure you that Article I of the Third Protocol of the proposed US-UK Income Tax Treaty gives full effect to the Senate's reservation on

Article 9(4) of that treaty. Let me also assure you that there is no similar state tax issue in any of the other five treaties which were considered by the Committee yesterday.

Again let me emphasize our view that each of these treaties is important to the United States and that their prompt approval is desirable.

I am also enclosing answers to the written questions submitted to me by your staff at the hearings as well as copies of my answers to questions from Senator Helms and Senator Javits.

Sincerely,

Donald C. Lubick,
Assistant Secretary (*Tax Policy*).

Enclosures.

Questions for Assistant Secretary for Tax Policy Donald C. Lubick [1]

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[60] QUESTIONS ON UNITED STATES-FRANCE ESTATE AND GIFT TAX TREATY

Question 1. The proposed Convention is an extension of the Foreign Investors Tax Act of 1966 [Pub. L. 89-809, 1966-2 C.B. 656], could you please describe the benefits, as you see them, that the U.S. has derived from the 1966 Act as well as the first convention under the Act with the Netherlands [1967-2 C.B. 472]?

Answer. The proposed Convention is not really an "extension" of the Foreign Investors Tax Act of 1966. It is a Convention which modifies the provisions of the convention currently in force between two parties in order to harmonize the treaty arrangement with the provisions of the 1966 Act.

The primary objective of the 1966 Act was to remove or reduce barriers created by the tax system to the free flow of foreign capital into the United States. The estate tax provisions of the Act lowered the tax rate imposed upon the estates of foreigners who owned U.S. property at their death. The primary achievement of the statute was [61] to lessen tax barriers to the inflow of foreign capital into the United States.

The primary achievement of the Netherlands Convention from the perspective of the United States was the agreement by the Netherlands to the special rules which deem a U.S. citizen a domiciliary of the U.S. if he is deemed domiciled in both countries at the time of his death, but if he has not lived in the Netherlands more than 7 of the 10 years ending with his death. This ensures that American citizens living in the Netherlands will not be subject to Netherlands estate tax unless they have formed an intent to stay in the Netherlands, or have lived there a long time. This is of substantial importance to U.S. companies doing business in the Netherlands, since it permits them to assign their executives to the Netherlands without the employees becoming subject, simply by virtue of living in the Netherlands for a short time, to Netherlands estate taxes.

Question 2. A major feature of the proposed convention is the use of a five year time period that will be the basis for determining the domicile of a taxpayer. Could you explain the reason the five year time period was selected?

Answer. The five-year period is relevant only in cases where each State under its own law considers an individual to be its own domiciliary at the same time. The five-year period is irrelevant to the determination of domicile under domestic law, and comes into play only after such a determination has been made in each State. It also applies only if the person is a citizen of only one of the Contracting States.

The five-year period (or the 5-of-7 rule of Article 4(3) of the Convention) was the product of bargaining between the parties. The official U.S. position, reflected in the model treaty and the U.S.-Netherlands treaty, is that a person should have to live in a country other than that of his citizenship 7 of 10 years before his death to be subject to the new country's death taxes. The French position was that only the "tie-breaker" rules of Article 4(2) should be used for any case of "double domicile," regardless of the fact that the person was a citizen of only one Contracting State. The 5-of-7 rule represents a compromise between the two positions.

The 7-of-10 year rule of the model is based upon a balancing of concerns for determining which State should have the right to tax the lifetime accumulation of an individual. In general, the U.S. believes that the momentary circumstance of residence at death should not be controlling, particularly where a citizen of one country is residing abroad, and doing so only for a short time. The U.S. believes, however, that if a person lives in a country for a substantial period of time, at some point that country acquires a legitimate claim to tax the person's lifetime accumulation, even if the person is not a citizen of the country and does not intend to remain there forever.

Question 3. Would you detail the number of individuals affected by the proposed Convention and the revenue that will be received by the Treasury as a result of the proposed Convention? In addition, would you, for the record, submit estimated cost to the Department of Treasury, IRS, or other U.S. Government entities responsible for enforcing the terms of the Convention?

[62] *Answer.* It is impossible to determine which individuals will be affected by the proposed Convention, since that depends upon the domicile of individuals at the time of their death or their gifts, and upon what property such individuals own at such times. The Treasury does not have statistics on the number of U.S. citizens living in France or French citizens living in the United States, who might be affected by the domicile determination rules of the Convention; nor does it have reliable data concerning the amount of U.S. situs property held by French domiciliaries, or French situs property held by U.S. domiciliaries, the taxation of which might be affected by the allocation of tax jurisdiction effected by the Convention.

The Treasury believes, however, that the Convention will not have a substantial revenue effect. This is because the Convention embodies a balance of concessions by the two sides, respective revenue effects of which are likely to cancel each other out. For instance, the Convention's domicile rules enable the U.S. to tax its citizens living in France if they have not lived there more than 5 of 7 years: to this extent, it is likely to result in a slight revenue gain to the U.S. On the other hand, the Convention also restricts the rights of the U.S. to tax certain intangible U.S. property owned by French persons at the time of death; to this extent, it probably involves some revenue cost to the U.S. To the extent the Convention as a whole eliminates barriers created by potential double taxation to the free flow of goods, persons, and capital between the two countries, it probably results in a slight revenue gain to each country.

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[1] General questions and answers 1-5 may be found in Senate Executive Report 96-6, 1980-4 I.R.B. 28. The questions and answers relating specifically to the other protocols and treaties considered at the June 6, 1979, hearings are set forth in the committee reports relating to those treaties.

The Convention should not involve appreciable administrative costs to the U.S. Government. The rules of the Convention apply to estates, gifts, and generation-skipping transfers which even in the absence of the Convention would be subject to U.S. statutory law, and would therefore have to be subject to return requirements, audit and collection procedures, and the like, under statutory law. The Convention only results in substitute or supplementary legal rules governing the taxation of such transfers, and as such should not result in any measurable administrative costs.

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TECHNICAL EXPLANATION[1] OF THE CONVENTION BETWEEN THE UNITED STATES OF AMERICA AND THE FRENCH REPUBLIC FOR THE AVOIDANCE OF DOUBLE TAXATION AND THE PREVENTION OF FISCAL EVASION WITH RESPECT TO TAXES ON ESTATES, INHERITANCES, AND GIFTS, SIGNED AT WASHINGTON ON NOVEMBER 24, 1978[2]

Introduction

The Estate and Gift Tax Convention with France is the second such Convention signed by the United States since U.S. estate and gift tax laws were substantially modified in the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1]. Modification included combining the separate estate and gift tax rates into a single rate schedule, substituting a unified credit for the former separate estate and gift tax exemptions, and imposing a tax on generation-skipping transfers. The Convention will replace the existing estate tax convention between the two countries, which has been in force since 1946 [1956-1 C.B. 837].

The Convention is similar to the United States Estate Tax Convention with the Netherlands [1976-1 C.B. 471], which entered into force in 1971, and to the United States Model Estate and Gift Tax Convention published by the Treasury Department on March 16, 1977. The Convention is also based, in part, on the provisions of the Model Estate Tax Convention (Draft Double Taxation Convention on Estates and Inheritances) of the Organization for Economic Cooperation and Development (OECD), published in 1966.

The general principle underlying the Convention is that the primary right to tax the worldwide estate, gifts, or generation-skipping transfers of a decedent, donor, or deemed transferor should lie with the country of domicile. Property situated in the other State is either exempted from tax in that State or the tax levied by that State is allowed as a credit in the State of domicile. Immovable (real) property, certain business assets, and certain categories of tangible movable (personal) property are the types of property that are taxable in the State of situs. The Convention also contemplates that the United States will impose a tax on the worldwide property of its citizens, but that it will allow a credit for taxes paid to France by any person who was a domiciliary of France at the time of death, or at the time of a gift or generation-skipping transfer.

CHAPTER I
SCOPE OF THE CONVENTION

Article 1. Estates and Gifts Covered

This article describes the transfers of estates or by gift or generation-skipping transfer that are subject to the provisions of the Convention. Paragraph (1) provides that the Convention applies to estates of decedents whose domicile at death was in France, and to estates of decedents which are subject to the taxing jurisdiction of the United States by reason of the decedent's domicile in, or citizenship of, the United States at the time of death. The Convention does not apply to transfers of estates of decedents who were citizens of France at the time of their death, if they were not domiciled in France or the United States at that time. Under paragraph (1), the Convention applies to generation-skipping transfers deemed to occur at or after the death of the deemed transferor, if the deemed transferor was a citizen or domiciliary of the United States at the time of his death.

Paragraph (2) provides that the Convention applies to gifts of donors whose domicile at the time of making the gift was in France, and to gifts subject to the taxing jurisdiction of the United States by reason of the donor's domicile in, or citizenship of, the United States at the time of the gift. The Convention does not apply to gifts made by persons who were citizens of France, but not domiciled in either France or the United States, at the time of the making of the gift. Under paragraph (2), the Convention applies to transfers deemed to occur under the U.S. generation-skipping transfer tax at a time before the death of a deemed transferor, if the deemed transferor was a domiciliary or citizen of the United States at that time.

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[1] It is the practice of the Treasury Department to prepare for the use of the Senate and other interested persons a Technical Explanation of the tax conventions which are submitted to the Senate for its advice and consent to ratification.

An estate, inheritance, and gift tax convention with France was signed on November 24, 1978, and submitted by the President to the Senate on February 9, 1979. On June 6, 1979, The Senate Committee on Foreign Relations held hearings and this Technical Explanation was presented. The Senate voted its advice and consent on July 9, 1979, and instruments of ratification were exchanged on August 7, 1980.

[2] Page 15; pertinent excerpts from Senate Executive Report No. 96-3, page 21; Senate Executive J is not published.

Paragraph (3) provides that a person who is at the time of his death or the making of a gift a resident of a possession of the United States, and who acquired U.S. citizenship solely by being a citizen of such U.S. possession, or by birth or residence within such possession, is considered as being neither domiciled in, nor a citizen of, the U.S. for purposes of the Convention. Under sections 2208 and 2209 of the Internal Revenue Code, such persons are treated as nonresidents not citizens of the United States for purposes of U.S. estate, gift, and generation-skipping transfer taxes, and therefore are not subject to such taxes on their worldwide property.

Article 2. Taxes Covered

Paragraph (1) identifies the taxes covered by the Convention. In the case of the United States, the Convention applies to the Federal gift tax and the Federal estate tax, including the tax on generation-skipping transfers. In the case of France, the Convention applies to the duty on gifts and the duty levied on succession. The Convention does not apply to any state, sub-Federal, or local taxes imposed in either Contracting State.

Paragraph (2) provides that the Convention also applies to any substantially similar taxes which are subsequently enacted in addition to, or in place of, the existing taxes. Under paragraph (3), the competent authorities of the Contracting States are required to notify each other of substantial changes in their respective laws relating to the taxation of estates and gifts.

Article 3. General Definitions

Paragraph (1) defines the terms "Contracting State" and "other Contracting States," "United States," "France," "enterprise," "tax," and "competent authority." The term "United States" does not include Puerto Rico, the Virgin Islands, Guam, or any other U.S. possession or territory. The term "France" includes the overseas departments of the French Republic.

Paragraph (2) provides that any term not otherwise defined in the Convention shall, unless the context otherwise requires, have the meaning which that term has under the tax laws of the Contracting State whose tax is being determined. If, however, the meaning of a term under the laws of one of the Contracting States is different from the meaning of the term under the laws of the other State, the two States may, in order to prevent double taxation or to further any other purpose of the Convention, establish a common meaning for purposes of the Convention.

Article 4. Fiscal Domicile

This Article sets forth rules for determining "domicile" for purposes of the Convention. The determination of a single fiscal domicile for Convention purposes is important, because the country of domicile has the primary right to tax the worldwide estate, gifts, or other transfers of a decedent, donor, or deemed transferor, with the exception of property covered by Articles 5 (Immovable (Real) Property), 6 (Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Professional Services), and 7 (Tangible Movable Property).

Under paragraph (1), domicile is determined in the first instance under the domestic law of the respective Contracting States. Paragraphs (2) and (3) set forth rules for resolving cases of double domicile—where each State considers a person domiciled in that State under its domestic law. Under paragraph (2) such a person is deemed domiciled in the Contracting State in which he maintained his permanent home. If he has a permanent home in both Contracting States or in neither State, he is deemed domiciled in the Contracting State with which his personal relations were closest (his center of vital interests). If his center of vital interests cannot be determined, his domicile is deemed to be in the State in which he had an habitual abode. If he had an habitual abode in both Contracting States or neither of them, his domicile is deemed to be in the State of which he was a citizen. If he was a citizen of neither Contracting State or of both, his domicile is to be determined by the competent authorities by mutual agreement.

Paragraph (3) provides special rules for cases of double domicile with respect to individuals who were citizens of only one of the Contracting States. These special rules override the general rules of paragraph (2). Paragraph (3)(a) provides that such an individual shall be deemed domiciled in the Contracting State of which he was a citizen if he had a clear intention of retaining his domicile in that State, and if he was domiciled in the other Contracting State in the aggregate less than 5 years during the 7-year period ending on the date of his death or the making of a gift. In the case of a generation-skipping transfer, the relevant 7-year period ends with the year during which the transfer is deemed made, in the case of a transfer deemed made before the death of the deemed transferor, and with the year of death, in the event a transfer is deemed made at or after the death of the deemed transferor. Paragraph (3)(b) provides that an individual with "double domicile" but "single citizenship" shall be deemed domiciled in the Contracting State of which he was a citizen, even in the absence of a clear intention of retaining his domicile in that State, if he was domiciled in the other Contracting State in the aggregate less than 5 years during the 7-year period ending with the year of his death or the making of a gift, provided he was in the other State by reason of an assignment of employment or as the spouse or other dependent of a person present in that State for such a purpose; or if he was domiciled in the other Contracting State in the aggregate less than 7 years during the 10-year period ending with the year of his death or the making of a gift, provided he was in the other State by reason of a renewal of an assignment of employment, or as the spouse or other dependent of a person present in the other State for such a purpose. These domicile rules are reciprocal.

If the rules of paragraph (3) do not apply to an individual who would be deemed under paragraph (1) to be domiciled in both Contracting States, but who is a citizen of only one of the Contracting States, then that individual's domicile shall be determined in accordance with the rules of paragraph (2).

CHAPTER III
TAXING RULES

Article 5. Immovable (Real) Property

This Article provides that immovable property may be taxed in a Contracting State if such property is situated in that State. The term "immovable (real) property" is defined in accordance with the tax laws of the Contracting State in which such property is situated.

Under paragraph (3), the provisions of Article 5 apply to property which forms part of the business property of a permanent establishment or is used for the performance of professional services or other independent activities of a similar character. For example, real property situated in France owned by a domiciliary of France not a citizen of the U.S. which formed part of the business property of a permanent establishment in the United States would be subject to tax in France and not in the United States.

Article 6. Business Property of a Permanent Establishment and Assets Pertaining to a Fixed Base Used for the Performance of Professional Services

Paragraph (1) establishes the general rule that, except as provided in Article 5 (Immovable (Real) Property), and with the exception of ships and aircraft operated in international traffic and movable property pertaining to the operation of such ships and aircraft, assets forming part of the business property of a permanent establishment of an enterprise may be taxed by a Contracting State if the permanent establishment is situated in that State.

Paragraph (2) defines the term "permanent establishment" as a fixed place of business through which the business of an enterprise is wholly or partly carried on. The definition is substantially similar to the definition of "permanent establishment" in Article 4 of the Income Tax Convention between the United States and the French Republic signed on July 28, 1967 [1968-2 C.B. 691, 693]. Illustrations in paragraph (3) of a permanent establishment include a branch; an office; a factory; a workshop; a warehouse; a mine, quarry, or other place of extraction of natural resources; and a building site or construction or installation project which lasts for more than twelve months. The twelve month period for a construction or installation project begins when work physically commences in the other Contracting State. A series of contracts or projects which are interdependent both commercially and geographically is to be treated as a single project for the purpose of applying the twelve-months test.

Paragraph (4) provides that a permanent establishment does not include: the use of facilities solely for the purpose of storage, display, or delivery of goods or merchandise belonging to the enterprise; the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of processing by another enterprise; the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise, or of collecting information, for the enterprise; the maintenance of a fixed place of business solely for the purpose of advertising, supplying information, conducting scientific research, or similar activities which have a preparatory or auxiliary character; or the maintenance of a fixed place of business solely for investment purposes (and not for purposes of engaging in industrial or commercial activity) of an individual, whether by the individual or his employees or through a broker or other agent. These exceptions are cumulative; a fixed place of business used solely for one or more of these purposes will not be considered a permanent establishment under the Convention.

Under paragraph (5), a person, other than an agent of an independent status to whom paragraph (4)(f) or (6) applies, acting in one Contracting State on behalf of an enterprise of the other Contracting State, will be deemed to constitute a permanent establishment if such person has, and habitually exercises in this first-mentioned Contracting State, an authority to conclude contracts in the name of the enterprise, unless that person's activities are limited to the purchase of goods or merchandise for the enterprise.

On the other hand, paragraph (6) provides that an enterprise of one Contracting State will not be deemed to have a permanent establishment in the other Contracting State merely because such enterprise carries on business in the other Contracting State through a broker, general commission agent, or any other agent of an independent status, where the broker or agent is acting in the ordinary course of his business.

Under paragraph (7), the fact that an enterprise controls a corporation which is engaged in industrial or commercial activity in a Contracting State (whether through a permanent establishment or otherwise) is not to be taken into account in determining whether the enterprise had a permanent establishment in that State.

Paragraph (8) provides that, except for assets described in Article 5 (Immovable (Real) Property), assets pertaining to a fixed base used for the performance of independent personal services may be taxed by a Contracting State if the fixed base is situated in that State.

Article 7. Tangible Movable Property

Under paragraph (1), tangible movable property other than currency may be taxed by a Contracting State if the property is situated in that State, and if the property does not form part of the business assets of a permanent establishment situated in the other Contracting State. Tangible movable property for purposes of the wealth transfer taxes imposed by the United States includes whatever property would be considered tangible property under section 2501(a)(2) of the Internal Revenue Code other than property which would be considered real property. Paragraph (1) provides that tangible movable property which is in transit is to be considered situated at the place of its destination.

Under paragraph (2), notwithstanding the provisions of paragraph (1), tangible movable property owned by an individual referred to in paragraph (3) of Article 4 and used for that person's normal personal use or that of his family may be taxed only by the Contracting State in which the individual was domiciled. Under this paragraph, personal property owned by a person who has "double domicile" but who is taxable in the state of his citizenship by virtue of Article 4(3) will be taxable only in the State of citizenship.

Under paragraph (3), notwithstanding paragraph (1), ships and aircraft operated in international traffic, and movable property pertaining to the operation of such ships and aircraft, may be taxed by a Contracting State if the ship or aircraft is registered in that Contracting State. In addition, a ship or aircraft not registered in a Contracting State may be taxed by a Contracting State if the harbors or airports most frequently used by such ship or aircraft are situated in that State.

Article 8. Taxation Other Than Pursuant to Articles 5, 6 and 7

Article 8 states that, except as provided in Articles 5, 6, and 7, property, including shares of stock in a corporation, debt obligations (whether or not there is written evidence of such obligations), other intangible property, and currency may be taxed by a Contracting State only if the decedent or donor was a citizen of, or was domiciled in, that State at the time of death or the making of the gift, and only if the transfer was taxable by that State under its law. The proviso that the transfer must be taxable under the law of the State of domicile or citizenship is intended to ensure that the Convention not be interpreted as permitting a tax not contemplated by internal law.

Article 9. Deduction of Debts

Under paragraph (1), debts, to the extent they are deductible according to the internal law of a Contracting State, are to be deducted from the gross value of property which may be taxed by that State in the proportion that that gross value bears to the gross value of the entire property wherever situated. Under U.S. law, the proration required by paragraph (1) will be made only with respect to transfers of estates of decedents and generation-skipping transfers deemed to occur at or after the death of the deemed transferor. U.S. gift tax law, which in these respects also supplies the law applicable to generation-skipping transfers deemed to occur before the death of the deemed transferor, does not provide a deduction for debts. However, if a donee of a gift, or a transferee of a deemed generation-skipping transfer, assumes a liability in connection with a gift or transfer, the value of the gift or transfer subject to tax will ordinarily be the value of the property transferred net of the liability assumed.

Paragraph (2)(a) provides that, notwithstanding paragraph (1), for purposes of determining French tax debts pertaining to a permanent establishment or to a fixed base used for the performance of independent personal services are to be deducted from the value of assets referred to in Article 6. These deductions are to be allowed, regardless of whether they would be allowed according to French internal law. Under paragraph (2)(b), again notwithstanding paragraph (1), for purposes of determining French tax debts pertaining to ships and aircraft operated in international traffic and to movable property related to the operation of such ships and aircraft are to be deducted from the value of the property to which such debts pertain. These deductions too are to be allowed regardless of whether they would be allowed according to French internal law.

Article 10. Charitable Exemptions and Deductions

Under paragraph (1), a transfer to a legal entity created or organized in a Contracting State is exempt from tax, or fully deductible from the gross value liable to tax, in the other Contracting State, with respect to taxes referred to in Article 2, if the transfer would be eligible for such exemption or deduction if the legal entity had been created or organized in the other Contracting State. Under paragraph (2), the provisions of paragraph (1) apply only if the legal entity to which property is transferred (a) has tax exempt status in the State in which it is created or organized by reason of which transfers to it are exempt or fully deductible from the taxes described in Article 2; (b) is organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes; and (c) receives a substantial part of its support from contributions from the public or from government funds. Under paragraph (3), the provisions of Article 10 apply to transfers to a Contracting State or a political or administrative subdivision of a Contracting State only if the transfers are specifically limited to a religious, charitable, scientific, literary, or educational purpose.

The provisions of Article 10 apply to estates, gifts, and generation-skipping transfers regardless of where the property transferred is situated. In addition, Article 10 requires a Contracting State to exempt or give a full deduction for property situated in that Contracting State transferred by a person who is a domiciliary of that State, if the property is transferred to an entity of the other Contracting State which meets the conditions set forth in paragraphs (1) and (2).

Article 11. Community Property and Marital Deduction

Under paragraph (1), property (other than community property) which was acquired during marriage for consideration by an individual who at the time of death or the making of a gift was domiciled in or a citizen of the United States, and which passes to the spouse, and which under the Convention is taxable by France, whether by virtue of Article 5, 6, or 7 or by virtue of the fact that the individual was domiciled in France, is treated as if it were community property, unless the spouses have elected expressly to have the property treated other than as community property under French civil law.

Under paragraph (2), in the case of an individual domiciled in France, there must be allowed, for purposes of determining the United States tax upon property taxable by the United States under Articles 5, 6, or 7, a marital deduction computed and applied in the manner in which a marital deduction claimed by an individual who was domiciled in the United States would be computed and applied under the law in effect on November 24, 1978. If such deduction is claimed and allowed, the rate of tax imposed upon the property is to be the rate which would be imposed under the law in effect on the date of transfer to transfers by U.S. domiciliaries. If the tax determined without a marital deduction, and with the application of rates applicable under United States law to nonresidents not citizens of the U.S., is lower than the tax resulting from the application of the rule of the first sentence of paragraph (2), then the lower tax shall be the amount due.

The rationale for paragraph (2) derives from modification of internal U.S. law governing the taxation of the estates of nonresidents not citizens of the United States by the Foreign Investors Tax Act of 1966. In adopting that law, Congress was cognizant of the facts that many foreign countries had estate tax rates substantially lower than the U.S., but that the effect of these lower rates was counteracted to some extent by the fact that many of these countries did not allow a marital deduction comparable to that permitted under U.S. law. In order to create more parallel treatment between U.S. and foreign laws with respect to the estates of nonresidents who were not U.S. citizens, Congress adopted a separate rate schedule applicable to such estates, and did not provide a marital deduction for such estates. The rate schedule was substantially lower than that applicable to the estates of citizens and residents. Paragraph (2) assures to domiciliaries of France that they will receive the more favorable of the two forms of treatment—lower rates with no marital deduction, or higher rates with a marital deduction. The benefit conferred by this paragraph is matched by the benefit conferred by France on U.S. citizens and domiciliaries under paragraph (1), under which France has agreed to give community property treatment to all property acquired for consideration after marriage which passes from one spouse to another. This treatment accomplishes substantially the equivalent of a marital deduction on all after-acquired property subject to tax by France under the Convention.

Under paragraph (3), the competent authorities are required to consult to determine whether Article 11 shall be modified or cease to have effect in the event the laws of either Contracting State are changed substantially to reduce the benefits of marital deduction or community property provisions.*

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* Corrected.

CHAPTER IV
RELIEF FROM DOUBLE TAXATION

Article 12. Exemptions and Credits

Under paragraph (1), each Contracting State is required, except as otherwise provided in the Convention, to impose its tax, and to allow exemptions, deductions, credits, and other allowances, in accordance with its own internal laws.

Paragraph (2) provides specific rules for relieving double taxation. Under paragraph (2)(a), property which may be taxed by the United States in accordance with Article 5, 6, or 7, is exempted from French tax. However, French tax with respect to property which is taxable by France in accordance with the Convention is to be computed at the rate appropriate to the total of property taxable under French law. Thus, the Convention provides for "exemption under progression" with respect to French tax for property that remains subject to taxation by France under the Convention.

Under paragraph (2)(b)(i), where both States impose a tax with respect to property which is taxable by France in accordance with Articles 5, 6, or 7, the United States must allow a credit equal to the amount of the tax imposed by France with respect to such property. Under paragraph (2)(b)(ii), notwithstanding the provisions of paragraph (2)(b)(i), the total amount of all credits allowed by the United States pursuant to Article 12 or pursuant to its own laws or other conventions with respect to all property in respect of which a foreign tax credit is allowable under subparagraph (i) of paragraph (2)(b) is not to exceed that part of the United States tax which is attributable to such property. The part of the tax deemed to be so attributable is to be determined in accordance with the principles of section 2014(b)(2) of the Code and section 20.2014-3 of the Estate Tax Regulations. Under paragraph (2)(b)(iii), the credits for tax imposed by France under Article 10(2) are in lieu of, and not in addition to, any credits for such taxes allowed by the internal law of the United States.

Under paragraph (3), if a decedent, donor or deemed transferor was a citizen of the United States at the time of his death or the making of a gift, and such person is considered under Article 4 as having been domiciled in France, the United States must allow a credit equal to the amount of the tax imposed by France. There is no limitation imposed upon the credit which must be allowed under paragraph (3), except that the amount must be an amount of tax paid to France.

Under paragraph (4), exemptions and credits required by Article 12 are to be tentatively allowed by the United States on the basis of statements made in the tax return as to the amount of any tax paid or payable to France. Such exemptions and credits, however, are not finally allowed until such tax for which the exemption or credit is allowable has actually been paid. Under this provision, interest and penalties for underpayments of tax may not be assessed by the United States for any underpayments attributable to a claim for a credit or exemption required under Article 12 if at the time payment of the tax for which the credit or exemption is claimed is not due to France. Interest and penalties may be assessed, however, from such time as tax is due and payable to France, if at such time the amount of tax due and payable is less than the amount of the credit claimed.

Under paragraph (5), the provisions of the Convention may not result in an increase in the amount of the tax imposed by either Contracting State under its domestic laws. A reduction in the credit allowed against United States tax for tax paid to France, which reduction results from the application of the Convention, is not for these purposes to be construed as an increase in tax.

CHAPTER V
SPECIAL PROVISIONS

Article 13. Time Limitations on Claims for Credit or Refund

Under paragraph (1), a claim for credit or for refund of tax founded on the provisions of the Convention must be made before the latest of three dates specified in paragraph (1). The three dates are (1) the time for the making of a claim for refund of tax specified under the internal law of the Contracting State to which the claim for refund or credit is made; (2) five years from the date of death of the decedent, or from the making of a gift with respect to which the claim is made; or (3) one year after final determination (administrative or judicial) and payment of tax for which any credit under Article 12 is claimed, provided that the determination and payment are made within 10 years of the date of death of the decedent or the making of the gift. Under paragraph (2), any refund based on the provisions of the Convention is to be made without payment of interest on the amount refunded.

Article 14. Mutual Agreement

Article 14 provides for competent authority procedures to ensure taxation in accordance with the Convention, and for other purposes. Under paragraph (1), any person who considers that the actions of one or both Contracting States results or will result in taxation not in accordance with the Convention may, notwithstanding remedies provided by the internal law of the Contracting States, present his case to the competent authority of either Contracting State. Such a presentation must be made within the time period specified by Article 13(1) for filing a claim for refund. If the person's claim is considered to have merit by the competent authority to which the claim is made, that authority is required to seek agreement with the competent authority of the other Contracting State with a view to avoiding taxation contrary to the provisions of the Convention.

Under paragraph (2), the competent authorities are to resolve by mutual agreement any difficulties or doubts arising as to the application of the Convention.

Under paragraph (3), the competent authorities of the Contracting States may communicate with each other directly for the purpose of reaching an agreement under Article 14. When it seems to them advisable, the competent authorities are empowered to meet together for an oral exchange of opinions.

Under paragraph (4), when the competent authorities reach an agreement for the purpose of avoiding taxation not in accordance with the Convention, taxes are to be imposed, and refund or credit of taxes to be allowed in accordance with the agreement, notwithstanding any procedural rule (including the statute of limitations) applicable under the laws of either Contracting State. Under this paragraph, an agreement between the competent authorities is to be implemented notwithstanding time limitations imposed by the internal law of the Contracting States, and notwithstanding the time limitations for filing a claim for refund or credit imposed by Article 13.

Under paragraph (5), the competent authorities of the Contracting States are permitted to prescribe any regulations and forms as may be necessary or appropriate to give effect to and implement the Convention.

Article 15. Filing of Returns and Exchange of Information

Paragraph (1) preserves obligations to file returns or transfer certificates or notices, or to maintain records, imposed by the internal law of each State, notwithstanding alterations of substantive taxing jurisdiction made by the Convention. Under paragraph (1)(a), the provisions of Articles 5, 6, 7, and 8 which change the taxability or situs of property or the amount of tax which would have been due in the absence of the Convention, do not change (i) the requirements of the respective tax laws of the Contracting States relating to information or tax returns or notices, transfer certificates, or maintenance of records; or (ii) the applicability and amount of any sanctions of such laws with respect to those requirements.

Under paragraph (1)(a)(i), the executor of a French domiciliary whose estate included property which would be considered situated in the United States under United States internal law would be required to file a tax return with respect to such property, even if the property is not subject to taxation by the United States by reason of Article 8, and even though property not subject to taxation by the United States by reason of Article 8 is the only property in the estate that is situated in the United States. Under paragraph (1)(b), as concerns the United States and notwithstanding the provisions of paragraph (1)(a), requirements or sanctions found to be unnecessary for the prevention of fraud or fiscal evasion with respect to taxes to which this Convention applies may be eliminated or modified (but not made more burdensome) by regulations prescribed pursuant to paragraph (5) of Article 14. Under this paragraph, the Treasury Department will be empowered, through published regulations, to vary the requirements of U.S. statutory law with respect to filing of tax or information returns, or maintenance of records or transfer certificates, if it finds any such requirements unnecessary for the prevention of fraud or fiscal evasion with respect to taxes covered by this Convention.

Under paragraph (2), the competent authority of each Contracting State is required to exchange information with the competent authority of the other Contracting State. Two categories of information are required to be exchanged: (a) information pertinent to carrying out the provisions of the Convention or the laws of the other Contracting State concerning the taxes subject to the Convention, insofar as taxation under those laws is in accordance with the Convention; or (b) information pertinent to preventing fraud or fiscal evasion in relation to the taxes which are the subject of the Convention, including information in the possession of a Contracting State with respect to property not subject to taxation by that State by reason of Article 8. The paragraph contains a proviso to the effect that the competent authority of a Contracting State is not required to furnish information not in the possession of that State with respect to property exempted from that State's tax by reason of Article 8. Thus, a competent authority is not required to gather information from sources outside its government concerning exempt property. The competent authority is required to furnish information in its own possesion, or in the possession of other agencies of the Contracting State, concerning such property. Paragraph (2) further provides that any information furnished must be treated as secret by the recipient State. Such information may not be disclosed to persons other than those concerned with assessment, collection, enforcement, or prosecution in respect of the taxes which are the subject of the Convention. Such persons include a court or administrative body.

Under paragraph (3), the provisions of paragraph (2) are in no case to be construed so as to impose upon a Contracting State obligations (a) to carry out administrative measures at variance with its own laws or administrative practices, or those of the other Contracting State; (b) to supply particulars which are not obtainable under its laws or in the normal course of its administration, or that of the other Contracting State; or (c) to supply information which would tend to disclose any trade, business, industrial, commercial, or professional secret or trade process, or information the disclosure of which would be contrary to public policy.

Under paragraph (4), the furnishing of information may be either on a routine basis, or on request with reference to particular cases. The competent authorities are required to agree on a list of information to be subject to routine exchange.

Article 16. Assistance in Collection

Under paragraph (1), each Contracting State undertakes to lend assistance and support to the other in the collection of the taxes subject to the Convention, as well as interest, costs, and additions to the taxes and fines not of a penal character. This assistance is to be provided only in cases where the taxes are definitively due according to the laws of the applicant State.

Under paragraph (2), in the case of an application for the enforcement of taxes, revenue claims of each of the Contracting States which have been finally determined will be accepted for enforcement by the State to which application is made, and shall be collected in that State in accordance with the laws applicable to the enforcement and collection of its own taxes.

Under paragraph (3), an application under Article 16 must be accompanied by such documents as are required by the laws of the State making the application to establish that the taxes have been finally determined.

Under paragraph (4), if a revenue claim has not been finally determined, the State to which application is made is required to take such measures of conservancy, including measures applicable with respect to transfers of property belonging to nonresident aliens, as are authorized by its own laws for the enforcement of its own taxes.

Under paragraph (5), the assistance in collection available under Article 16 is not to be accorded with respect to estates of citizens of the Contracting State to which application is made.

Article 17. Diplomatic and Consular Officials

Article 17 preserves such rights as each Contracting State has to impose wealth transfer taxes upon its diplomatic and consular officials. Under paragraph (1), nothing in the Convention is to affect the fiscal privileges of diplomatic or consular officials under the general rules of international law or under the provisions of special agreements. Under paragraph (2), insofar as such privileges prevent the imposition of tax in a receiving Contracting State, the right to tax is reserved to the Contracting State in whose service the persons concerned exercised their functions and, notwithstanding any other provisions of the Convention, such persons are not to be deemed to have been domiciled in the receiving State.

Article 18. Territorial Extension

Under paragraph (1), the Convention may be extended, either in its entirety or with necessary modifications, to all or any of the Overseas Territories of the French Republic or the territories for whose international relations the United States is responsible, if the territory to which the Convention is to be extended imposes taxes substantially similar in character to those referred to in Article 2. Any such extension is permitted to take effect from such date and subject to such modifications and conditions as may be specified and agreed between the Contracting States in notes to be exchanged through diplomatic channels or in any other manner in accordance with the constitutional procedures of the Contracting States. In the case of the United States, extension of the Convention to one of its territories or to a territory of France must be accomplished in accordance with the procedure required by Article II, Section 2, of the Constitution of the United States, which requires that the President secure the advice and consent of a two-thirds vote of the Senate of the United States as a prerequisite to ratification of a treaty.

Under paragraph (2), at any time after the expiration of a period of 1 year from the effective date of an extension made by virtue of paragraph (1), either of the Contracting States is permitted, by written notice of termination given to the other Contracting State through diplomatic channels, to terminate the application of the provisions of the Convention with respect to any territory to which it has been extended. If such notice is given, the Convention shall cease to be applicable to such territory on and after the first day of January following the date of such notice.

Under paragraph (3), unless it is otherwise agreed by both Contracting States, the termination of the Convention by one of the Contracting States under Article 20 will also terminate the application of the Convention to any territory to which it has been extended under Article 18.

CHAPTER VI.
FINAL PROVISIONS

Article 19. Entry into Force

Under paragraph (1), the Convention is required to be ratified, and instruments of ratification are to be exchanged at Paris as soon as possible.

Under paragraph (2), the Convention will enter into force on the first day of the second month following the month in which the exchange of instruments of ratification takes place. The provisions of the Convention are to apply to estates of persons dying, to gifts made, and to generation-skipping transfers deemed to occur, on or after the date on which the Convention enters into force.

Under paragraph (3), the Convention of October 18, 1946, as modified by the Protocol of May 17, 1948, and the Convention of June 22, 1956, shall be terminated on, and shall cease to have effect from, the date on which this Convention enters into force according to paragraph (2).

Article 20. Termination

Under paragraph (1), the Convention is to remain in force until it is terminated by one of the Contracting States. However, not earlier than the fifth year following the year in which the Convention enters into force, either Contracting State is permitted, between January 1 and June 30 of any year, to give written notice of termination, through diplomatic channels. Such written notice will terminate the Convention, effective from the end of the calendar year in which the notice is given. In the event of termination, the provisions of the Convention are not to apply to estates of persons dying, to gifts made, or to generation-skipping transfers deemed to occur, on or after the end of the calendar year with respect to the end of which the Convention is terminated.

Under paragraph (2), notwithstanding the provisions of paragraph (1), if the effects of the Convention are substantially altered as a result of changes made in the tax law of either Contracting State, either Contracting State may, through diplomatic channels, give written notice of termination. Such a notice will have effect on a date to be specified in the notice, which date may not be earlier than 6 months following the date of the notice. In the event notice of termination is given under paragraph (2), the Convention will not apply to estates of persons dying, to gifts made, or to generation-skipping transfers deemed to occur, on or after the effective date of the termination.

The provisions of Article 11 may be terminated without termination of the entire Convention in the event of certain described changes in the tax laws of the Contracting States. See the discussion of Article 11 above. Changes in the tax laws of one or both of the Contracting States which are grounds for termination of the provisions of Article 11, if unaccompanied by other changes which would independently give grounds for termination under paragraph (2) of Article 20, may not be grounds for termination of the entire Convention under paragraph (2) of Article 20.

Part IV. Items of General Interest

Investment Credit for Energy Property—Public Hearing

Announcement 80-139 [1]

AGENCY: Internal Revenue Service, Treasury.

ACTION: Notice of hearing on proposed regulations.

SUMMARY: This document provides notice of a public hearing on proposed regulations relating to business investment credit for energy property.

DATES: The public hearing will be held on December 4, 1980, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by November 20, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-165-77), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under section 48 of the Internal Revenue Code of 1954. The proposed regulations appeared in the Federal Register for Friday, September 19, 1980 (45 FR 62496).

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted written comments within the time prescribed in the notice of proposed rulemaking and also desire to present oral comments at the hearing on proposed regulations should submit an outline of the comments to be presented at the hearing and the time they wish to devote to each subject by November 20, 1980. Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive for improving government regulations appearing in the Federal Register for Wednesday, November 8, 1978.

By direction of the Commissioner of Internal Revenue.

Foundation Status of Certain Organizations

Announcement 80-140

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Ambassador Cultural Foundation, Isanti, MN
American Committee for Torah Center—Ohev Yisrael in Jerusalem, Brooklyn, NY
American Field Sports Society, Ltd., Washington, DC
American Friends of Yad Shlomo, Brooklyn, NY
American Jazz, Inc. (AJI), Washington, DC
American Media Corporation of the Deaf, Minneapolis, MN
American Metaphysical Society, Inc., Washington, DC
Aurora Research Corp., Washington, DC
Bali Project, The, Wilmington, DE
Barco Employees Educational Trust, The, Berkeley, CA
Battery Park Tennis Association, Richmond, VA
Behaviometric and Economic Systems Research Scientific Management Consultants Foundation, Phoenix, AZ
Beit Shiloh, Inc., Tampa, FL
Big Sisters of Hampton Roads, Inc., Hampton, VA
Bluegrass Institute of Child Development and Related Studies, Inc., Lexington, KY
Board of Governors Cardiovascular Institute of Hahnemann Medical College, Philadelphia, PA
Branches of the Arts, Inc., Richmond, VA
Cape Fear Area Opportunities, Wilmington, NC
Christian Community Centers, Inc., Marshall, MN
Citizens Committee for a Better Sheboygan Inc., Sheboygan, WI
Conference on Handicapped Individuals, Bethlehem, PA
Cullen Memorial Scholarship Fund Inc., The James A., Westbury, NY
Dakota's Children Benefit Association Inc., St. Paul, MN
Davis Evangelistic Association, Inc., The Fred, Knoxville, TN
De Novo, New Brighton, MN
Development Resources, Washington, DC

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[1] Filed by the Office of the Federal Register on October 2, 1980, 8:45 a.m., and published in the issue of the Federal Register for October 3, 1980, 45 F.R. 65625.

East Bank Cultural Resources, Inc., Rensselaer, NY
East Ocean View Christian Foundation, Norfolk, VA
Encouragement Inc., Baltimore, MD
Evangelicals for Social Action Inc., Philadelphia, PA
Fishermen's and Seamen's Memorial Fund, San Francisco, CA
Frederick County 4-H Camp Center, Inc., Frederick, MD
Friends of the Minnesota Valley Regional Library, Mankato, MN
Frontiers of Self Awareness Inc., Madison, WI
Germantown Area Soccer Association, Germantown, TN
Greater Washington Area Evangelical Women's Caucus, Arlington, VA
Greenwood Council of the Arts, Inc., Greenwood, SC
International Carpentry Apprenticeship, Washington, DC
International Committee for the Future, Inc., Washington, DC
International Foundation for Preventive Medicine, The, Richmond, VA
Intersection, The, McKeesport, PA
Kensington Repeater Association Inc., Albany, CA
Latchstring Crisis Center, Inc., The, Abingdon, VA
Lupus Foundation of Greater Washington, Washington, DC
Mankato Area Youth Athletic Association, Inc., Mankato, MN
Many Mansions, Inc., Plainfield, NJ
Maryland Foundation of College Park, Inc., The, College Park, MD
Meals on Wheels of Clairton, Clairton, PA
Memphis Guild of Handloom Weavers, The, Germantown, TN
Mid-America Performing Arts Workshop, Inc., Memphis, TN
Mid-Tennessee Fibre Arts Guild, Nashville, TN
Mission of Good News and Hope, Inc., Indianapolis, IN
Morgan Memorial Educational Foundation, Inc., Lydia Gail, Gatesville, NC
Nassau County Aquarium Society, Levittown, NY
National Animals Association, Inc., Port Washington, NY
New Bern Civic Theatre Inc., New Bern, NC
New York State Association of Rehabilitation Facilities, Albany, NY
North Star Hockey Club, Morristown, NJ
Our Place to Grow, Hendersonville, TN
Parent Education & Human Relations Center, Upper Darby, PA
Picciola Area Volunteer Fire Department, Inc., Leesburg, FL
Plainfield Heritage, Inc., Plainfield, NJ
Playhouse Theatre, Inc., Mendon, NY
Primm Evangelistic Association, Larry, Richmond, VA
Progressive Repertory Company of Cincinnati, Cincinnati, OH
Project Change, Inc., Minneapolis, MN
Queens Skilled Employment Center, Kew Gardens, NY
Quezon Province Association—Eastern U.S.A., Elmhurst, NY
Rochester Peace & Justice Center, Inc., Rochester, NY
St. Louis Sex Information Bureau, St. Louis, MO
San Joaquin Elementary School, Parent-Teacher Organization, The, Laguna Hill, CA
Santiago Community Players, Orange, CA
Semler Fund, Inc., Natalia P., Fairfax, VA
Senior Alliance For Independent Living, Inc., Phoenix, AZ
Sierra Nevada Institute, The, Olympic Valley, CA
Sierra Vista Hospital Auxiliary, San Luis Obispo, CA
Society of Demonstrative Art Foundation, The, Riverside, CA
Southwest Community Corp., St. Louis, MO
Sunshine Center, Inc., Delano, CA
Susquehanna County Association for Retarded Citizens, Montrose, PA
Tira Technical Institute for Research and Action, Clark, NJ
Urban Bay Area Service Center, Oakland, CA
Will Institute, The, New Palty, NY
Youth Development Association of Huntington Station Inc., New York, NY
8th Congressional District Maryland Intern Selection Committee, The, Wheaton, MD

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Practice Before the Service—Tax Shelters—Extension of Comment Date—Public Hearing

Announcement 80-145 [1]

AGENCY: Department of the Treasury.

ACTION: Proposed rule: additional time to submit written comments and notice of public hearing.

SUMMARY: A notice of proposed rulemaking to amend the regulations governing practice before the Internal Revenue Service for the purpose of setting standards relative to opinions used in the promotion of tax shelters was published in the Federal Register on Thursday, September 4, 1980 (45 FR 58594) [Announcement 80-129, 1980-42 I.R.B. 23]. The public was invited to submit written comments on the proposal on or before November 3, 1980. No public hearing was contemplated unless requested. It has been determined that the time to submit written comments be extended, and, while to date there has been no request to be heard, the Department believes a hearing on the proposed rule is warranted.

DATES: The time in which to submit written comments is extended until

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[1] Filed by the Office of the Federal Register on October 15, 1980, 8:45 a.m., and published in the issue of the Federal Register for October 16, 1980, 45 F.R. 68686.

Friday, November 14, 1980. The hearing on the proposed rule is scheduled for Tuesday, November 25, 1980, beginning at 10:00 a.m.

ADDRESS: All written comments on the proposed amendment and all requests for an opportunity to be heard, together with required statements, should be sent to the Office of Director of Practice, U.S. Department of the Treasury, Washington, D.C. 20220. The hearing will be held in the Cash Room, Main Treasury Building, 15th Street and Pennsylvania Avenue, NW., Washington, D.C.

FOR FURTHER INFORMATION CONTACT: Mr. Leslie S. Shapiro, Director of Practice, 202-376-0767.

SUPPLEMENTARY INFORMATION: The hearing will be open to the public as space is available. Persons wishing to make statements at the hearing should advise the Director of Practice in writing by November 14, 1980, and should submit in triplicate the text or, at a minimum, an outline of comments they propose to make. Comments will be restricted to 10 minutes in length. Written comments also should be sent in triplicate.

Overseas Employees of Charitable Organizations

Announcement 80-146 [1]

Certain overseas employees of charitable organizations, as defined in section 501(c)(3) of the Internal Revenue Code, who resided in a lesser developed country while employed by such an organization during any part of their 1979 taxable year, will have until December 15, 1980, to file their 1979 income tax returns.

This extension is granted to those taxpayers who, under legislation reported by the Senate Finance Committee would be allowed to elect an income exclusion of up to $20,000 under section 911 in lieu of the deduction provided for excess foreign living costs under section 913, and who were residing or traveling outside the United States and Puerto Rico on April 15, 1980. Qualifying taxpayers need take no further action to obtain this extension, but they should note in the top margin on the front page of the return, "charitable organization overseas employee."

A previous automatic extension to October 15, 1980, was announced in News Release IR-8069, of June 10, 1980 [Announcement 80-94, 1980-30 I.R.B. 28].

Taxpayers who qualify for the exclusion election, but who were in the United States or Puerto Rico on April 15 will not qualify for this extension. If these taxpayers applied for and received an extension to June 15, 1980, their returns were due October 15, 1980.

Under the Senate Finance Committee bill, those who have filed their returns under present law and later wish to make the election for the 911 exclusion, which that bill would provide, would have 24 months from the date of enactment to file amended returns. If the legislation is enacted, any necessary revised tax forms will be issued.

Lesser developed countries are countries not on the following list:

- Australia
- Austria
- Canada
- Czechoslovakia
- European Economic Community member states
    - Belgium
    - Britain
    - Denmark
    - France
    - Ireland
    - Italy
    - Luxemburg
    - Netherlands
    - West Germany
- Finland
- Germany (East)
- Hungary
- Iceland
- Japan
- Liechtenstein
- Monaco
- New Zealand
- Norway
- Poland
- Republic of South Africa
- San Marino
- Spain
- Sweden
- Switzerland
- Union of Soviet Socialist Republics

Any foreign country within the Sino-Soviet bloc as defined in section 2 of E.O. 11071, 1963-1 C.B. 137.

Taxpayers eligible for the exclusion who were outside the U.S. and Puerto Rico on April 15 will not be penalized for failure to pay any tax due on the return if they file their returns and pay the amount due by December 15, 1980. However, taxpayers who were residing or traveling within the United States are subject to penalties if their returns were not filed and their taxes paid by October 15, 1980. In either case, interest will be due on any unpaid taxes from April 15, 1980, to the date of payment.

The due dates for estimated tax payments for the 1980 tax year are not changed by this extension.

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[1] Based on News Release IR-80-108, dated October 16, 1980.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing, the following individual has been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
J. Franklin Moore	Lenoir, NC	Certified Public Accountant	August 18, 1980

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Anthony G. Bellas	Littleton, CO	Enrolled Agent	Twelve months effective September 1, 1980
Roy W. Lynch	New Bedford, MA	Enrolled Agent	Indefinite effective August 28, 1980
Roger C. Hennings	Stillwater, MN	Attorney	Indefinite effective August 28, 1980
Vincent E. Heyworth	Hagerstown, MD	Enrolled Agent	Six months effective September 30, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.6013-6(a)(2)(v) amended.	Relationship of election by nonresident alien to be treated as a resident and income tax treaties.	Sept. 12, 1980	Nov. 11, 1980
26 CFR 1.47-1 amended, 1.48-9 added.	Business investment credit for energy property.	Sept. 19, 1980	Nov. 18, 1980
26 CFR 150.4989-1(c) amended; published as temporary regulations in T.D. 7720, 1980-42 I.R.B. 12.	Interim rule for determining base prices for tier 2 and tier 3 oil.	Sept. 24, 1980	Nov. 24, 1980
26 CFR 150.4989-1(c), 150.4995-1(b)(2) revised; published as temporary regulations in T.D. 7721, 1980-42 I.R.B. 13.	Base prices of tier 2 and tier 3 oil and withholding in the absence of effective operator's certificate.	Sept. 30, 1980	Dec. 1, 1980
26 CFR 1.584-1 through 1.584-4, 1.6032-1 amended.	Common trust funds.	Sept. 22, 1980	Nov. 21, 1980
26 CFR 31.6205-1(b)(2) amended.	Interest-free adjustment with respect to erroneous filing of FICA and RRTA returns.	Sept. 26, 1980	Nov. 25, 1980

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Key to Abbreviations:

RR	Revenue Ruling
RP	Revenue Procedure
TD	Treasury Decision
CD	Court Decision
PL	Public Law
EO	Executive Order
DO	Delegation Order
TDO	Treasury Department Order
TC	Tax Convention
SPR	Statement of Procedural Rules
PTE	Prohibited Transaction Exemption

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______	1928-1	6.95
______	1928-2	9.50
______	1929-1	12.00
______	*1929-2*	*3.15*
______	1930-1	7.30
______	1930-2	9.50
______	*1931-1*	*3.60*
______	1931-2	13.00
______	*1932-1*	*2.80*
______	1932-2	8.65
______	*1933-1*	*3.35*
______	*1933-2*	*3.45*
______	*1934-1*	*3.70*
______	1934-2	14.00
______	1935-1	6.90
______	*1935-2*	*14.00*
______	*1936-1*	*3.55*
______	*1936-2*	*14.00*
______	*1937-1*	*13.00*
______	1937-2	7.70
______	*1938-1*	*16.00*
______	*1938-2*	*13.00*
______	1939-1-1	8.25
______	1939-1-2	10.90
______	1939-2	9.40
______	1940-1	5.55
______	1940-2	14.00
______	1941-1	*$6.95*
______	*1941-2*	*3.55*
______	1942-1	7.25
______	*1942-2*	*5.55*
______	*1943*(*)	*9.55*
______	*1944*(*)	*7.85*
______	1945(*)	9.40
______	*1946-1*	*2.55*
______	1946-2	5.20
______	*1947-1*	*1.80*
______	1947-2	3.40
______	*1948-1*	*3.15*
______	1948-2	7.50
______	*1949-1*	*6.90*
______	*1949-2*	*2.80*
______	1950-1	6.35
______	*1950-2*	*4.70*
______	*1951-1*	*12.00*
______	*1951-2*	*5.05*
______	*1952-1*	*2.55*
______	1952-2	7.05
______	*1953-1*	*4.25*
______	1953-2	12.00
______	1954-1	12.00
______	1954-2	12.00
______	1955-1	10.25
______	1955-2	13.00
______	1956-1	15.00
______	1956-2	18.00
______	1957-1	$16.00
______	1957-2	13.00
______	1958-1	9.60
______	1958-2	13.00
______	1958-3	15.00
______	1959-1	15.00
______	1959-2	9.60
______	1960-1	19.00
______	1960-2	11.50
______	1961-1	14.00
______	1961-2	10.00
______	1962-1	14.00
______	1962-2	13.00
______	1962-3	20.00
______	1963-1	9.00
______	1963-2	10.75
______	1964-1-1	10.00
______	1964-1-2	11.00
______	1964-2	9.80
______	1965-1	10.70
______	1965-2	12.25
______	1966-1	14.00
______	1966-2	14.05
______	1967-1	10.00
______	1967-2	14.00
______	1968-1	14.00
______	1968-2	11.75
______	1969-1	14.00
______	1969-2	6.50
______	1969-3	$12.50
______	1970-1	11.00
______	1970-2	14.00
______	1971-1	10.55
______	1971-2	8.50
______	1972-1	13.50
______	1972-2	13.70
______	1973-1	16.00
______	1973-2	8.30
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______	1974-2	9.95
______	*1974-3*	*8.20*
______	1974-3 Supp.	10.00
______	1975-1	13.25
______	1975-2	13.00
______	1976-1	11.00
______	1976-2	10.25
______	1976-3-1	9.50
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______	1976-3-3	10.00
______	1977-1	10.75
______	1977-2	11.75
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November 10, 1980
Bulletin No. 1980-45

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-299, page 5.

Cooperative housing corporation; tenant-occupant protected by rent control laws. An otherwise qualifying cooperative housing corporation is not precluded from meeting the requirements of section 216(b)(1)(B) of the Code by state and local rent control laws that prevent a purchaser of shares from obtaining occupancy of a unit until the current tenant-occupant voluntarily vacates the unit or breaches the lease and is dispossessed.

Rev. Rul. 80-300, page 5.

Gross income; stock appreciation rights; year includible. A corporation grants to its key employees stock appreciation rights that entitle them to a cash payment for each right exercised equal to the excess of the fair market value of a share of the corporation's common stock on the date of exercise over the fair market value of a share on the date the right is granted. The rights cannot be exercised before one year, and if they are not exercised within five years, they are deemed exercised on the fifth anniversary of the grant. At that time, the employee will be paid the amount of the appreciation. Payments received for the stock appreciation rights are includible in gross income in the year the rights are exercised.

T.D. 7725, page 9.

Amendments to the regulations under section 1502 of the Code provide rules for computing the limitation on percentage depletion with respect to oil and gas wells for independent producers and royalty owners that file consolidated returns.

Announcement 80-142, page 30.

Various areas of the States of Maine and Michigan have been declared disaster areas in which losses qualify for the special tax treatment under section 165(h) of the Code.

Announcement 80-143, page 30.

The disaster areas announcement for the State of Texas has been amended to add to the list of areas in which losses qualify for the special tax treatment under section 165(h) of the Code.

Announcement 80-148, page 30.

A public meeting will be held on November 19, 1980, to solicit views on issues being considered in the negotiation of an income tax treaty between the U.S. and Tunisia.

EXEMPT ORGANIZATIONS

Rev. Rul. 80-301, page 6.

Genealogical research; public interest. A genealogical society that (1) opens its membership to all persons in a particular area, (2) provides instruction in genealogical research techniques to its members and to the general public, but does not research genealogies for its members, (3) conducts research projects and makes the results available to the state historical society, (4) provides materials for libraries and community displays, and (5) promotes various other related activities for the public qualifies for exemption under section 501(c)(3) of the Code; Rev. Rul. 80-302 distinguished.

(Continued on page 4)

Finding Lists begin on page 35.
Announcement of Disbarment and Suspensions on page 32.
Announcement of Notice of Proposed Rulemaking on page 33.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

EXEMPT ORGANIZATIONS—Cont'd

Rev. Rul. 80-302, page 7.

Genealogical research; private interest. An organization that (1) limits its membership to descendants of a particular family, (2) compiles family genealogical research data for use by its members for reasons other than to conform to the religious precepts of the family's denomination, (3) presents the data to designated libraries, (4) publishes volumes of family history, and (5) promotes social activities among family members does not qualify for exemption under section 501 (c)(3) of the Code; Rev. Ruls. 71-580 and 80-301 distinguished.

ESTATE TAX

Rev. Proc. 80-49, page 29.

Valuation; farms and closely held businesses; partial revocation of section 2032A election. Procedures are provided for electing to value less than all qualified real property in a decedent's gross estate under section 2032A of the Code where an election to value all the qualified real property under section 2032A was previously made on or before August 30, 1980.

EMPLOYMENT TAXES

Rev. Rul. 80-303, page 10.

Unwritten sick pay plan. Payments that are made under an employer's unwritten sick pay plan that is open to all full-time employees and in which the employees have, for a number of years, been made aware by the customary practice of the employer are excepted from wages under sections 3121(a)(2) and 3306(b)(2) of the Code.

EXCISE TAXES

Announcement 80-144, page 30.

Form 720, Quarterly Federal Excise Tax Return, and Form 4638, Federal Use Tax Return on Civil Aircraft, are being revised to reflect the reduction or expiration of certain aviation-related excise taxes on September 30, 1980. The revised Form 720, to be used for quarters ending on or after December 31, 1980, and the revised Form 4638, for the period July 1 through September 30, 1980, will be available at a later date.

Announcement 80-149, page 31.

The temporary regulations relating to base prices for tier 2 and tier 3 oil of the windfall profit tax will be modified to provide that base prices are to be determined on a property-by-property basis.

Announcement 80-150, page 31.

The temporary regulations relating to the windfall profit tax will be changed to allow additional time for filing annual statements and returns and for making withholding adjustments.

TAX CONVENTIONS

Rev. Rul. 80-304, page 25.

Austria; situs of nonprofit organization. The exemption from tax provided under Article XIII (3) of the U.S.-Austria Income Tax Convention for a recipient of a grant, allowance, or award from a nonprofit religious, charitable, scientific, literary, or educational organization shall be allowed without regard to the situs of the nonprofit organization.

ADMINISTRATIVE

Rev. Proc. 80-45, page 26.

Forms 949 and 949-A; filing extension. Contractors and subcontractors with contracts subject to the Vinson-Trammell Act are granted an extension until October 1, 1981, to file Forms 949 and 949-A for taxable years ended before January 31, 1981; Rev. Proc. 77-47 modified and Rev. Proc. 80-13 superseded.

Rev. Proc. 80-46, page 26.

Disclosure authorization lists; business entities. Procedures are set forth by which business entities may submit letters authorizing the Service to disclose confidential tax information to certain employees listed in the authorization.

T.D. 7723, page 11.

Amendments to the regulations under section 6103 of the Code relate to disclosures of returns and return information under certain circumstances.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-2: Compensation for services, including fees, commissions, and similar items.

When an employee is in receipt of income because of the grant to the employee of a stock appreciation right. See Rev. Rul. 80-300, this page.

Section 216.—Deduction of Taxes, Interest, and Business Depreciation by Cooperative Housing Corporation Tenant-Stockholder

26 CFR 1.216-1: Amounts representing taxes and interest paid to cooperative housing corporation.

Cooperative housing corporation; tenant-occupant protected by rent control laws. An otherwise qualifying cooperative housing corporation is not precluded from meeting the requirements of section 216(b)(1)(B) of the Code by state and local rent control laws that prevent a purchaser of shares from obtaining occupancy of a unit until the current tenant-occupant voluntarily vacates the unit or breaches the lease and is dispossessed.

Rev. Rul. 80-299

ISSUE

Does a corporation meet the requirement of section 216(b)(1)(B) of the Internal Revenue Code, under the circumstances described below?

FACTS

A partnership owned an apartment building that is subject to state and local rent control laws under which a tenant-occupant is entitled to a renewal of the tenant's lease prior to its termination. Thus, the tenant may continually renew the lease. The building was transferred to a corporation organized by the partnership in exchange for stock that the partnership offered for sale to the tenants and to the general public. Of the total number of shares available for sale, different blocks of shares were allocated to each apartment unit. The purchaser of a block of shares is entitled to a proprietary lease of the allocable apartment unit.

The proprietary lease received by a nonoccupant purchaser of shares is subject to the rights under the rent control laws of the tenant in occupancy. That is, a purchaser of a unit that is occupied may obtain occupancy only if the tenant-occupant voluntarily vacates the unit or breaches the obligations and is involuntarily dispossessed. The purchaser becomes a lessee under the proprietary lease, and, if the tenant-occupant remains in possession, a sublessor with respect to the tenant-occupant.

A minority of the tenant-occupants purchased blocks of stock in the corporation and received leases from the corporation for the allocable apartment units. The remaining tenant-occupants did not purchase stock. This stock was sold by the partnership to purchasers who are not able to occupy the allocable apartment units because they are occupied by tenant-occupants who are protected by the rent control laws.

LAW AND ANALYSIS

Section 216(b)(1)(B) of the Code provides that the term "cooperative housing corporation" means a corporation in which, among other things, each of the stockholders is entitled, solely by reason of the stockholder's ownership of stock in the corporation, to occupy for dwelling purposes a house, or an apartment in a building, owned or leased by the corporation.

Section 1.216-1(d)(2) of the Income Tax Regulations provides that each stockholder of the corporation must be entitled to occupy for dwelling purposes an apartment in a building or a unit in a housing development owned or leased by such corporation. The stockholder is not required to occupy the premises. The right as against the corporation to occupy the premises is sufficient. Such right must be conferred on each stockholder solely by reason of the stockholder's ownership of stock in the corporation; that is, the stock must entitle the owner thereof either to occupy the premises or to a lease of the premises. The fact that the right to continue to occupy the premises is dependent upon the payment of charges to the corporation in the nature of rentals or assessments is immaterial.

Section 216(b)(1)(B) of the Code and regulations thereunder require only that the stockholder have a right by reason of the stockholder's ownership of stock either to occupy the premises or to a lease of the premises and such right as against the corporation is all that is needed. Actual occupancy is not required.

In this case, a nonoccupant stockholder is entitled to a proprietary lease solely by reason of ownership of stock in the corporation and such lease confers occupancy rights upon the stockholder as against the corporation. Therefore, it is not material that the stockholder is precluded from actual occupancy of an apartment because it is occupied by a tenant whose lease is protected by the rent control laws.

A tenant-occupant who purchased stock in the corporation is also entitled to a proprietary lease that confers occupancy rights upon the tenant-occupant, notwithstanding the fact that the tenant-occupant may also have a right to occupy the apartment under the rent control laws. As to the occupant-shareholder, who possesses occupancy rights by reason of the occupant-stockholder's stock ownership, the occupancy rights conferred by the rent control laws are immaterial.

HOLDING

The corporation meets the requirements of section 216(b)(1)(B) of the Code.

Section 451.—General Rule for Taxable Year of Inclusion

26 CFR 1.451-2: Constructive receipt of income.
(Also Section 61; 1.61-2.)

Gross income; stock appreciation rights; year includible. A corporation grants to its key employees stock appreciation rights that entitle them to a cash payment for each right exercised equal to the excess of the fair market value of a

share of the corporation's common stock on the date of exercise over the fair market value of a share on the date the right is granted. The rights cannot be exercised before one year, and if they are not exercised within five years, they are deemed exercised on the fifth anniversary of the grant. At that time, the employee will be paid the amount of the appreciation. Payments received for the stock appreciation rights are includible in gross income in the year the rights are exercised.

Rev. Rul. 80-300

ISSUE

When is an employee in receipt of income because of the grant to the employee of a stock appreciation right?

FACTS

A corporation adopted a plan under which key employees of the corporation are granted stock appreciation rights (SAR's). An SAR entitles the employee to a cash payment equal to the excess of the fair market value of one share of the common stock of the corporation on the date of the exercise of the SAR over the fair market value of a share on the date the SAR was granted to the employee. An employee need not own any stock of the corporation to receive an SAR, and SAR's are granted without cost to the employee. To exercise an SAR, an employee must notify the corporation in writing. No SAR is exercisable before one year, and if not exercised by the employee within five years, the SAR's will be deemed to have been exercised on the fifth anniversary of the grant. At that time, the amount of the stock appreciation will automatically be paid to the employee. SAR's are not traded on an established market, and are nonassignable and nontransferable by the grantees.

In 1975, the corporation granted 10 SAR's to *A*, an employee of the corporation. On the date of the grant, the fair market value of the corporation's common stock was 30*x* dollars a share. In 1980, *A* exercised the SAR's when the fair market value of a share of the corporation's stock was 80*x* dollars. *A* received 500*x* dollars.

LAW AND ANALYSIS

Section 61 of the Internal Revenue Code provides that, except as otherwise provided, income means all income from whatever source derived.

Section 451(a) of the Code provides that the amount of any item of gross income is includible in gross income for the taxable year in which received by the taxpayer, unless, under the method of accounting used in computing taxable income, the amount is to be properly accounted for as of a different period.

Section 1.451-2(a) of the Income Tax Regulations provides that income, although not actually reduced to a taxpayer's possession, is constructively received in the taxable year during which it is credited to the taxpayer's account, set apart for the taxpayer, or otherwise made available so that the taxpayer may draw upon it at any time, or so that the taxpayer could have drawn upon it during the taxable year if notice of intention to withdraw had been given. However, income is not constructively received if the taxpayer's control of its receipt is subject to substantial limitations or restrictions.

The courts and the Internal Revenue Service have recognized that a requirement of surrender or forfeiture of a valuable right is a sufficient restriction to make inapplicable the doctrine of constructive receipt. See *Hales v. Commissioner*, 40 B.T.A. 1245 (1939), *acq.*, 1940-1 C.B. 2. See also Rev. Rul. 58-230, 1958-1 C.B. 204, which holds that a requirement of a six-month suspension from participation in an employees' profit sharing plan upon an employee's withdrawal of the employer's contributions and earnings thereon, and the employee's consequent loss of the benefit of the employer's contributions that would have been made for the six-month period, is a substantial limitation that precludes constructive receipt of the withdrawable amounts.

The forfeiture of a valuable right is a substantial limitation that precludes constructive receipt of income. The employee's right to benefit from further appreciation of stock, in this case, without risking any capital is a valuable right. However, once the employee exercises the stock appreciation rights, the employee loses all chance of further appreciation with respect to that stock and the amount payable becomes fixed and available without limitation. Accordingly, an employee will be in receipt of income on the date the SAR's are exercised.

HOLDING

An employee who possesses stock appreciation rights is not in constructive receipt of income by virtue of the appreciation of the employer's stock. The cash payment to which the employee is entitled is includible in gross income in the year a stock appreciation right is exercised. Thus, in the example above, the employee must include in gross income 500*x* dollars in 1980 because the SAR's were exercised in that year.

Section 501.—Exemption From Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Genealogical research; public interest. A genealogical society that (1) opens its membership to all persons in a particular area, (2) provides instruction in genealogical research techniques to its members and to the general public, but does not research genealogies for its members, (3) conducts research projects and makes the results available to the state historical society, (4) provides materials for libraries and community displays, and (5) promotes various other related activities for the public qualifies for exemption under section 501(c)(3) of the Code; Rev. Rul. 80-302 distinguished.

Rev. Rul. 80-301

ISSUE

May a genealogical society whose membership is open to all persons in a particular area and which provides instruction in genealogical research techniques qualify for exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code?

FACTS

The organization is a genealogical society whose membership is open to all interested persons in a particular geographical area. The society provides instruction in genealogical research techniques to both members and the general public through monthly lectures held in a meeting room donated by the community center. It distributes instructional manuals, sponsors tours of historical museums, donates books and other research materials on genealogy to the area's public library, maintains a display board in a community center listing the early pioneers from the area, and conducts a free genealogical speakers bureau. It also conducts various historical genealogical research projects the results of which are made available to the state historical society. The society does not conduct genealogical research for its members. Rather, its members research genealogies independently using the society's research materials. The organization also provides assistance to beginners.

The society's income is derived from membership dues and contributions. Its expenses include the costs of printing, postage, display boards, books, and other miscellaneous items.

LAW AND ANALYSIS

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for educational purposes.

Section 1.501(c)(3)-1(d)(3) of the Income Tax Regulations provides that the term "educational" includes the instruction or training of the individual for the purpose of developing his capabilities and the instruction of the public on subjects useful to the individual and beneficial to the community.

Section 1.501(c)(3)-1(d)(1)(ii) of the regulations provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest.

The Callaway Family Association, Inc. v. Commissioner, 71 T.C. 340 (1978), held that a family association formed as a nonprofit organization to study immigration to and migration within the United States by focusing on its own family history and genealogy does not qualify for exemption under section 501(c)(3) of the Code. The association's activities included researching the genealogy of its members for the ultimate purpose of publishing a family history. The court stated that the association's family genealogical activities were not insubstantial and were not in furtherance of an exempt purpose. Rather, they served the private interests of the members. Thus, the association was not operated exclusively for exempt purposes. See also *Benjamin Price Genealogical Association v. United States*, Civil No. 78-2117 (D.D.C., April 26, 1979).

Rev. Rul. 71-580, 1971-2 C.B. 235, holds that a nonprofit organization formed by members of a particular family to compile genealogical research data on the family in order to perform religious ordinances of the religious denomination to which the family members belong is exempt from federal income tax under section 501(c)(3) of the Code.

Rev. Rul. 80-302, this page, this Bulletin, holds that a genealogical society whose primary activity is the compilation of genealogical data for members of a particular family does not qualify for exemption from federal income tax under section 501(c)(3) of the Code.

Here, the society is educating the individual and the community generally when it conducts lectures, sponsors public displays and museum tours, provides written materials to instruct members of the general public on genealogical research, and compiles the area's pioneer history. Thus, the society instructs the public on subjects useful to the individual and beneficial to the community within the meaning of section 1.501(c)(3)-1(d)(3) of the regulations.

Unlike the organizations described in the *Callaway* and *Price* cases, and in Rev. Rul. 80-302, the society does not conduct research for its members and does not focus its activities on any one family. Rather, its activities include all interested members in the geographical area, and seek to develop a better understanding of the history of the area. Thus, the society is operated for a public rather than a private interest, within the meaning of section 1.501(c)(3)-1(d)(1)(ii) of the regulations.

HOLDING

A nonprofit organization whose membership is open to all persons in a particular area and which provides instruction in genealogical research techniques in the manner described above is operated exclusively for educational purposes and, thus, qualifies for exemption from federal income tax under section 501(c)(3) of the Code.

APPLICATION INSTRUCTIONS

Even though an organization considers itself within the scope of this revenue ruling, it must file an application on Form 1023, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. See sections 1.501(a)-1 and 1.508-1(a) of the regulations. In accordance with the instructions to Form 1023, the application should be filed with the District Director of Internal Revenue for the key district indicated therein.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 80-302 is distinguished.

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26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Genealogical research; private interest. An organization that (1) limits its membership to descendants of a particular family, (2) compiles family genealogical research data for use by its members for reasons other than to conform to the religious precepts of the family's denomination, (3) presents the data to designated libraries, (4) publishes volumes of family his-

tory, and (5) promotes social activities among family members does not qualify for exemption under section 501(c)(3) of the Code; Rev. Ruls. 71-580 and 80-301 distinguished.

Rev. Rul. 80-302

ISSUE

Does the organization described below, which conducts genealogical activities primarily for members of a particular family, qualify for exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code?

FACTS

The organization was formed to locate, acquire, restore, and preserve all available genealogical records of a particular family. Membership in the organization is limited to lineal or legal descendants of the family.

The organization's primary activity is the compilation of genealogical data on its members. This data is recorded and documented, held for use by members, and presented to designated libraries. Copies of the genealogical data are made available for a fee to any interested individuals, generally family members, who request such data. The organization utilizes the data in preparing and publishing volumes of family history. Other activities of the organization include holding periodic reunions for family members and sponsoring an occasional social activity.

The genealogical data is not developed for the express purpose of conforming to the religious precepts of the denomination to which family members belong.

Income is derived from fees charged for the reproducing, shipping, and handling of genealogical data and from contributions raised at social functions.

LAW

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable or educational purposes.

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private interest.

Section 1.501(c)(3)-1(d)(3) of the regulations defines the term "educational" as including the instruction or training of the individual for the purpose of improving or developing his capabilities, or the instruction of the public on subjects useful to the individual and beneficial to the community.

Rev. Rul. 71-580, 1971-2 C.B. 235, holds that a nonprofit organization formed by members of a particular family to compile genealogical research data on the family in order to perform religious ordinances of the religious denomination to which the family members belong is exempt from federal income tax under section 501(c)(3) of the Code.

Rev. Rul. 80-301, page 6, this Bulletin, holds that a genealogical society whose membership is open to all persons in a particular area and that provides instruction in genealogical research techniques is operated exclusively for educational purposes and qualifies for exemption under section 501(c)(3) of the Code.

The Callaway Family Association, Inc. v. Commissioner, 71 T.C. 340 (1978), held that a family association formed as a nonprofit organization to study immigration to and migration within the United States by focusing on its own family history and genealogy does not qualify for exemption under section 501(c)(3) of the Code. The association's activities included researching the genealogy of its members for the ultimate purpose of publishing a family history. The court stated that the association's family genealogical activities were not insubstantial and were not in furtherance of an exempt purpose. Rather, they served the private interests of the members. Thus, the association was not operated exclusively for exempt purposes. See also *Benjamin Price Genealogical Association v. United States,* Civil No. 78-2117 (D.D.C., April 26, 1979).

ANALYSIS

Compilation, publication, preservation, and distribution of genealogical data has some educational value to the individual members. However, when these activities are primarily limited to one particular family the activities do not advance education to benefit the public interest within the meaning of section 1.501(c)(3)-1(d)(1)(ii) of the regulations. Any benefit to the general public is merely incidental to the private benefit accruing to family members.

Similar to the organizations described in the *Callaway* and *Price* cases, the instant organization is formed primarily for members of a particular family who focus in on their own genealogy with limited public orientation. The Supreme Court in *Better Business Bureau v. United States,* 326 U.S. 279 (1945), held that the presence of a single non-educational purpose will destroy exemption regardless of the number of truly educational purposes. Since more than an insubstantial part of the organization's activities are in furtherance of private interests it is not operated exclusively for educational purposes. Such activity is not insubstantial and is not in furtherance of an exempt purpose under section 501(c)(3) of the Code.

Rev. Rul. 80-301 is distinguishable from the instant case because the organization described therein provided instruction in genealogical research techniques to any interested member of the general public. On the other hand, the instant organization was formed to compile genealogical data on and promote social activities among its family members, and its membership is limited to members of a particular family.

Rev. Rul. 71-580 is also distinguishable because the genealogical research data in the instant ruling is not compiled in order to perform religious ordinances in accord with the precepts of the religious denomination to which the family members belong.

Compare Rev. Rul. 67-8, 1967-1 C.B. 142, which holds that an organization formed to bring the members of a particular family into closer association through social activities revolving around matters of common genealogical and historical interest may qualify for exemption under section 501(c)(7) of the Code.

HOLDING

An organization that conducts genealogical activities primarily for members of a particular family, under the circumstances described above, does not qualify for exemption from federal income tax under section 501(c)(3) of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 71-580 and Rev. Rul. 80-301 are distinguished.

Section 1502.—Regulations [Consolidated Returns]

26 CFR 1.1502-44: Percentage depletion for independent producers and royalty owners.

T.D. 7725

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953

Limitation on percentage depletion for independent producers and royalty owners that join in filing consolidated returns

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to consolidated returns for percentage depletion for independent producers and royalty owners. Changes to the applicable tax law were made by the Tax Reduction Act of 1975 [Pub. L. 94-12, 1975-1 C.B. 545]. The regulations would provide the public with guidance needed to comply with that Act and would affect certain corporations that file consolidated returns.

DATES: The regulations are effective for taxable years for which the due date (without extensions) for filing returns is after September 30, 1980.

FOR FURTHER INFORMATION CONTACT: Lawrence M. Axelrod of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224, Attention: CC:LR:T (202-566-3458, not a toll-free call).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On April 9, 1980, the Federal Register published proposed amendments to the Income Tax Regulations (26 CFR Part 1) under section 1502 of the Internal Revenue Code of 1954 (45 FR 24203). The amendments were proposed to conform to the consolidated return regulations to section 501(a) of the Tax Reduction Act of 1975 (89 Stat. 47) [*supra* at 558]. No comments were received with respect to the proposed amendments, and no public hearing was requested or held. The proposed amendments are adopted by this Treasury decision without change.

PERCENTAGE DEPLETION FOR INDEPENDENT PRODUCERS AND ROYALTY OWNERS

Section 613 provides general rules permitting a taxpayer that extracts minerals to deduct a reasonable allowance for depletion, computed as a percentage of the gross income from the property. The allowance may not exceed 50 percent of the taxpayer's taxable income from the property (computed without allowance for depletion). In the case of oil and gas wells, however, section 613A, as added by section 501(a) of the Tax Reduction Act of 1975, restricts the percentage depletion allowance to certain domestic gas wells and independent producers and royalty owners. Section 613A(d) further limits the allowance in the case of independent producers and royalty owners to "65 percent of the taxpayer's taxable income" for the taxable year.

These regulations provide rules for computing the limitation under section 613A(d) on percentage depletion with respect to oil and gas wells if the corporation operating the wells is a member of an affiliated group that files a consolidated return. The regulations adopt the group's consolidated taxable income as the base for computing the 65-percent limitation. For a discussion of the reasons that alternative approaches were rejected, see the preamble to the notice of proposed rulemaking (45 FR 24203).

DRAFTING INFORMATION

The principal author of this regulation is Lawrence M. Axelrod of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to 26 CFR Part 1 are hereby adopted:

Paragraph 1. Section 1.1502-12 is amended as follows:

1. The material preceding paragraph (a) is revised.
2. The word "and" at the end of paragraph (n) is deleted.
3. Paragraph (o) is revised.
4. A new paragraph (p) is added.

The new and revised provisions read as follows:

§ 1.1502-12 Separate taxable income.

The separate taxable income of a member (including a case in which deductions exceed gross income) is computed in accordance with the provisions of the Code covering the determination of taxable income of separate corporations, subject to the following modifications:

* * * * *

(o) Basis shall be determined under §§ 1.1502-31 and 1.1502-32, and earnings and profits shall be determined under § 1.1502-33; and

(p) The limitation on deductions provided in section 613A shall be taken into account for each member's oil and gas properties as provided in § 1.1502-44.

Par. 2. A new § 1.1502-44 is added to read as follows:

§ 1.1502-44 Percentage depletion for independent producers and royalty owners.

(a) *In general.* The sum of the percentage depletion deductions for the taxable year for all oil or gas property owned by all members, plus any carryovers under section 613A(d)(1) or paragraph (d) of this section from a prior taxable year, may not exceed 65 percent of the group's adjusted consolidated taxable income (under paragraph (b) of this section) for the consolidated return year.

(b) *Adjusted consolidated taxable income.* For purposes of this section, adjusted consolidated taxable income is an amount (not less than zero) equal to the group's consolidated taxable income determined without—

(1) Any depletion with respect to an oil or gas property (other than a gas property with respect to which the depletion allowance for all production is determined pursuant to section 613A (b)) for which percentage depletion would exceed cost depletion in the absence of the depletable quantity limitations contained in section 613A (c)(1) and (6) and the consolidated taxable income limitation contained in paragraph (a) of this section,

(2) Any consolidated net operating loss carryback to the consolidated return year under § 1.1502-21, and

(3) Any consolidated net capital loss carryback to the consolidated return year under § 1.1502-22.

(c) *Allocation to oil and gas properties.* The maximum amount allowable as a deduction under section 613A (c), after the application of paragraph (a) of this section, is allocated to properties held by members in accordance with the regulations under section 613A(d). Those regulations provide for an initial allocation and possible reallocation of the maximum allowable percentage depletion deduction among oil and gas properties. Thus, if, after the initial allocation, cost depletion exceeds the percentage depletion that would be allowable for a particular oil or gas property, cost depletion must be used for that property and the maximum amount of percentage depletion allowable as a deduction for the group is reallocated among only the remaining properties held by all members.

(d) *Carryover for disallowed amounts.* (1) If any amount is disallowed as a deduction for the taxable year by reason of section 613A(d)(1) or paragraph (a) of this section, the disallowed amount for each oil or gas property is treated as an amount allowed as a deduction under section 613A(c), for the following taxable year for the member that owned the property, in accordance with the regulations under section 613A and paragraphs (a) and (d)(2) of this section.

(2) Any amount that was disallowed as a deduction in a separate return limitation year of a member may be carried to a consolidated return year only to the extent that 65 percent of the excess determined under paragraph (d)(3) of this section exceeds the sum of the otherwise allowable percentage depletion deductions for the member's oil and gas properties for the year.

(3) The excess determined in this subparagraph (3) for a member is the excess, if any, of adjusted consolidated taxable income for the year under paragraph (b) of this section over that income recomputed by excluding the items of income and deductions of the member.

(e) *Effective date.* This section applies to taxable years for which the due date (without extensions) for filing returns is after September 30, 1980.

This Treasury decision is issued under the authority contained in sections 1502 and 7805 of the Internal Revenue Code of 1954 (68A Stat. 367 and 917; 26 U.S. 1502 and 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved September 26, 1980.

Donald C. Lubick,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on September 30, 1980, 4:15 p.m., and published in the issue of the Federal Register for October 3, 1980, 45 F.R. 65560)

Section 2032A.—Valuation of Certain Farm, Etc., Real Property

26 CFR 20.2032A-8: Election and agreement to have certain property valued under section 2032A for estate tax purposes.

Procedures for electing to value less than all qualified real property in a decedent's gross estate under section 2032A of the Code where an election to value all the qualified real property under section 2032A was previously made on or before August 30, 1980. See Rev. Proc. 80-49, page 29.

Section 3121.—Definitions [Federal Insurance Contributions Act]

26 CFR 31.3121(a)(2)-1: Payments under employers' plans on account of retirement, sickness or accident disability, medical or hospitalization expenses, or death.
(Also Section 3306; 31.3306(b)(2)-1.)

Unwritten sick pay plan. Payments that are made under an employer's unwritten sick pay plan that is open to all full-time employees and in which the employees have, for a number of years, been made aware by the customary practice of the employer are excepted from wages under sections 3121(a)(2) and 3306(b)(2) of the Code.

Rev. Rul. 80-303

ISSUE

Are payments made by an employer under an unwritten sick pay plan excluded from "wages" under sections 3121(a)(2) and 3306(b)(2) of the Internal Revenue Code?

FACTS

The employer's plan is open to all full-time employees after 6 months of service. Employees with the company for at least six months are entitled to a minimum of one day's regular wage for one day sick per year. For periods in excess of one day supervisors decide whether to authorize sick pay and the duration of the payments to employees.

The employer initiated the plan voluntarily and has, for a number of years, made payments pursuant to the plan to all employees generally. Although the plan is not in writing, the employees are made aware of it by custom and usage and by discussions among the employees.

LAW AND ANALYSIS

Sections 3121(a)(2) and 3306(b)(2) of the Code except from wages payments made to employees under sick pay plans or systems established by their employer.

For sick pay payments to employees to come within the exclusion from wages, the employer must have a definite plan or system applicable to all employees generally, or to a class or classes of employees, as distinguished from merely a good intention to aid employees in time of need.

Generally, a plan or system exists if any one of the following conditions exists: (A) the plan or system is in writing or is otherwise made known to the employees (for example, through the medium of a bulletin board announcement or the long and established practice of the employer); (B) there is a reference to the plan or system in the contract of employment; (C) employees contribute to the plan or system; (D) there is a special fund for these payments, separate and apart from the salary account; or (E) the employer is required to make the payments.

The payments in this case are made to employees when absent from work because of illness, and are paid under a definite sick pay plan or system that is made known to the employees. The plan was in effect for a number of years, the employees were aware of it and sick pay payments were made pursuant to the plan.

HOLDING

The payments made by the employer under the plan are excepted from wages under sections 3121(a)(2) and 3306(b)(2) of the Code.

Section 3306.—Definitions [Federal Unemployment Tax Act]

26 CFR 31.3306(b)(2)-1: Payments under employers' plans on account of retirement, sickness or accident disability, medical or hospitalization expenses, or death.

Whether payments made by an employer under an unwritten sick pay plan are excepted from wages. See Rev. Rul. 80-303, page 10.

Section 6103.—Confidentiality and Disclosure of Returns and Return Information

26 CFR 301.6103(a)-1: Disclosures after December 31, 1976 by officers and employees of Federal agencies of returns and return information (including taxpayer return information) disclosed to such officers and employees by the Internal Revenue Service before January 1, 1977 for a purpose not involving tax administration.

T.D. 7723[1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART 301.—REGULATIONS ON PROCEDURE AND ADMINISTRATION; PART 404.—TEMPORARY REGULATIONS UNDER THE TAX REFORM ACT OF 1976; PART 420.—TEMPORARY REGULATIONS UNDER THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

Disclosures of returns and return information

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to disclosures of returns and return information under certain circumstances. These regulations affect disclosures of such returns and return information for such purposes as are described herein.

DATES: The regulations apply to disclosures of returns and return information made after October 3, 1980.

FOR FURTHER INFORMATION CONTACT: David E. Dickinson of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. Attention: CC:LR:T, 202-566-3218, not a toll-free call.

SUPPLEMENTARY INFORMATION

BACKGROUND

On March 24, 1980, the Federal Register published proposed regulations on section 6103 of the Internal Revenue Code of 1954, relating to disclosures of returns and return information (45 FR 18986). Three comments on these proposed regulations were received, but no public hearing was requested or held.

This Treasury decision adopts the regulations as proposed with changes to §§ 301.6103(l)(2)-3 and 301.6103(n)-1 described below.

PROVISIONS OF THE REGULATIONS

Sections 301.6103(a)-1 and 301.6103(a)-2

Prior to its amendment by section 1202 of the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 143], effective as of January 1, 1977, section 6103(a) of the Code authorized the disclosure of Federal tax data by the Internal Revenue Service to other Federal agencies for nontax related purposes as provided by orders of the President and implementing rules and regulations approved by the President. Section 301.6103(a)-1 provides that returns and return information so disclosed by the Service to another Federal agency before January 1, 1977 pursuant to the authority of prior law (and orders of the President and implementing rules and regulations) may, with one restriction, be disclosed after December 31, 1976 by such agency for any purpose authorized by such prior law (and orders, rules, and regulations). The restriction on such further disclosure is use of such returns or return information after December 31, 1976, by, or on behalf of, the Federal agency in an administrative or judicial proceeding. Such use is restricted to an administrative or judicial proceeding described in section 6103(i)(4) and then only if the requirements of section 6103(i)(4) are first met.

Prior to amendment by the Tax Reform Act of 1976, the Code authorized disclosures of tax returns and tax return information to Justice Department attorneys and Internal Revenue Service Chief Counsel personnel for Federal tax administration purposes as provided by Presidentially approved regulations. A substantial volume of tax returns and tax return information furnished to these attorneys and personnel for tax administration purposes under prior law and regulations was in their possession on January 1, 1977, the effective date of the new statutory disclosure rules of the Act.

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[1] This publication of the Treasury Decision contains the complete text of the amendments to the regulations. The instructions for modifying the notice of proposed rulemaking have been omitted.

Section 301.6103(a)-2 provides that, as a general rule, tax returns and tax return information furnished to these persons under prior law for Federal tax administration purposes may be used by them after December 31, 1976 for tax administration purposes authorized by prior law. However, if any such tax returns or tax return information is to be introduced into evidence in tax litigation after that date, the statutory relevancy tests prescribed by the new law must first be met.

Section 301.6103(c)-1

The Tax Reform Act of 1976 amended section 6103(c) of the Code to permit disclosures of tax returns and tax return information to a person designated by the taxpayer in a written request or consent. Paragraph (a) of § 301.6103(c)-1 prescribes rules governing the necessary form and content of these written requests or consents. Paragraph (b) of § 301.6103(c)-1 prescribes rules for disclosures to a person who has been requested by the taxpayer to obtain information or provide assistance concerning a contact between the taxpayer and the Service.

Section 301.6103(h)(2)-1

This Treasury decision amends § 301.6103(h)(2)-1 of existing regulations to conform them to certain amendments made to section 6103(h)(2) of the Code by section 503 of the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1, 113]. First, the section is amended to make the requirements of section 6103(h)(2), rather than those of section 6103(h)(4), applicable to the use of returns and return information in Federal grand jury proceedings involving tax administration. Second, the section is amended to authorize Service disclosures of returns and return information to "officers and employees" of the Department of Justice as opposed to the more limited category of "attorneys" as provided by prior law.

Section 301.6103(i)-1

This section of the regulations describes the circumstances and conditions under which returns and return information may be disclosed to and by officers and employees of the Department of Justice and other Federal agencies in connection with preparation for, or investigations which may result in, proceedings pertaining to the enforcement of specifically designated Federal criminal statutes (not involving tax administration) to which the United States or a Federal agency is or may be a party. This section also makes it clear that use of returns and return information by the Department of Justice in Federal grand jury proceedings is governed by the requirements of section 6103(i)(1) or (2) of the Code rather than those of section 6103(i)(4).

Section 301.6103(j)(2)-1

This section of the regulations provides rules governing disclosures of return information to certain officers and employees of the Federal Trade Commission for statistical purposes and related activities authorized by section 6103(j)(2) of the Code.

The regulations describe in detail the particular return information which the Service will disclose to officers and employees of the Division of Financial Statistics of the Bureau of Economics of the Federal Trade Commission for use in statistical programs and related activities authorized by law. The regulations also prescribe the procedures to be followed with respect to requested disclosures of return information and the limited extent to which such return can be redisclosed and provide that the confidentiality of return information disclosed as provided by the regulations must be protected to the satisfaction of the Service.

Section 301.6103(k)(6)-1

This section of the regulations provides rules governing disclosures of return information by officers and employees of the Service and Office of the Chief Counsel thereof for investigative purposes authorized by section 6103(k)(6) of the Code.

The regulations describe the circumstances and conditions under which such officers or employees are authorized to disclose return information to a person other than the taxpayer to whom such return information relates (or such taxpayer's representative) in connection with official duties relating to an examination, collection activity, civil or criminal investigation, enforcement activity, or other offense under the internal revenue laws or relating to certain personnel or claimant representative matters under such laws or 31 U.S.C. 1026.

Sections 301.6103(l)(2)-1, 301.6103(l)(2)-2 and 301.6103(l)(2)-3

These sections of the regulations under section 6103(l)(2) of the Code provide rules regarding disclosures of returns and return information to and by officers and employees of the Department of Labor, the Pension Benefit Guaranty Corporation, and the Department of Justice for purposes of administering titles I and IV of the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1, 172]. The section also makes it clear that returns and return information may be used by the Department of Justice in Federal grand jury proceedings where necessary to enforce the Act.

In response to a comment received, § 301.6103(l)(2)-3(a)(9), (21), and (22), as proposed, is revised, three additional categories of return information subject to automatic disclosure by the Service are added to § 301.6103(l)(2)-3(a), and § 301.6103(l)(2)-3(b)(3) is revised to require that requests for disclosures of additional returns and return information to officers and employees of the Department of Labor and Pension Benefit Guaranty Corporation identify such officers and employees only by title rather than by name and title. These changes are designed to further enhance compliance programs under titles I and IV of the Act.

Section 301.6103(n)-1

These regulations describe the circumstances and conditions under which an officer or employee of the Treasury Department (including the Internal Revenue Service), a State tax agency described in section 6103 (d), or the Social Security Administration is authorized under section 6103(n) of the Code to disclose returns and return information to a person for the purpose of procuring property and services necessary to Federal or State tax administration. The regulations provide general rules regarding the requirement of necessity for the disclosure and limiting the extent to which such disclosures are authorized. The regulations also provide that the person to whom disclosures are made for these purposes may in turn disclose the tax data only for purposes specified by section 6103 (n) and must maintain, to the satisfaction of the Service, safeguards to protect the confidentiality of the returns and return information and ensure against unauthorized disclosures.

As proposed, § 301.6103(n)-1(d) failed to specify that the terms of a contract between the Social Security Administration and its contractor provide, or be amended to provide, that the contractor is to comply with the safeguard requirements described in that paragraph. As adopted, § 301. 6103(n)-1(d) makes this clear.

Section 301.6103(p)(2)(B)-1

Under section 6103 of the Code, a substantial volume of tax returns and tax return information is disclosable by the Service to other Federal agencies for purposes authorized or required by section 6103. It is likely that much of this tax information otherwise disclosable directly by the Service to yet other agencies as authorized or required by section 6103 may be more readily available from the intermediate Federal agency than the Service. For this reason, § 301.6103(p)(2)(B)-1 permits the Service to authorize disclosures of tax returns and tax return information by the intermediate Federal agency to other agencies to whom section 6103 otherwise authorizes or requires disclosures directly by the Service. Under this regulation, however, the Service retains the authority to impose, by regulation or otherwise, such restrictions on these disclosures as the Service may deem appropriate to properly protect the confidentiality of the information to be disclosed consistent with the requirements of section 6103. Further, this regulation imposes upon the head of the disclosing Federal agency the duty to maintain records of disclosures made under this regulation in order to meet the reporting requirements of section 6103(p) (3)(B) and (C).

DRAFTING INFORMATION

The principal author of these regulations was David E. Dickinson of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to 26 CFR Parts 301, 404, and 420 are hereby adopted:

REGULATIONS ON PROCEDURE AND ADMINISTRATION

(26 CFR Part 301)

Paragraph 1. The following new sections are added immediately after § 301.6102-1:

§ 301.6103(a)-1 Disclosures after December 31, 1976 by officers and employees of Federal agencies of returns and return information (including taxpayer return information) disclosed to such officers and employees by the Internal Revenue Service before January 1, 1977 for a purpose not involving tax administration.

(a) *General rule.* Except as provided by paragraph (b) of this section, a return or return information (including taxpayer return information), as defined in section 6103(b)(1), (2), and (3) of the Internal Revenue Code, disclosed by the Internal Revenue Service before January 1, 1977, to an officer or employee of a Federal agency (as defined in section 6103(b) (9)) for a purpose not involving tax administration (as defined in section 6103(b)(4)) pursuant to the authority of section 6103 (or any order of the President under section 6103 or rules and regulations thereunder prescribed by the Secretary or his delegate and approved by the President) before amendment of such section by section 1202 of the Tax Reform Act of 1976 (Pub. L. 94-455, 90 Stat. 1667) [1976-3 C.B. (Vol. 1) 1, 143] may be disclosed by, or on behalf of, such officer, employee, or agency after December 31, 1976, for any purpose authorized by such section (or such order or rules and regulations) before such amendment.

(b) *Exception.* Notwithstanding the provisions of paragraph (a) of this section, a return or return information (including taxpayer return information) disclosed before January 1, 1977, by the Service to an officer or employee of a Federal agency for a purpose unrelated to tax administration as described in paragraph (a) may, after December 31, 1976, be disclosed by, or on behalf of, such agency, officer, or employee in an administrative or judicial proceeding only if such proceeding is one described in section 6103(i)(4) of the Code and if the requirements of section 6103(i)(4) have first been met.

§ 301.6103(a)-2 Disclosures after December 31, 1976 by attorneys of the Department of Justice and officers and employees of the Office of the Chief Counsel for the Internal Revenue Service of returns and return information (including taxpayer return information) disclosed to such attorneys, officers, and employees by the Service before January 1, 1977 for a purpose involving tax administration.

(a) *General rule.* Except as provided by paragraph (b) of this section and subject to the requirements of this paragraph, a return or return information (including taxpayer return information), as defined in section 6103(b)(1), (2), and (3), of the Internal Revenue Code disclosed by the Internal Revenue Service before January 1, 1977, to an attorney of the Department of Justice (including a United States attorney) or to an officer or employee of the Office of the Chief Counsel for the Service for a purpose involving tax administration (as defined in section 6103(b)(4)) pursuant to the authority of section 6103 (or any order of the President under section 6103 or rules and regulations thereunder prescribed by the Secretary or his delegate and approved by the President) before amendment of such section by section 1202 of the Tax Reform Act of 1976 (Pub. L. 94-455, 90 Stat. 1667 [1976-3 C.B. (Vol. 1) 1, 143]) may be disclosed by, or on behalf of, such attorney, officer, or employee after December 31, 1976, for any purpose authorized by such section (or such order or rules and regulations) before such amendment.

(b) *Exception.* Notwithstanding the provisions of paragraph (a) of this section, a return or return information (including taxpayer return information) disclosed before January 1, 1977, by the Service to an attorney of the Department of Justice or to an officer or employee of the Office of the Chief Counsel for the Service for a purpose related to tax administration as described in paragraph (a) may, after December 31, 1976, be disclosed by, or on behalf of, such attorney, officer, or employee in an administrative or judicial proceeding only if such proceeding is one described in section 6103(h)(4) of the Code and if the requirements of section 6103(h)(4) have first been met.

§ 301.6103(c)-1 Disclosure of returns and return information (including taxpayer return information) to designee of taxpayer.

(a) *Disclosure of returns and return information (including taxpayer return information) to person or persons designated in a written request or consent.* Section 6103(c) of the Internal Revenue Code applies to disclosures of a return or return information (including taxpayer return information) to a person designated in a written request for or consent to disclosure. A request for or consent to disclosure must be in the form of a written document pertaining solely to the authorized disclosure. The written document must be signed and dated by the taxpayer who filed the return or to whom the return information relates. The taxpayer must also indicate in the written document—

(1) The taxpayer's taxpayer identity information described in section 6103(b)(6);

(2) The identity of the person to whom disclosure is to be made;

(3) The type of return (or specified portion of the return) or return information (and the particular data) that is to be disclosed; and

(4) The taxable year covered by the return or return information.

Thus, for example, a provision included in a taxpayer's application for a loan or other benefit authorizing the Internal Revenue Service to disclose to the grantor of the loan or other benefit such returns or return information as the grantor may request for purposes of verifying information supplied on the application does not meet the requirements of this paragraph. The disclosure of a return or return information authorized by a request for or consent to the disclosure shall not be made unless the request or consent is received by the Service within 60 days following the date upon which the request or consent was signed and dated by the taxpayer.

(b) *Disclosure of returns and return information (including taxpayer return information) to designee of taxpayer to comply with request for information or assistance.* Section 6103(c) of the Code applies to requests made by the taxpayer to other persons (for example, members of Congress, friends or relatives of the taxpayer, and, when not acting as a taxpayer's representative, income tax return preparers) for information or assistance relating to the taxpayer's return or a transaction or other contact between the taxpayer and the Service.

The taxpayer's request for information or assistance must be in the form of a letter or other written document signed and dated by the taxpayer. The taxpayer must also indicate in the written request—

(1) The taxpayer's taxpayer identity information described in section 6103(b)(6);

(2) The identity of the person to whom disclosure is to be made; and

(3) Sufficient facts underlying the request for information or assistance to enable the Service to determine the nature and extent of the information or assistance requested and the returns or return information to be disclosed in order to comply with the taxpayer's request.

A return or return information will be disclosed to the taxpayer's designee as provided by this paragraph only to the extent considered necessary by the Service to comply with the taxpayer's request for information or assistance. This paragraph does not apply to disclosures to a taxpayer's representative in connection with practice before the Service (as defined in Treasury Department Circular No. 230). For disclosures in these cases, see § 601.502(c) of this chapter.

(c) *Exceptions.* A disclosure of return information shall not be made under this section if the Service determines that the disclosure would seriously impair Federal tax administration (as defined in section 6103(b)(4) of the Code).

Par. 2. Section 301.6103(h)(2)-1 is amended to read as follows:

§ 301.6103(h)(2)-1 Disclosure of returns and return information (including taxpayer return information) to and by officers and employees of the Department of Justice for use in Federal grand jury proceeding, or in preparation for proceeding or investigation, involving tax administration.

(a) *Disclosure of returns and return information (including taxpayer return information) to and by officers and employees of the Department of Justice.* (1) Returns and return information (including taxpayer return information), as defined in section 6103(b)(1), (2), and (3) of the Internal Revenue Code, shall, to the extent provided by section 6103(h)(2)(A), (B), and (C) and subject to the requirements of section 6103(h)(3), be open to inspection by or disclosure to officers and employees of the Department of Justice (including United States attorneys) personally and directly engaged in, and for their necessary use in, any Federal grand jury proceeding, or preparation for any proceeding (or for their necessary use in an investigation which may result in such a proceeding) before a Federal grand jury or any Federal or State court, in a matter involving tax administration (as defined in section 6103(b)(4)), including any such proceeding (or any such investigation) also involving the enforcement of a related Federal criminal statute which has been referred by the Secretary to the Department of Justice.

(2) Returns and return information (including taxpayer return information) inspected by or disclosed to officers and employees of the Department of Justice as provided in paragraph (a)(1) of this section may also be used by such officers and employees or disclosed by them to other officers and employees (including United States attorneys and supervisory personnel, such as Section Chiefs, Deputy Assistant Attorneys General, Assistant Attorneys General, the Deputy Attorney General, and the Attorney General), of the Department of Justice where necessary—

(i) In connection with any Federal grand jury proceeding, or preparation for any proceeding (or with an investigation which may result in such a proceeding), described in paragraph (a)(1), or

(ii) In connection with any Federal grand jury proceeding, or preparation for any proceeding (or with an investigation which may result in such a proceeding), described in paragraph (a)(1) which also involves enforcement of a specific Federal criminal statute other than one described in paragraph (a)(1) to which the United States is or may be a party, provided such matter involves or arises out of the particular facts and circumstances giving rise to the proceeding (or investigation) described in paragraph (a)(1) and further provided the tax portion of such proceeding (or investigation) has been duly authorized by or on behalf of the Assistant Attorney General for the Tax Division of the Department of Justice, pursuant to the request of the Secretary, as a proceeding (or investigation) described in paragraph (a)(1).

If, in the course of a Federal grand jury proceeding, or preparation for a proceeding (or the conduct of an investigation which may result in such a proceeding), described in subdivision (ii) of this subparagraph, the tax administration portion thereof is terminated for any reason, any further use or disclosure of such returns or taxpayer return information in such Federal grand jury proceeding, or preparation or investigation, with respect to the remaining portion may be made only pursuant to, and upon the grant of, a court order as provided by section 6103(i)(1)(A), provided, however, that the returns and taxpayer return information may in any event be used for purposes of obtaining the necessary court order.

(b) *Disclosure of returns and return information (including taxpayer return information) by officers and employees of the Department of Justice.* (1) Returns and return information (including taxpayer return information), as defined in section 6103(b)(1), (2), and (3) of the Code, inspected by or disclosed to officers and employees of the Department of Justice as provided by paragraph (a) of this section may be disclosed by such officers and employees to other persons, including, but not limited to, persons described in paragraph (b)(2), but only to the extent necessary in connection with a Federal grand jury proceeding, or the proper preparation for a proceeding (or in connection with an investigation which may result in such a proceeding), described in paragraph (a). Such disclosures may include, but are not limited to, disclosures—

(i) To properly accomplish any purpose or activity of the nature described in section 6103(k)(6) and the regulations thereunder which is essential to such Federal grand jury proceeding, or to such proper preparation (or to such investigation);

(ii) To properly interview, consult, depose, or interrogate or otherwise obtain relevant information from, the taxpayer to whom such return or return information relates (or such taxpayer's legal representative) or from any witness who may be called to give evidence in the proceeding; or

(iii) To properly conduct negotiations concerning, or obtain authorization for, settlement or disposition of the proceeding, in whole or in part, or stipulations of fact in connection with the proceeding.

Disclosure of a return or return information to a person other than the taxpayer to whom such return or return information relates or such taxpayer's legal representative to properly accomplish any purpose or activity described in this paragraph should be made, however, only if such purpose or activity cannot otherwise properly be accomplished without making such disclosure.

(2) Among those persons to whom returns and return information may be disclosed by officers and employees of the Department of Justice as provided by paragraph (a)(1) of this section are—

(i) Other officers and employees of the Department of Justice, such as personnel of an office, board, division, or bureau of such department (for example, the Federal Bureau of Investigation or the Drug Enforcement Administration), clerical personnel (for example, secretaries, stenographers, docket and file room clerks, and mail room employees) and supervisory personnel (such as supervisory personnel of the Federal Bureau of Investigation or the Drug Enforcement Administration);

(ii) Officers and employees of another Federal agency (as defined in section 6103(b)(9)) working under the direction and control of any such officers and employees of the Department of Justice; and

(iii) Court reporters.

Par. 3. The following new sections are added immediately after § 301.6103(h)(2)-1:

§ 301.6103(i)-1 Disclosure of returns and return information (including taxpayer return information) to and by officers and employees of the Department of Justice or another Federal agency for use in Federal grand jury proceeding, or preparation for proceeding or investigation, involving enforcement of Federal criminal statute not involving tax administration.

(a) *Disclosure of returns and return information (including taxpayer return information) to officers and employees of the Department of Justice or another Federal agency.* Returns and return information (including taxpayer return information), as defined in section 6103(b)(1), (2), and (3) of the Internal Revenue Code, shall, to the extent provided by section 6103 (i)(1), (2), and (3) and subject to the requirements of section 6103(i)(1) and (2), be open to inspection by or disclosure to officers and employees of the Department of Justice (including United States attorneys) or of another Federal agency (as defined in section 6103(b)(9)) personally and directly engaged in, and for their necessary use in, any Federal grand jury proceeding, or preparation for any administration or judicial proceeding (or their necessary use in an investigation which may result in such a proceeding), pertaining to enforcement of a specifically designated Federal criminal statute not involving or related to tax administration to which the United States or such agency is or may be a party.

(b) *Disclosure of returns and return information (including taxpayer return information) by officers and employees of the Department of Justice or another Federal agency.* (1) Returns and return information (including taxpayer return information), as defined in section 6103(b)(1), (2), and (3) of the Code, disclosed to officers and employees of the Department of Justice or other Federal agency (as defined in section 6103 (b)(9)) as provided by paragraph (a) of this section may be disclosed by such officers and employees to other persons, including, but not limited to, persons described in subparagraph (2) of this paragraph, but only to the extent necessary in connection with a Federal grand jury proceeding, or the proper preparation for a proceeding (or in connection with an investigation which may result in such a proceeding), described in paragraph (a). Such disclosures may include, but are not limited to, disclosures where necessary—

(i) To properly obtain the services of persons having special knowledge or technical skills (such as, but not limited to, handwriting analysis, photographic development, sound recording enhancement, or voice identification);

(ii) To properly interview, consult, depose, or interrogate or otherwise obtain relevant information from, the taxpayer to whom such return or return information relates (or such taxpayer's legal representative) or any witness who may be called to give evidence in the proceeding; or

(iii) To properly conduct negotiations concerning, or obtain authorization for, disposition of the proceeding, in whole or in part, or stipulations of fact in connection with the proceeding.

Disclosure of a return or return information to a person other than the taxpayer to whom such return or return information relates or such taxpayer's legal representative to properly accomplish any purpose or activity described in this subparagraph should be made, however, only if such purpose or activity cannot otherwise properly be accomplished without making such disclosures.

(2) Among those persons to whom returns and return information may be disclosed by officers and employees of the Department of Justice or other Federal agency as provided by subparagraph (1) of this paragraph are—

(i) Other officers and employees of the Department of Justice (including an office, board, division, or bureau of such department, such as the Federal Bureau of Investigation or the Drug Enforcement Administration) or other Federal agency described in subparagraph (1), such as clerical personnel (for example, secretaries, stenographers, docket and file room clerks, and mail room employees) and supervisory personnel (for example, in the case of the Department of Justice, Section Chiefs, Deputy Assistant Attorneys General, Assistant Attorneys General, the Deputy Attorney General, the Attorney General, and supervisory personnel of the Federal Bureau of Investigation or the Drug Enforcement Administration);

(ii) Officers and employees of another Federal agency (as defined in section 6103(b)(9)) working under the direction and control of such officers and employees of the Department of Justice or other Federal agency described in subparagraph (1); and

(iii) Court reporters.

§ 301.6103(j)(2)-1 Disclosure of return information to officers and employees of the Federal Trade Commission for certain statistical purposes and related activities.

(a) *General rule.* (1) Pursuant to the provisions of section 6103(j)(2) of the Internal Revenue Code and subject to the requirements of paragraph (b) of this section, officers or employees of the Internal Revenue Service will disclose the following return information (as defined by section 6103(b)(2) but not including return information described in section 6103(o)(2)) reflected on the return of a corporation with respect to the tax imposed by chapter 1 to officers and employees of the Division of Financial Statistics of the Bureau of Economics of the Federal Trade Commission for purposes of, but only to the extent necessary in, developing and preparing, as authorized by law, the Quarterly Financial Report —

(i) From the business master files of the Service—

(A) Taxpayer identity information (as defined in section 6103(b)(6)),

(B) Consolidated return and final return indicators,

(C) Principal industrial activity code,

(D) Partial year indicator,

(E) Annual accounting period,

(F) Gross receipts less returns and allowances,

(G) Net income or loss,

(H) Total assets; and

(ii) From Form SS-4—

(A) Month and year in which such form was executed,

(B) Taxpayer identity information; and

(C) Principal industrial activity, geographic, firm size, and reason for application codes.

(2) Subject to the requirements of paragraph (b) of this section and § 301.6103(p)(2)(B)-1, officers or employees of the Social Security Administration to whom the following return information reflected on Form SS-4 with respect to a corporation has been disclosed as provided by section 6103(l)(1)(A) may disclose such return information to officers and employees of the Division of Financial Statistics of the Bureau of Economics of the Federal Trade Commission for a purpose described in subparagraph (1) of this paragraph—

(i) Month and year in which such form was executed;

(ii) Taxpayer identity information; and

(iii) Principal industrial activity, geographic, firm size, and reason for application codes.

(b) *Procedures and restrictions.* Disclosure of return information by officers or employees of the Service or the Social Security Administration as provided by paragraph (a) of this section will be made only upon written request to the Commissioner of Internal Revenue by the Chairman of the Federal Trade Commission describing the particular return information to be disclosed and the taxable period or date to which such return information relates and designating by name and title the officers and employees of the Division of Financial Statistics of the Bureau of Economics to whom such disclosure is authorized. No such officer or employee to whom return information is disclosed pursuant to the provisions of paragraph (a) shall disclose such return information to any person, other than the taxpayer to whom such return information relates or other officers or employees of such division whose duties or responsibilities require such disclosure for a purpose described in paragraph (a), except in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer. If the Service determines that the division, or any officer or employee thereof, has failed to, or does not, satisfy the requirements of section 6103(p)(4) of the Code or regulations or published procedures thereunder, the Service may take such actions as are deemed necessary to ensure that such requirements are or will be satisfied, including suspension of disclosures of return information otherwise authorized by section 6103(j)(2) and paragraph (a) of this section until the Service determines that such requirements have been or will be satisfied.

§ 301.6103(k)(6)-1 Disclosure of return information by internal revenue officers and employees for investigative purposes.

(a) *Disclosure of taxpayer identity information and fact of investigation in connection with official duties relating to examination, collection activity, civil or criminal investigation, enforcement activity, or other offense under the internal revenue laws.* In connection with the performance of official duties relating to any examination, collection activity, civil or criminal investigation, enforcement activity, or other offense under the internal revenue laws, or in connection with preparation for any proceeding (or investigation which may result in such a proceeding) described in section 6103(h)(2) of the Internal Revenue Code, an officer or employee of the Internal Revenue Service or Office of the Chief Counsel therefor is authorized to disclose taxpayer identity information (as defined in section 6103(b)(6)), the fact that the inquiry pertains to the performance of official duties, and the nature of the official duties in order to obtain necessary information relating to performance of such official duties or where necessary in order to properly accomplish any activity described in subparagraph (6) of paragraph (b) of this section. Disclosure of taxpayer identity information to a person other than the taxpayer to whom such taxpayer identity information relates or such taxpayer's legal representative for the purpose of obtaining such necessary information or otherwise properly accomplishing such activities as authorized by this paragraph should be made, however, only if the necessary information cannot, under the facts and circumstances of the particular case, otherwise reasonably be obtained in accurate and sufficiently probative form, or in a timely manner, and without impairing the proper performance of the official duties, or if such activities cannot otherwise properly be accomplished without making such disclosure.

(b) *Disclosure of return information in connection with official duties relating to examination, collection activity, civil or criminal investigation, enforcement activity, or other offense under the internal revenue laws.* In connection with the performance of official duties relating to any examination, collection activity, civil or criminal investigation, enforcement activity, or other offense under the internal revenue laws, an officer or employee of the Service or Office of the Chief Counsel therefor is authorized to disclose return information (as defined in section 6103(b)(2)) in order to obtain necessary information relating to the following—

(1) To establish or verify the correctness or completeness of any return (as defined in section 6103(b)(1) of the Code) or return information;

(2) To determine the responsibility for filing a return, for making a return where none has been made, or for performing such acts as may be required by law concerning such matters;

(3) To establish or verify the liability (or possible liability) of any person, or the liability (or possible liability) at law or in equity of any transferee or fiduciary of any person, for any tax, penalty, interest, fine, forfeiture, or other imposition or offense under the internal revenue laws or the amount thereof to be collected;

(4) To establish or verify misconduct (or possible misconduct) or other activity proscribed by the internal revenue laws;

(5) To obtain the services of persons having special knowledge or technical skills (such as, but not limited to, knowledge of particular facts and circumstances relevant to a correct determination of a liability described in subparagraph (3) of this paragraph or skills relating to handwriting analysis, photographic development, sound recording enhancement, or voice identification) or having recognized expertise in matters involving the valuation of property where relevant to proper

performance of a duty or responsibility described in this paragraph;

(6) To establish or verify the financial status or condition and location of the taxpayer against whom collection activity is or may be directed, to locate assets in which the taxpayer has an interest, to ascertain the amount of any liability described in subparagraph (3) of this paragraph to be collected, or otherwise to apply the provisions of the Code relating to establishment of liens against such assets, or levy on, or seizure, or sale of, the assets to satisfy any such liability; or

(7) To prepare for any proceeding described in section 6103(h)(2) or conduct an investigation which may result in such a proceeding,

or where necessary in order to accomplish any activity described in subparagraph (6) of this paragraph. Disclosure of return information to a person other than the taxpayer to whom such return information relates or such taxpayer's legal representative for the purpose of obtaining information necessary to properly carry out the foregoing duties and responsibilities as authorized by this paragraph or for the purpose of otherwise properly accomplishing any activity described in subparagraph (6) of this paragraph should be made, however, only if such necessary information cannot, under the facts and circumstances of the particular case, otherwise reasonably be obtained in accurate and sufficiently probative form, or in a timely manner, and without impairing the proper performance of such duties and responsibilities, or if the activities described in subparagraph (6) of this paragraph cannot otherwise properly be accomplished without making such disclosure.

(c) *Disclosure of return information in connection with certain personnel or claimant representative matters.* In connection with the performance of official duties relating to any investigation concerned with the enforcement of any provision of the Code, including enforcement of any rules, directives, or manual issuances prescribed by the Secretary or his delegate under section 7803 or any other provision of the Code, which affects or may affect the personnel or employment rights or status, or civil or criminal liability, of any employee or former or prospective employee of the Treasury Department or the rights of any person who is or may be a party to an administrative action or proceeding pursuant to 31 U.S.C. 1026, an officer or employee of the Service or Office of the Chief Counsel therefor is authorized to disclose return information (as defined in section 6103 (b)(2)) for the purpose of obtaining, verifying, or establishing other information which is or may be relevant and material to such investigation. Disclosure of return information to a person other than the taxpayer to whom such return information relates or such taxpayer's legal representative for the purpose of obtaining information necessary to properly carry out the foregoing duties and responsibilities as authorized by this paragraph should be made, however, only if such necessary information cannot, under the facts and circumstances of the particular case, otherwise reasonably be obtained in accurate and sufficiently probative form, or in a timely manner, and without impairing the proper performance of such duties and responsibilities.

§ 301.6103(l)(2)-1 Disclosure of returns and return information to Pension Benefit Guaranty Corporation for purposes of research and studies.

(a) *General rule.* Pursuant to the provisions of section 6103(l)(2) of the Internal Revenue Code and subject to the requirements of paragraph (b) of this section, officers and employees of the Internal Revenue Service may disclose returns and return information (as defined by section 6103(b)) to officers and employees of the Pension Benefit Guaranty Corporation for purposes of, but only to the extent necessary in, conducting research and studies authorized by title IV of the Employee Retirement Income Security Act of 1974.

(b) *Procedures and restrictions.* Disclosure of returns or return information by officers or employees of the Service as provided by paragraph (a) of this section will be made only upon written request to the Commissioner of Internal Revenue by the Executive Director of the Pension Benefit Guaranty Corporation describing the returns or return information to be disclosed, the taxable period or date to which such returns or return information relates, and the purpose for which the returns or return information is needed in the administration of title IV of the Employee Retirement Income Security Act of 1974, and designating by title the officers and employees of such corporation to whom such disclosure is authorized. No such officer or employee to whom returns or return information is disclosed pursuant to the provisions of paragraph (a) shall disclose such returns or return information to any person, other than the taxpayer by whom the return was made or to whom the return information relates or other officers or employees of such corporation whose duties or responsibilities require such disclosure for a purpose described in paragraph (a), except in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer.

§ 301.6103(l)(2)-2 Disclosure of returns and return information to Department of Labor for purposes of research and studies.

(a) *General rule.* Pursuant to the provisions of section 6103(l)(2) of the Internal Revenue Code and subject to the requirements of paragraph (b) of this section, officers or employees of the Internal Revenue Service may disclose returns and return information (as defined by section 6103(b)) to officers and employees of the Department of Labor for purposes of, but only to the extent necessary in, conducting research and studies authorized by section 513 of the Employee Retirement Income Security Act of 1974.

(b) *Procedures and restrictions.* Disclosure of returns or return information by officers or employees of the Service as provided by paragraph (a) of this section will be made only upon written request to the Commissioner of Internal Revenue by the Administrator of the Pension and Welfare Benefit Programs of the Department of Labor describing the returns or return information to be disclosed, the taxable period or date to which such returns or return information relates, and the purpose for which the returns or return information is needed in the administration of title I of the Employee Retirement Income Security Act of 1974, and designating by title the officers and employees of such department to whom such disclosure is authorized. No such officer or employee to whom returns or return information is disclosed pursuant to the provisions of paragraph (a) shall disclose such returns or return information to any person, other than the taxpayer by whom the return was made or to whom the return information relates or other officers or employees of such department whose duties or responsibilities require such disclosure for a purpose described in paragraph (a), except in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer.

§ 301.6103(l)(2)-3 Disclosure of Department of Labor and Pension Benefit Guaranty Corporation of certain returns and return information.

(a) *Disclosure following general requests.* Pursuant to the provisions of section 6103(l)(2) of the Internal Revenue Code and subject to the requirements of this paragraph, officers or employees of the Internal Revenue Service may disclose the following returns and return information (as defined by section 6103(b)) to officers and employees of the Department of Labor or the Pension Benefit Guaranty Corporation for purposes of, but only to the extent necessary in, the administration of title I or IV of the Employee Retirement Income Security Act of 1974 (hereinafter referred to in this section as the Act)—

(1) Notification of receipt by the Service of an application by a particular taxpayer for a determination of whether a pension, profit-sharing, or stock bonus plan, a trust which is a part of such a plan, or an annuity or bond purchase plan meets the applicable requirements of part I of subchapter D of chapter 1 of the Code;

(2) Notification that a particular application described in subparagraph (1) of this paragraph alleges that certain employees may be excluded from participation by reason of section 410 (b)(2)(A) and (B) for the purpose of obtaining the finding necessary for the application of such section;

(3) An application by a particular taxpayer for a determination of whether a pension, profit-sharing, or stock bonus plan, or an annuity or bond purchase plan, meets the applicable requirements of part I of subchapter D of chapter 1 of the Code with respect to a termination or proposed termination of the plan or to a partial termination or proposed partial termination of the plan, and any statement filed as provided by section 6058(b);

(4) Notification that the Service has determined that a plan or trust described in subparagraph (1) or (3) of this paragraph meets or does not meet the applicable requirements of part I of subchapter D of chapter 1 of the Code and has issued a determination letter to such effect to a particular taxpayer or that an application for such a determination has been withdrawn by the taxpayer;

(5) If the Department of Labor or the Pension Benefit Guaranty Corporation has commented on an application upon which a determination letter described in subparagraph (4) of this paragraph has been issued, a copy of the letter or document issued to the applicant;

(6) Notification to a particular taxpayer that the Service intends to disqualify a pension, profit-sharing, or stock bonus plan, a trust which is a part of such plan, or an annuity or bond purchase plan because such plan or trust does not meet the requirements of section 410(a) or 411 as of the date that such notification is issued;

(7) Notification required by section 3002(a) of the Act of the commencement of any proceeding to determine whether a particular pension, profit-sharing, or stock bonus plan, a trust which is a part of such plan, or an annuity or bond purchase plan meets the requirements of section 410(a) or 411;

(8) Prior to issuance of a notice of deficiency to a particular taxpayer under section 6212, notification that the Service has determined that a deficiency exists under section 6211 with respect to the tax imposed by section 4971(a) or (b) on such taxpayer, except that if the Service determines that the collection of such tax is in jeopardy within the meaning of section 6861(a), such notification may be disclosed after issuance of the notice of deficiency or jeopardy assessment;

(9) Notification of receipt by the Service of, and action taken with respect to, an application by or on behalf of a particular taxpayer for a waiver of the tax imposed by section 4971(b);

(10) Prior to issuance of a notice of deficiency to a particular taxpayer under section 6212, notification that a deficiency exists under section 6211 with respect to the tax imposed by section 4975(a) or (b) on such taxpayer, except that if the Service determines that the collection of such tax is in jeopardy within the meaning of section 6861(a), such notification may be disclosed after issuance of the notice of deficiency or jeopardy assessment;

(11) Notification that the Service has waived the tax imposed by section 4975(b) on a particular taxpayer;

(12) Notification of applicability of section 4975 to a particular pension, profit-sharing, or stock bonus plan, a trust which is a part of such plan, or an annuity or stock purchase plan engaged in prohibited transactions within the meaning of section 4975(c);

(13) Notification to a plan administrator that the Service has determined that a pension, profit-sharing, stock bonus, annuity, or stock purchase plan no longer meets the requirements of section 401(a) or 404(a)(2);

(14) Notification that the Service has determined that there has been a termination or partial termination of a particular pension, profit-sharing, stock bonus, annuity, or stock purchase plan within the meaning of section 411(d)(3);

(15) Notification of the occurrence of an event (other than an event described in subparagraph (13), (14), or (18) of this paragraph) which the Service has determined to indicate that a particular pension, profit-sharing, stock bonus, annuity, or stock purchase plan may not be sound under section 4043(c)(2) of the Act;

(16) Notification that the Service has received and responded to a request on behalf of a particular pension, profit-sharing, or stock bonus plan, a trust which is a part of such plan, or an annuity or stock purchase plan for an extension of time for filing an annual return by such plan or trust;

(17) Notification that the Service has received and responded to a request on behalf of a particular pension, profit-sharing, or stock bonus plan, a trust which is a part of such plan, or an annuity or stock purchase plan to change the annual accounting period of such plan or trust;

(18) Notification that the Service has determined that a particular plan does not meet the requirements of section 412 without regard to whether such plan is one described in section 4021(a)(2) of the Act;

(19) Notification of the results of an investigation by the Service requested by the Department of Labor or the Pension Benefit Guaranty Corporation, or both, with respect to whether the tax described in section 4971 should be imposed on any employer named in such request or whether the tax imposed by section 4975 should be paid by any person named in the request;

(20) Notification of receipt by the Service of an application by a particular taxpayer for exemption under section 4975(c)(2) or of initiation by the Service of an administrative proceeding for such exemption;

(21) Notification of receipt by the Service of, and action taken with respect to, an application by or on behalf of a particular taxpayer for a waiver or variance of the minimum funding standard under section 303 of the Act or section 412(d);

(22) Notification that the Service intends to undertake, is undertaking, or has completed, an examination to determine whether—

(i) A particular pension, profit-sharing, or stock bonus plan, a trust which is a part of such plan, or an annuity or stock purchase plan meets the applicable requirements of part 1 of subchapter D of chapter 1 of the Code;

(ii) Any particular person is or may be liable for any tax imposed by section 4971 or 4975; or

(iii) A particular employee welfare benefit plan, as defined in section 3(1) of the Act, meets the applicable requirements of section 501(c) or 120,

together with any completed Department of Labor or Pension Benefit Guaranty Corporation form (and supplemental schedules) relating to such examination;

(23) Copies of initial pleadings indicating that the Service intends to intervene in a civil action under section 502(h) of the Act.

Return information disclosed under this paragraph includes the taxpayer identity information (as defined in section 6103(b)(6)) of the plan or trust, the name and address of the sponsor and administrator of the plan or trustee of the trust, and the name and address of the person authorized to represent the plan or trust before the Service; and

(24) Notification of receipt by the Service of a request for technical advice as to whether a particular pension, profit-sharing, or stock bonus plan, a trust which is a part of such plan, or an annuity or bond purchase plan should be disqualified because of fiduciary actions subject to part 4 of subtitle B of title I of the Act which may violate the exclusive benefit rule of section 401(a);

(25) Notification of receipt by the National Office of the Service of a request by or on behalf of a particular taxpayer for a ruling, opinion, variance, or waiver under any provision of title I of the Act and a copy of any such ruling, opinion, variance or waiver;

(26) Notification that the Service proposes to take substantive action which would significantly impact on or substantially affect collectively bargained plans and a description of such proposed substantive action; and

(27) Notification of receipt by the Service of, and action taken with respect to, a request by a particular taxpayer for a ruling under section 412(c)(8), 412(e), or 412(f).

Disclosure of returns or return information as provided by this paragraph will be made only following receipt by the Commissioner of Internal Revenue of an annual written request for such disclosure by the Administrator of Pension and Benefit Welfare Programs of the Department of Labor or the Executive Director of the Pension Benefit Guaranty Corporation describing the categories of returns or return information to be disclosed by the Service and the particular purpose for which the returns or return information is needed in the administration of title I or IV of the Act, and designating by title the officers and employees of the Department of Labor or such corporation to whom such disclosure is authorized.

(b) *Additional returns and return information subject to disclosure*—(1) *Returns and return information relating to automatic notification.* Subject to the requirements of subparagraph (3) of this paragraph, officers or employees of the Service may disclose to officers and employees of the Department of Labor or the Pension Benefit Guaranty Corporation for purposes of, but only to the extent necessary in, the administration of title I or IV of the Act additional returns and return information relating to any item described in paragraph (a) of this section.

(2) *Other returns and return information.* Subject to the requirements of subparagraph (3) of this paragraph, officers or employees of the Service may disclose to officers and employees of the Department of Labor or the Pension Benefit Guaranty Corporation returns and return information (other than returns and return information disclosed as provided by paragraph (a) of this section or § 301.6103(l)(2)-1 or § 301.6103(l)(2)-2 for purposes of, but only to the extent necessary in, administration of title I or IV of the Act.

(3) *Procedures.* Disclosure of returns or return information by officers

or employees of the Service as provided by this paragraph will be made only upon written request to the Commissioner of Internal Revenue or his delegate by the Secretary of Labor or his delegate or the Executive Director of the Pension Benefit Guaranty Corporation or his delegate identifying the particular taxpayer by whom such return was made or to whom such return information relates, describing the particular returns or return information to be disclosed, stating the purpose for which the returns or return information is needed in the administration of title I or IV of the Act, and designating by title the officers and employees of such department or corporation to whom such disclosure is authorized.

(c) *Disclosure and use of returns and return information by officers and employees of Department of Labor, Pension Benefit Guaranty Corporation, and Department of Justice*—(1) *Use by officers and employees of Department of Labor and Pension Benefit Guaranty Corporation.* Returns and return information disclosed to officers and employees of the Department of Labor and the Pension Benefit Guaranty Corporation as provided by this section may be used by such officers and employees for purposes of, but only to the extent necessary in, administration of any provision of title I or IV of the Act, including any preparation for any administrative or judicial proceeding (or investigation which may result in such a proceeding) authorized by, or described in, title I or IV of the Act.

(2) *Disclosure by officers and employees of Department of Labor and Pension Benefit Guaranty Corporation to, and use by, other persons, including officers and employees of the Department of Justice.* (i) Returns and return information disclosed to officers and employees of the Department of Labor or the Pension Benefit Guaranty Corporation as provided by this section may be disclosed by such officers and employees to officers and employees of the Department of Justice (including United States attorneys) personally and directly engaged in, and for their necessary use in, any Federal grand jury proceeding, or preparation for any civil or criminal judicial proceeding (or for their necessary use in an investigation which may result in such a proceeding), authorized by, or described in, title I or IV of the Act.

(ii) Returns and return information disclosed to officers and employees of the Department of Labor, the Pension Benefit Guaranty Corporation, and the Department of Justice as provided by this section may be disclosed by such officers and employees to other persons, including, but not limited to, persons described in subparagraph (2) (iii) of this paragraph, but only to the extent necessary in connection with administration of the provisions of title I or IV of the Act, including a Federal grand jury proceeding, and proper preparation for a proceeding (or investigation), described in subparagraph (1) or (2) (i). Such disclosures may include, but are not limited to, disclosures where necessary—

(A) To properly obtain the services of persons having special knowledge or technical skills;

(B) To properly interview, consult, depose, or interrogate or otherwise obtain relevant information from the taxpayer to whom such return or return information relates (or the legal representative of such taxpayer) or any witness who may be called to give evidence in the proceeding; or

(C) To properly conduct negotiations concerning, or obtain authorization for, settlement or disposition of the proceeding, in whole or in part, or stipulations of fact in connection with the proceeding.

Disclosure of a return or return information to a person other than the taxpayer to whom such return or return information relates (or the legal representative of such taxpayer) to properly accomplish any purpose or activity described in this subparagraph should be made, however, only if such purpose or activity cannot otherwise properly be accomplished without making such disclosure.

(iii) Among those persons to whom returns and return information may be disclosed by officers and employees of the Department of Labor, the Pension Benefit Guaranty Corporation, and the Department of Justice as provided by subparagraph (2) (ii) of this paragraph are:

(A) Other officers and employees of the Department of Labor, the Pension Benefit Guaranty Corporation, and the Department of Justice;

(B) Officers and employees of another Federal agency (as defined in section 6103(b) (9)) working under the direction and control of such officers and employees of the Department of Labor, the Pension Benefit Guaranty Corporation, or the Department of Justice; and

(C) Court reporters.

Disclosure of returns or return information to other persons by officers and employees of the Department of Labor or the Pension Benefit Guaranty Corporation as provided by subparagraph (2) (ii) of this paragraph for purposes of conducting research, surveys, studies, and publications referred to in section 513(a), or authorized by title IV, of the Act shall be restricted, however, to disclosure to other officers and employees of such department or corporation to whom such disclosure is necessary in connection with such conduct or to the taxpayer by whom such return was made or to whom such return information relates if the return or return information can be associated with, or otherwise identify, directly or indirectly, a particular taxpayer.

(3) *Disclosure in judicial proceedings.* A return or return information disclosed to officers and employees of the Department of Labor, the Pension Benefit Guaranty Corporation, or the Department of Justice as provided by this section may be entered into evidence by such officers or employees in a civil or criminal judicial proceeding authorized by, or described in, title I or IV of the Act, provided that, in the case of a judicial proceeding described in section 6103(i) (4), the requirements of section 6103(i) (4) have first been met.

(d) *Disclosure of returns and return information in connection with certain consultations between Departments of the Treasury and Labor.* Upon general written request to the

Commissioner of Internal Revenue by the Secretary of Labor, officers and employees of the Service may disclose to officers and employees of the Department of Labor such returns and return information as may be necessary to properly carry out any consultation required by section 3002, 3003, or 3004 of the Act.

(e) *Return information open to public inspection under section 6104.* Nothing in these regulations shall be construed to deny officers and employees of the Department of Labor and the Pension Benefit Guaranty Corporation the right to inspect return information available to the public under section 6104 of the Code.

§ 301.6103(n)-1 Disclosure of returns and return information in connection with procurement of property and services for tax administration purposes.

(a) *General rule.* Pursuant to the provisions of section 6103(n) of the Internal Revenue Code and subject to the requirements of paragraphs (b), (c), and (d) of this section, officers or employees of the Treasury Department, a State tax agency, or the Social Security Administration are authorized to disclose returns and return information (as defined in section 6103 (b)) to any person (including, in the case of the Treasury Department, any person described in section 7513(a)), or to an officer or employee of such person, to the extent necessary in connection with contractual procurement of—

(1) Equipment or other property, or

(2) Services relating to the processing, storage, transmission, or reproduction of such returns or return information, or to the programming, maintenance, repair, or testing of equipment or other property, for purposes of tax administration (as defined in section 6103(b)(4)).

No person, or officer or employee of such person, to whom a return or return information is disclosed by an officer or employee of the Treasury Department, the State tax agency, or the Social Security Administration under the authority of this paragraph shall in turn disclose such return or return information for any purpose other than as described in this paragraph, and no such further disclosure for any such described purpose shall be made by such person, officer, or employee to anyone, other than another officer or employee of such person whose duties or responsibilities require such disclosure for a purpose described in this paragraph, without written approval by the Internal Revenue Service.

(b) *Limitation.* For purposes of paragraph (a) of this section, disclosure of returns or return information in connection with contractual procurement of property or services described in such paragraph will be treated as necessary only if such procurement or the performance of such services cannot otherwise be reasonably, properly, or economically carried out or performed without such disclosures. Thus, for example, disclosures of returns or return information to employees of a contractor for purposes of programming, maintaining, repairing, or testing computer equipment used by the Internal Revenue Service or a State tax agency should be made only if such services cannot be reasonably, properly, or economically performed by use of information or other data in a form which does not identify a particular taxpayer. If, however, disclosure of returns or return information is in fact necessary in order for such employees to reasonably, properly, or economically perform the computer related services, such disclosures should be restricted to returns or return information selected or appearing at random. Further, for purposes of paragraph (a), disclosure of returns or return information in connection with the contractual procurement of property or services described in such paragraph should be made only to the extent necessary to reasonably, properly, or economically conduct such procurement activity.

Thus, for example, if an activity described in paragraph (a) can be reasonably, properly, and economically conducted by disclosure of only parts or portions of a return or if deletion of taxpayer identity information (as defined in section 6103(b)(6) of the Code) reflected on a return would not seriously impair the ability of the contractor or his officers or employees to conduct the activity, then only such parts or portions of the return, or only the return with taxpayer identity information deleted, should be disclosed.

(c) *Notification requirements.* Each officer or employee of any person to whom returns or return information is or may be disclosed as authorized by paragraph (a) of this section shall be notified in writing by such person that returns or return information disclosed to such officer or employee can be used only for a purpose and to the extent authorized by paragraph (a) of this section and that further disclosure of any such returns or return information for a purpose or to an extent unauthorized by such paragraph constitutes a felony, punishable upon conviction by a fine of as much as $5,000, or imprisonment for as long as 5 years, or both, together with the costs of prosecution. Such person shall also so notify each such officer and employee that any such unauthorized further disclosure of returns or return information may also result in an award of civil damages against the officer or employee in an amount not less than $1,000 with respect to each instance of unauthorized disclosure.

(d) *Safeguards.* Any person to whom a return or return information is disclosed as authorized by paragraph (a) of this section shall comply with all applicable conditions and requirements which may be prescribed by the Internal Revenue Service for the purposes of protecting the confidentiality of returns and return information and preventing disclosures of returns or return information in a manner unauthorized by paragraph (a). The terms of any contract between the Treasury Department, a State tax agency, or the Social Security Administration and a person pursuant to which a return or return information is or may be disclosed for a purpose described in paragraph (a) shall provide, or shall be amended to provide, that such person, and officers and employees of the person, shall comply with all such applicable conditions and restrictions as may be prescribed by the Service by regulation, published rules or procedures, or written communication to such person. If the Service determines that any person, or an officer or employee of any such person, to whom returns or return information has been disclosed as provided in paragraph (a) has failed to, or does not, satisfy such prescribed conditions or requirements, the Service may take such actions as are deemed necessary to ensure that such conditions or requirements are or will be satisfied, including—

(1) Suspension or termination of any duty or obligation arising under a contract with the Treasury Department referred to in this paragraph or suspension of disclosures by the Treasury Department otherwise authorized by paragraph (a) of this section, or

(2) Suspension of further disclosures of returns or return information by the Service to the State tax agency, until the Service determines that such conditions and requirements have been or will be satisfied.

(e) *Definitions.* For purposes of this section—

(1) The term "Treasury Department" includes the Internal Revenue Service and the Office of the Chief Counsel for the Internal Revenue Service, and

(2) The term "State tax agency" means an agency, body, or commission described in section 6103(d) of the Code.

§ 301.6103(p)(2)(B)-1 Disclosure of certain returns and return information by other Federal agencies.

(a) *General rule.* Subject to the requirements of this section, returns and return information disclosed by the Internal Revenue Service to officers and employees of another Federal agency (as defined in section 6103(b)(9) of the Internal Revenue Code) as provided by section 6103 may, if the Commissioner of Internal Revenue determines that such returns or return information is more readily available from such Federal agency, be disclosed by such officers and employees to officers and employees of another Federal agency, the General Accounting Office, an agency, body, or commission described in section 6103(d) or (l)(6), or a person described in section 6103(e) for a purpose or use authorized or required by, but subject to any requirements imposed by, any other provision of section 6103 and the regulations thereunder. Any such disclosure may be made only as, to the extent, and to such persons as may be authorized in writing by the Commissioner pursuant to a written request for such disclosure by such person, and containing such information, as may be designated or provided by the applicable provision of section 6103 and the regulations thereunder pursuant to which the disclosure is sought. Such disclosure authorization by the Commissioner shall be directed to the head of the Federal agency from which disclosure is sought and may contain such conditions or restrictions as the Commissioner may prescribe.

(b) *Records and reports of disclosure.* The Federal agency making a disclosure authorized by paragraph (a) of this section shall maintain to the satisfaction of the Service a permanent system of standardized records with respect to any disclosure authorization by the Commissioner described in paragraph (a) and any disclosure of returns or return information made pursuant to such authorization. In order to enable the Service to make a timely submission of the public report on disclosures to the Joint Committee on Taxation as required by section 6103(p)(3)(C) of the Code, the Federal agency shall, within 30 days after the close of each calendar year, furnish to the Commissioner a report with respect to such records which provides the number of—

(1) Disclosure authorizations by the Commissioner,

(2) Instances in which returns or return information was disclosed pursuant to such disclosure authorizations and to disclosure authorizations executed in prior calendar years, and

(3) Taxpayers whose returns or return information with respect to whom was disclosed pursuant to the disclosure authorization described in subparagraph (2).

In addition, in order to enable the Service to make a timely submission of the report to the Joint Committee on Taxation required by section 6103(p)(3)(B), the Federal agency shall furnish to the Commissioner a report with respect to, or summary of, the records at such time or times, in such form, and containing such information as the Commissioner may prescribe in a written request directed to the head of such Federal agency. The requirements of this paragraph do not apply to disclosures of taxpayer identity information described in section 6103(m) or to disclosures of returns and return information as provided by paragraph (a) which, had such disclosures been made directly by the Service, would not have been subject to the recordkeeping requirements imposed by section 6103(p)(3)(A).

TEMPORARY REGULATIONS ON PROCEDURE AND ADMINISTRATION UNDER THE TAX REFORM ACT OF 1976

(26 CFR Part 404)

Par. 4. Sections 404.6103(a)-1, 404.6103(a)-2, 404.6103(c)-1, 404.6103(i)-1, 404.6103(j)(2)-1, 404.6103(k)(6)-1, and 404.6103(n)-1 are deleted.

TEMPORARY REGULATIONS ON PROCEDURE AND ADMINISTRATION UNDER THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

(26 CFR Part 420)

Par. 5. Sections 420.6103(1)(2)-1, 420.6103(l)(2)-2, and 420.6103(l)(2)-3 are deleted.

This Treasury decision is issued under the authority contained in sections 6103 and 7805 of the Internal Revenue Code of 1954 (90 Stat. 1667, 68A Stat. 917; 26 U.S.C. 6103 and 7805).

Jerome Kurtz,
Commissioner of
Internal Revenue.

Approved September 10, 1980.

DONALD C. LUBICK,
Assistant Secretary of
the Treasury.

(Filed by the Office of the Federal Register on September 30, 1980, 5:01 p.m., and published in the issue of the Federal Register for October 3, 1980, 45 F.R. 65564)

26 CFR 301.6103(c)-1: Disclosure of returns and return information (including taxpayer return information) to designee of taxpayer.

Procedures by which business entities may submit letters authorizing the Service to disclose confidential tax information to certain employees. See Rev. Proc. 80-46, page 26.

Section 6651.—Failure to File Tax Return or to Pay Tax

26 CFR 301.6651-1: Failure to file tax return or to pay tax.

An extension of the time in which contractors or subcontractors with contracts subject to the Vinson-Trammell Act must file Form 949 and 949-A. See Rev. Proc. 80-45, page 26.

Part II. Treaties and Tax Legislation

Subpart A.—Tax Conventions

United States-Republic of Austria Income Tax Convention

1957-2 C.B. 985

Austria; situs of nonprofit organization. The exemption from tax provided under Article XIII (3) of the U.S.-Austria Income Tax Convention for a recipient of a grant, allowance, or award from a nonprofit religious, charitable, scientific, literary, or educational organization shall be allowed without regard to the situs of the nonprofit organization.

Rev. Rul. 80-304

Advice has been requested whether the situs of nonprofit organizations has any effect on the application of Article XIII (3) of the United States-Republic of Austria Income Tax Convention (the Convention), 1957-2 C.B. 985.

Article XIII (3) of the Convention provides that a resident of one of the contracting States who is a recipient of a grant, allowance or award from a nonprofit religious, charitable, scientific, literary or educational organization, shall be exempt from tax by the other State on such payments from such organization (other than compensation for personal services).

Under the authority granted by Article XVII of the Convention, the Competent Authority of the United States and the Competent Authority for the Republic of Austria have agreed that the exemption provided under Article XIII (3) of the Convention shall be allowed without regard to the situs of the nonprofit organization.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.602: Forms and instructions.
(Also Part I, Section 6651; 301.6651-1.)

Rev. Proc. 80-45 [1]

Section 1. Purpose

The purpose of this revenue procedure is to further extend the time set forth in Rev. Proc. 77-47, 1977-2 C.B. 580, in which contractors or subcontractors with contracts subject to the Vinson-Trammell Act, 48 Stat. 503 (current version at 10 U.S.C. sections 2382 and 7300 (1970)) in taxable years that end after September 30, 1976, must file certain reports.

Section 1005(a) of the Department of Defense Authorization Act, 1981, Pub. L. 96-342, 96th Cong., 2d Sess. (September 8, 1980), exempts from the profit limitations of the Vinson-Trammell Act contracts for the construction or manufacture of aircraft or naval vessels and parts thereof when the final payment under such contracts is made before October 1, 1981. Further, section 1005(b) of such Act prohibits the Internal Revenue Service from requiring any reports under the Vinson-Trammell Act to be filed before October 1, 1981.

Sec. 2. Extension and Effect on Other Documents

Section 4.02 of Rev. Proc. 77-47, as modified by Rev. Proc. 78-38, 1978-2 C.B. 542, Rev. Proc. 79-25, 1979-1 C.B. 566, Rev. Proc. 79-53, 1979-2 C.B. 538, and Rev. Proc. 80-13, 1980-16 I.R.B. 32, is further modified by extending to October 1, 1981, the time for filing Forms 949 and 949-A for taxpayers with taxable years that end before January 1, 1981.

An extension of the time granted taxpayers for filing Forms 949 and 949-A does not extend the time for filing their federal income tax returns.

Interest on any excess profits will be charged from the due date of the report, without regard to any extensions, to the date of payment. However, taxpayers who repay excess profits by October 1, 1981, will not be subject to the penalty for failure to pay tax with respect to the excess profits under section 6651 of the Internal Revenue Code.

Rev. Proc. 80-13, which provides that Rev. Proc. 77-47 is extended to October 15, 1980, for taxpayers with tax years that ended before January 31, 1981, is superseded.

Rev. Proc. 77-47 is further modified.

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26 CFR 601.502: Requirements for conference—recognition to practice and, in certain cases, power of attorney or tax information authorization.
(Also Part I, Section 6103; 301.6103(c)-1.)

Rev. Proc. 80-46

Section 1. Purpose

The purpose of this revenue procedure is to enhance the ability of the Internal Revenue Service district offices to respond fully and effectively to inquiries by employees of business entities. This procedure is intended to facilitate the resolution of account related questions and does not provide for the furnishing of tax returns to third parties. It has no effect on the Conference and Practice Requirements (26 CFR 601.501 et seq.), technical advice requests or ruling determination letters. Nor does it affect the ability of a taxpayer, or any person acting on behalf of a taxpayer, to contact the Internal Revenue Service by telephone for the purpose of obtaining general information regarding the meaning of a bill, notice, or letter.

Sec. 2. Background

The Internal Revenue Code specifies that confidential tax information with respect to sole proprietorships, partnerships, corporations, estates and trusts may be disclosed to certain persons. The Service is prohibited from disclosing confidential tax information to another person acting on behalf of a taxpayer in the absence of a written authorization from the taxpayer. It is recognized that the limitations on disclosure often cause delays in servicing requests for tax assistance. The restrictions are particularly troublesome for businesses that have a number of employees who need to contact the Service to resolve day to day tax matters. For example, an employee who is not specifically authorized in writing to receive confidential tax information might contact the Service to resolve a tax matter of the business, such as a notice or a bill. In these situations, the Service makes every effort to resolve the issue by discussing it in general terms without disclosing confidential tax information from our records. However, on many occasions, due to the complexity of the business's tax matters, the question cannot be resolved without disclosure of confidential tax information by the Service. Accordingly, the Service will accept letters of authorization, pursuant to the requirements of this revenue procedure, with attached lists specifying employees of business entities who are authorized to receive confidential tax information.

Sec. 3. Persons Who May Submit a List.

.01 A sole proprietor may submit a list.

.02 With respect to a partnership, any partner may submit a list but the scope of the authorization is limited to those tax periods during which he or she is a partner.

.03 Authorization lists may be submitted on behalf of a corporation by the corporate president/chief executive officer or an officer authorized by law to bind the corporation. As an alternative, the list may be submitted by any principal officer if attested to by the secretary or any other officer.

.04 If the business entity is included in an estate, a list may be submitted by the administrator, executor or trustee of the estate.

.05 A trustee may submit an authorization list on behalf of a business entity that is a trust.

.06 In the case of business matters of an incompetent, an authorization list may be submitted by the trustee, guardian or committee for the incompetent.

.07 If substantially all of the property of the business is in the hands of a receiver or trustee in bankruptcy, such persons may submit a list.

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[1] Also released in News Release IR-80-107, dated October 15, 1980.

Sec. 4. Contents of the Letter of Authorization

.01 The letter of authorization shall:

1 be dated, provide the employer identification number (EIN) for the entity and reference this revenue procedure;

2 specify the tax periods and type of tax with respect to which information may be provided;

3 contain a statement that the listed authorized employees have granted permission for the use of their social security numbers for the purpose of identification;

4 contain a statement that the taxpayer assumes the responsibility to notify the addressee in writing of any changes to be made to the list;

5 provide a statement as to the authority of the person to authorize the disclosure of the confidential tax information;

6 be signed by the appropriate person;

7 have attached a copy of any appropriate documentation such as an officer's authority contained in a corporate charter, etc. However, documentation is not needed if the authorization is submitted by two corporate officers;

8 be received by the Service within sixty days of the date it is signed and dated.

.02 The attached list shall set forth the names of the authorized employees in alphabetical order and include their social security numbers for identification purposes.

.03 The following format should be used for authorizations by a president/chief executive officer or an officer authorized by law to bind the corporation:

Corporate Letterhead

(*Date*)

Disclosure Officer

______________ District Office

In accordance with Revenue Procedure 80-46, the employees named in the attached list are authorized to receive return information pertaining to (*name of corporation and employer identification number*) [*or* (*name of subsidiary and employer identification number*) a subsidiary of (*name of corporation*)] with respect of Form(s) (*941, 1120, etc.*), for tax period(s) ______________.

Each of the employees named in the attached list have granted permission for the use of their social security numbers for identity verification purposes prior to receipt of confidential tax information.

(*Name of corporation or subsidiary*) will notify the addressee in writing of any changes to be made to the list.

I certify that I am the President/Chief Executive Officer or an officer authorized by law to bind (*name of corporation or subsidiary*).

/s/ ______________

(*Title*)

.04 The following format should be used for authorizations signed by a principal corporate officer and attested to by the secretary or another officer:

Corporate Letterhead

(*Date*)

Disclosure Officer

______________ District Office

In accordance with Revenue Procedure 80-46, the employees named in the attached list are authorized to receive return information pertaining to (*name of corporation and employer identification number*) [*or name of subsidiary and employer identification number a subsidiary of* (*name of corporation*)] with respect to Form(s) (*941, 1120 etc.*), for tax period(s) ______________.

Each of the employees named in the attached list has granted permission for the use of their social security numbers for identity verification purposes prior to receipt of confidential tax information.

(*Name of corporation or subsidiary*) will notify the addressee in writing of changes to be made to the list.

This authorization is intended to comply with Internal Revenue Code Section 6103(e)(1)(D)(ii).

/s/ ______________
(Any) Principal
Officer (*Title*)
and

/s/ ______________
Secretary or any
other officer (*Title*)

.05 The following format should be used for authorizations with respect to business entities which are not corporations:

Business Letterhead (if any)

(*Date*)

Disclosure Officer

______________ District Office

In accordance with Revenue Procedure 80-46, the employees named in the attached list are authorized to receive return information pertaining to (*name of entity and employer identification number or social security number*) with respect to Form(s) (*941, 940, etc.*) for tax period(s) ______________.

Each of the employees named in the attached list have granted permission for use of their social security numbers for identity verification purposes prior to receipt of confidential tax information.

(*Name of entity*) assumes the responsibility to notify the addressee in writing of any changes to be made to the list.

I certify that (*statement of authority to authorize individuals to receive confidential tax information of the taxpayer*).

/s/ ______________

Sec. 5. Where to Send the Letter of Authorization

The letter of authorization shall be submitted to the Disclosure Officer for the Internal Revenue Service district office with which contacts are expected. A list of Disclosure Officer addresses appears in Sec. 7. If contact with more than one district office is anticipated, a letter must be sent to each District Disclosure Officer. The Disclosure Officer will acknowledge receipt by letter, which will provide a telephone number for contacts pursuant to Sec. 6.03.

Sec. 6. Modification of the Authorization List

.01 It is the responsibility of the taxpayer to keep the authorization lists current and to modify the list when necessary. The Service will recognize authorizations as effective until revised or revoked, unless otherwise specified in the letter of authorization.

.02 The taxpayer shall modify the authorization list by sending a letter which meets the requirements of Secs. 3 and 4. The letter shall be addressed to the appropriate District Disclosure Officer(s) and shall clearly indicate the names of employees to be deleted from the list and the names of employees to be added to the list. If revocation of the Disclosure Authorization List is desired, the letter shall so state. Modifications will become effective when the Disclosure Officer receives the letter.

.03 To quickly effect deletions from the list, taxpayers may advise the Disclosure Officer of the deletions by telephone. The deletions become effective upon notification of the Disclosure Officer but shall then be confirmed in writing.

.04 The Disclosure Officer should be contacted five days after the modification letter is mailed to confirm receipt.

SEC. 7. DISCLOSURE OFFICER ADDRESSES

The following is a listing of district disclosure officer mailing addresses:

Central Region

Cincinnati	P.O. Box 1818 Cincinnati, OH 45201
Cleveland	P.O. Box 99181 Cleveland, OH 44199
Detroit	P.O. Box 32513 Detroit, MI 48232
Indianapolis	P.O. Box 44211 Indianapolis, IN 46244
Louisville	P.O. Box 1735 Louisville, KY 40201
Parkersburg	P.O. Box 1388 Parkersburg, WV 26101

Mid-Atlantic Region

Baltimore	FOB, P.O. Box 1018 Baltimore, MD 21203
Newark	P.O. Box 476 Room 1135 Newark, NJ 07101
Philadelphia	600 Arch Street Philadelphia, PA 19106
Pittsburgh	P.O. Box 2488 Pittsburgh, PA 15230
Richmond	P.O. Box 10049 Richmond, VA 23240
Wilmington	P.O. Box 1206 844 King Street Wilmington, DE 19899

Midwest Region

Aberdeen	P.O. Box 370 Aberdeen, SD 57401
Chicago	230 S. Dearborn St. Room 2865 Chicago, IL 60690
Des Moines	P.O. Box 1337 Room 579 Des Moines, IA 50305
Fargo	P.O. Box 8 Fargo, ND 58102
Milwaukee	P.O. Box 493 Room 528B Milwaukee, WI 53201
Omaha	P.O. Box 1052 Downtown Station Room 102 Omaha, NE 68101
St. Louis	P.O. Box 1147 Room 702 St. Louis, MO 63188
St. Paul	316 No. Robert Street Room 482 St. Paul, MN 55101
Springfield	320 W. Washington St. P.O. Box 398 Springfield, IL 62705

North-Atlantic Region

Albany	Leo O'Brien Federal Office Building Clinton Avenue & Pearl Street Albany, NY 12207
Augusta	P.O. Box 1964 Augusta, ME 04330
Boston	P.O. Box 9097 JFK Post Office Boston, MA 02203
Brooklyn	35 Tillary Street Brooklyn, NY 11201
Buffalo	P.O. Box 1040 Niagara Square Station Buffalo, NY 14201
Burlington	11 Elmwood Avenue Burlington, VT 05401
Hartford	450 Main Street Hartford, CN 06115
Manhattan	P.O. Box 3036 Church Street Station New York, NY 10008
Portsmouth	80 Daniel Street Portsmouth, NH 03801
Providence	130 Broadway Providence, RI 02903

Southeast Region

Atlanta	275 Peachtree St., N.E. P.O. Box 904 Room 230 Atlanta, GA 30301
Birmingham	2121 Eighth Avenue, N. Room 1205 Birmingham, AL 35203
Columbia	Federal Office Building 1835 Assembly St. Room 466 Columbia, SC 29201
Greensboro	Federal Office Building 320 Federal Plaza Room 305 Greensboro, NC 27401
Jackson	301 Building 100 W. Capitol St. Suite 504 Stop 9 Jackson, MS 39201
Jacksonville	Federal Office Building 400 W. Bay Street Room 544 P.O. Box 35045 (Stop #610) Jacksonville, FL 32202
Nashville	U.S. Courthouse 801 Broadway, Room 481 P.O. Box 1107 Nashville, TN 37202

Southwest Region

Albuquerque	P.O. Box 1967 Albuquerque, NM 87103
Austin	P.O. Box 1448 Mail Stop 620 Austin, TX 78767
Cheyenne	308 West 21st Street Cheyenne, WY 82001
Dallas	1100 Commerce Street Code 428 Dallas, TX 75242
Denver	1050 17th Street Denver, CO 80265
Little Rock	P.O. Box 3778 Stop 25 Little Rock, AR 72203
New Orleans	P.O. Box 30350 Stop 40 New Orleans, LA 70190

Oklahoma City	P.O. Box 66 Stop T-D Oklahoma City, OK 73101
Wichita	P.O. Box 400 Wichita, KS 67201

Western Region

Anchorage	P.O. Box 1500 Anchorage, AK 99510
Boise	550 West Fort Street P.O. Box 041 Boise, ID 83724
Helena	2nd Floor West Federal Building Helena, MT 59601
Honolulu	P.O. Box 50089 Honolulu, HI 96850
Los Angeles	P.O. Box 3151 Los Angeles, CA 90053
Phoenix	2120 N. Central Stop 450 Phoenix, AZ 85004
Portland	1220 S.W. 3rd Avenue Portland, OR 97201
Reno	300 Booth Street Reno, NV 89502
Salt Lake City	465 S. 400 East Salt Lake City, UT 84111
San Francisco	450 Golden Gate Avenue San Francisco, CA 94102
Seattle	915 2nd Avenue M.S. 180 Seattle, WA 98174

Office of International Operations

1325 K. Street, N.W.
Room 900
Washington, DC 20225

SEC. 8. INQUIRIES

Inquiries in regard to this revenue procedure should be directed to the District Disclosure Officer.

SEC. 9. EFFECTIVE DATE

This revenue procedure becomes effective December 10, 1980.

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, Section 2032A; 20.2032A-8.)

Rev. Proc. 80-49

SECTION 1. PURPOSE

The purpose of this revenue procedure is to outline the procedure for electing to value less than all qualified real property in a decedent's gross estate under section 2032A of the Internal Revenue Code where an election to value all the qualified real property under section 2032A was previously made on or before August 30, 1980.

SEC. 2. BACKGROUND

.01 Section 2032A of the Code provides that, under certain conditions, an executor may elect to value real property included in a decedent's gross estate which was used as a farm or a closely held business at a value based upon its current use rather than at its full fair market value. This election must be made no later than nine months after the decedent's death (unless an extension of time to file the estate tax return is granted) pursuant to section 2032A(d)(1).

.02 Prior to the publication of section 20.2032A-8(a)(2) of the Estate Tax Regulations on July 31, 1980, it was unclear whether an election could be made to value less than all qualified real property included in an estate. That regulation clarifies the issue by permitting such an election, provided the threshold requirements of section 2032A(b)(1)(B) of the Code have been met by property actually valued under section 2032A.

.03 Those executors who made an election on or before August 30, 1980, to value all qualified real property included in a decedent's estate at its current use value may now want to withdraw a portion of that property from section 2032A treatment. Such a change is a partial revocation of the section 2032A election.

.04 Section 20.2032A-8(a)(1) of the regulations provides that once made, an election is irrevocable. However, section 20.2032A-8(d) provides an exception to this general rule. Elections to use section 2032A of the Code made on or before August 30, 1980, may be revoked. The deadline for filing a notice of revocation is January 31, 1981 (six months after the publication of section 20.2032A-8 in the Federal Register). However, if the period of limitations for assessments for the affected estate (normally three years and nine months from date of death) will expire earlier than January 31, 1981, such expiration date is the last day for filing the notice of revocation.

.05 Provided the threshold requirements of section 2032A(b)(1)(B) of the Code will be met following the revocation, a revocation may be made as to part of the qualified property. A partial revocation is made by filing a notice of revocation and paying any additional estate tax and interest due. The notice must contain the decedent's name, date of death, and taxpayer identification number.

Appropriate revised schedules should be attached showing the property for which the election is being made and the tax recomputation. If the partial revocation results in a decrease in tax, the executor should, in addition, file a claim for refund for the amount of refund to which the estate is entitled. Such a reduction may result for example, if after the partial revocation, the remaining specially valued property satisfies the requirements for valuation based under section 2032A(e)(7), but section 2032A(e)(8) was used prior to the revocation. *See* section 20.2032A-8(d) of the regulations for the requirement concerning the filing of an amended return to conform an election.

.06 As a result of the revocation the agreement required under sections 2032A(b)(1)(D) and (d)(2) of the Code must be conformed to specify by legal description the property which remains subject to section 2032A.

SEC. 3. EFFECTIVE DATE

Section 2032A of the Code is restricted to estates of decedents dying after December 31, 1976. This revenue procedure applies only to executors desiring to make partial revocations for estates where the original election under section 2032A was made on or before August 30, 1980. The notice of revocation must be filed by January 31, 1981 (six months after the publication of section 20.2032A-8 in the Federal Register). However, if the period of limitations for assessments for the affected estate will expire (normally three years and nine months from date of death) earlier than January 31, 1981, such expiration date is the last day for filing the notice of revocation.

Part IV. Items of General Interest

Disaster Areas

Announcement 80-142

The President of the United States has determined that the areas listed below were adversely affected by disasters of sufficient severity and magnitude to warrant federal disaster assistance.

Taxpayers who suffered losses in these areas as a result of these disasters may elect the special tax treatment provided under section 165(h) of the Internal Revenue Code. Section 1.165-11 of the Income Tax Regulations sets forth the procedure for making this election. Losses not incurred with respect to a trade or business or any transaction entered into for profit will not qualify for treatment under section 165(h) unless such losses qualify as casualty losses.

State: Maine
Counties affected: Cumberland, Hancock, Knox, Lincoln, Sagadahoc, Waldo, Washington, York
Type of disaster: Toxic paralytic shellfish poisoning
Begun on or about: July 30, 1980

State: Michigan
Counties affected: Allegan, Berrien, Calhoun, Cass, Jackson, Ottawa, St. Joseph, Van Buren, Washtenaw, Wayne
Type of disaster: Severe thunderstorms and high winds
Begun on or about: July 15, 1980 through July 20, 1980

Disaster Areas

Announcement 80-143

An area is listed to be added to the list of those areas previously announced as adversely affected by disasters of sufficient severity and magnitude to warrant federal disaster assistance.

Taxpayers who suffered losses in these areas as a result of these disasters may elect the special tax treatment provided under section 165(h) of the Internal Revenue Code. Section 1.165-11 of the Income Tax Regulations sets forth the procedure for making this election. Losses not incurred with respect to a trade or business or any transaction entered into for profit will not qualify for treatment under section 165(h) unless such losses qualify as casualty losses.

State: Texas
Area affected: Robert Mueller Airport in Travis County for repair and restoration of fixed hanger facilities
Type of disaster: Hurricane Allen
Begun on or about: August 10, 1980

Revised Forms 720 and 4638

Announcement 80-144 [1]

At midnight September 30, 1980, two of the aviation related federal excise taxes were reduced and most of the remaining aviation related excise taxes expired.

The air passenger ticket tax is reduced from eight percent to five percent. In addition, the three-cent user portion of the seven-cents-per-gallon tax on gasoline fuel is eliminated. The remaining four-cents-per-gallon gasoline fuel tax applies to manufacturers only.

The expired taxes are the five percent tax on the transportation of property by air, the $3-per-passenger international departure tax, the seven-cents-per-gallon tax on nongasoline fuels and the aircraft use tax.

The five-cents-per-pound tax on aircraft tires and the ten-cents-per-pound tax on tubes continue in effect.

A revised Form 720, Quarterly Federal Excise Tax Return, will be made available at a later date to be used for quarters ending on or after December 31, 1980.

Form 4638, Federal Use Tax Return on Civil Aircraft, will be revised to apply for the period July 1 through September 30, 1980, and will be due on January 31, 1981. Forms and instructions will be mailed to affected taxpayers at a later date.

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[1] Based on News Release IR-80-105, dated October 10, 1980.

U.S.-Tunisia Income Tax Treaty—Public Meeting

Announcement 80-148 [1]

The Treasury Department announces that it will hold a public meeting on November 19, 1980, to solicit the views of interested persons on issues being considered in the negotiation of an income tax treaty between the United States and Tunisia.

The public meeting will be held at the Treasury Department at 2:00 p.m., in Room 4125. Persons interested in attending are requested to give notice in writing by November 14, 1980, of their intention to attend. Notices should be addressed to H. David Rosenbloom, International Tax Counsel, Room 3064, Department of the Treasury, Washington, D.C. 20220.

There is no income tax treaty now in effect between the United States and Tunisia. Today's announcement of the public meeting follows a series of negotiations between representatives of the two countries based on the U.S. and OECD model income tax treaties.

The Treasury seeks the views of interested persons on any of the items covered in those models and on any aspect of Tunisian income tax relevant to such a treaty, including the taxation of dividends, interest, royalties, film rentals, insurance, and independent personal services.

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[1] Filed by the Office of the Federal Register on October 22, 1980 and published in the issue of the Federal Register for October 23, 1980, 45 F.R. 70371.

Windfall Profit Tax—Base Prices for Tier 2 and Tier 3 Oil

Announcement 80-149 [1]

The Service will modify the temporary and proposed regulations on base prices of tier two and tier three oil for the crude oil windfall profit tax, published in the Federal Register on September 30, 1980, T.D. 7721, 1980-42 I.R.B. 13.

As revised, the regulations will provide that base prices are to be determined on a property-by-property basis.

The new base price rules will apply to oil removed after September 30, 1980, but deposits of withheld or estimated tax need not reflect the new rules until December 15, 1980. Deposits made before December 15, 1980, may be made under the interim rule for determining base prices of oil removed before October 1, 1980, contained in Temporary Excise Tax Regulations section 150.4989-1(c)(8), *supra* at 17.

Windfall Profit Tax—Time for Filing Statements and Returns and Making Withholding Adjustments

Announcement 80-150

The existing temporary regulations under the Crude Oil Windfall Profit Tax Act of 1980 will be changed to allow additional time for filing annual statements and returns and for making withholding adjustments.

The current regulations, T.D. 7690, 1980-16 I.R.B. 11, 27, require purchasers (or in some cases, operators) to furnish a yearly statement of windfall profit tax liability and amount withheld and a yearly statement of amount deductible for income tax purposes to producers, operators, or partnerships by January 31, 1981. Yearly returns with the same information are required to be filed with the Service by February 28, 1981. Withholding adjustments in subsequent payments for oil removed during 1980 may not be made after the annual statement is furnished to producers, operators, or partnerships. Producers for whom too little tax was withheld for the calendar year must file an annual return and pay the additional tax due by February 28, 1981.

The changes to the regulations under the Crude Oil Windfall Profit Tax Act of 1980 will include the following revised requirements concerning annual statements and returns and withholding adjustments:

Form 6248 will be provided for the yearly statement of windfall profit tax liability and amount withheld. It will be due to be furnished to producers, operators, or partnerships by March 31, 1981, and will be due to be filed with the Internal Revenue Service by April 30, 1981.

A separate statement of the amount deductible for income tax purposes will be due to producers, operators, or partnerships by January 31, 1981. Corresponding information must be furnished the Service on the annual return (Form 6248) due April 30.

As provided under the current regulations, withholding adjustments in subsequent payments for oil removed during the removal year may be made until the yearly statement of windfall profit tax liability and amount withheld is furnished producers, operators, or partnerships. Because the due date for furnishing this statement will be extended, the time for making adjustments will also be extended.

Producers for whom too little tax was withheld (after adjustments) for 1980 will be required to file an annual return and pay the additional tax due by May 31 of the year after the removal year.

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[1] Based on News Release IR-80-111, dated October 28, 1980.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under Section 1026, Title 31 of the United States Code (1970 ed.), the Secretary of the Treasury, after due notice and opportunity for hearing, is authorized to suspend or disbar from practice before the Internal Revenue Service any person who has violated the rules and regulations governing the recognition of attorneys, certified public accountants, enrolled agents or enrolled actuaries to practice before the Internal Revenue Service.

Attorneys, certified public accountants and enrolled agents are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify such disbarred or suspended practitioners, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been disbarred or suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date of disbarment or period of suspension. This announcement will appear and will continue to appear in the weekly Bulletins for five successive weeks for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended or disbarred and will later be consolidated and published in the Cumulative Bulletin.

After due notice and opportunity for hearing, the following individual has been disbarred from further practice before the Internal Revenue Service:

Name	Address	Designation	Effective Date
J. Franklin Moore	Lenoir, NC	Certified Public Accountant	August 18, 1980

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Anthony G. Bellas	Littleton, CO	Enrolled Agent	Twelve months effective September 1, 1980
Roy W. Lynch	New Bedford, MA	Enrolled Agent	Indefinite effective August 28, 1980
Roger C. Hennings	Stillwater, MN	Attorney	Indefinite effective August 28, 1980
Vincent E. Heyworth	Hagerstown, MD	Enrolled Agent	Six months effective September 30, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.6013-6(a)(2)(v) amended.	Relationship of election by nonresident alien to be treated as a resident and income tax treaties.	Sept. 12, 1980	Nov. 11, 1980
26 CFR 1.47-1 amended, 1.48-9 added.	Business investment credit for energy property.	Sept. 19, 1980	Nov. 18, 1980
26 CFR 150.4989-1(c) amended; published as temporary regulations in T.D. 7720, 1980-42 I.R.B. 12.	Interim rule for determining base prices for tier 2 and tier 3 oil.	Sept. 24, 1980	Nov. 24, 1980
26 CFR 150.4989-1(c), 150.4995-1(b)(2) revised; published as temporary regulations in T.D. 7721, 1980-42 I.R.B. 13.	Base prices of tier 2 and tier 3 oil and withholding in the absence of effective operator's certificate.	Sept. 30, 1980	Dec. 1, 1980
26 CFR 1.584-1 through 1.584-4, 1.6032-1 amended.	Common trust funds.	Sept. 22, 1980	Nov. 21, 1980
26 CFR 31.6205-1(b)(2) amended.	Interest-free adjustment with respect to erroneous filing of FICA and RRTA returns.	Sept. 26, 1980	Nov. 25, 1980
26 CFR 1.507-2(c)(1)(IV)(A), 1.509(a)-3, 1.509(a)-4(k)(2), 1.509(a)-5 as proposed in the Federal Register for July 24, 1979, 44 F.R. 43290, withdrawn; 1.507-2(c)(1)(IV)(A), 1.509(a)-3, 1.509(a)-4(k)(2), 1.509(a)-5, amended.	Definition of a private foundation.	Oct. 10, 1980	Dec. 9, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27, dated July 7, 1980.

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1928–2	9.50
1929–1	12.00
1929–2	*3.15*
1930–1	7.30
1930–2	9.50
1931–1	*3.60*
1931–2	13.00
1932–1	*2.80*
1932–2	8.65
1933–1	*3.35*
1933–2	*3.45*
1934–1	*3.70*
1934–2	14.00
1935–1	6.90
1935–2	*14.00*
1936–1	*3.55*
1936–2	*14.00*
1937–1	*13.00*
1937–2	7.70
1938–1	*16.00*
1938–2	*13.00*
1939–1–1	8.25
1939–1–2	10.90
1939–2	9.40
1940–1	5.55
1940–2	14.00
1941–1	*$6.95*
1941–2	*3.55*
1942–1	7.25
1942–2	*5.55*
1943(*)	*9.55*
1944(*)	*7.85*
1945(*)	9.40
1946–1	*2.55*
1946–2	5.20
1947–1	*1.80*
1947–2	3.40
1948–1	*3.15*
1948–2	7.50
1949–1	*6.90*
1949–2	*2.80*
1950–1	6.35
1950–2	*4.70*
1951–1	*12.00*
1951–2	*5.05*
1952–1	*2.55*
1952–2	7.05
1953–1	*4.25*
1953–2	12.00
1954–1	12.00
1954–2	12.00
1955–1	10.25
1955–2	13.00
1956–1	15.00
1956–2	18.00
1957–1	$16.00
1957–2	13.00
1958–1	9.60
1958–2	13.00
1958–3	15.00
1959–1	15.00
1959–2	9.60
1960–1	19.00
1960–2	11.50
1961–1	14.00
1961–2	10.00
1962–1	14.00
1962–2	13.00
1962–3	20.00
1963–1	9.00
1963–2	10.75
1964–1–1	10.00
1964–1–2	11.00
1964–2	9.80
1965–1	10.70
1965–2	12.25
1966–1	14.00
1966–2	14.05
1967–1	10.00
1967–2	14.00
1968–1	14.00
1968–2	11.75
1969–1	14.00
1969–2	6.50
1969–3	$12.50
1970–1	11.00
1970–2	14.00
1971–1	10.55
1971–2	8.50
1972–1	13.50
1972–2	13.70
1973–1	16.00
1973–2	8.30
1974–1	11.00
1974–2	9.95
1974–3	*8.20*
1974–3 Supp.	10.00
1975–1	13.25
1975–2	13.00
1976–1	11.00
1976–2	10.25
1976–3–1	9.50
1976–3–2	16.00
1976–3–3	10.00
1977–1	10.75
1977–2	11.75
1978–1	11.75
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Internal Revenue bulletin

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Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-308, page 7.
Public utilities; fuel adjustment charges; when includible in income. A public utility that uses the accrual method of accounting is authorized to include fuel adjustment charges in its customers' bills for natural gas. The charges may be adjusted every six months and are based on estimated sales for the period they are in effect, but they are intended to recover the increased fuel costs for the preceding six-month period. The utility must include the fuel adjustment charges in gross income as part of the selling price of gas sold during the period the charges are in effect.

EMPLOYEE PLANS

Rev. Rul. 80-306, page 6.
Plan funded solely by employees. A defined contribution pension plan established by an employer may be a qualified plan under section 401 of the Code even though the only contributions are those made by the employees; Rev. Ruls. 54-152 and 66-205 superseded.

Rev. Rul. 80-307, page 6.
Discrimination; mandatory employee contribution plan. A mandatory employee contribution plan offered to all employees that operates to deny participation to lower paid employees or to deprive lower paid employees of benefits at least as high as the benefits provided for higher paid employees in proportion to compensation, after considering differentials permitted under the requirements for integration with social security, may result in discrimination within the meaning of section 410 (b)(1) or 401(a)(4) of the Code; Rev. Rul. 72-58 superseded.

Rev. Proc. 80-50, page 45.
Funding; change in method; automatic approval. Changes in funding methods for certain defined benefit plans that are granted automatic approval are described effective for plan years beginning on or after July 1, 1979 and before January 1, 1986.

EXEMPT ORGANIZATIONS

Rev. Rul. 80-305, page 5.
Private foundation controlled by community trust; contribution limitation. A trust is operated, supervised, and controlled by the distribution committee of a community trust. Each individual donor to the trust has the right to designate charitable recipients of the income and corpus of the trust attributable to the donor's contribution. The trust is described in section 170(b)(1)(D)(iii) of the Code and the 50 percent charitable deduction limitation of section 170(b)(1) is applicable for transfers to the trust.

Rev. Rul. 80-309, page 8.
Hospital; organization formed to construct, maintain, and operate or lease. An otherwise qualifying nonprofit organization that was created to construct, maintain, and operate or lease a public hospital and related facilities for the benefit of a

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Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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EXEMPT ORGANIZATIONS—Cont'd

city and the surrounding communities is operated exclusively for charitable purposes and qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 80-310, page 9.
Private foundations; self-dealing; incidental benefit to disqualified person. A private foundation made a grant to an exempt university to establish an educational program providing instruction in manufacturing engineering. A corporation that is a disqualified person with respect to the private foundation intends to hire graduates of the new program and encourage its employees to enroll in the program, but will not receive preferential treatment in recruiting graduates or enrolling its employees. The grant is not an act of self-dealing within the meaning of section 4941 of the Code.

Announcement 80-147, page 47.
A listing is given of organizations now classified as private foundations.

ADMINISTRATIVE

Rev. Proc. 80-47, page 11.
Reproduction requirements; tax return forms and schedules. Requirements are set forth for the reproduction and private design and printing of substitute federal tax return forms; Rev. Proc. 79-57 superseded.

Rev. Proc. 80-48, page 21.
Computer-prepared forms and computer-generated forms and schedules. Conditions are prescribed under which the Service will accept computer-prepared tax forms and computer-generated tax forms and schedules; Rev. Proc. 79-58 superseded.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 170.—Charitable, Etc., Contributions and Gifts

26 CFR 1.170A-9: Definition of section 170 (b)(1)(A) organization.

Private foundation controlled by community trust; contribution limitation. A trust is operated, supervised, and controlled by the distribution committee of a community trust. Each individual donor to the trust has the right to designate charitable recipients of the income and corpus of the trust attributable to the donor's contribution. The trust is described in section 170 (b)(1)(D)(iii) of the Code and the 50 percent charitable deduction limitation of section 170(b)(1) is applicable for transfers to the trust.

Rev. Rul. 80-305

ISSUE

Does the trust described below qualify for status as an organization described in section 170(b)(1)(D)(iii) of the Internal Revenue Code?

FACTS

The trust is exempt from federal income tax under section 501(c)(3) of the Code. Its governing instrument states that it was created to receive donations, to pool them in a common fund, and to distribute all of its income to organizations that are publicly supported organizations under section 509 (a)(1). The trustee is required to keep an accounting of the portion of the income that is attributable to the contribution of each of the donors. Each donor has the right to designate annually the recipient of such portion, subject to the requirement that the recipient be a publicly supported organization under section 509(a)(1), and to direct (by deed or by will) the payment, to an organization described in section 509(a)(1), of the corpus in the common fund attributable to his or her contribution. All of the income of the trust is required to be (and is) distributed to one or more organizations described in section 509(a)(1) not later than the 15th day of the third month after the close of the taxable year in which the income is realized by the trust. All of the corpus attributable to any donor's contribution to the trust is required to be (and is) distributed to one or more organizations described in section 509(a)(1) not later than one year after the death of the donor or the donor's surviving spouse if the surviving spouse has the right to designate the recipients of the corpus.

The trust is subject to the control of the distribution committee of a community trust that is a publicly supported organization described in sections 170(b)(1)(A)(vi) and 509 (a)(1) of the Code. If a donor does not exercise his right to designate a recipient, the funds are disbursed as the distribution committee may direct. The distribution committee also has the power to replace the trustee for breach of fiduciary duty or failure to earn a reasonable rate of return on the trust principal.

LAW

Section 170(b)(1)(D)(iii) of the Code describes an organization to which an individual may make a charitable contribution subject to the 50 percent deduction limitation set forth in section 170(b)(1). Included in section 170(b)(1)(D)(iii) is a private foundation all of the contributions to which are pooled in a common fund and which would be described in section 509(a)(3) but for the right of any substantial contributor or the spouse of a substantial contributor to designate annually the recipients, from among organizations described in section 509 (a)(1), of the income attributable to the donor's contribution to the fund, and but for the right to direct (by deed or will) the payment, to an organization described in section 509(a)(1), of the corpus in the common fund attributable to the donor's contribution. Additionally, all of the income of the common fund is required to be (and is) distributed to one or more organizations described in section 509(a)(1) not later than the 15th day of the third month after the close of the taxable year in which the income is realized by the fund. Finally, all of the corpus attributable to any donor's contribution to the fund is required to be (and is) distributed to one or more such organizations not later than one year after the donor's death or after the death of the donor's surviving spouse if the spouse has the right to designate the recipients of such corpus.

Section 509(a)(3) of the Code describes a suporting organization as one which—

(A) is organized, and at all times thereafter is operated, exclusively for the benefit of, to perform the functions of, or to carry out the purposes of one or more specified organizations described in section 509(a)(1) or (2).

(B) is operated, supervised, or controlled by or in connection with one or more organizations described in section 509(a)(1) or (2), and

(C) is not controlled directly or indirectly by one or more disqualified persons (as defined in section 4946) other than foundation managers and other than one or more organizations described in section 509(a)(1) or (2).

Section 1.509(a)-4(d)(2) of the Income Tax Regulations provides that the "specified organizations" referred to in section 509(a)(3)(A) of the Code may be specified by class rather than by name if the supporting organization is operated, supported, or controlled by a publicly supported organization and if the organization's articles require that it be operated to benefit one or more organizations that are designated by class, and which includes such publicly supported organization.

Section 1.509(a)-4(g) of the regulations provides that the term "operated, supervised, or controlled by" presupposes a substantial degree of direction over the policies, programs, and activities of a supporting organization by one or more publicly supported organizations. The relationship required is comparable to that of a parent and subsidiary where the subsidiary is under the direction of, and accountable or responsible to, the parent organization.

Section 1.509(a)-4(j)(1) of the regulations provides that an organization will be considered "controlled," for purposes of section 509(a)(3)(C) of the Code, if any substantial contributor has the right to designate annually the recipients, from among the publicly supported organizations, of the income attributable to his contribution to the supporting organization.

ANALYSIS

In this case, the trust does not specify by name the publicly supported organization on whose behalf it is to be operated. Rather, the trust is required by the terms of its governing instrument to distribute all of its income to organizations that are publicly supported organizations under section 509 (a)(1) of the Code. The community trust falls within this class of organizations. Therefore, under section 1.509 (a)-4(d)(2) of the regulations, in order for the trust to be described in section 509(a)(3), but for the rights retained by the donors, it must be operated, supervised, or controlled by the community trust within the meaning of section 1.509(a)-4(g).

The distribution committee of the community trust has the power to replace the trustee of the trust for breach of fiduciary duty or failure to earn a reasonable rate of return on the trust principal. Also, if a donor does not exercise his right to designate a recipient, the funds are disbursed as the distribution committee directs. These powers over the trust are sufficient to establish the relationship required by section 1.509(a)-4(g) of the regulations. Therefore, the trust is "operated, supervised, or controlled by" the community trust.

The donor's right to designate recipients, however, constitutes "control" by substantial contributors for purposes of section 509(a)(3)(C) of the Code. Therefore, the organization is controlled by disqualified persons within the meaning of section 509(a)(3)(C).

HOLDING

The trust meets the requirements of sections 509(a)(3)(A) and (B) of the Code, and would meet the requirements of section 509(a)(3)(C) but for the right of the donors to designate recipients. Accordingly, since the trust would be an organization described in section 509(a)(3) but for the right of the donors to designate recipients, it is an organization described in section 170(b)(1)(D)(iii).

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401-1: Qualified pension, profit-sharing, and stock bonus plans.

Plan funded solely by employees. A defined contribution pension plan established by an employer may be a qualified plan under section 401 of the Code even though the only contributions are those made by the employees; Rev. Ruls. 54-152 and 66-205 superseded.

Rev. Rul. 80-306

The purpose of this revenue ruling is to restate the position in Rev. Rul. 54-152, 1954-1 C.B. 149, and Rev. Rul. 66-205, 1966-2 C.B. 119, in view of the amendment of section 401(a) of the Internal Revenue Code by the Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 1974-3 C.B. 1.

The issue in the two revenue rulings is whether a pension plan will fail to qualify under section 401(a) of the Code merely because no contributions are made by the employer so that the pension plan is funded by employee contributions only.

An employer established a defined contribution pension plan under which the only contributions are employee contributions. The contributions are deducted from each employee's wages paid by the employer at the rate of (x) cents per hour worked. Benefits under the plan are distributed only upon the death, disability, retirement, or separation from service of an employee.

Section 401(a)(1) of the Code generally provides, in part, that a pension plan of an employer may qualify under section 401(a) if contributions are made by the employer, or employees, or both for the purpose of distributing to such employees or their beneficiaries the corpus and the income of the fund in accordance with the plan.

Thus, a pension plan established and maintained by an employer may be funded by either employer or employee contributions, or both, so long as the plan is not one established by the unilateral action of employees.

Accordingly, the defined contribution pension plan will not fail to qualify under section 401(a) of the Code merely because contributions are only made by employees.

Similarly, a defined benefit pension plan (whether or not the employer retains a liability to provide the plan benefits to the extent the employee contributions are insufficient) will not fail to qualify under section 401(a) of the Code merely because no employer contributions are made under the plan.

This revenue ruling does not deal with whether the employee contributions will of themselves satisfy the minimum funding requirements of section 412 of the Code to the extent such requirements apply.

Rev. Rul. 54-152 and Rev. Rul. 66-205 are superseded because the positions stated therein are restated under current law in this revenue ruling.

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26 CFR 1.401-4: Discrimination as to contributions or benefits.
(Also Section 410; 1.410(b)-1.)

Discrimination; mandatory employee contribution plan. A mandatory employee contribution plan offered to all employees that operates to deny participation to lower paid employees or to deprive lower paid employees of benefits at least as high as the benefits provided for higher paid employees in proportion to compensation, after considering differentials permitted under the requirements for integration with social security, may result in discrimination within the meaning of section 410(b)(1) or 401(a)(4) of the Code; Rev. Rul. 72-58 superseded.

Rev. Rul. 80-307

The purpose of this revenue ruling is to restate the position of Rev. Rul. 72-58, 1972-1 C.B. 111, in view of the amendment of section 401(a) of the Internal Revenue Code by the Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 1974-3 C.B. 1.

The issue in Rev. Rul. 72-58 is whether mandatory employee contributions under a qualified plan may result in discrimination within the meaning of section 410(b) (1) or 401(a) (4) of the Code under the circumstances described below.

Section 410(b) (1) of the Code requires that a qualified plan cover either a certain percentage of an employer's employees or a classification of employees that does not discriminate in favor of employees who are officers, shareholders, or highly compensated.

If a mandatory employee contribution plan is offered to all employees, but the contributions required of the employee-participants are burdensome, some of the lower paid employees may not participate because of such requirement. In such event the plan may not meet the coverage requirements of section 410(b) (1) of the Code.

Section 401(a) (4) of the Code requires that a qualified plan must provide either benefits or contributions which do not discriminate in favor of employees who are officers, shareholders, or highly compensated.

In cases where the plan provides for optional rates of contributions by employees, and employer contributions or the benefits are geared to the employee contributions in such a way that a higher rate of employee contributions will result in larger benefits from employer contributions, the employee contributions may similarly result in discrimination within the meaning of section 401(a) (4) of the Code, because the employer-derived benefits favor those who are highly compensated.

Accordingly, mandatory employee contributions may operate either to deny participation to lower paid employees or to deprive lower paid employees of benefits at least as high in proportion to compensation as are provided for higher paid employees, after taking into account differentials permitted under the requirements for integration with social security benefits. Thus, mandatory employee contributions may result in discrimination within the meaning of sections 410 (b) (1) or 401(a) (4) of the Code.

Although Rev. Rul. 72-58 provided that, generally, discrimination would not result if the rate of mandatory employee contributions did not exceed six percent of compensation, discrimination may result even in that case.

The principles stated herein also apply to a plan described in section 410(c) of the Code.

Rev. Rul. 72-58 is superseded because the position stated therein is restated under current law in this revenue ruling.

Section 410.—Minimum Participation Standards

26 CFR 1.410(b)-1: Minimum coverage requirements.

Whether mandatory employee contributions under an employee benefit plan may result in discrimination within the meaning of sections 410(b) (1) (B) or 401(a) (4) of the Code. See Rev. Rul. 80-307, page 6.

Section 412.—Minimum Funding Standards

Automatic approval for certain changes in funding methods for defined benefit plans. See Rev. Proc. 80-50, page 45.

Section 451.—General Rule for Taxable Year of Inclusion

26 CFR 1.451-1: General rule for taxable year of inclusion.

Public utilities; fuel adjustment charges; when includible in income. A public utility that uses the accrual method of accounting is authorized to include fuel adjustment charges in its customers' bills for natural gas. The charges may be adjusted every six months and are based on estimated sales for the period they are in effect, but they are intended to recover the increased fuel costs for the preceding six-month period. The utility must include the fuel adjustment charges in gross income as part of the selling price of gas sold during the period the charges are in effect.

Rev. Rul. 80-308

ISSUE

When must a public utility company that uses the accrual method of accounting include in its gross income its increased fuel costs that are passed through to the utility's customers over a 6-month cycle by a fuel adjustment charge?

FACTS

M is a natural gas company that files its federal income tax return on a calendar year basis using the accrual method of accounting. The rates for natural gas charged by *M* to its customers are regulated by the Federal Energy Regulatory Commission (FERC). The FERC determines the amount of any increase in *M*'s rates based upon, among other things, 12 months of actual increased operating expenses, adjusted for any known changes that will occur within the following 9 months. This 12-month period is called the "base period." Generally a FERC rate increase does not become effective until about 10 months after the end of the base period. *M* does not receive payment until it delivers gas to its customers and bills them. Thus, under the normal rate-making process, *M* cannot recover any increased costs until a considerable time after they are incurred. This delay is often referred to as "regulatory lag."

Because of regulatory lag and unusual increases in the cost of gas, the FERC authorized a special method for *M* to recover its increased gas costs charged by *M*'s suppliers by inserting a "purchased gas adjustment" (PGA) clause in *M*'s tariff. Under the PGA clause *M* can adjust its rates every 6 months to recover its increased gas costs during that period (first six months). This adjustment (fuel adjustment charge) is based on estimated sales and is in addition to the normal rate *M* is otherwise authorized to charge its customers. It is effective for the succeeding full 6-month period (second six months). Any overcollections or undercollections resulting from the fuel adjustment charges must be included in the calculation of the next 6 months' fuel adjustment charge (third six months). Thus, the PGA clause has significantly reduced regulatory lag for *M*'s increased gas costs.

For financial reporting purposes *M* defers the increased gas costs for the first six months until the second six months, the period during which it includes the fuel adjustment charges in its customers' bills. For income tax purposes *M* deducts the increased gas costs in the year the gas is delivered to its customers, the first six months. See Rev. Rul. 75-407, 1975-2 C.B. 197. For financial reporting and income tax purposes *M* includes the fuel adjustment charges in its gross income when they are added to a customer's bill as part of the selling price of fuel sold during the 6 months the fuel adjustment charge is in effect, the second six months.

LAW

Section 451(a) of the Internal Revenue Code provides that the amount of any item of gross income is included in the gross income for the taxable year in which received by the taxpayer, unless under the method of accounting used in computing taxable income this amount is to be properly accounted for as of a different period.

Section 1.451-1(a) of the Income Tax Regulations provides that under an accrual method of accounting income is includable in gross income when all the events have occurred that fix the right to receive the income and its amount can be determined with reasonable accuracy.

All the events that fix the right to receive income occur when (1) the required performance takes place, (2) payment is due, or (3) payment is made, whichever happens first. See *Schlude v. Commissioner,* 372 U.S. 128 (1963), Ct. D. 1879, 1963-1 C.B. 99 and Rev. Rul. 79-195, 1979-1 C.B. 177.

Rev. Rul. 63-182, 1963-2 C.B. 194 discusses a situation in which a natural gas distributor using the accrual method of accounting receives a refund from its supplier because of a retroactive decrease in the price of previously purchased gas. The refund was the result of a settlement agreement reached between the distributor and its supplier and was conditioned upon approval by the Federal Power Commission (FPC). The distributor was required by the FPC to adjust its gas charges to its customers to reflect any decrease in its price paid for gas. The distributor passed the refund on to its customers by adjusting their gas bills over the 12 months following receipt of the refund by offsetting or crediting the refund against future charges.

Rev. Rul. 63-182 concludes that the distributor's liability to make refunds to its customers was established on the date the FPC issued its order approving the rate settlement agreement entered into by the distributor and its supplier and not over the 12-month period during which the customer's gas bills are being adjusted.

ANALYSIS

The fuel adjustment charge is an addition to the normal approved billing rate that *M* uses to bill its customers. It is intended to permit *M* to recover its increased gas costs sooner than the normal billing-rate process allows. Although the fuel adjustment charge is calculated by reference to the increased cost of gas purchased by *M* during the first six months, it is not a charge that is a part of the selling price of this gas. Rather, it is an adjustment to the selling price of gas that is sold during the 6 months the fuel adjustment charge is in effect, the second six months.

M is authorized by the PGA clause to adjust its rates every six months when it incurs increased gas costs. *M* must make additional sales in the future in order to recover, or to have the right to recover, the increased costs represented by the fuel adjustment charge. Accordingly, the "all events test" under section 1.451-1(a) of the regulations is not met until *M* sells gas during the 6 months the fuel adjustment clause is in effect.

In Rev. Rul. 63-182 the taxpayer was required to make refunds to its customers when the FPC issued its order approving the settlement agreement. Although the taxpayer chose to make the refunds by adjusting its customers' bills over 12 months, the taxpayer's liability to its customers was unconditional upon the FPC's approval of the agreement. The liability was fixed at that time and not contingent upon the taxpayers having future sales. Thus, the "all events test" was met upon approval of the settlement agreement by the FPC.

HOLDING

A public utility company that uses the accrual method of accounting must include fuel adjustment charges that are applied as part of the rate charged for future sales in its gross income as part of the selling price of fuel sold during the specific 6-month period the fuel adjustment charge is in effect.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 63-182 is distinguished.

Section 501.—Exemption From Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(c)(3)-1: Organizations organized and operated for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals.

Hospital; organization formed to construct, maintain, and operate or lease. An otherwise qualifying nonprofit organization that was created to construct, maintain, and operate or lease a public hospital and related facilities for the benefit of a city and the surrounding communities is operated exclusively for charitable purposes and qualifies for exemption under section 501(c)(3) of the Code.

Rev. Rul. 80-309

ISSUE

Is the nonprofit organization described below, which otherwise qualifies for exemption from federal income tax under section 501(c)(3) of the Internal Revenue Code, operated exclusively for charitable purposes?

FACTS

The organization was created to construct, maintain, and operate or lease a public hospital and related facilities. After construction of these facilities, the organization's only activity has been to lease such facilities to an association exempt from federal income tax under section 501(c)(3) of the

Code. The lessee operates the facilities and pays as consideration an amount sufficient only to retire the organization's indebtedness incurred to finance the hospital and meet the organization's administrative expenses. Trustees of the lessee association make up the lessor organization's entire board of directors.

The articles of incorporation provide that the organization's purpose is to provide hospital facilities for city *Y* and the surrounding communities. The articles also provide that all of the organization's assets will be transferred, without consideration, to city *Y* when all indebtedness has been paid. City *Y* has agreed to accept title at such time.

With minor exceptions, the organization's income is derived from the lease payments and disbursements are made for administrative expenses and retirement of indebtedness.

LAW AND ANALYSIS

Section 501(c)(3) of the Code provides for the exemption from federal income tax of organizations organized and operated exclusively for charitable purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(d)(2) of the Income Tax Regulations states that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense.

In the general law of charity, the promotion of health is considered to be a charitable purpose. *Restatement (Second), Trusts,* secs. 368, 372; *IV Scott on Trusts* (3d ed. 1967), secs. 368, 372.

The organization, by building and leasing a public hospital and related facilities to an exempt charitable association, which operates the facilities, for an amount sufficient only to retire indebtedness and meet necessary operating expenses, is furthering the charitable purpose of promoting the health of the community. *See* Rev. Rul. 73-313, 1973-2 C.B. 174; *see also* Rev. Rul. 69-631, 1969-2 C.B. 119.

HOLDING

The organization as described above is operated exclusively for charitable purposes and, thus, qualifies for exemption from federal income tax under section 501(c)(3) of the Code.

APPLICATION INSTRUCTIONS

Even though an organization considers itself within the scope of this revenue ruling, it must file an application on Form 1023, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(c)(3) of the Code. See sections 1.501(a)-1 and 1.508-1(a) of the regulations. In accordance with the instructions to Form 1023, the application should be filed with the District Director of Internal Revenue for the key district indicated therein.

Section 4941.—Taxes on Self-Dealing

26 CFR 53.4941(d)-1: Definition of self-dealing.

Private foundations; self-dealing; incidental benefit to disqualified person. A private foundation made a grant to an exempt university to establish an educational program providing instruction in manufacturing engineering. A corporation that is a disqualified person with respect to the private foundation intends to hire graduates of the new program and encourage its employees to enroll in the program, but will not receive preferential treatment in recruiting graduates or enrolling its employees. The grant is not an act of self-dealing within the meaning of section 4941 of the Code.

Rev. Rul. 80-310

ISSUE

In the situation described below, does a grant by a private foundation to a university to establish an educational program constitute an act of self-dealing within the meaning of section 4941 of the Internal Revenue Code because the program benefits a corporation that is a disqualified person?

FACTS

P is exempt from federal income tax under section 501(c)(3) of the Code, and is a private foundation within the meaning of section 509(a). *P* has made a grant to *U*, a university that is exempt under section 501(c)(3), and is not a private foundation because it is described in sections 170(b)(1)(A)(ii) and 509(a)(1). By its terms, the grant must be used by *U* to establish a new educational department providing instruction in manufacturing engineering. Students enrolled in the program will acquire skills useful in a wide range of manufacturing businesses.

W corporation has its headquarters and principal manufacturing plant located in the same city as *P* and *U*. *W* is a disqualified person with respect to *P* within the meaning of section 4946 of the Code. *W* intends to seek to employ graduates of the new program at *U*, and will encourage its employees to enroll in the program. However, *W* will not receive preferential treatment in its attempts to recruit graduates, and its employees will compete for admission to the program on an equal nondiscriminatory basis with other members of the general public. It is expected that a number of other manufacturers, including competitors of *W*, will seek to recruit graduates of the program and to enroll their employees in the program.

LAW AND ANALYSIS

Section 4941 of the Code imposes a tax on each act of self-dealing between a disqualified person and a private foundation. Section 4941(d)(1)(E) provides that the term "self-dealing" includes any direct or indirect transfer to, or use by or for the benefit of, a disqualified person of the income or the assets of a private foundation.

Section 53.4941(d)-2(f)(2) of the Foundation Excise Tax Regulations provides that the fact that a disqualified person receives an incidental or tenuous benefit from the use by a foundation of its income or assets will not, by itself, make such use an act of self-dealing. For example, a grant by a private foundation to a section 509(a)(1), (2), or (3) organization will not be an act of self-dealing merely because such organization is located in the same area as a corporation that is a substantial contributor and thus a disqualified person with respect to the foundation. This is illustrated by *Example* (1) of section 53.4941(d)-2(f)(4), which considers a grant by a private foundation to the governing body of a city for the purpose of alleviating the slum conditions that exist in a particular neighborhood of the city. A corporation that is a substantial contributor to the foundation, and thus a disqualified person with respect to the foundation, is located in the same area in which the grant is to be used. Although the general improvement of the area may constitute an incidental and tenuous benefit to the corporation, such benefit by itself will not constitute an act of self-dealing under section 4941 of the Code.

An incidental or tenuous benefit occurs when the general reputation or prestige of a disqualified person is enhanced by public acknowledgement of some specific donation by such person, when a disqualified person receives some other relatively minor benefit of an indirect nature, or when such person merely participates to a wholly incidental degree in the fruits of some charitable program that is of broad public interest in the community. See Rev. Rul. 77-331, 1977-2 C.B. 388.

In this case, as in the slum clearance program described in *Example* (1) of section 53.4941(d)-2(f)(4) of the regulations, the educational program is of broad public interest to the community. The corporation will benefit from the program only in an incidental manner as one of many manufacturing businesses that can benefit from the skills acquired by the students in the program. *W* will not receive preferential treatment in recruiting graduates of the program, and *W*'s employees must compete for admission to the program on an equal basis with the general public, including employees of other manufacturing businesses. Under the circumstances, *W* will receive only an incidental or tenuous benefit from the grant by *P* to *U*.

HOLDING

Since any benefit to the corporation, a disqualified person, is incidental, the grant by the private foundation to the university to establish an educational program in manufacturing engineering does not constitute an act of self-dealing within the meaning of section 4941 of the Code.

Section 6001.—Notice or Regulations Requiring Records, Statements, and Special Returns

26 CFR 1.6001-1: Records.

Requirements for the reproduction and private design and printing of substitute federal tax return forms. See Rev. Proc. 80-47, page 11.

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26 CFR 1.6001-1: Records.

Conditions for the acceptance of computer-prepared tax forms and computer-generated tax forms and schedules. See Rev. Proc. 80-48, page 21.

Section 6011.—General Requirement of Return, Statement, or List

26 CFR 1.6011-1: General requirement of return, statement, or list.

Requirements for the reproduction and private design and printing of substitute federal tax return forms. See Rev. Proc. 80-47, page 11.

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26 CFR 1.6011-1: General requirement of return, statement, or list.

Conditions for the acceptance of computer-prepared tax forms and computer-generated tax forms and schedules. See Rev. Proc. 80-48, page 21.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.602: Forms and instructions.
(Also Part I, Sections 6001, 6011; 1.6001-1, 1.6011-1.)

Rev. Proc. 80-47

Section 1. Purpose

This revenue procedure states the requirements of the Internal Revenue Service relating to the preparation of acceptable reproductions and private design and printing of substitute federal tax return forms (*i.e.*, Forms 1040, 1040A, 1120, 940, 941, etc.) and related forms (schedules) for filing purposes in place of the official forms and schedules.

Sec. 2. Definitions

.01 Definitions Used in This Publication (Relating to Tax Forms).

1 *Substitute Form.* A tax form or related form or schedule that differs in any way from the official version and is intended to replace the entire form that is printed and distributed by the Service. This term also covers those approved substitute formats and forms described in this revenue procedure. (A photocopy of an official form or a copy produced from an unchanged reproduction proof, supplied by the Service, is not a substitute form.)

2 *Supporting Statement* (*Supplemental Schedule*). A document filed as a part of a tax return that provides detailed information to support an entry for a line (or lines) on an official form. A supporting statement cannot take the place of an official form.

3 *Computer-Prepared Form.* A preprinted form in which the taxpayer's name, address and tax entry information has been printed by a computer, computer-printer or other computer-type equipment, such as word-processing equipment.

4 *Manually Prepared Form.* A preprinted form in which the taxpayer's name, address and tax entry information is entered by an individual using a pen, pencil, typewriter or other non-automated equipment.

5 *Computer-Generated Tax Form.* A document that is entirely prepared by the use of a computer printing device so that all the line numbers, line captions, and the tax amount data entries are in the same type face. No graphics appear on the form.

6 *Graphics.* Those parts of the tax form that are not the tax amount entries or called-for information. Generally, these are line numbers, captions, instructions, rules and borders, special indicators, rules or strokes created by type-setting, photo-graphics, photo-composition, etc.

7 *Printed Form.* A form produced using conventional printing processes, photocopying, or other similar processes.

8 *Preprinted Pin-Fed Form.* A form printed beforehand by conventional methods on paper that has marginal perforations for use with automated and high-speed printing equipment.

Sec. 3. Summary of Contents

.01 MESSAGE TO TAX RETURN PREPARERS

IF YOU PLAN TO CHANGE OR MODIFY *ANY* TAX FORMS, YOU MUST FOLLOW INTERNAL REVENUE PROCEDURES AND, IN MOST CASES, *YOU MUST GET OFFICIAL APPROVAL BEFORE USING SUBSTITUTE FORMS. THE SERVICE IS CONTINUING A NATIONWIDE PROGRAM TO IDENTIFY AND CONTACT TAX RETURN PREPARERS USING UNAPPROVED FORMS*

.02 Additional information you may also need is contained in Rev. Proc. 80-48, page 21, this Bulletin. You can get this procedure by (1) ordering it on the form provided in Package X, Informational Copies of Federal Income Tax Forms, or (2) by writing to: IRS REV. PROC., P.O. Box 27322, Richmond, VA 23261. They are also obtainable at your local district office.

.03 THINGS YOU *CAN DO* TO INTERNAL REVENUE SERVICE PRINTED TAX FORMS.

1 *You can PHOTOCOPY* any federal tax form or schedule and use it instead of the official one.

2 *You can REPRODUCE ANY CURRENT* form (or schedule) as cut sheets, snap-sets, marginally-punched pin-fed forms, so long as you use an official Service version as the master copy. An official version is one supplied by the Service, such as those in the taxpayer's tax package, those in Package X, reproduction proofs (sold by the Service) and those printed in revenue procedures.

3 *You can ADJUST* the graphics on printed Forms 1040 and 1040A (and other forms) to allow for computer-printed or word processor fill-in. Guidelines for making these adjustments are listed in Rev. Proc. 80-48.

4 *You can PRINT AND DUPLICATE* the substitute "worksheet-type" versions of Schedules A and B (see exhibits section) for use when you need a "worksheet." The Service will accept these substitute schedules instead of the official versions. These schedules serve different purposes. One allows the form to contain state tax information which is blocked-out before submission to the Service. The other allows the form to be used singly or as part of a snap-set.

.04 THINGS YOU *CANNOT* DO TO INTERNAL REVENUE SERVICE PRINTED TAX FORMS.

1 *You cannot* change any Internal Revenue Service tax form or use your own (non-approved) version, unless permitted by revenue procedures without prior Service approval.

2 *You cannot* change any of the graphics on Forms 1040 and 1040A (except those specified in revenue procedures) without prior approval from the Service.

3 *You cannot* use your own version of Schedule A (Itemized Deductions) UNLESS YOU FIRST GET IT APPROVED. When using attachements to the official Schedule A, you must *COMPLETELY FILL OUT ALL REFERENCED* (*NUMBERED OR LETTERED*) *LINES OF THE OFFICIAL SCHEDULE A*; not just the total lines, but the line items that make up the totals as well. In other words, you may not enter just the totals for the various deduction categories, *i.e.*, "Medical," "Taxes," etc., and write "See Attached Schedule" across the

part of the form. The Service wants only one Schedule A—either yours or an official version; yours needs prior approval from the Service.

4 *You cannot* use your own preprinted label on tax returns filed with the Service. The ONLY label permitted is the one provided the taxpayers in their tax packages. Otherwise, the taxpayer's name and address must be entered on the return in the spaces provided.

5 *Other items are also not permitted.* Please read the rest of this revenue procedure for details.

SEC. 4. SPECIFICATIONS FOR FILING SUBSTITUTE FORMS

.01 *Computer-Prepared Tax Forms.* For filing purposes, the Service will accept computer-prepared tax forms (*i.e.*, Forms 1040, 1040A, 1120, 940, 941, etc.) filled in by a computer or by word-processing equipment, but these forms MUST be preprinted.

.02 *Computer-Generated Forms.* For filing purposes, the Service will accept computer-generated versions of schedules and forms that are attached to individual and business income tax returns, provided they meet the requirements prescribed in Rev. Proc. 80-48.

.03 *Combination of Manually Prepared and Computer-Prepared/Generated Forms.* For filing purposes, the Service will accept substitute tax forms that contain a combination of computer prepared/generated and manually filled in information.

.04 *Substitute Schedules K-1.* Prior approval is NOT required for Schedules K-1 that accompany Forms 1065, for partnerships, 1120-S, for small businesses, and 1041, for fiduciaries, when the K-1's meet the following requirements:

(a) The K-1 must contain only the line items required for use by the taxpayer,

(b) These line items must be in the same order and arrangement as the official form,

(c) The line items must be numbered, titled, and/or captioned exactly as shown on the official form, and

(d) Each taxpayer's information must be on a separate piece of paper.

SEC. 5. APPROVAL INFORMATION

.01 *Approvals.*

1 *Guidelines.* Preparers who desire to file privately designed and printed substitute tax forms must develop such substitutes using these guidelines and those contained in Rev. Proc. 80-48 and, unless permitted by revenue procedures, must obtain approval from the Service before the forms are filed.

2 *Changes to Tax Forms.* Any person making changes to any tax form or schedule (EXCEPT THOSE STATED IN THIS OR OTHER REVENUE PROCEDURES) must obtain approval from the Service before filing the substitute.

Because a substitute form is a variation from the official form, you should know the requirements of the official form before you modify it to meet your needs. For the most frequently used tax forms, the quickest way to obtain an official form is to request reproduction proofs of these forms. Reproduction proofs can only be ordered by using the Form M-5368, Order for Reproduction Proofs. Form M-5368 can be obtained in two ways: (1) by written request to Internal Revenue Service, RM:FM:P, Room 1528, 1111 Constitution Ave., N.W., Washington, D.C. 20224, or (2) by telephone request (at your expense) to the Reproduction Proof Coordinator at (202) 566-2473.

(a) THE GUIDELINES FOR PRIVATELY DESIGNED AND PRINTED TAX FORMS ARE AS FOLLOWS:

(1) Each form must follow the design of the official form as to format, arrangement, item caption, line numbers, line references and sequence.

(2) When a form is designed with both federal and state columns, *THE FEDERAL COLUMN MUST BE TO THE LEFT OF THE STATE COLUMN AND ADJACENT TO THE LINE CAPTION.*

(3) When a form is to be manually prepared (see definitions), the federal column must have a vertical line in the amount field to separate dollars from cents if the official form has a vertical line. The cents column must be at least ⅛th inch wide.

(4) Please note that certain forms have a newly added "sequence number" located just below the year designation in the upper right corner of the form. The Service uses this number to indicate the order in which forms are processed when filed with a return. It must be printed on the affected form, in no less than 12-point bold-face type, and centered below the form's year designation. THE SEQUENCE NUMBER IS REQUIRED ON FORMS LISTED BELOW. Please note: some of the numbers have been changed since last year.

Form 1040 Schedule/Form	*Sequence Number*
A	08
C	09
D	15
E	16
F (front)	17
F (reverse) print in top margin at least 2½" from left edge	18
G	21
R and RP	22
SE	23
2119	25
2440	26
2441	27
2555	36
3468	28
4136	29
4136-T	29
4625	30
4726	31
5329	32
5695	34
6251	35

3 *Mailing Address.* Proposed substitutes should be forwarded by letter to the Internal Revenue Service, Attention: Substitute Forms Program, TX:R:I, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

4 *When to Submit.* Proposed substitutes should be sent to the address listed in 3 above, as much in advance of the filing period for the form as possible. This is to allow adequate time for analysis and response and to permit notice to our field offices. Quarterly filed forms, such as the Form 941, must be submitted by the first day of the last month of the quarter.

5 *Required Statement.* When the sample substitute is submitted, there must also be an accompanying statement that lists the form number of each substitute requested and details those items that deviate from the official form in position, arrangement, appearance, line numbers, additions, deletions, etc. Included with each of the items must be a detailed reason or

justification for the change and an approximation of the number of forms expected to be filed.

6 *Approval Letter.* Upon determination that approval can be given, the Service sends a formal letter of approval which also may contain qualifications for use of the substitutes.

7 *Duration of Approval.* Approvals, when granted, are good for only one calendar year (January through December) or, in the case of corporation tax forms (with the exception noted below), for the remainder of the quarters of the calendar year.

PLEASE NOTE: Each new filing season requires a new approval, even if the official form does not change.

Exception: Certain quarterly tax forms in the 94X series (941, 942, etc.) are approved for only one quarter. Each new quarter requires a new approval.

8 *Required Copies.* Once an approval is granted for the use of a substitute form, you may be requested to send to the Service eleven (11) copies of each approved form. When requested, the copies will be used to notify Internal Revenue Service Centers that your substitute forms are approved. The requested forms must be assembled in sets. A set constitutes a return with the related schedules and forms in order as they will be filed, *i.e.*, Form 1040, Schedules A, B, C, etc., Forms 2440, 2441, etc. The Service reserves the right to reject sets not assembled in the order specified.

9 *Other Forms Not Listed.* Other Service forms, such as Forms W-2, 1087, 1099, and 1040-ES, are governed by different revenue procedures. These procedures are available at your local district office.

SEC. 6. PHYSICAL ASPECTS AND REQUIREMENTS

.01 *Printing Medium.* The private printing of these substitutes must be produced by conventional printing processes, photocopying or other similar reproduction process.

1 *Remove Government Printing Office Symbol.* When privately printing a tax form, the Government Printing Office symbol and jacket numbers must be removed, and in its place (using the same type size) *print the Employer Identifying Number (EIN) of the printer or the Social Security Number (SSN) of the form designer.*

.02 *Paper Requirements.* The paper must be chemical wood writing paper that is equal to or better than the quality used for the official forms.

1 Official tax forms are printed on 18 pound (17″ × 22″, 500 sheets) white, chemical wood writing paper, or

2 45 pound offset white (25″ × 38″, 500 sheets).

3 The thickness of the stock cannot be less than .003 inch.

.03 *Prohibited Paper.* Carbon bonded paper is prohibited from use for forms filed with the Service.

.04 *Chemical Transfer Paper—LIMITED USE.* Chemical transfer paper may be used ONLY when the following specifications are met:

1 Each ply within the chemical transfer set of forms or schedules must be labeled.

2 Only the top ply (ply one and white in color), the one which contains chemical on the back only (coated back), may be filed with the Service. For example, a set containing three plies would be constructed as follows: Ply one (coated back), "Federal Return, File with IRS"; Ply two (coated front and back), "Taxpayer's copy"; and Ply three (coated front), "Preparer's copy."

3 The file designation, "Federal Return, File with IRS," for ply one must be printed in the bottom right margin (just below the last line of the form) in 12-point bold-face type. It is not mandatory, but recommended, that the file designation, "Federal Return, File with IRS," be printed using a contrasting ink to be clearly visible to the taxpayer.

.05 *Paper and Ink Color.* The color of paper and ink must substantially duplicate that of the original form in order to be accepted. This means that your substitute *must be printed in black ink and on the color paper the Service form is printed on.* An exception to this rule is that Forms 1040A and 1040 reproductions may be in black ink without the colored screening. Any additional exceptions to this rule require written approval from the Service.

.06 *Legibility.* Reproductions must have a high standard of legibility, both as to original form and as to fill-in matter. The Service reserves the right to reject any reproductions with poor legibility.

.07 *Size of Page.* Reproductions and privately designed and printed substitutes may be the same size as the official form (8″ × 11″, in most cases) or they may be the standard commercial size (8½″ × 11″).

.08 *Image Size, Text Removal, and Type Font.* The image size of printed material should be as close as possible to that of the official form. You may omit any text that is solely instructional in nature.

1 To allow a larger top margin for marginal printing (see .09 below), the title line(s) for all forms (not including the form's year designation and sequence code when present) may be photographically reduced by 40 percent or reset as one line of type. When reset as one line, the type size may be no smaller than 14 point. You may omit the "Department of the Treasury-Internal Revenue Service" and all references to instructions that appear in the form's title area.

2 Almost all federal tax forms are printed using "News Gothic" as the basic type font. We request that this type font be used when composing substitute forms.

3 Maintain at least a one-half (½) inch margin on all sides of the form. This allows room for Service employees to make necessary entries on the form during processing.

.09 *Marginal Printing — Limited Area.* You may print your logo, company or firm name, identifying and collation symbols, etc., in the *top left margin* of any Service form. The area you may use extends vertically from the top of the form's title designation to the top edge of the form and horizontally 3½ inches from the left edge. *No printing is permitted in the top right margin.* With the exception of the actual tax return form (*i.e.*, Forms 1040, 1040A, 1120, 940, 941, etc.) you may also print in the left vertical and bottom left margins. The bottom left margin you may use extends 3½ inches from the left edge of the form.

SEC. 7. APPROVED SUBSTITUTE FORMATS FOR FORM 1040 SCHEDULES A AND B

.01 *Schedules A and B (Form 1040).*

1 *Exhibits of Approved Formats.* There are two sets of exhibits (Exhibits A-1 & B-1 and A-2 & B-2) shown in this publication. They are acceptable substitutes for the official forms. Both sets are usable for manual entry or computer preparation. (Vertical spacing is six (6) lines to the inch.)

.02 *Duplication of Exhibits A-1 & A-2 and B-1 & B-2.* You are permitted to duplicate these exhibits photographically or using photo-reproduction techniques, PROVIDING YOUR PRINTED IMAGES ARE EXACTLY LIKE THE ONES IN THE EXHIBITS. WITH THE EXCEPTION NOTED BELOW, NOTHING CAN BE CHANGED. **Please note: The Service does NOT supply reproduction proofs for these exhibits.**

.03 *Use of Duplicated Exhibits.*

1 If your forms are *EXACT DUPLICATES* of these exhibits, THEY MAY BE USED WITHOUT PRIOR AUTHORIZATION.

2 *SIZE OF EXHIBITS.* The exhibits are shown at 92 percent of actual size. These substitutes should be restored to their original size during your reproduction process.

ANY CHANGE TO THE FORMAT, CAPTIONS, SPACING, ARRANGEMENT AND/OR POSITION OF THE VARIOUS CATEGORIES, ETC., OF THESE EXHIBITS REQUIRES PRIOR WRITTEN APPROVAL.

EXCEPTION—The areas in the Exhibits A-1 and A-2 identified by the circled numbers 1 through 9 may be changed as follows. The areas inside the perimeter of the boxes containing the dash-leaders, *i.e.*, ----, (designated by the circled numbers), may be used to print any particular deduction item associated with the corresponding deduction category. You may remove the dash-leaders if you wish. *YOU MAY NOT CHANGE THE AMOUNT COLUMN BOX SIZE OR POSITION.* Strip out the circled numbers before use.

3 *Exhibit A-1.* This substitute Schedule A format may be used as a single sheet or as one of the copies of a snap-set. It is designed to be used in place of the official Schedule A (Form 1040).

4 *Exhibit A-2.* This substitute Schedule A format may be used as a single sheet when both federal and state tax information is placed on the same form.

NO STATE TAX INFORMATION CAN APPEAR ON THESE FORMS WHEN FILED WITH THE FORM 1040. THE STATE COLUMN MAY BE PRESENT BUT THE STATE TAX INFORMATION MUST NOT BE VISIBLE WHEN FILED WITH THE SERVICE. We prefer that the entire state column be COMPLETELY BLOCKED OUT.

5 *Exhibits B-1 and B-2.* These exhibits correspond to Exhibits A-1 and A-2 and the provisions in 3 and 4 apply. Both of these exhibits are acceptable for use in place of the official Schedule B (Form 1040). Both are designed for either manual or computer-generated entries.

6 *Exhibits A-1 and B-1 or A-2 and B-2.* These exhibits may be used as sets when the return calls for both Schedules A and B. PLEASE NOTE: DO NOT USE BOTH THESE SUBSTITUTES AND THE OFFICIAL VERSIONS. USE ONE OR THE OTHER.

7 *BLOCK OUT METHODS.* A suggested method to block out the state tax information is: (1) place the substitute form in a clear plastic folder, (2) on the folder place a strip of opaque material the exact width and length of the column you wish to block out, then (3) photocopy the substitute form while still in the folder. The result will be a form with only the federal tax information visible. Another method is to take a black marking pen and using either vertical or horizontal strokes cross out the state figures. Carbon interleaved sets may be used where the amounts entered in the state column are filled in with black carbon overprint. This copy may be filed with the return.

SEC. 8. OTHER CONSIDERATIONS

.01 Reproductions of official forms and substitute forms which do not meet the requirements of this revenue procedure may not be filed instead of the official forms and schedules.

.02 *Required Preparation of Forms.* You must completely fill out all the numbered or referenced lines on official forms (NOT JUST THE TOTALS, BUT ALL THE ITEMS THAT MAKE UP THE TOTALS AS WELL) before attaching any supporting statement (see exceptions below). The Service processes the return based on information entered on the official or approved version of the tax forms. References are made to attachments ONLY as required by law and as processing requirements direct. When you fail to complete all the lines on the official forms, Internal Revenue Service Tax Examiners have to locate the information on your attachment and write it on the proper line of the official form. This unfortunate process causes delays in processing the return and increases the potential for errors both in transcription and in interpretation. *THE SERVICE IS CONTINUING A NATIONWIDE PROGRAM TO NOTIFY PREPARERS WHO FAIL TO MEET THIS REQUIREMENT.*

.03 *Exceptions.*

1 *Lines Captioned "Other."* It is not necessary to fill in every numbered or referenced line of tax forms when the line caption calls for "Other," *i.e.*, "Other (itemize)," "Other (specify)," "Other (attach schedule)," etc. Examples of this exception are lines 6c, 15, 19, 21b and 31 for Schedule A (Form 1040). When this occurs, a supporting statement may be used and only the total amount of these "Other" items entered on the line of the official form. However, we prefer that the space on the official form be used when it is adequate.

2 *Schedule A (Form 1040).* All numbered and lettered lines must be filled in, if applicable. Supporting statements may be used to give the details of the totals entered on such lines

but may not be used as a substitute for a collection of lines. For example, the detailed information for "Taxes" may not be shown on a supporting statement (supplemental schedule) and only line 16 filled in; but the details of "State and local income taxes" may be shown on a supporting statement and the total of such taxes entered on line 11. Also, lines 33 through 38 need not be shown, but the total of itemized deductions must be shown on line 39.

3 *Schedule B* (*Form 1040*). Lines 1 and 3 need not be filled in on the form. A supporting statement may be used for the details of interest and dividend income and the appropriate totals of such income entered on lines 2 and 4 unless nominee distribution or accrued interest criteria apply. (See the tax package instructions concerning interest.)

4 *Schedule C* (*Form 1040*). All lines on page 1 must be filled in when applicable except the line where "Other expenses-specify" is listed. (See instruction (2) above.) All information for Schedule C-1 must be entered. Schedule C-2 information may be entered on a supporting statement so long as the method of depreciation used (if any) is entered on the form in column (e). Schedule C-3 information may be shown on a supporting statement and not entered on the form.

5 *Schedule E* (*Form 1040*).

(a) When there are entries on page 1 for any of the Parts I through IV, the following requirements must be met: (1) in Part I, lines 1a through 4, the questions must be answered and tax information must be entered on the lines provided, (2) in Part II, lines 5a through 6b, the question boxes must be answered; if the answer to question 6a is "yes," the amortizable basis must be entered on line 6b. Be sure there is a place on line 6b for the amount.

(b) Supporting statements may be used for the details of rental income and expenses and for royalty income. The appropriate totals must be carried to line 7, columns (b) and (g), when a Form 4835 is filed with the return. Totals must also be entered on line 8, columns (b) through (g).

(c) The income and loss from various partnerships, estates or trusts, and small business corporations also may be detailed on a supporting statement, but the appropriate total income and total loss must be entered on lines 10 through 18 and also on line 19 when applicable.

(d) Page 2 need not be used so long as the information is provided on a supporting statement. The supporting statement must show the details required by the form.

6 *Schedule F* (*Form 1040*). Depending on which accounting method is used (cash or accrual), all of parts I and II or II and V must be printed in their entirety.

.04 *Supporting Statements.*

1 You may attach supporting statements to explain or support any line item on an official or approved form. Supporting statements must provide details and explain entries made on the official form or schedule, must furnish all required information in the same sequence as called for on the official forms or schedules, and must be attached to the return following all other official forms. All tax returns must be arranged in this order: the tax return, lettered forms in alphabetical order, numbered forms in numerical sequence and supporting statements. Information on supporting statements must be in the same order as the items appeared on the form to which it is referenced. THEIR USE MUST BE TO SUPPORT LINE ENTRIES ON THE OFFICIAL FORM AND NOT TO AVOID COMPLETING REQUIRED LINES ON THE OFFICIAL FORM.

2 Additionally, each of your supporting statements must be referenced to the form it supports, and the entry on the form must be cross-referenced to the supporting statement. For example, put "See Statement X" on the line of the form that references the statement and put "Statement X" on the top of the supporting statement that contains the identified line number and the supporting information.

.05 *Printing On One Side of Paper.* While it is preferred that both sides of the paper be used in making reproductions, resulting in the same page arrangement as that of the official form or schedule, the Service will not object if only one side of the paper is used or if the reproduction has a different fold from that provided on the official form.

.06 *Paid Preparer's Information and Signature Area.* On both Forms 1040A and 1040, the "Paid Preparer's Information" area may not be rearranged or relocated. You may add one extra line to the paid preparer's address area. An exact facsimile must appear on Page 1 of Form 1040A and Page 2 of Form 1040. This applies to other tax forms as well.

.07 *Use Preaddressed Label.* When filing reproduced or privately printed federal tax returns and related schedules, use the preaddressed label furnished to the taxpayer in the tax package by the Service on the copy that is to be filed with the Service. Use of the label avoids larger processing costs because it reduces the potential for error—the kind of error which can delay the receipt of refund and information needed by the taxpayer. **No other label may be used.**

.08 *State Tax Information Prohibited.* State tax information must not appear on the federal tax return which is filed with the Internal Revenue Service Center, except where amounts are claimed on or required by the federal return, *e.g.*, line 11, Schedule A (Form 1040).

.09 *Use Internal Revenue Service Envelope.* When filing reproduced or privately printed federal tax returns use the envelope enclosed with the taxpayer's tax package. This envelope is coded for sorting into several categories. Use of the envelope can help speed up the processing and reduce processing costs. Do not use the Service-provided tax package envelope for other correspondence with the Service, as its misuse could delay the correspondence.

.10 *Filing Substitute Forms.* Follow the same instructions as for filing official forms. These instructions are in the taxpayer's tax package.

.11 *Voluntarily Submitted Information.* Additional information required or voluntarily submitted should be on the same size paper as the official form.

SEC. 9. REPRODUCTION PROOFS

Camera-ready, reproduction-quality, proof copies of many of the tax forms issued by the Service are available to the public. Order blanks for reproduction proofs will be mailed to requestors of record and, on request, to prospective users. Printers and others wishing to obtain reproduction proofs may send their requests to the Internal Revenue Service, Attention: Publishing Services, RM:FM:P, Room 1528, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

Basic specifications, such as margin, pagination, etc., will be printed in the margins of the reproduction proofs and must be removed before printing. The official reproduction proof margins across the top, bottom, and sides must be maintained on all reproductions and privately printed federal tax returns and related schedules.

A charge of $1.00 per page will be made for each reproduction proof regardless of page size. After an order has been filled, invoices will be mailed to the requestor.

SEC. 10. ADDITIONAL INSTRUCTIONS

.01 *Photocopy Equipment.* The Service does not undertake to approve or disapprove the specific equipment or process used in reproducing official forms, but requires only that the reproduced forms and schedules satisfy the conditions stated in revenue procedures.

.02 *Taxpayer and Preparer Signatures.* All taxpayer signatures on forms to be filed with the Service must be original signatures, affixed subsequent to the reproduction process. However, the income tax preparer can satisfy the manual signature requirement by signing a completed income tax return form, making a photocopy of the return form, and having the taxpayer sign and file the photocopy. (See Rev. Rul. 78-370, 1978-2 C.B. 336.)

.03 *Requests for Approvals.* When specific approval of a reproduction of any form is desired, or if the use of a reproduction of any form is not listed or specified herein or otherwise specifically authorized, a sample of the proposed reproduction should be forwarded by letter to the Internal Revenue Service, Attention: Substitute Forms Program, TX:R:I, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, for consideration. When copies of privately designed forms are submitted for approval, please follow the instructions listed near the beginning of this revenue procedure.

SEC. 11. AGREEMENT

Any person or company who uses substitute forms and makes all or part of the changes specified in this revenue procedure, agrees to the following stipulation: The Service presumes the changes are made in accordance with these procedures and, as such, will be noninterruptive to the processing of the tax return. Should any of the changes prove to be not exactly as described, and as a result become disruptive to the Service during processing of the tax return, the person or company agrees to accept the determination of the Service as to whether or not the form may continue to be used during the filing season, and also agrees to work with the Service in correcting noted deficiencies. Notification of deficiencies may be made by letter, phone call or both.

SEC. 12. EFFECT ON OTHER DOCUMENTS

This revenue procedure supersedes Rev. Proc. 79-57, 1979-2 C.B. 540.

SEC. 13. EXHIBITS SECTION

Exhibits shown in this section are acceptable substitutes for official forms and are intended to be used *in place of* their corresponding official forms. No prior approval is needed before using them so long as all other requirements in this revenue procedure are met.

Exhibit A-1 (Substitute Schedule A—Preferred Format)

Schedule A
(Form 1040)
Department of the Treasury
Internal Revenue Service

Itemized Deductions

▶ Attach to Form 1040. ▶ See instructions for Schedule A (Form 1040)

1980
08

Name(s) as shown on Form 1040

Your social security number

Medical and Dental Expenses — Federal

1 ½ insurance premiums

2 Medicine and drugs

3 Enter 1% of Form 1040, line 31

4 Subtract line 3 from line 2

5 Balance of insurance premiums

Doctors, dentists, nurses, etc.

①

6(a) Total doctors, dentists, nurses, etc.

Hospitals

②

6(b) Total hospitals

Other medical and dental expenses (itemize—hearing aids, eyeglasses, transportation, etc.)

③

6(c) Total other medical and dental expenses

7 Total (add lines 4 through 6c)

8 Enter 3% of Form 1040, line 31

9 Subtract line 8 from line 7

10 Total (add lines 1 and 9).

Taxes

11 State $.......... Local $..........

12 Real estate

13 General sales

14 Personal property

Other (itemize) ▶

④

15 Total other

16 Total taxes ▶

Interest Expense

17 Home mortgage

18 Credit and charge cards

Other (itemize) ▶

⑤

19 Total other

20 Total interest expense ▶

Contributions — Federal

Cash contributions for which you have receipts, cancelled checks, etc.

⑥

21a Total receipts cash

Other cash contributions (show to whom you gave and how much)

⑦

21b Total no receipt cash

Other than cash

⑧

22 Total other than cash

23 Carryover from prior years

24 Total contributions

Casualty or Theft Loss(es)

25 Loss before insurance

26 Insurance reimbursement

27 Subtract line 26 from line 25

28 Enter $100 or smaller of line 27

29 Total casualty or theft loss(es) ▶

Miscellaneous Deductions

A

30 Union dues

Other (itemize) ▶

⑨

31 Total other

32 Total miscellaneous deductions ▶

39 Total deductions ▶

40 If you checked Form 1040, Filing Status box:
2 or 5, enter $3,400
1 or 4, enter $2,300
3, enter $1,700

41 Subtract line 40 from line 39 ▶

Federal copy—File with Form 1040

Exhibit B-1 (Substitute Schedule B—Preferred Format)

Schedule B (Form 1040)
Department of the Treasury
Internal Revenue Service

Interest and Dividend Income

▶ Attach to Form 1040. ▶ See Instructions for Schedule B (Form 1040)

1980

Name(s) as shown on Form 1040 (Do not enter name and social security number if shown on other side)

Your social security number

Part I

Interest Income

	Federal
1	
2 Total interest income	

Part II

Dividend Income

	Federal
3 gross dividends	
4 Total of line 3	
5 Capital gain distributions. Enter here and on appropriate line(s) on Schedule D	
6 Nontaxable distributions	
7 Total (add lines 5 and 6)	
8 Dividends before exclusion	

Part III

Foreign Accounts and Foreign Trusts

	Yes	No
A At any time during the tax year, did you have an interest in or a signature or other authority over a bank account, securities account, or other financial account in a foreign country (see page 19 of instructions)?		
B Were you the grantor of, or transferor to, a foreign trust which existed during the current tax year, whether or not you have any beneficial interest in it? If "Yes," you may have to file Forms 3520, 3520-A, or 926.		

Federal Copy **B**

Exhibit A-2 (Substitute Schedule A—Acceptable Format)

Schedule A
(Form 1040)
Department of the Treasury
Internal Revenue Service

Itemized Deductions

▶ Attach to Form 1040. ▶ See Instructions for Schedule A (Form 1040)

1980
08

Name(s) as shown on Form 1040

Your social security number

Medical and Dental Expenses

	Federal
1 ½ insurance premiums . . .	
2 Medicine and drugs	
3 Enter 1% of Form 1040, line 31	
4 Subtract line 3 from line 2 . .	
5 Balance of insurance premiums.	

Doctors, dentists, nurses, etc. ▶

①

6(a) Total doctors, dentists, etc. .	

Hospitals ▶

②

6(b) Total hospitals	

Other medical and dental expenses (itemize) ▶

③

6(c) Total other medical . . .	
7 Total (add lines 4 through 6c) .	
8 Enter 3% of Form 1040, line 31	
9 Subtract line 8 from line 7 . .	
10 Total (add lines 1 and 9) .	

Taxes

11 State $........ Local $........	
12 Real estate	
13 General sales	
14 Personal property	

Other (itemize) ▶

④

15 Total other	
16 Total taxes . . . . . . ▶	

Interest Expense

17 Home mortgage	
18 Credit and charge cards . . .	

Other (itemize) ▶

⑤

19 Total other	
20 Total interest expense . . ▶	

Contributions

Federal

Cash contributions for which you have receipts, cancelled checks, etc. ▶

⑥

21a Total receipts cash	

Other cash contributions (show to whom you gave and how much) ▶

⑦

21b Total no receipt cash . . .	

Other than cash . . . .

⑧

22 Total other than cash . . .	
23 Carryover from prior years . .	
24 Total contributions	

Casualty or Theft Loss(es)

25 Loss before insurance . . .	
26 Insurance reimbursement . .	
27 Subtract line 26 from line 25 .	
28 Enter $100 or smaller of line 27	
29 Total casualty or loss(es) . .	

Miscellaneous Deductions

30 Union dues	

31 Other (itemize) ▶

⑨

Total other	
32 Total miscellaneous deductions . . . . . ▶	
39 Total deductions . . . . ▶	
40 If you checked Form 1040, Filing Status box: 2 or 5, enter $3,400 . . . 1 or 4, enter $2,300 . . . 3, enter $1,700	
41 Subtract line 40 from line 39 ▶	

Federal copy—File with Form 1040

A

Exhibit B-2 (Substitute Schedule B—Acceptable Format)

Schedule B
(Form 1040)
Department of the Treasury
Internal Revenue Service

Interest and Dividend Income

▶ Attach to Form 1040. ▶ See Instructions for Schedule B (Form 1040)

1980

Name(s) as shown on Form 1040 (Do not enter name and social security number if shown on other side)

Your social security number

Part I **Interest Income**

Federal

1

2 Total interest income

Part II **Dividend Income**

3 gross dividends

4 Total of line 3	
5 Capital gain distributions. Enter here and on appropriate line(s) on Schedule D	
6 Nontaxable distributions	
7 Total (add lines 5 and 6)	
8 Dividends before exclusion	

Part III **Foreign Accounts and Foreign Trusts**

	Yes	No
A At any time during the tax year, did you have an interest in or a signature or other authority over a bank account, securities account, or other financial account in a foreign country (see page 19 of instructions)?		
B Were you the grantor of, or transferor to, a foreign trust which existed during the current tax year, whether or not you have any beneficial interest in it? If "Yes," you may have to file Forms 3520, 3520-A, or 926.		

Federal Copy **B**

26 CFR 601.602: Forms and instructions. (Also Part I, Sections 6001, 6011; 1.6001-1, 1.60011-1.)

Rev. Proc. 80-48

SECTION 1. PURPOSE

This Revenue procedure states the requirements of the Internal Revenue Service regarding the acceptance of computer-prepared tax forms (i.e., Forms 1040, 1040A, 1120, 940, 941, etc.) and computer-generated forms (and schedules) to be attached thereto.

SEC. 2. DEFINITIONS

.01 *Definitions Used in This Procedure (Relating to Tax Forms).*

1 *Substitute Form.* A tax form or related form that differs in any way from the official versions and is intended to replace the entire form printed and distributed by the Service. This term also covers those approved substitute formats and forms described in this revenue procedure. (A photocopy or a copy produced from an unchanged reproduction proof, supplied by the Service, is not a substitute form.)

2 *Supporting Statement (Supplemental Schedule).* A document filed as a part of a tax return that provides detailed information to support an entry for a line (or lines) on an official form. A supporting statement cannot take the place of an official form.

3 *Computer-Prepared Form.* A preprinted form in which the taxpayer's name, address and tax entry information has been printed by a computer, computer-printer or other computer-type equipment, such as word-processing equipment.

4 *Manually Prepared Form.* A preprinted form in which the taxpayer's name, address and tax entry information is entered by an individual using pen, pencil, typewriter or other non-automated equipment.

5 *Computer-Generated Tax Forms.* A document that is entirely prepared by the use of a computer-printing device so that all the line numbers, line captions, and the tax amount data entries are in the same typeface. No graphics appear on the form.

6 *Graphics.* Those parts of the tax form that are not the tax amount entries or called-for information. Generally, these are line numbers, captions, instructions, rules and borders, special indicators, and rules or strokes created by type-setting, photo-graphics, photocomposition, etc.

7 *Printed Form.* A form produced using conventional printing processes, photocopying, or other similar processes.

8 *Preprinted Pin-Fed Form.* A form printed beforehand by conventional methods on paper with marginal perforations for use with automated and/or high-speed printing equipment.

SEC. 3. SUMMARY OF CONTENTS

.01 MESSAGE TO TAX RETURN PREPARERS.

IF YOU PLAN TO CHANGE OR MODIFY *ANY* TAX FORMS, YOU MUST FOLLOW THESE INTERNAL REVENUE PROCEDURES. IN MOST CASES, *YOU MUST GET OFFICIAL APPROVAL BEFORE USING SUBSTITUTE FORMS.*

THE SERVICE IS CONTINUING A NATIONWIDE PROGRAM TO IDENTIFY AND CONTACT TAX RETURN PREPARERS USING UNAPPROVED FORMS.

.02 Additional information you may also need is contained in Rev. Proc. 80-47, page 11, this Bulletin. You can obtain this revenue procedure by (1) ordering it on the form included in Package X, Informational Copies of Federal Tax Forms, or (2) writing to: IRS Rev. Proc., P.O. Box 27322, Richmond, VA 23261. They are also obtainable at your local district office.

.03 THINGS YOU *CAN DO* TO INTERNAL REVENUE SERVICE PRINTED TAX FORMS TO MAKE THEM SUITABLE FOR COMPUTER PREPARATION.

1 *You can PHOTOCOPY* any federal tax form or schedule and use it instead of the official one.

2 *You can REPRODUCE ANY CURRENT* form (or schedule) cut sheets, snap-sets, and marginally-punched pin-fed forms, so long as you use an official Service version as the master copy. An official version is one supplied by the Service, such as those in the taxpayer's tax package, those in Package X, reproduction proofs (sold by the Service), and those printed in revenue procedures.

3 *You can ADJUST* the graphics on printed Forms 1040, 1040A, 1120, 940, 941, etc., to allow for computer-printed or word processor fill-in. Only the areas listed in revenue procedures may be changed without prior approval.

4 *You can PRINT AND DUPLICATE* the substitute "worksheet-type" versions of Schedules A and B (shown as exhibits) in Rev. Proc. 80-47 when you need a "worksheet-type" format. The Service will accept these substitute schedules instead of the official versions. These schedules serve different purposes. One allows the form to contain a state tax column. (The state tax information must not be visible on the copy filed with the Service.) The other allows the form to be used singly or as part of a snap-set.

.04 THINGS YOU *CANNOT* DO TO INTERNAL REVENUE SERVICE PRINTED TAX FORMS.

1 *You cannot* change any Internal Revenue Service form or use your own (non-approved) version, unless permitted by revenue procedures, without prior Service approval.

2 *You cannot* change any of the graphics on Forms 1040 and 1040A (except those specified in revenue procedures) without prior approval from the Service.

3 *You cannot* use your own version of Schedule A (Itemized Deductions) *UNLESS YOU FIRST GET IT APPROVED.* When using attachments to the official Schedule A, you must *COMPLETELY FILL OUT ALL REFERENCED (NUMBERED OR LETTERED) LINES OF THE OFFICIAL SCHEDULE A,* not just the total lines, but also the line items that make up the totals. In other words, you may not enter just the totals for the various deduction categories, *i.e.,* "Medical," "Taxes," etc., and write "See Attached Schedule" across that part of the form. The Service wants only one Schedule A—either yours or an official version; yours needs prior approval from the Service.

4 *You cannot* use your own preprinted label on tax returns filed with the Service. The ONLY label permitted is the one provided the taxpayers in their tax packages. Otherwise, the taxpayer's name and address must be entered on the return in the spaces provided.

5 *Other items are also not permitted.* Please read the rest of this revenue procedure for details.

.05 THINGS YOU *CAN DO* TO FILE COMPUTER-PREPARED/ GENERATED FORMS.

1 *You can* DUPLICATE the approved, computer-generated formats of Schedules A, B, C, D, E, F, G, R, RP, SE and TC (shown in the Exhibit Section of this revenue procedure) and use them without prior approval.

2 *You can* FILL IN official Internal Revenue Service supplied forms using computer or word-processing equipment. Internal Revenue Service forms are designed for a vertical spacing of six lines to the inch, with money amount columns wide enough to allow for the computer printing of ten characters.

3 *You can* CHANGE CERTAIN SPECIFIED AREAS on the Forms 1040 and 1040A (spelled out in the revenue procedures) to assist computer-printing requirements and to allow for a little more room on certain lines.

4 *Other items are also permitted.* Please read the rest of this revenue procedure for more details.

.06 THINGS YOU *CANNOT DO* TO INTERNAL REVENUE SERVICE FORMS.

1 *You cannot* use computer graphics on any Internal Revenue Service form without prior approval.

2 *You cannot* computer-generate the TAX FORMS THEMSELVES (i.e., forms requiring signatures; for example, Forms 1040, 1040A, 1120, 940, and 941). These forms must be preprinted using conventional printing processes, photocopying or similar reproduction processes. The forms may be filled in by a computer, by a word processor, or the like, but the forms themselves must be printed like the Service versions are. Forms designed using computer graphics may be submitted for approval.

3 *You cannot* use your own computer-generated version of any tax form that is to be attached to the tax return, unless permitted by revenue procedures, without prior Service approval.

4 *Other items are also not allowed.* Please read the rest of this revenue procedure for more details.

SEC. 4. SPECIFICATIONS FOR FILING SUBSTITUTE FORMS

.01 *Computer-Prepared Tax Forms.* For filing purposes the Service will accept computer-prepared tax forms (i.e., Forms 1040, 1040A, 1120, 940, 941, etc.) filled in by a computer or by word-processing equipment, but these forms MUST be pre-printed.

.02 *Computer-Generated Forms.* For filing purposes, the Service will accept computer-generated versions of forms that are attached to individual and business income tax returns, provided the substitutes and their manner of completion meet the guidelines prescribed herein.

.03 *Combination of Manually Prepared and Computer-Prepared/Generated Forms.* For filing purposes, the Service will accept substitute tax forms that contain a combination of computer-prepared/generated and manually filled in information.

SEC. 5. GENERAL INFORMATION

.01 *Approvals.*

1 *Guidelines.* Preparers who desire to file substitute computer-prepared forms and/or computer-generated forms must develop such substitutes using guidelines in revenue procedures. Substitutes other than those described here must be approved by the Service before being filed.

2 *Changes to Tax Forms.* Any person making changes to any tax form (EXCEPT THOSE ALLOWED BY REVENUE PROCEDURES) must obtain approval from the Service before filing the substitute.

3 *Mailing Address.* Proposed substitutes should be forwarded by letter to the Internal Revenue Service, Attention: Substitute Forms Program, TX:R:I, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

4 *When to Submit.* Proposed substitutes should be sent to the address in 3 above, as much in advance of the filing period for the form as possible. This is to allow adequate time for analysis and response and to permit notice to our field offices. Quarterly filed forms, such as the Form 941, must be submitted by the first day of the last month of the quarter.

5 *Required Statement.* When the sample substitute is submitted, there must also be an accompanying statement that lists the form number of each substitute requested and details those items that deviate from the official form in position, arrangement, appearance, line numbers, additions, deletions, etc. Included with each of the items must be a detailed reason or justification for the change and an approximation of the number of forms expected to be filed.

6 *Approval Letter.* Upon determination that approval can be given, the Service sends a formal letter of approval which also may contain qualifications for the substitute's use.

7 *Duration of Approval.* Approvals when granted are good for only one calendar year (January-December) or, in the case of corporation tax forms (with the exception noted below), for the remainder of the quarter of the calendar year.

PLEASE NOTE: Each new filing season requires a new approval, even if the official form does not change.

Exception: Forms in the 94X series (941, 942, etc.) are approved only for one quarter. Each new quarter requires a new approval from the Service.

8 *Required Copies.* Once an approval is granted for the use of a computer-prepared or computer-generated substitute form, you may be requested to send the Service eleven (11) copies of each approved form. When requested, the form(s) must be assembled in sets and submitted to the Service so that we can notify our Service Centers of the approvals we have given. A set constitutes a return with the related schedules and forms in order as they will be filed, i.e., Forms 1040, Schedules A, B, C, D, etc., Form 2440, 2442, etc. We reserve the right

to reject sets which are not assembled in the order specified.

SEC. 6. PHYSICAL ASPECTS AND REQUIREMENTS

.01 *Lined Paper.* Computer-generated substitute forms must be submitted on quality, lined, machine paper. Lined, color-barred paper is also acceptable. Lined paper assists Service employees during processing of the returns by allowing speedy location of tax entries corresponding to line captions. The lines provide the basic means for eye-travel from one side of the form to the other.

.02 *Margins.* A one-half inch margin must be maintained across the top, bottom, and both sides (exclusive of any pin-feed holes) of all computer-generated substitutes. One-half inch margins allow for slight printing misalignment when forms are prepared on high-speed equipment. The margin area is also used by Service employees to make necessary entries on the form during processing.

.03 *Page Size.* Computer-prepared/generated substitutes may be the same size as the official (8″ × 11″, in most cases) or they may be the standard commercial size (8½″ × 11″). Computer-generated forms must be on the same size paper as the tax form to which it is attached.

.04 *Prohibited Paper.* Carbon-bonded paper is prohibited from use for forms filed with the Service.

.05 *Chemical Transfer Paper—Limited Use.*

Chemical transfer paper may be used ONLY when the following specifications are met:

1 Each ply within the chemical-transfer set of forms must be labeled.

2 Only the top ply (ply one), the one which contains chemical on the back only (coated back), may be filed with the Service. For example, a set containing three plies would be constructed as follows: Ply one (coated back), "Federal Return, File with IRS"; Ply two (coated front and back), "Taxpayer's copy"; and Ply three (coated front), "Preparer's copy."

SEC. 7. CONDITIONS—TAX FORMS (1040A, 1040, 1120, 940, 941, ETC.)

.01 *PROHIBITED FORMS.*

1 *COMPUTER-GENERATED VERSIONS.* Computer-generated versions of a tax form which requires a signature are not permitted. Only preprinted substitutes of these forms are allowed.

2 *COMPUTER-GENERATED GRAPHICS.* Computer - generated graphics CANNOT be used on any form without prior approval.

.02 *FILL - IN INFORMATION.* The tax form itself (i.e., 1040, 1040A, 1120, 940, 941, etc.) may be filled in by a computer printer or other similar automated equipment, but the form itself must be created beforehand (i.e. preprinted) using conventional printing methods, photocopying or other similar reproduction processes.

.03 *CHANGES PERMITTED TO THE FORMS 1040 & 1040A.*

1 Certain changes (listed below) are permitted to the graphics of the form without prior approval, but these changes apply only to preprinted forms as described in .02 above.

2 Changes not requiring prior approval are good only for the filing period January through December 1981.

3 *OTHER CHANGES NOT LISTED.* All changes not listed here require prior approval from the Service *BEFORE* the form may be filed with the Service.

4 *OTHER FORMS NOT LISTED.* Other Internal Revenue Service forms, such as Forms W-2, 1087, 1099, and 1040-ES, are governed by different revenue procedures. These revenue procedures are available at your local district office.

SEC. 8. AGREEMENT

Any person who uses substitute forms and makes all or part of the changes specified in this revenue procedure, agrees to the following stipulation: The Service presumes the changes are made in accordance with these procedures and, as such, will be noninterruptive to the processing of the tax return. Should any of the changes prove to be not exactly as described, and as a result become disruptive to the Service during processing of the tax return, the preparer agrees to accept the determination of the Service as to whether or not the form may continue to be used during the filing season, and also agrees to work with the Service in correcting noted deficiencies. Notification of deficiencies may be made by letter, phone call or both.

SEC. 9. CHANGES PERMITTED TO THE GRAPHICS ON BOTH FORM 1040 AND 1040A AND, WHERE APPLICABLE, ON OTHER FORMS AS WELL (FOR USE WITH COMPUTER-PREPARED FORMS ONLY)

.01 *Adjustments.* You may make minor vertical and horizontal spacing adjustments to allow for computer or word-processing printing. This includes widening the amount columns or tax entry areas so long as the adjustments do not exceed other provisions stated in revenue procedures. No prior approval is needed for these changes. However, the user of forms with such changes are bound by the "Agreement" in Section 8.

.02 *NAME AND ADDRESS AREA.*

1 The horizontal rules and instructions within the name and address area may be removed and the entire area left blank; no line or instruction can remain in the area.

2 The heavy ruled border (when present) that outlines the name and address area must not be removed, relocated, expanded or contracted.

3 *Required Format.*

(a) When the name and address area is left blank, as provided in 1 above, the following format *MUST* be used when printing the taxpayer's name and address. Otherwise, unless the taxpayer's preprinted label is affixed over the information entered in this area, the lines must be filled-in as shown.

1st name line (35 characters maximum)

In-care-of name line (35 characters maximum)

Street address (35 characters maximum)

City, State (24 char. max.), one blank char., & zip (five char.)

(b) When there is no in-care-of name line, the name and address will consist of only three lines. Examples of the formats follow:

Example of name and address with NO in-care-of name line:

JOHN AND MARY JONES
1234 ANYWHERE ST. APT 111
ANYTOWN, VA. 12345

Example of name and address WITH in-care-of name line:

JOHN AND MARY JONES
C/O THOMAS A. JONES
4311 SOMEWHERE AVE.
SAMETOWN, VA. 54321

(c) YOU *MAY NOT* USE YOUR OWN PREADDRESSED LABEL ON ANY INTERNAL REVENUE SERVICE FORM.

(d) The *ONLY* label that may be used is the OFFICIAL INTERNAL REVENUE SERVICE LABEL SUPPLIED to the taxpayer in his/her tax package. Please use the official Internal Revenue Service supplied label to help reduce errors.

(e) For identification purposes, you may computer print the taxpayer's name and address on the form and afterward affix the OFFICIAL INTERNAL REVENUE SERVICE SUPPLIED LABEL over the computer printed address. This applies whether or not the horizontal rules and the instructions have been removed.

.03 *SOCIAL SECURITY NUMBER (SSN) AND EMPLOYER IDENTIFICATION NUMBER (EIN) AREA.*

1 The vertical lines separating the format arrangement of the SSN/EIN may be removed.

2 When the vertical lines are removed, the SSN and EIN formats must be 000-00-0000 and 00-0000000, respectively.

.04 *CENSUS INFORMATION.* When present, this area may be vertically compressed into two lines; one for captions and one line below for computer entries. The areas A-D (Forms 1040 and 1040A) must NOT be rearranged or relocated. You may remove the vertical dash-leader in section A that separates "State" and "City." Captions may be shortened to fit in the space but sufficient "key words" must be used to identify the items requested.

.05 *CENTS COLUMNS.*

1 You may remove the vertical rule that separates the dollars from the cents.

2 All entries in the amount column must have a decimal point following the whole dollar amounts whether or not the vertical line that separates the dollars from the cents is present.

3 You may omit printing the cents, but all amounts entered on the form must follow a consistent format. YOU ARE STRONGLY URGED TO ROUND OFF THE FIGURES TO WHOLE DOLLAR AMOUNTS.

4 When printing money amounts, you must use one of the following ten-character formats:

(a) 0,000,000.
(b) 000,000.00

5 When there is no entry for a line, leave the line blank.

.06 *PAID PREPARER'S INFORMATION AREA.*

1 On all forms, where present, the paid preparer's information area may NOT be rearranged or relocated.

2 You may add one line to the preparer's address area.

SEC. 10. CHANGES PERMITTED TO FORM 1040A GRAPHICS (for use with computer-printed forms only)

.01 *LINE 4.*

This line may be compressed vertically to one line (to allow for a larger entry area for the name of the qualifying unmarried child) by using the following line caption:

"Head of household; unmarried child's name... ..."

.02 *LINE 5d.*

1 The vertical lines separating columns (1) through (5) may be removed.

2 The number of lines for listing "other dependents" may be expanded to a maximum of 5.

.03 *LINE 9a (and 9b).*

These lines may be changed to allow larger amount entry fields by removing references to instructions.

.04 *LINE 11.*

This line may be vertically compressed to one line by using the following line caption:

"Adjusted Gross Income."

.05 *LINES 12a, 12b, 14a, 14b, and 17.*

These lines may be vertically compressed to one line by removing references to instructions.

SEC. 11. MARGINAL PRINTING

You may print your logo, company or firm name, identifying and collation symbols, etc., in the top left margin of the form. The area you may use extends vertically from the top of the Form 1040A title designation to the top edge of the form and horizontally 3½ inches from the left edge.

SEC. 12. OTHER CHANGES PROHIBITED

NO OTHER CHANGES TO THE FORM 1040A GRAPHICS ARE ALLOWED WITHOUT PRIOR APPROVAL.

SEC. 13. CHANGES PERMITTED TO THE FORM 1040 GRAPHICS (FOR USE WITH COMPUTER-PREPARED FORMS ONLY)

.01 *LINE 4.* This line may be compressed horizontally (to allow for a larger entry area for the name of the qualifying unmarried child) by using the following line caption:

"Head of household; unmarried child's name."

.02 *LINE 6d.*

1 The vertical lines separating columns (1) through (5) may be removed. The captions may be shortened to allow a one-line caption for each column.

2 The number of lines for listing "other dependents" may be expanded to a maximum of 5 by compressing other noted areas listed here.

.03 *LINES 10a and 10b.* This line may be horizontally compressed to allow for larger entry fields for Dividends and Exclusions by the use of the following line caption (on one line):

"10a Dividends . . . (15 char.) . . . 10b Exclusion . . . (15 char.)."

.04 *LINE 11.* This line may be vertically compressed to one line by using the following line caption:

"State and local income tax refunds."

.05 *LINES 20a and b.* These lines may be compressed horizonally and vertically to allow a larger entry field for "total received" and to make a two-line entry on one line by using the following caption:

"a. Total unempl. comp. rec'd (10 char.) b. Taxable amt."

.06 *LINE 21.*

1 This line may be expanded vertically to a maximum of 4 lines.

2 The amount entry box must remain a single entry and the cross-hatched shading must extend down the numbered line box by the same number of lines you add.

.07 *LINE 31.* This line may be vertically compressed to one line by removing references to instructions.

.08 *LINE 35.* You may change the line caption to read "Tax" and computer-print either the words "FROM TAX TABLES" or "FROM SCHEDULE TC."

.09 *LINE 36.* You may change the caption to read:

"Additional taxes from Form/Section" and computer-print only the form(s) or/and section number that apply.

SEC. 14. OTHER CHANGES PROHIBITED

NO OTHER CHANGES TO THE FORM 1040 GRAPHICS ARE PERMITTED WITHOUT PRIOR APPROVAL.

SEC. 15. ACCEPTABLE FORMATS — COMPUTER-GENERATED FORMS AND SCHEDULES

.01 *Exhibits of Acceptable Formats for Form 1040 Schedules.*

1 Exhibits of acceptable computer-generated formats for the schedules usually attached to the Form 1040 are shown in the Exhibits section of this revenue procedure. The exhibits are for Schedules A, B, C, D, E, F, G, R, RP, SE, and TC.

Because a substitute form is a variation from the official form, you should know the requirements of the official form before you modify it to meet your needs. For the most frequently used tax forms, the quickest way to obtain an official form is to request reproduction proofs of these forms. Reproduction proofs can only be ordered by using Form M-5368, Order for Reproduction Proofs. Form M-5368 can be obtained in two ways: (1) by written request to Internal Revenue Service, RM:FM:P, Room 1528, 1111 Constitution Ave., N.W., Washington, D.C. 20224, or (2) by telephone request (at your expense) to the Reproduction Proof Coordinator at (202) 566-2473.

2 *Use of Acceptable Formats.* If your computer-generated forms appear exactly like the exhibits, no prior authorization is needed.

3 *CHANGES TO EXHIBITS NOT PERMITTED WITHOUT PRIOR APPROVAL.* Any change to the text or format of any of the exhibits requires PRIOR WRITTEN APPROVAL.

SEC. 16. COMPUTER - GENERATED FORMS NOT SHOWN AS EXHIBITS IN THIS REVENUE PROCEDURE

.01 Persons or companies desiring to change the computer-generated forms shown as exhibits MUST obtain prior approval before use.

.02 Those desiring to computer-generate forms not shown here may do so, but they must design such forms themselves by following the manner and style of those in the Exhibits section of this publication and by taking care to observe other requirements and conditions stated here.

.03 Computer-generated forms so designed DO NOT require prior approval from the Service. However, the user of such forms is bound by the "Agreement" in Sec. 8 above.

.04 If you wish, you may submit any substitute form to the Service for approval consideration.

SEC. 17. INSTRUCTIONS FOR PREPARING COMPUTER-GENERATED SUBSTITUTES

.01 *Format Arrangement.*

The format of each substitute schedule must follow the format of the official schedule as to item caption, line reference, line numbers, sequence, form arrangement and format, etc. Basically try to make the form look like the official one, with readability being a primary factor. Use periods and/or other special characters to separate the various parts and sections of the form. With the exceptions in .02 below, all line numbers and items must be printed even though an amount is not entered on the line.

.02 *Exceptions.*

1 *Zero Entries.* Detailed information for any deduction or income category may be omitted from the printout if the category total to be reported is zero. However, the substitute form must show the total (zero when applicable) for each category.

2 *Lines Captioned "Other."* It is not necessary to fill in every numbered or referenced line of forms when the line caption calls for "Other," e.g., "Other (itemize)," "Other (specify)," "Other (attach schedule)," etc. Examples of this exception are lines 6c, 15, 19, 21b and 31 for Schedule A (Form 1040). When this occurs, a supporting statement may be used and only the total amount of these "Other" items entered on the line of the official form. However, we prefer that the space on the official form be used when it is adequate.

3 *Schedule A (Form 1040).* All numbered and lettered lines must be filled in, if applicable. Supporting statements may be used to give the details of the totals entered on such lines but may not be used as a substitute for a collection of lines. For example, the detailed information for "Taxes" may not be shown on a supporting statement (supplemental schedule) and only line 16 filled in; but the details of "state and local income taxes" may be shown on a supporting statement and the total of such taxes entered on line 11. Also, lines 33 through 38 need not be shown, but the total of itemized deductions must be shown on line 39.

4 *Schedule B (Form 1040).* Lines 1 and 3 need not be filled in on the form. A supporting statement may be used for the details of interest and dividend income and the appropriate totals of such income entered on lines 2 and 4 unless nominee distribution or accrued interest criteria apply. (See the tax package instructions concerning interest.)

5 *Schedule C (Form 1040).* All lines on page 1 must be filled in when applicable except the line where "Other expenses (specify)" is listed. (See instruction 2 above.) All information for Schedule C-1 must be entered. Schedule C-2 information may be entered on a supporting statement so long as the method of depreciation

used (if any) is entered on the form in column (e). Schedule C-3 information may be shown on a supporting statement and not entered on the form.

6 *Schedule E* (*Form 1400*).

(a) When there are entries on page 1 for any of the Parts I and IV, the following requirements and/or questions must be answered and tax information must be entered on the lines provided, in Part II, lines 5a through 6b, the question boxes must be answered; if the answer to question 6a is "yes," the amortizable basis must be entered on line 6b. Be sure there is a place on line 6b for the amount.

(b) Supporting statements may be used for the details of rental income and expenses and for royalty income. The appropriate totals must be carried to line 7, columns (b) through (g).

(c) The income and loss from various partnerships, estates or trusts, and small business corporations also may be detailed on a supporting statement, but the appropriate total income and total loss must be entered on lines 10 through 18 and also on line 19 when applicable.

(d) Page 2 need not be used so long as the information is provided on a supporting statement. The supporting statement must show the details required by the form.

7 *Schedule F* (*Form 1040*). Depending on which accounting method is used (cash or accrual), all of parts I and II or II and V must be printed in their entirety.

.03 *Vertical Alignment of Amount Fields.* Vertically align the amount entry fields where possible.

.04 *Line Numbers.*

1 When a line on an official form is designated by a number or a letter, that designation (reference code) must be used on a computer-generated substitute form.

2 The reference code must be printed to the left of the corresponding captioned line and also immediately preceding the data field even if there is no reference code immediately preceding the data field on the official form.

3 In addition, the reference code that is immediately before the data field must be either followed by a period or enclosed in parentheses. There also must be at least two blank spaces between the period or the right parenthesis and the first character of the data field. (See example in 4 below.)

4 A decimal point (i.e., a period) must be used for each money amount regardless of whether the amount is reported in dollars and cents or in whole dollars or whether or not the vertical line that separates the dollars from the cents is present. The decimal points must be vertically aligned when possible.

Example:

12 Real Estate --------	12.	495.00
13 General Sales ------	13.	
14 Personal Property --	14.	198.00

or

12 Real Estate --------	(12)	496.00
13 General Sales -------	(13)	
14 Personal Property --	(14)	198.00

.05 *Sequence Numbers.*

1 Please note that certain forms have a newly added "sequence number" located in the upper right hand corner of official forms. On computer-generated forms, place this sequence number following the year designation for the tax form and separate with an asterisk. (Example. 1980 * 08)

2 The affected forms and their respective sequence numbers follow:

Please note that some of the numbers have been changed since the 1979 tax forms.

Form 1040 Schedule/Form	*Sequence Number*
A	08
C	09
D	15
E	16
F (front)	17
F (reverse)	18
G	21
R and RP	22
SE	23
2119	25
2440	26
2441	27
2555	36
3468	28
4136	29
4136-T	29
4625	30
4726	31
5329	32
5695	34
6251	35

.06 *Multiple Page Forms.* With the exceptions noted above, when printing multiple page forms and no entries are present in an entire section of the form, you may omit printing the line numbers, captions, etc. by following these rules:

1 the section title/description must be printed

2 skip one blank line following the title/description

3 on the second print line print the following statement: SECTION/PART XX DOES NOT APPLY

4 skip one blank line, and

5 begin the next section.

Sec. 18. Additional Instructions for All Forms

.01 Internal control numbers and identifying symbols of the computer preparer may be shown on the substitute, if the use of such numbers or symbols is acceptable to the taxpayer and the taxpayer's representative. If shown, such information *must not* be printed in the top one-half inch clear area, from the center to the right edge, of any form or schedule requiring a signature.

With the exception of the actual tax return form (i.e., Forms 1040, 1120, 940, 941, etc.) you may also print in the left vertical and bottom left margins. The bottom left margin you may use extends 3½ inches from the left edge of the form.

.02 Descriptions for captions, lines, etc., appearing on the substitute forms may be limited to one print line by using abbreviations and contractions and by omitting articles, prepositions, etc. However, sufficient key words must be retained to permit ready identification of the caption, line or item.

1 Explanatory details and/or intermediate calculations for derivation of final line totals, may be included on the substitute. We prefer that such calculations be submitted in the form of a supporting statement. If intermediate calculations are included on the substitute, the lines on which they appear may not be numbered or lettered. Intermediate calculations may not be printed in the right column. This column is reserved for official numbered and lettered lines that correspond to the ones on the official form. If a supporting statement is submitted, intermediate calculations or subtotals may be formatted at the preparer's option.

All supporting statements submitted must be referenced to the schedule entry which it supports, and the entry on the schedule, in turn, must be cross-referenced to the supporting statement. However, all total lines on supporting forms must have a total printed. This total must be carried forward from any supporting statements.

2 Text prescribed for the official form, which is solely instructional in nature, e.g., "Attach this schedule to Form 1040," "See instructions," etc., may be omitted from the substitute form.

3 Information for more than one schedule *may not* be shown on the same printout page without prior approval from the Service. Except for computer-generated Schedules A and B (Form 1040), any form may be continued on two or more pages if necessary. When a form is continued on two or more pages, clearly identify at the bottom of each page, including page 1, that it is continued, e.g., "page 1, Schedule C continued." **It is strongly recommended that a substitute form not exceed the same number of pages used for the official form.**

4 Identify all computer-prepared substitutes clearly; print the form designation one-half inch from the top margin and one and one-half inches from the left margin; print the title centered on the first line of print; and print the taxable year and, where applicable, the sequence number on the same line one-half to one inch from right margin. Include the taxpayer's name and SSN on all forms and attachments.

5 State tax information must not appear on the federal tax return which is filed with the Internal Revenue Service Center, except where amounts are claimed as a state tax deduction, e.g., line 11, Schedule A (Form 1040).

The state column may be present, but the state tax information must NOT be visible on the copy filed with the Service. When a form is designed with both federal and state columns, *THE FEDERAL COLUMN MUST BE TO THE LEFT OF THE STATE COLUMN AND ADJACENT TO THE LINE CAPTION.*

6 Use the preaddressed label supplied with the taxpayer's tax package on all computer-prepared substitute forms that will be filed with the Service. Use of the label avoids larger processing costs because it reduces the potential for error—the kind of error which can delay the receipt of refund and information needed by the taxpayer.

7 When filing substitute computer-prepared or computer-generated schedules, use the envelope enclosed with the taxpayer's tax package. This envelope is coded for sorting into several categories. Use of the coded envelope can help speed up the processing of the return and reduce processing costs. Use of the Service provided tax package envelope for other correspondence with the Service could delay the correspondence.

8 Attach all schedules in alphabetical order and forms in numerical order followed by supporting statements. The sequence of information on supporting statements must be the same order as the items appear on the form(s) to which it is referenced.

9 Additional information required or voluntarily submitted should be on the same size paper as the official form and attached to the return following the supporting statements.

10 Attach all payments (checks or money order, no cash) to the front of the tax return.

11 Reproductions must have a high standard of legibility, both as to original form and as to fill-in matter. The Service reserves the right to reject any computer-generated or computer-prepared substitutes or related forms that have poor legibility or that do not meet the specifications of this revenue procedure.

SEC. 19. FILING SUBSTITUTE FORMS WITH IRS

Follow the same instructions as for filing official forms. These instructions are in the taxpayer's tax package.

SEC. 20. EFFECT ON OTHER DOCUMENTS

This revenue procedure supersedes Rev. Proc. 79-58, 1979-2 C.B. 549.

SEC. 21. EXHIBITS SECTION

Exhibit CG-A1 (Schedule A—Preferred Format)

```
SCHEDULE A (FORM 1040)     ITEMIZED DEDUCTIONS                         1980 * 08

JOHN Q. & MARY J. TAXPAYER                                       SSN 000-00-0000
********************************************************************************
**** MEDICAL AND DENTAL EXPENSES ****    | ********** CONTRIBUTIONS *********
                                         | 21A CASH CONTRIB.. 21A.  00,000.00
1  1/2 INSURANCE PREM.   1.  00,000.00   |     (WITH RECEIPTS)
                                         | 21B OTHER CASH.... 21B.
2  MEDICINE & DRUGS .... 2.              |     (NO RECEIPTS)
3  1% OF LINE 31, 1040.. 3.              |   LIST DONEES & AMTS
4  LINE 2 LESS LINE 3... 4.              |  1ST ]
                                         |  2ND |
5  BALANCE OF INS PREM.. 5.              |  3RD }    OR SEE STATEMENT XX
                                         |  4TH |
6  OTHER MEDICAL & DENT.                 |  5TH |
   (A) DOCTORS, DENT... 6A.              |  6TH ]
   (B) HOSPITALS ...... 6B.              | 22 OTHER THAN CASH. 22.
   (C) OTHER (ITEMIZE)                   |  SEE STATEMENT XX
1ST ["OTHER" ITEM....... 6C.             | 23 CARRY OVER...... 23.
2ND |                                    | 24 TOTAL CONTRIB... 24.
3RD |                                    |
4TH } OR SEE STATEMENT XX                | ***** CASUALTY, THEFT LOSS  ******
5TH |                                    | 25 LOSS BEFORE INS. 25.
6TH |                                    | 26 INSUR. REIMBURSE 26.
7TH ]                                    | 27 L 25 LESS L 26.. 27.
7  TOTAL (4 THRU 6C).... 7.              | 28 $100 OR L27..... 28.
8  3% OF LINE 31, 1040.. 8.              |
9  LINE 7 LESS LINE 8... 9.              | 29 TOTAL LOSS ..... 29.
                                         |
                                         | ******* MISC. DEDUCTIONS *********
                                         | 30 UNION DUES...... 30.
10 TOTAL ( LINES 1+9)    10.  00,000.00  | 31 OTHER (ITEMIZE). 31.
                                         |  1ST ]
****** TAXES *************************   |  2ND |
11 ST & LOCAL INCOME... 11.              |  3RD |
12 REAL ESTATE......... 12.              |  4TH |
13 GENERAL SALES....... 13.              |  5TH }     OR SEE STATEMENT XX
14 PERSONAL PROPERTY... 14.              |  6TH |
15 OTHER (ITEMIZE)      15.              |  7TH |
   1ST ]OTHER...........                 |  8TH |
   2ND } OR SEE STATEMENT XX             |  9TH |
   3RD ]                                 |  10TH|
16 TOTAL TAXES ........ 16.              |  11TH]
** INTEREST EXPENSE *****************    | 32  TOTAL MISC DED..32.
17  HOME MORTGAGE...... 17.              |************************************
18  CREDIT & CHG CARDS. 18.              |
19 OTHER (ITEMIZE)..... 19.              | 39 TOTAL DEDUCTIONS.39.
  1ST ]ITEM                              |
  2ND |                                  | 40 ZERO BRACKET AMT.40.
  3RD }    OR SEE STATEMENT XX           |
      ]                                  |
                                         | 41 L 40 LESS L 39...41.
                                         |
20 TOTAL INTEREST ..... 20.              |
```

Exhibit CG-A2 (Schedule A—Acceptable Format)

```
SCHEDULE A-1040             ITEMIZED DEDUCTIONS                1980 * 08

JOHN W. & MARY J. TAXPAYER                            SSN 000-00-0000
**************************************************************************
***** MEDICAL AND DENTAL EXPENSES *********************************** FEDERAL
  1  ONE HALF MED INS PREM ....................................... 1. 000,000.00
  2  MEDICINE & DRUGS ............................................ 2.
  3  1% L31 1040 ................................................. 3.
  4  L2 LESS L3 .................................................. 4.
  5  BAL INS PREMS ............................................... 5.
  6  OTHER MED & DENT EXP
   A DOCTORS, DENTISTS, ETC. .................................... 6A.
   B HOSPITALS .................................................. 6B.
   C OTHER (ITEMIZE) - SEE STATEMENT XX ......................... 6C.
  7  ADD LN 4 THRU LN 6C.......................................... 7.
  8  3% L31 1040 ................................................. 8.
  9  L7 LESS L8 .................................................. 9.
 10  TOTAL MED L7 PLUS L9 ........................................ 10.

*****  TAXES  ************************************************************
 11  ST & LOCAL INCOME ........................................... 11.
 12  REAL ESTATE ................................................. 12.
 13  GENL SALES .................................................. 13.
 14  PERS PROP ................................................... 14.
 15  OTHER (ITEMIZE)- SEE STATEMENT XX ........................... 15.
 16  TOTAL TAXES (ADD L11 THRU L15) .............................. 16.

*****  INTEREST EXPENSE  ************************************************
 17  HOME MTG .................................................... 17.
 18  CREDIT & CHG CARDS .......................................... 18.
 19  OTHER (ITEMIZE) -SEE STATEMTMENT XX ......................... 19.
 20  TOTAL INTEREST EXPENSE (ADD L17 THRU L19) ................... 20.

*****  CONTRIBUTIONS  ***************************************************
21A  TOTAL CASH .................................................. 21A.
21B  TOTAL OTHER CASH (ITEMIZE) -SEE STATEMENT XX ................ 21B.
22   OTHER THAN CASH - SEE STATEMENT XX .......................... 22.
23   CARRYOVER ................................................... 23.
24   TOTAL CONTRIBUTIONS (ADD L21A THRU L23) ..................... 24.

*****  CASUALTY OR THEFT LOSS    ****************************************
25   LOSS BEFORE INSURANCE REIMBURSMENT........................... 25.
26   INSURANCE REIMBURSEMENT...................................... 26.
27   L25 LESS L26 ................................................ 27.
28   SMALLER OF $100 or L27 ...................................... 28.
29   TOTAL CASUALTY OR THEFT LOSS (L27 LESS L28) ................. 29.

*****  MISCELLANEOUS DEDUCTIONS******************************************
30   UNION DUES................................................... 30.
31   OTHER MISC-SEE STMNT A8 ..................................... 31.
32   TOT MISC DED (L30 PLUS L31) ................................. 32.
**************************************************************************
39   TOTAL ITEM DEDUCTIONS - SUM OF L10,16,20,24,29,32 ...... 39.

40   ZERO BRACKET AMOUNT ......................................... 40.

41   EXCESS ITEMIZED DEDUCTIONS (L39 LESS L40) .............. 41.  000,000.00
```

Exhibit CG-B1 (Schedule B—Preferred Format)

```
SCHEDULE B (FORM 1040)  DIVIDEND AND INTEREST INCOME                 1980

JOHN Q. & MARY J. TAXPAYER                                  SSN 000-00-0000
***************************************************************************
PART I  INTEREST INCOME                   PART II  DIVIDEND INCOME

1 IF YOU RECEIVED MORE THAN $400 IN      3 GROSS DIVIDENDS (INCLUDING CAPITAL
  INTEREST, COMPLETE PARTS I AND III       GAIN DISTRIBUTIONS) AND OTHER
                                           DISTRIBUTIONS ON STOCK.

          NAME OF PAYER          AMOUNT          NAME OF PAYER            AMOUNT
(1ST PAYER)                   00,000.00   (1ST PAYER)                  00,000.00
(2ND PAYER) } OR SEE STATEMENT XX         (2ND PAYER) } OR SEE STATEMENT XX
(3RD PAYER)                               (3RD PAYER)




  2  TOTAL INTEREST INCOME 2.

  PART III  FOREIGN ACCOUNTS & TRUSTS
                                          4  TOTAL OF LINE 3 . 4.
  A   AT ANY TIME DURING THE YEAR         5  CAPITAL GAIN
      DID YOU HAVE ANY INTEREST, SIG-        DISTRIBUTIONS ... 5.
      NATURE AUTHORITY OVER A BANK,
      SECURITIES, OR FINANCIAL AC-         6  NONTAXABLE DIS-. 6.
      COUNT IN A FOREIGN COUNTRY...(ANS)     TRIBUTIONS

  B   WERE YOU GRANTOR,TRANSFEROR          7  TOTAL LN 5+LN 6  7.
      IN CURRENT TAX YEAR TO FOREIGN
      TRUST WHETHER OR NOT IT WAS TO       8  DIVIDENDS        8.  00,000.00
      YOUR BENEFIT?................(ANS)     BEFORE EXCLUSION
```

Exhibit CG-B2 (Schedule B—Acceptable Format)

```
SCHEDULE B (FORM1040)   DIVIDEND AND INTEREST INCOME                    1980

JOHN Q. & MARY J. TAXPAYER                                  SSN 000-00-0000
***************************************************************************
PART I  INTEREST INCOME

1  IF YOU RECEIVED MORE THAN $400 IN
   INTEREST, COMPLETE PARTS I

         NAME OF PAYER                                                AMOUNT

                                                                   00,000.00
(1ST PAYER)
(2ND PAYER)  }  OR SEE STATEMENT XX
(3RD PAYER)




2  TOTAL INTEREST INCOME                                      2.   00,000.00

***************************************************************************
PART II  DIVIDEND INCOME

3  GROSS DIVIDENDS (INCLUDING CAPITAL GAIN DISTRIBUTIONS) AND OTHER
   DISTRIBUTIONS ON STOCK.

         NAME OF PAYER                                               AMOUNT

(1ST PAYER)                                                       00,000.00
(2ND PAYER)  }  OR SEE STATEMENT XX
(3RD PAYER)




4.  TOTAL ALL ITEMS FOR LINE 3                               4.
5.  CAPITAL GAIN                                             5.
6.  NONTAXABLE DISTRIBUTIONS                                 6.
7.  TOTAL LINES 5 AND 6                                      7.
8.  DIVIDENDS BEFORE EXCLUSION  LN 4 LESS LN 7               8.  00,000.00

***************************************************************************
PART III  FOREIGN ACCOUNTS & TRUSTS

A  AT ANYTIME DURING THE YEAR DID YOU HAVE ANY INTEREST,         (ANS)
   SIGNATURE AUTHIORITY OVER A BANK ACCOUNT,SECURITIES
   ACCOUNT OR OTHER FINANCIAL ACCOUNT IN A FOREIGN COUNTRY?

B  WERE YOU THE GRANTOR OF, OR TRANSFEROR TO, A FOREIGN TRUST     (ANS)
   DURING CURRNT TAX YEAR WHETHER OR NOT IT WAS TO YOUR BENEFIT.
```

Exhibit CG-C (Schedule C—Page 1)

```
SCHEDULE C       PROFIT (OR LOSS) FROM BUSINESS OR PROFESSION        1980 * 09
(FORM 1040)                  (SOLE PROPRIETORSHIP)

JOHN Q. & MARY J. TAXPAYER                                     SSN  000-00-0000
*******************************************************************************
A MAIN BUSINESS ACTIVITY: SALES REPRESENTATIVE     PRODUCT: MACHINE TOOLS
B BUSINESS NAME:    MY COMPANY
C EMPLOYER ID NO.:  00-0000000
D BUSINESS ADDRESS:  1 SOUTH MAIN ST.
  CITY STATE & ZIP:  WASHINGTON, DC 12345
E ACCOUNTING METH.:  (1)  XX CASH
F METHOD(S) USED TO VALUE CLOSING INVENTORY:
  (1) X COST
G WAS THERE ANY SUBSTANTIAL CHANGE IN THE METHOD OF VALUATION ?        (ANS)
H DID YOU DEDUCT EXPENSES FOR OFFICE IN HOME ?                         (ANS)
I DID YOU CLAIM AMORT. OR DEPREC. FOR REHAB. HISTORIC STRUCTURE ?      (ANS)
*******************************************************************************
PART I-INCOME:
1 A GROSS RECEIPTS OR SALES ..................................1A.  0,000,000.
  B RETURNS AND ALLOWANCES ...................................1B.
  C BALANCE (LINE 1A LESS LINE 1B) ...........................1C.
2 COSTS OF GOODS SOLD AND/OR OPERATIONS ..................... 2.
3 GROSS PROFIT (LINE 1C LESS LINE 2) ........................ 3.
4 OTHER INCOME  - SEE STATEMENT XX .......................... 4.
5 TOTAL INCOME (ADD LINES 3 AND 4) .......................... 5.  0,000,000.
*******************************************************************************
PART II-DEDUCTIONS:
 6 ADVERTISING ........... 0,000,000. 31A WAGES .............     0,000,000.
 7 AMORTIZATION  .........              B JOBS CREDIT .......
 8 BAD DEBTS .............              C WIN CREDIT  .......
 9 BANK CHARGES  .........              D TOTAL CREDITS .....
10 CAR/TRUCK EXPENSES ....              E 31A LESS 31D  .....
11 COMMISSIONS ...........            32 OTHER EXPENSES (SPECIFY)
12 DEPLETION .............              A  ┐
13 DEPRECIATION (SEE C-2).              B  │
14 DUES AND PUBLICATIONS .              C  │
15 EMPLOYEE BENEFIT PROGMS              D  │
16 FREIGHT (NOT ON C-1)...              E  │
17 INSURANCE .............              F  │
18 INTEREST ON BUS. INDEBT              G  │
19 LAUNDRY AND CLEANING .               H  │
20 LEGAL/PROF'L SERVICES                I  │
21 OFFICE SUPPLIES .......              J  ├ OR SEE STATEMENT XX
22 PENSION/PROFIT SHARING               K  │
23 POSTAGE ...............              L  │
24 RENT ON BUSINESS PROP.               M  │
25 REPAIRS ...............              N  │
26 SUPPLIES (NOT ON C-1) .              O  │
27 TAXES .................              P  │
28 TELEPHONE .............              Q  │
29 TRAVEL AND ENTERTAINMNT              R  │
30 UTILITIES .............              S  ┘
*******************************************************************************
33 TOTAL DEDUCTIONS (ADD COLS. 6 THROUGH 32S) ............  33.
34 NET PROFIT (OR LOSS) (LINE 5 LESS LINE 33).............  34.  0,000,000.
35 IF LOSS, DO YOU HAVE AMTS IN THIS BUSINESS NOT AT RISK?  (ANS)

SCHEDULE C CONTINUED ON NEXT PAGE
```

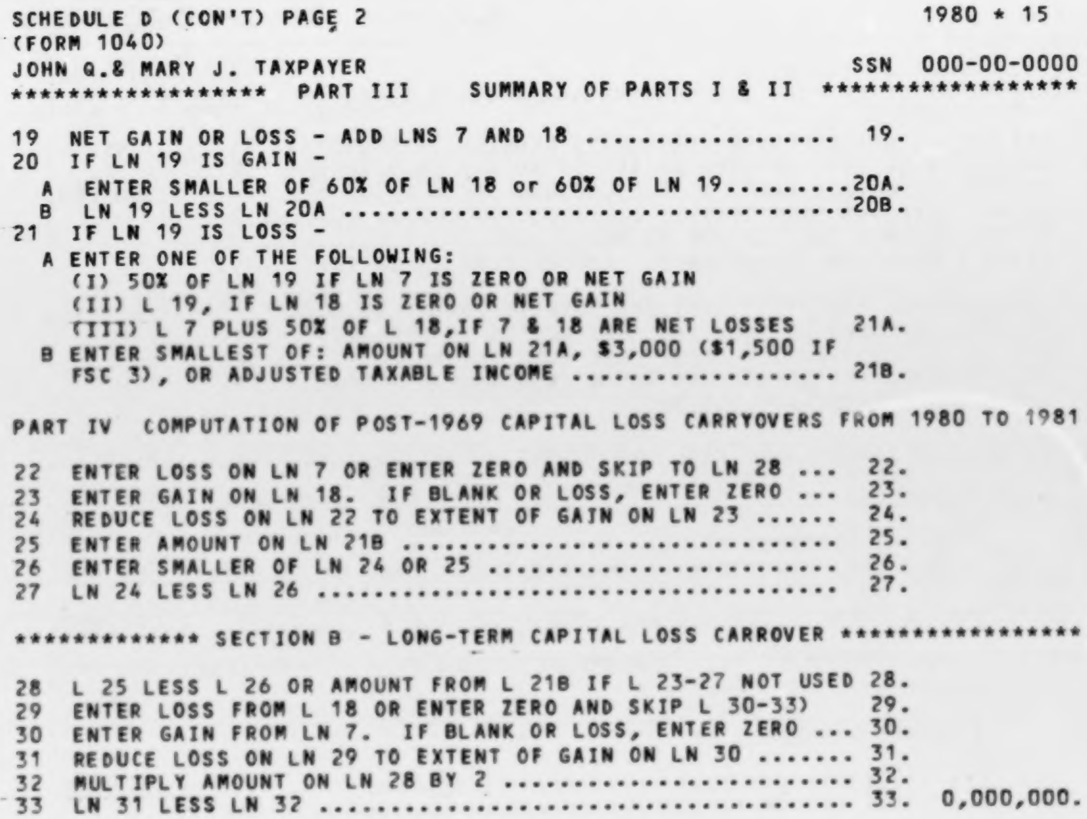
Exhibit CG-C (Schedule C—Page 2)

```
SCHEDULE C  (CONT'D)  PAGE 2                                               1980 * 09
(FORM 1040)
JOHN Q. & MARY J. TAXPAYER                                               SSN 123-45-6789

*****  SCHEDULE C-1     COST OF GOODS SOLD AND/OR OPERATIONS   ***************
1  INVENTORY AT BEGINNING OF YEAR (EXPLAIN IF NOT 1980).  1.       0,000,000.
2A PURCHASES .........................................  2A.
2B COST OF ITEMS WITHDRAWN ...........................  2B.
2C BALANCE (LINE 2A LESS LINE 2B) ....................  2C.
3  COST OF LABOR (DO NOT INCLUDE OWN SALARY) .........  3.
4  MATERIALS AND SUPPLIES ............................  4.
5  OTHER COSTS (SEE STATEMENT XX).....................  5.
6  ADD LINES 1, 2C, AND 3 THROUGH 5 ..................  6.
7  INVENTORY AT END OF YEAR ..........................  7.
8  COST OF GOODS AND/OR OPERATIONS (LN 6 LESS LN 7) ....  8.

*****  SCHEDULE C-2 - DEPRECIATION  ******************************************
DESCRIPTION OF PROP.      DATE   COST OR   DEPRECIA-  METHOD  LIFE   DEPRECIA-
                          ACQ.   BASIS     TION PRIOR         /RATE  TION 1980
        (A)               (B)    (C)         (D)       (E)     (F)     (G)
1  TOTAL ADDITIONAL FIRST YEAR DEPRECIATION ....................  0,000,000.
2  OTHER DEPRECIATION .........................................................
   BUILDINGS ..........2/80  0,000,000.  0,000,000.  SL       R    0,000,000.
   FURN & FIXTURES .....
   TRANS. EQUIP.........  OR SEE STATEMENT XX          TYPE OF METHOD MUST
   MACHINERY/EQUIP......                               BE HERE IN ORDER TO
   OTHER (SPECIFY) .....                               USE STATEMENT OPTION

3 TOTALS ..................  0,000,000.                      3.
4 DEPRECIATION IN C-1.......................................4.
5 BALANCE, ENTER ON PART II, LINE 13                         5.     0,000,000.

     ENTER INFORMATION FOR YOURSELF AND 5 HIGHEST PAID EMPLOYEES. TO DETERMINE
     HIGHEST PAID EMPLOYEES, ADD EXPENSE ACCT. TO SALARIES AND WAGES.
                 NAME                        EXP. ACCOUNT      SALARIES/WAGES
                 (A)                             (B)                (C)
     OWNER ..............................    0,000,000.         0,000,000.
1    1ST HIGHEST PAID EMPLOYEE'S NAME
2    2ND
3    3RD                                  OR SEE STATEMENT XX
4
5
     DID YOU CLAIM A DEDUCTION FOR EXPENSES CONNECTED WITH:          YES  NO
A    ENTERTAINMENT FACILITY (BOAT, RESORT, RANCH, ETC.) ...............
B    LIVING ACCOMODATIONS (EXCEPT EMPL. ON BUSINESS) ..................
C    CONVENTIONS OR MEETINGS OUTSIDE THE UNITED STATES ................
D    EMPLOYEES' FAMILIES AT CONVENTIONS/MEETINGS ......................
     IF YES, WERE ANY OUTSIDE OF U.S. OR POSSESSIONS ..................
E    VACATIONS FOR EMPLOYEES AND FAMILIES NOT ON W-2 ..................
```

Exhibit CG-D (Schedule D—Page 1)

```
SCHEDULE D
(FORM 1040)                    CAPITAL GAINS AND LOSSES                 1980 * 15
JOHN Q. & MARY J. TAXPAYER
********************************************************************SSN 000-00-0000
*************** PART I - SHORT-TERM CAPITAL GAINS AND LOSSES ***************
      (A)          (B)    (C)       (D)           (E)          (F)         (G)
1  KIND OF        DATE   DATE      GROSS        COST OR     LOSS: (E)    GAIN: (D)
   PROPERTY       ACQ.   SOLD   SALE PRICE       BASIS       LESS (D)     LESS  (E)
 1ST PROP      ┐ 2/80   6/80   0,000,000.   0,000,000.   0,000,000.   0,000,000.
 2ND           │
 3RD           }   OR SEE STATEMENT XX
               ┘

2  GAIN FROM SALE/EXC RES.HELD 1 YEAR OR LESS  2. XXXXXXXXXX    0,000,000.


3  YOUR SHARE OF NET S-TERM GAIN PARTN/FUDIC..  3.  0,000,000.   0,000,000.
4   ADD LN 1, 2, 3, COLS F & G ................ 4.
5   COMBINE LN 4, COLS F & G ............................... 5.
6   SHORT TERM GAIN OR (LOSS) CARRYOVER (AFTER 1969)     ... 6.
7   NET ST GAIN OR LOSS  ADD LNS 5 & 6...................... 7.   0,000,000.


*************** PART II - LONG-TERM CAPITAL GAINS AND LOSSES ***************
8 1ST PROP    ┐ 2/80  7/80   0,000,000.  0,000,000.  0,000,000.   0,000,000.
  2ND         │
              }─ OR SEE STATEMENT XX
              │
              ┘
9  GAINS FROM SALE/EXC RES. HELD OVER 1 YEAR.. 9. XXXXXXXXXX    0,000,000.


10  YOUR SHARE OF NET L-TERM GAIN/LOSS ....... 10.  0,000,000.   0,000,000.
    PARTNERSHIP, FIDUCIARY
11  ADD LNS 8, 9 & 10, COLS F & G ............ 11.
12  ADD LN 11 COL F & G, ENTER GAIN OR LOSS .............. 12.
13  CAPITAL GAIN DISTRIBUTIONS ........................... 13.
14  GAIN FROM FORM 4797 .................................. 14.
15  YOUR SHARE NET L-TERM GAIN FROM S-BUSINESS CORP....... 15.
16  ADD LNS 12 THRU 15 ................................... 16.
17  L-TERM CAPITAL LOSS CARRYOVER AFTER 1969 ............. 17.
18  NET L-TERM GAIN OR (LOSS)  ADD LNS 16 AND 17 ......... 18.   0,000,000.


SCHEDULE D CONTINUED ON PAGE 2
```

Exhibit CG-D (Schedule D—Page 2)



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SCHEDULE D (CON'T) PAGE 2                                        1980 * 15
(FORM 1040)
JOHN Q.& MARY J. TAXPAYER                                     SSN  000-00-0000
******************  PART III    SUMMARY OF PARTS I & II  ******************

19   NET GAIN OR LOSS - ADD LNS 7 AND 18 ..................  19.
20   IF LN 19 IS GAIN -
  A   ENTER SMALLER OF 60% OF LN 18 or 60% OF LN 19.........20A.
  B   LN 19 LESS LN 20A ....................................20B.
21   IF LN 19 IS LOSS -
  A  ENTER ONE OF THE FOLLOWING:
     (I) 50% OF LN 19 IF LN 7 IS ZERO OR NET GAIN
     (II) L 19, IF LN 18 IS ZERO OR NET GAIN
     (III) L 7 PLUS 50% OF L 18,IF 7 & 18 ARE NET LOSSES    21A.
  B  ENTER SMALLEST OF: AMOUNT ON LN 21A, $3,000 ($1,500 IF
     FSC 3), OR ADJUSTED TAXABLE INCOME ................... 21B.

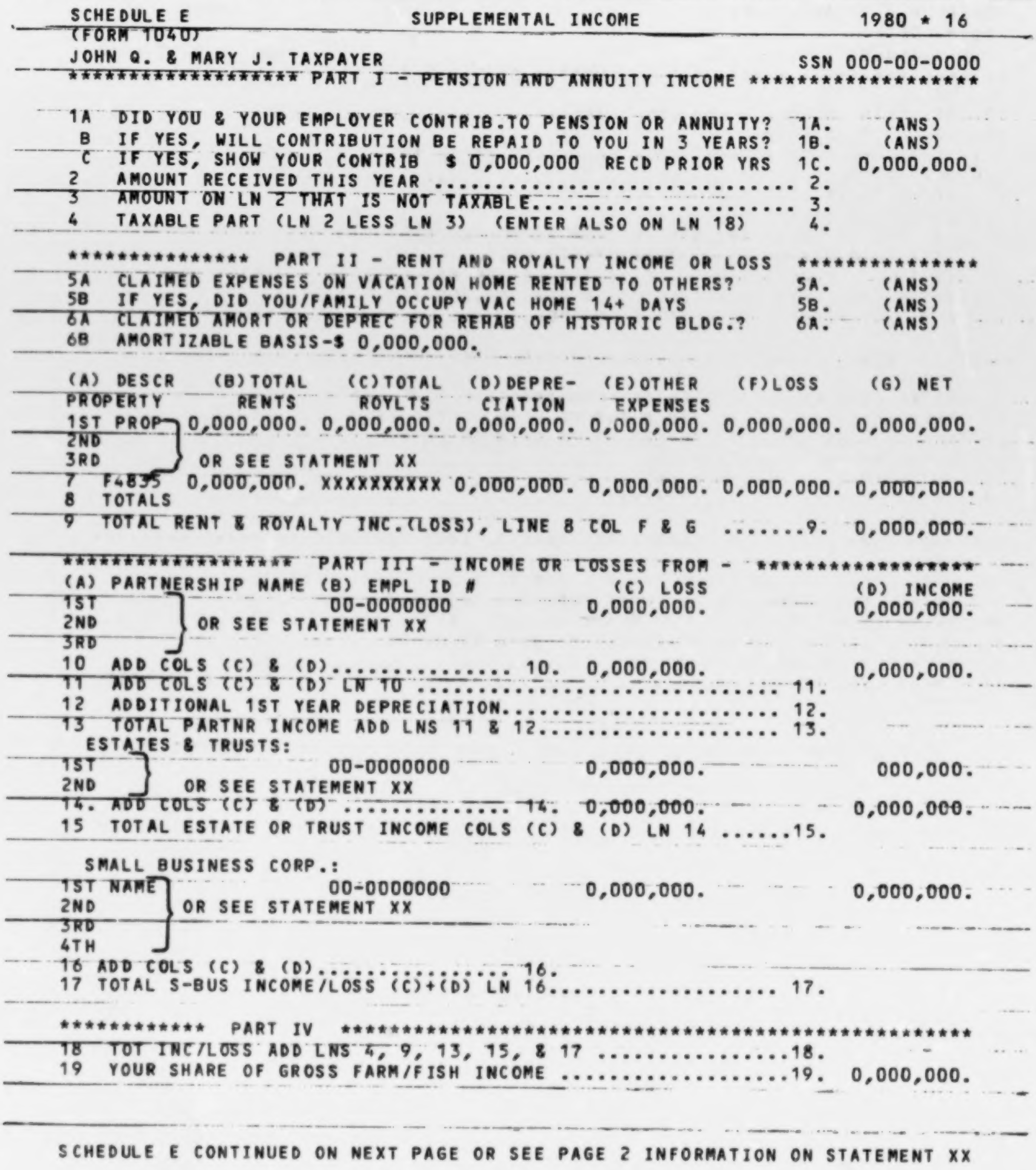
PART IV  COMPUTATION OF POST-1969 CAPITAL LOSS CARRYOVERS FROM 1980 TO 1981

22   ENTER LOSS ON LN 7 OR ENTER ZERO AND SKIP TO LN 28 ...  22.
23   ENTER GAIN ON LN 18.  IF BLANK OR LOSS, ENTER ZERO ...  23.
24   REDUCE LOSS ON LN 22 TO EXTENT OF GAIN ON LN 23 ......  24.
25   ENTER AMOUNT ON LN 21B ...............................  25.
26   ENTER SMALLER OF LN 24 OR 25 .........................  26.
27   LN 24 LESS LN 26 .....................................  27.

************* SECTION B - LONG-TERM CAPITAL LOSS CARROVER ****************

28   L 25 LESS L 26 OR AMOUNT FROM L 21B IF L 23-27 NOT USED 28.
29   ENTER LOSS FROM L 18 OR ENTER ZERO AND SKIP L 30-33)    29.
30   ENTER GAIN FROM LN 7.  IF BLANK OR LOSS, ENTER ZERO ... 30.
31   REDUCE LOSS ON LN 29 TO EXTENT OF GAIN ON LN 30 ....... 31.
32   MULTIPLY AMOUNT ON LN 28 BY 2 ......................... 32.
33   LN 31 LESS LN 32 ...................................... 33.  0,000,000.
```

Exhibit CG-E (Schedule E—Page 1)



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SCHEDULE E                      SUPPLEMENTAL INCOME                       1980 * 16
(FORM 1040)
JOHN Q. & MARY J. TAXPAYER                                            SSN 000-00-0000
******************** PART I - PENSION AND ANNUITY INCOME ********************

1A  DID YOU & YOUR EMPLOYER CONTRIB.TO PENSION OR ANNUITY?  1A.    (ANS)
 B  IF YES, WILL CONTRIBUTION BE REPAID TO YOU IN 3 YEARS?  1B.    (ANS)
 C  IF YES, SHOW YOUR CONTRIB  $ 0,000,000  RECD PRIOR YRS  1C.  0,000,000.
2   AMOUNT RECEIVED THIS YEAR ................................ 2.
3   AMOUNT ON LN 2 THAT IS NOT TAXABLE........................ 3.
4   TAXABLE PART (LN 2 LESS LN 3)  (ENTER ALSO ON LN 18)       4.

***************  PART II - RENT AND ROYALTY INCOME OR LOSS  ****************
5A  CLAIMED EXPENSES ON VACATION HOME RENTED TO OTHERS?      5A.    (ANS)
5B  IF YES, DID YOU/FAMILY OCCUPY VAC HOME 14+ DAYS          5B.    (ANS)
6A  CLAIMED AMORT OR DEPREC FOR REHAB OF HISTORIC BLDG.?     6A.    (ANS)
6B  AMORTIZABLE BASIS-$ 0,000,000.

(A) DESCR    (B)TOTAL    (C)TOTAL   (D)DEPRE-  (E)OTHER    (F)LOSS    (G) NET
PROPERTY       RENTS      ROYLTS     CIATION    EXPENSES
1ST PROP   0,000,000. 0,000,000. 0,000,000. 0,000,000. 0,000,000. 0,000,000.
2ND
3RD          OR SEE STATMENT XX
7  F4835   0,000,000. XXXXXXXXXX 0,000,000. 0,000,000. 0,000,000. 0,000,000.
8  TOTALS
9  TOTAL RENT & ROYALTY INC.(LOSS), LINE 8 COL F & G   .......9.  0,000,000.

******************** PART III - INCOME OR LOSSES FROM -  ******************
(A) PARTNERSHIP NAME (B) EMPL ID #            (C) LOSS                (D) INCOME
1ST                     00-0000000           0,000,000.               0,000,000.
2ND               OR SEE STATEMENT XX
3RD
10   ADD COLS (C) & (D)............... 10.  0,000,000.               0,000,000.
11   ADD COLS (C) & (D) LN 10 ............................... 11.
12   ADDITIONAL 1ST YEAR DEPRECIATION........................ 12.
13   TOTAL PARTNR INCOME ADD LNS 11 & 12..................... 13.
  ESTATES & TRUSTS:
1ST                     00-0000000           0,000,000.                 000,000.
2ND              OR SEE STATEMENT XX
14. ADD COLS (C) & (D) ............... 14.   0,000,000.               0,000,000.
15   TOTAL ESTATE OR TRUST INCOME COLS (C) & (D) LN 14 ......15.

  SMALL BUSINESS CORP.:
1ST NAME                00-0000000           0,000,000.               0,000,000.
2ND              OR SEE STATEMENT XX
3RD
4TH
16 ADD COLS (C) & (D)................. 16.
17 TOTAL S-BUS INCOME/LOSS (C)+(D) LN 16.................... 17.

*************  PART IV  ****************************************************
18   TOT INC/LOSS ADD LNS 4, 9, 13, 15, & 17 .................18.
19   YOUR SHARE OF GROSS FARM/FISH INCOME ....................19.  0,000,000.


SCHEDULE E CONTINUED ON NEXT PAGE OR SEE PAGE 2 INFORMATION ON STATEMENT XX
```
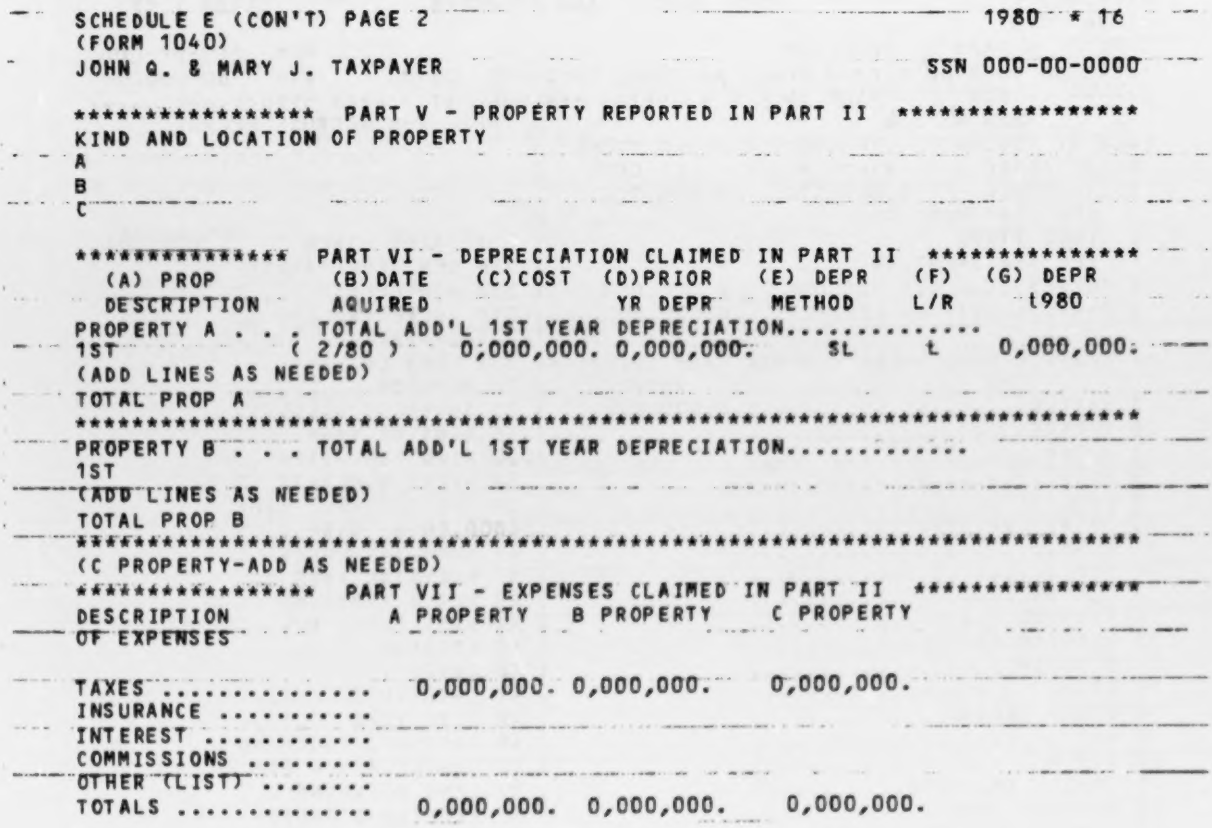

Exhibit CG-E (Schedule E—Page 2)



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SCHEDULE E (CON'T) PAGE 2                                           1980  * 16
(FORM 1040)
JOHN Q. & MARY J. TAXPAYER                                       SSN 000-00-0000

******************  PART V - PROPERTY REPORTED IN PART II  ******************
KIND AND LOCATION OF PROPERTY
A
B
C

****************  PART VI - DEPRECIATION CLAIMED IN PART II  ****************
  (A) PROP         (B)DATE   (C)COST  (D)PRIOR   (E) DEPR   (F)  (G) DEPR
  DESCRIPTION      AQUIRED            YR DEPR    METHOD     L/R     t980
PROPERTY A . . . TOTAL ADD'L 1ST YEAR DEPRECIATION..............
1ST           ( 2/80 )    0,000,000. 0,000,000.     SL       t    0,000,000.
(ADD LINES AS NEEDED)
TOTAL PROP A
****************************************************************************
PROPERTY B . . . TOTAL ADD'L 1ST YEAR DEPRECIATION.............
1ST
(ADD LINES AS NEEDED)
TOTAL PROP B
****************************************************************************
(C PROPERTY-ADD AS NEEDED)
*****************  PART VII - EXPENSES CLAIMED IN PART II  ****************
DESCRIPTION              A PROPERTY   B PROPERTY    C PROPERTY
OF EXPENSES

TAXES ...............   0,000,000. 0,000,000.    0,000,000.
INSURANCE ...........
INTEREST ............
COMMISSIONS .........
OTHER (LIST) ........
TOTALS ..............   0,000,000.  0,000,000.    0,000,000.
```

Exhibit CG-F (Schedule F—Page 1)

```
SCHEDULE F                 FARM INCOME  AND EXPENSES               1980 * 17
(FORM 1040)
JOHN Q. & MARY J. TAXPAYER                                     SSN  000-00-0000
AMERICAN FARM 0000 FARM ROAD, ANYTOWN, ANYSTATE  00000        EIN   00-0000000
********* PART I - FARM INCOME ************* PART II - FARM DEDUCTIONS *****
        CASH METHOD                         |  CASH AND ACCRUAL METHOD
SALE OF PURCHASED LIVESTOCK & OTHER ITEMS   |
(A) DESCRIBE      (B)AMT REC'D   (C) COST   |
 1 LIVESTOCK      0,000,000.   0,000,000.   |
   SEE STATEMENT XX                         |
 2 OTHER ITEMS                              | 33A LABOR HIRED ....0,000,000.
   SEE STATEMENT XX                         | 33B NEW JOBS CREDIT
 3 TOTALS........0,000,000.    0,000,000.   | 33C WIN CREDIT .....
 4 PROFIT(LOSS) L3 LESS L3C    0,000,000.   | 33D TOTAL CREDITS ..
                                            | 33E BALANCE ........
** LVSTK & PROD SALES + OTHER FARM INCOME** | 33A LESS LN 33D) ...
        KIND                        AMOUNT  | 34 REPAIRS .........
 5 CATTLE.................... 0,000,000.    | 35 INTEREST ........
 6 CALVES....................               | 36 RENT OF FARM ....
 7 SHEEP.....................               | 37 FEED PURCHASED ..
 8 SWINE ....................               | 38 SEEDS & PLANTS ..
 9 POULTRY...................               | 39 FERTILIZERS, LIME
10 DAIRY PRODUCTS............               | 40 MACHINE HIRE ....
11 EGGS......................               | 41 SUPPLIES PURCH ..
12 WOOL......................               | 42 BREEDING FEES ...
13 COTTON....................               | 43 VET & MEDICINE ..
14 TOBACCO...................               | 44 GAS, FUEL, OIL ..
15 VEGETABLES................               | 45 STORAGE .........
16 SOYBEANS..................               | 46 TAXES ...........
17 CORN......................               | 47 INSURANCE .......
18 OTHER GRAINS..............               | 48 UTILITIES .......
19 HAY.......................               | 49 FREIGHT, TRUCKING
20 STRAW.....................               | 50 CONSERVATION EXP.
21 FRUITS AND NUTS...........               | 51 LAND CLEARING ...
22 MACHINE WORK..............               | 52 PENSION & PROFIT
23A  PATRONAGE DIVIDENDS.....               |    SHARING .........
  B  LESS NON-INCOME ITEMS...               | 53 EMPL BENEFIT ....
  C  NET PATRONAGE DIVIDENDS.               |  54 OTHER (SPECIFY).
24 PER-UNIT RETAINS..........               |  1ST ]
25 NONPATRONAGE DISTRIBUTION.               |  2ND  }   OR SEE STATEMENT XX
26 AGRICULTURAL PAYMENTS.....               |  3RD ]
26A  AGRIG PMTS--CASH PMTS...               | (OTHERS AS NEEDED)
  B  MATERIALS/SERVICES .....               |
27 COMMODITY CREDIT LOANS ...               |
28 FEDERAL GAS TAX CREDIT ...               |
29 STATE GAS TAX REFUND .....               I
30 OTHER-SPECIFY-SEE STMT XX                |
31 ADD LNS 5 THRU 30 ........ 000,000.00    | 55 ADD LNS 53E-54...
********************************************| 56 DEPR FR PT III...
32 GROSS PROFITS ADD LNS 4&31 000,000.00    | 57 TOT-LNS 55 + 56   0,000,000.
*****************************************************************************
58 NET FARM PROFIT/LOSS LN 32 LESS LN 57  . . . . . . . . . 58.  0,000,000.
*****************************************************************************
59 IF LOSS, DO YOU HAVE AMTS FOR FARM THAT ARE NOT "AT RISK" . . . . .(ANS)

SCHEDULE F CONTINUED ON PAGE 2
```

Exhibit CG-F (Schedule F—Page 2)

```
SCHEDULE F (CON'T)       PAGE 2                                       1980 * 18
(FORM 1040)
JOHN Q. & MARY J. TAXPAYER                                  SSN   000-00-0000
************************* PART III - DEPRECIATION ***************************

60 TOTAL ADD'L 1ST YEAR DEPRECIATION ......................... 000,000.00
61 OTHER DEPRECIATION
(A)DESCRIP OF PROP  (B)DATE (C)COST   (D)DEPREC  (E)METHOD  (F)  (G)DEPRC
                       ACQ.   BASIS     PRIOR                L/R   1980
   BUILDINGS                000,000.00 000, 000.00                000,000.00
   ANIMALS
   TRANS.EQUIPT.
   MACHINERY
   OTHER (SPECIFY)          OR SEE STATEMENT XX
(1ST OTHER)
(2ND)
(ADD LINES AS NEEDED)

62 TOTALS. . . . . . . . . 000,000.00  000,000.00. . . . . . .     000,000.00
************************* PART IV AND V *************************************
  (ADD THESE SECTIONS ONLY AS NEEDED OR REQUIRED AND FOLLOW ABOVE EXAMPLES.
SEE INSTRUCTIONS IN SECTION 15.)
```

Exhibit CG-G (Schedule G)

```
SCHEDULE G                          INCOME AVERAGING                         1980 * 21
(FORM 1040)
JOHN Q AND MARY J TAXPAYER                                                SSN 000-00-0000
********************* BASE PERIOD INCOME AND ADJUSTMENTS *******************
                                (A)          (B)          (C)          (D)
                            1ST PREC YR  2ND PREC YR  3RD PREC YR  4TH PREC YR
                               1979         1978         1977         1976

  1 AMT FROM FORM 1040/1040A  00,000.00    00,000.00    00,000.00    XXXXXXXXX
  2A EXPMT X $750 ............XXXXXXXXX                              XXXXXXXXX
   B EXPMT X $1000 ...........             XXXXXXXXX    XXXXXXXXX    XXXXXXXXX
  3 TAXABLE INCOME L1-L2A/B...00,000.00    00,000.00    00,000.00    00,000.00

  4 INC NOT U.S. EARNED...... 00,000.00    00,000.00    00,000.00    00,000.00

  5 $3200/$2200/$1600........ XXXXXXXXX    XXXXXXXXX    XXXXXXXXX    00,000.00

  6 BASE INCOME (3+4+5)...... 00,000.00    00,000.00    00,000.00    00,000.00

********************* COMPUTATION OF AVERAGEABLE INCOME ********************
  7 TAXABLE INCOME (SCHED TC, PART I, LINE 3)................ 7.    00,000.00
  8 CERTAIN AMOUNTS RECEIVED BY OWNER-EMPLOYEES
    SUBJECT TO PENALTY, SECTION 72(M)(5)..................... 8.
  9 SUBTRACT LINE 8 FROM LINE 7.............................. 9.
 10 EXCESS COMMUNITY INCOME  ................................ 10.
 11 ADJUSTED TAXABLE INCOME (LN 9-LN 10) ZERO IF NEGATIVE... 11.
 12 ADD COLUMNS (A) THROUGH (D), LINE 6..................... 12.
 13 ENTER 30% OF LINE 12.................................... 13.

 14 AVERAGEABLE INCOME (SUBTRACT LINE 11 FROM LINE 13)...... 14.

****************************** COMPUTATION OF TAX ***************************
 15 AMOUNT FROM LINE 13 .................................... 15.
 16 20% OF LINE 14.......................................... 16.

 17 TOTAL (ADD LINES 15 AND 16)............................. 17.
 18 EXCESS COMMUNITY INCOME FROM LINE 10.................... 18.

 19 TOTAL (ADD LINES 17 AND 18)............................. 19.
 20 TAX ON AMOUNT ON LINE 19................................ 20.
 21 TAX ON AMOUNT ON LINE 17................................ 21.
 22 TAX ON AMOUNT ON LINE 15 ............................... 22.
 23 SUBTRACT LINE 22 FROM LINE 21........................... 23.
 24 MULTIPLY THE AMOUNT ON LINE 23 BY 4 .................... 24.
 25 TAX ON AMOUNT ON LINE 7................................. 25.
 26 TAX ON AMOUNT ON LINE 9................................. 26.
 27 SUBTRACT LINE 26 FROM LINE 25........................... 27.
 28 TAX (ADD LINES 20, 24 AND 27). ENTER ON SCHED TC........ 28.
```

Exhibit CG-R (Schedule R)

```
SCHEDULE R  ------------------CREDIT FOR THE ELDERLY--------------------- 1980 * 22 --
(FORM 1040)
JOHN Q. TAXPAYER------------------------------------------------------SSN 000-00-0000
*******************************************************************************
      SCHEDULE R - INDIVIDUAL(S) 65 OR OVER HAVING ANY KIND OF INCOME

FILING STATUS    (B XX  MARRIED FILING JOINT RETURN, ONLY ONE OVER 65 )

1  ENTER    $3750, $2500 OR $1875............................  1. 000,000.00
2A ENTER AMOUNTS RECEIVED AS NON-TAX PENSIONS OR ANNUITIES.. 2A.
2B ENTER AMOUNT FROM FORM 1040 LN 32........................ 2B.
2C ENTER    $10,000, $7500 OR $5000 ........................ 2C.
2D LINE 2B LESS LINE 2C..................................... 2D.
2E ENTER 50% OF LINE 2D..................................... 2E.
3  ADD LINES 2A AND 2E...................................... 3.
4  SUBTRACT LINE 3 FROM LINE 1.............................. 4.
5  MULTIPLY LINE 4 BY 15%  ................................. 5.
6  ENTER AMOUNT OF TAX FROM FORM 1040, LINE 37.............. 6.
7  ENTER SMALLER AMOUNT FROM LINE 5 OR LINE 6 .............. 7.
  (ENTER THIS AMOUNT ON FORM 1040, LINE 39)
*******************************************************************************
```

Exhibit CG-RP (Schedule RP)

```
SCHEDULE RP  CREDIT FOR ELDERLY  UNDER 65 YEARS                        1980 * 22
(FORM 1040)
JOHN Q.& MARY J. TAXPAYER                                         SSN 000-00-0000
*************************************************************************

FILING STATUS  (B)      MARRIED FILING JOINT RETURN, ONE UNDER 65

                                                  (A)                   (B)

1   ENTER    $3750, $2500 OR $1875 .......  1.  00,000.00          00,000.00
2A  ENTER AMTS REC'D NON-TAX (PENS, ANNUT).2A.
2BI UNDER 62 ENTER ALL OVER $900 .......  2BI.
2BII  62 + ENTER AMTS PER INSTRUCTIONS.. 2BII.
3   ADD LINES 2A AND 2B ..................  3.
4   SUBTRACT LINE 3 FROM LINE 1...........  4.
5A  UNDER 65 ENTER OTHER $ NOT ON LN 2A... 5A.
5B  65+ ENTER OTHER $ RECIEVED ........... 5B.
6   ENTER SMALLER OF LN 4 OR 5 ...........  6.
7   ADD COLS (A) & (B) LINE 6 ............  7.
8   MULTIPLY LINE 7 BY 15% ...............  8.
9   ENTER  TAX FROM FORM 1040, LINE 37....  9.
10  ENTER SMALLER OF LN 8 OR 9............ 10.
 (ENTER THIS AMOUNT ON FORM 1040, LINE 39)
```

Exhibit CG-SE (Schedule SE)

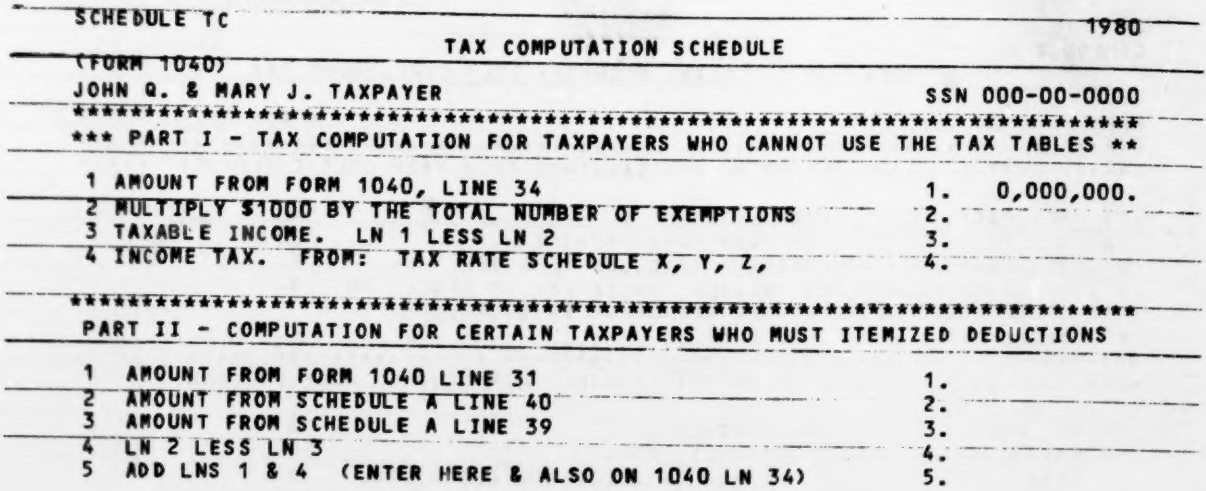
```
SCHEDULE SE                                                          1980 * 23
                 COMPUTATION OF SOCIAL SECURITY SELF-EMPLOYMENT TAX
(FORM 1040)
MARY J. TAXPAYER                                                  SSN 000-00-0000
******************************************************************************
****** PART I - COMPUTATION OF NET EARNINGS FROM FARM SELF-EMPLOYMENT *****

 1A   NET PROFIT/LOSS FROM  SCHEDULE F                            1A.   0,000,000.
 1B   NET PROFIT/LOSS FROM FARM PARTNERSHIPS                      1B.
 2    NET EARNINGS FROM FARMS    (ADD LNS 1A & 1B)                 2.
 3 A  IF GROSS PROFITS NOT $2400+  ENTER 66% OF GROSS, OR          3.
   B  IF GR PROFIT $2400+  NET NOT $1600 ENTER $1,600
 4    AMOUNT FROM LINE 2 OR LINE 3                                 4.
******************************************************************************
**** PART II - COMPUTATION OF NET EARNING FROM NONFARM SELF-EMPLOYMENT ****

 5A NET PROFIT/LOSS FROM SCHEDULE C                               5A.
 5B PARTNERSHIPS, JOINT VENTURES, ETC.                            5B.
 5C SERVICE AS MINISTER, MEMBER OF RELIGIOUS ORDER,ETC.           5C.
 5D SERVICE WITH A FOREIGN GOVT. OR INTERNAT. ORG.                5D.
 5E OTHER: SPECIFY- SEE STATEMENT XX                              5E.
 6 TOTAL (ADD LINES 5A THRU 5E)                                    6.
 7 OTHER ADJUSTMENTS                                               7.
 8 ADJUSTED NET EARNINGS (LOSS) (LN 6 LESS LN 7)                   8.
 9A MAX AMOUNT REPORTABLE USING BOTH OPTIONAL METHODS             9A.        1,600.
 9B AMOUNT ON LINE 3                                              9B.
 9C BALANCE (LN 9A LESS LN 9B                                     9C.
10 SMALLER OF 2/3 OF GROSS NONFARM PROFITS OR $1,600              10.
11 SMALLER OF LN 9C OR 10                                         11.
****** PART III - COMPUTATION OF SOCIAL SECURITY SELF-EMPLOYMENT TAX ******

12A  NET EARNINGS (LOSS) FROM FARMING (LINE 4)                   12A.
12B  FROM NONFARM (LINE 8, OR 11 IF OPTION USED)                 12B.
13   TOTAL NET EARNINGS (LOSS)  ADD LN 12A & 12B                  13.
14   THE LARGEST AMOUNT SUBJECT TO 1980 S. S. TAX:                14.       25,900.
15A  TOTAL FICA FROM W-2 FORM OR RRTA                            15A.
15B  UNREPORTED TIPS FROM FORM 4137 OR RRTA                      15B.
15C  TOTAL OF LNS 15A & 15B                                      15C.
16 BALANCE (LINE 14 LESS LINE 15C)                                16.
17 SELF-EMPLOYMENT INCOME (SMALLER OF LINE 13 OR 16)              17.
18 S-EMPLY TAX.(LN 17 $25900 = $2097.90  OR LN 17X.081)           18.    0,000,000.
```

Exhibit CG-TC (Schedule TC)



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SCHEDULE TC                                                              1980
                         TAX COMPUTATION SCHEDULE
(FORM 1040)
JOHN Q. & MARY J. TAXPAYER                                    SSN 000-00-0000
*****************************************************************************
*** PART I - TAX COMPUTATION FOR TAXPAYERS WHO CANNOT USE THE TAX TABLES **

 1 AMOUNT FROM FORM 1040, LINE 34                              1.   0,000,000.
 2 MULTIPLY $1000 BY THE TOTAL NUMBER OF EXEMPTIONS            2.
 3 TAXABLE INCOME.  LN 1 LESS LN 2                             3.
 4 INCOME TAX.  FROM:  TAX RATE SCHEDULE X, Y, Z,              4.

*****************************************************************************
PART II - COMPUTATION FOR CERTAIN TAXPAYERS WHO MUST ITEMIZED DEDUCTIONS

1  AMOUNT FROM FORM 1040 LINE 31                               1.
2  AMOUNT FROM SCHEDULE A LINE 40                              2.
3  AMOUNT FROM SCHEDULE A LINE 39                              3.
4  LN 2 LESS LN 3                                              4.
5  ADD LNS 1 & 4  (ENTER HERE & ALSO ON 1040 LN 34)            5.
```

26 CFR 601.201: Rulings and determination letters.
(Also Part I, Section 412.)

Rev. Proc. 80-50

SECTION 1. PURPOSE

This revenue procedure provides approval for certain defined benefit pension plans to change the funding method for plan years described in Section 7.

SEC. 2. BACKGROUND

Section 412(c)(5) of the Internal Revenue Code, as amended, and section 302(c)(5) of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 1974-3 C.B. 1, 40, state that if the funding method of a plan is changed, the new funding method shall become effective only if the change is approved by the Secretary.

SEC. 3. APPROVAL FOR SPECIFIED CHANGES

Except as restricted by Section 6 of this revenue procedure, approval is granted to the following:

.01 Approval 1—A change to either of the three Aggregate Methods described in sections 3.01(1), 3.01(2) or 3.01(3).

(1) The normal cost is computed in the aggregate as the normal cost accrual rate multiplied by compensation. The normal cost accrual rate is (A) the present value of future benefits less adjusted assets divided by (B) the present value of future compensation.

(2) The normal cost is computed in the aggregate as the normal cost per participant multiplied by the number of participants who are currently employed by employers maintaining the plan. The normal cost per participant is (A) the present value of future benefits less adjusted assets divided by (B) the sum of the present value of an annuity of $1 per year payable from the attained age to retirement age for each participant who is currently employed.

(3) The normal cost is computed in the aggregate as (A) the present value of future benefits less adjusted assets divided by (B) a temporary annuity factor. The temporary annuity factor is the present value of future individual level premium normal costs divided by the current year's individual level premium normal cost. For purposes of this subsection, the individual level premium normal cost for each participant is the sum of the level amounts to fund each increment of projected benefit from the attained age at which the increment occurs to the anticipated retirement age.

(4) In methods (1), (2), and (3), for purposes of section 412 of the Code, the assets are adjusted by subtracting any credit balance in the funding standard account or adding any funding deficiency. For purposes of section 404, the assets are adjusted by subtracting any undeducted contributions. Also, all existing amortization bases under sections 404 or 412 shall be considered fully amortized.

.02 Approval 2—A change to an Individual Aggregate Method that satisfies paragraphs (1), (2), (3), (4) and (5) of this subsection.

(1) The normal cost is the sum of individual normal costs for each participant for whom a normal cost is determined. The normal cost for a participant is (A) the present value of future benefits less allocated adjusted assets, divided by (B) a temporary annuity factor from attained age to the anticipated retirement age. (The temporary annuity factor may also be determined as the present value of future compensation for the participant divided by current compensation.)

(2) For purposes of section 412 of the Code, prior to the allocation of assets each year the assets are adjusted by subtracting any credit balance in the funding standard account or adding any funding deficiency. For purposes of section 404, any undeducted contributions are subtracted from the assets. Also, if the plan retains the liabilities for any participant or beneficiary for whom a normal cost is not computed, the assets are adjusted by subtracting the present value of such liabilities.

(3) In the first year the method is used, the adjusted assets are allocated on the basis of the present value of accrued benefits, the present value of future benefits, or the accrued liability under a funding method of the immediate gain type.

(4) After the first year the method is used, adjusted assets are allocated in the proportion that the sum of the allocated assets plus calculated normal cost of the prior year for each participant for whom a normal cost is computed bears to the total for all such participants.

(5) In the first year the method is used, all unamortized bases under sections 404 and 412 of the Code will be considered fully amortized.

.03 Approval 3—A change to a method described in paragraphs (1) or (2) if the requirements in paragraphs (3), (4), and (5) are also satisfied.

(1) The normal cost is computed in the aggregate as the normal cost accrual rate multiplied by compensation. The normal cost accrual rate is (A) the present value of future benefits less assets less unfunded liability divided by (B) the present value of future compensation.

(2) The normal cost is computed in the aggregate as the normal cost per participant multiplied by the number of participants who are currently employed by employers maintaining the plan. The normal cost per participant is (A) the present value of future benefits less assets less the unfunded liability divided by (B) the sum of the present value of an annuity of $1 per year payable from the attained age to retirement age for each participant who is currently employed.

(3) As of the date of change, the unfunded liability under the new method is determined under an acceptable funding method of the immediate gain type.

For years subsequent to the plan year of the change in method, the unfunded liability for any year equals

(A) the unfunded liability for the prior plan year plus the normal cost for the prior plan year, minus

(B) the actual contributions for the the prior plan year

where the amounts in (A) and (B) are adjusted with interest to the date as of which the unfunded liability is determined.

(4) The new amortization base resulting from the change in funding method is the difference between

(A) the unfunded liability under

the new method as determined under 3.03(3), and

(B) the net sum of the outstanding balance of all amortization bases (including the gain or loss base for the immediately preceding period), treating credit bases as negative bases, less the credit balance (or plus the funding deficiency) in the funding standard account.

(5) The amortization period for the new amortization base for purposes of sections 302 of ERISA and 412 of the Code is as follows:

(A) If the plan was in existence on January 1, 1974, any decrease in unfunded liability will be amortized over 40 years reduced by the number of prior plan years to which section 302 has applied, and any increase will be amortized over 30 years.

(B) If the plan was not in existence on January 1, 1974, any increase will be amortized over 30 years reduced by the number of prior plan years to which section 302 has applied, and any decrease will be amortized over 30 years.

SEC. 4. APPROVAL FOR TAKEOVER PLANS

.01 Approval is granted by this subsection for a change in funding method where all the conditions set forth in subsections .02 through .05 are satisfied.

.02 There has been both a change in the enrolled actuary for the plan and a change in the business organization providing actuarial services to the plan.

.03 The method used by the new actuary is substantially the same as the method used by the prior actuary, and is consistent with the information contained in the prior actuarial valuation reports or prior Schedule B's of Form 5500. Also, the method used by the new actuary must be applied to the prior year (using the assumptions of the prior actuary) and the net charge in the funding standard account produced must not differ by more than five percent from the net charges computed by the prior actuary for that year.

.04 The new enrolled actuary signs and attaches a statement to Schedule B of Form 5500 that the procedures and formula currently being used may produce different results from the prior procedures and formula, but that information is not available to reproduce the prior method exactly.

.05 The change in costs due to the change in method is treated in the same manner as an experience gain or loss, unless the actuarial assumptions are being changed, in which case the change in method is treated as part of the change in assumptions.

SEC. 5. CHANGE IN YEAR OF TERMINATION

.01 For a plan year beginning before a plan terminates, the funding method may be changed to a method that satisfies subsection .02 provided that the conditions set forth in subsection .03 are satisfied. As part of the change in method, the valuation date may be changed, if desired, to the date of termination, or the asset valuation method may be changed to fair market value.

.02 A method is described in this subsection if the normal cost for the plan year is the present value of the benefits accruing in the plan year under the method, and the accrued liability is the present value of the benefits accrued under the method as of the valuation date.

.03 The conditions in this subsection are satisfied if:

(1) as of the date of termination as approved by the Pension Benefit Guaranty Corporation (PBGC), the fair market value of the assets of the plan is not less than the present value of all accrued benefits (whether or not vested). The actuarial assumptions used for determining such present value must be acceptable to PBGC for use under section 4044 of ERISA, *supra*, at 194; and

(2) a timely notice of intention to terminate was filed with the PBGC.

SEC. 6. RESTRICTIONS

.01 This revenue procedure does not apply unless an actuarial valuation is made for the plan year for which a change in method is effective, and such valuation is used for purposes of section 302 of ERISA for such plan year.

.02 This revenue procedure does not apply unless the plan administrator or plan sponsor signs and attaches a statement to Schedule B of Form 5500 for the plan year for which a change is effective stating that the plan administrator or plan sponsor agrees to the change in funding method which is being made as approved by this revenue procedure.

.03 This revenue procedure does not apply if:

(1) The funding method (including the asset valuation method) is being changed in any manner other than that described above.

(2) A waiver of the minimum funding standards has been granted for the plan or the amortization charge described in section 412(b)(2)(C) of the Code is applicable in the plan year of the change.

(3) Except as described in Section 5, the change is made for a plan year in which the plan is terminated.

.04 The approvals under sections 3.01(1), 3.02(1), and 3.03(1) do not apply if the temporary annuity factor is weighted by compensation but the plan benefits are not based on compensation.

.05 Section 4 does not apply to any plan for any plan year beginning on or after the date final regulations under section 6059 of the Code are adopted.

.06 This revenue procedure does not apply for any plan year if Schedule B of Form 5500 has been filed or if the date (without extension) by which it must be filed has passed.

SEC. 7. EFFECTIVE DATE

This revenue procedure is effective for changes in funding methods made with respect to plan years commencing on or after July 1, 1979, and before January 1, 1986.

Part IV. Items of General Interest

Foundation Status of Certain Organizations

Announcement 80-147

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3) of the Code, eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Arlington Multiple Sclerosis Self Help Center, Arlington, TX
Astor Theatre Corp., Reading, PA
Athletic Events Organizers Association, Dallas, TX
Austin Forum for Political Integrity, Austin, TX
Christensen Memorial Foundation, Inc., Heber C. and Annie P., Spanish Fork, UT
Club Anonymous, Inc., Phoenixville, PA
Coweta Christian Growth Center, Coweta, OK
Crittenden County Senior Babe Ruth Association, Inc., West Memphis, AK
Displaced Homemakers of Texas, Dallas, TX
Dra Mu Opera Company, Inc., Philadelphia, PA
Early Childhood Associates, Inc., Lubbock, TX
Evangelistic Crusades, Inc., San Antonio, TX
Family Life Services of San Angelo, San Angelo, TX
First Americans' California Enterprises, McKinleyville, CA
Handicapped Helpers, Inc., Auburn, CA
Hearing Society of Stanislaus County, Turlock, CA
Liberty City Volunteer Fire Department, Inc., Gladewater, TX
Lohrville Recreational Club, The, Lohrville, IA
Lubbock Crime Prevention Association, Lubbock, TX
Metcalf Scholarly Award Fund Society, Normal, IL
Mission of Mercy, Inc., Odessa, TX
Missouri Citizens for Life Education Fund, Creve Coeur, MO
Popular Arts and Media Foundation, The, Mill Valley, CA
Reality Evangelistic Association, Fergus Falls, MN
Samaritans Suicide Prevention Service, St. Cloud, MN
Seneca Nation Organization for the Visual Arts, Inc., Salamanca, NY
Shalom Apartments of Federation Housing, Philadelphia, PA
Sonrise Breakfast, Inc., Atlanta, GA
Southern Arizona Association of Mexican-American Educators, Inc., Tucson, AZ
Springfield Senior Citizens Housing, Inc., Roselle, NJ
Stewart Park Housing Development Fund Company, Inc., Corning, NY
Summergate Dance Theater, Wilmington, DE
Sundancers, The, Manhattan Beach, CA
Youth Challenge Outreach Ministries, North Little Rock, AR

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individual has been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Vincent E. Heyworth	Hagerstown, MD	Enrolled Agent	Six months effective September 30, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.47-1 amended, 1.48-9 added.	Business investment credit for energy property.	Sept. 19, 1980	Nov. 18, 1980
26 CFR 150.4989-1(c) amended; published as temporary regulations in T.D. 7720, 1980-42 I.R.B. 12.	Interim rule for determining base prices for tier 2 and tier 3 oil.	Sept. 24, 1980	Nov. 24, 1980
26 CFR 150.4989-1(c), 150.4995-1(b)(2) revised; published as temporary regulations in T.D. 7721, 1980-42 I.R.B. 13.	Base prices of tier 2 and tier 3 oil and withholding in the absence of effective operator's certificate.	Sept. 30, 1980	Dec. 1, 1980
26 CFR 1.584-1 through 1.584-4, 1.6032-1 amended.	Common trust funds.	Sept. 22, 1980	Nov. 21, 1980
26 CFR 31.6205-1(b)(2) amended.	Interest-free adjustment with respect to erroneous filing of FICA and RRTA returns.	Sept. 26, 1980	Nov. 25, 1980
26 CFR 1.507-2(c)(1)(IV)(A), 1.509(a)-3, 1.509(a)-4(k)(2), 1.509(a)-5 as proposed in the Federal Register for July 24, 1979, 44 F.R. 43290, withdrawn; 1.507-2(c)(1)(IV)(A), 1.509(a)-3, 1.509(a)-4(k)(2), 1.509(a)-5, amended.	Definition of a private foundation.	Oct. 10, 1980	Dec. 9, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] See footnote at end of list.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

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[1] See footnote at end of list.

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80-301
Distinguished by
80-302, 1980-45 I.R.B. **7***

80-302
Distinguished by
80-301, 1980-45 I.R.B. **6***

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27, dated July 7, 1980.

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1928–2	9.50	*1942–2*	*5.55*	1958–2	13.00	1971–1	10.55
1929–1	12.00	*1943*(*)	*9.55*	1958–3	15.00	1971–2	8.50
1929–2	*3.15*	*1944*(*)	*7.85*	1959–1	15.00	1972–1	13.50
1930–1	7.30	1945(*)	9.40	1959–2	9.60	1972–2	13.70
1930–2	9.50	*1946–1*	*2.55*	1960–1	19.00	1973–1	16.00
1931–1	*3.60*	1946–2	5.20	1960–2	11.50	1973–2	8.30
1931–2	13.00	*1947–1*	*1.80*	1961–1	14.00	1974–1	11.00
1932–1	*2.80*	1947–2	3.40	1961–2	10.00	1974–2	9.95
1932–2	8.65	*1948–1*	*3.15*	1962–1	14.00	*1974–3*	*8.20*
1933–1	*3.35*	1948–2	7.50	1962–2	13.00	1974–3 Supp.	10.00
1933–2	*3.45*	*1949–1*	*6.90*	1962–3	20.00	1975–1	13.25
1934–1	*3.70*	*1949–2*	*2.80*	1963–1	9.00	1975–2	13.00
1934–2	14.00	1950–1	6.35	1963–2	10.75	1976–1	11.00
1935–1	6.90	*1950–2*	*4.70*	1964–1–1	10.00	1976–2	10.25
1935–2	*14.00*	*1951–1*	*12.00*	1964–1–2	11.00	1976–3–1	9.50
1936–1	*3.55*	*1951–2*	*5.05*	1964–2	9.80	1976–3–2	16.00
1936–2	*14.00*	*1952–1*	*2.55*	1965–1	10.70	1976–3–3	10.00
1937–1	*13.00*	1952–2	7.05	1965–2	12.25	1977–1	10.75
1937–2	7.70	*1953–1*	*4.25*	1966–1	14.00	1977–2	11.75
1938–1	*16.00*	1953–2	12.00	1966–2	14.05	1978–1	11.75
1938–2	*13.00*	1954–1	12.00	1967–1	10.00	1978–2	13.00
1939–1–1	8.25	1954–2	12.00	1967–2	14.00	1978–3–1	12.25
1939–1–2	10.90	1955–1	10.25	1968–1	14.00	1978–3–2	9.00
1939–2	9.40	1955–2	13.00	1968–2	11.75	1979–1	14.00
1940–1	5.55	1956–1	15.00	1969–1	14.00	1979–2	15.00
1940–2	14.00	1956–2	18.00	1969–2	6.50	1980–3	10.00

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Internal Revenue bulletin

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Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-311, page 5.
Investment credit; public utilities; retired items reused. An electric utility's qualified investment in new section 38 property that is public utility property includes minor items that are treated as mass assets recovered from retired electric public utility property and are reused in the constuction or reconstuction of electric utility property. A method for valuing the mass assets for determining basis is explained. A change to the method of valuing such items is a change in accounting method. Rev. Rul. 70-114 modified and superseded.

Rev. Rul. 80-312, page 6.
Investment credit; public utilities; acquisition v. construction. A public utility contracted with a manufacturer of turbine generating units and with a general contractor for an expansion of its generating plant. The manufacturer exercised direction and control over installation, testing, and start-up of the turbine generating unit purchased by the utility, while the utility exercised continuing control over the important details of construction under the general contract for construction of the plant addition. The turbine generating unit was acquired within the meaning of section 1.48-2(b)(6) of the regulations, but the addition was constructed within the meaning of section 1.48-2 (b)(1). The Service will not follow the *Public Service Co. of New Mexico* decision.

Rev. Rul. 80-313, page 7.
Investment credit; computer using reconstructed circuit boards. New computers that contain reconstructed circuit boards that conform to design characteristics similar to new unused components and that had been used in, and salvaged from, old scrapped computers qualify as "new section 38 property" when leased to customers.

Rev. Rul. 80-317, page 10.
Percentage depletion; taxable income from property; damages. Damages paid as a result of a breach of contract suit by a mineowner who was unable to deliver the mineral required by the contract because of a decrease in production are not deductible from gross income from mining for purposes of computing percentage depletion.

Rev. Rul. 80-318, page 11.
Tax on transfer to foreign trust; Virgin Islands resident. Section 1491 of the Code does not apply to the transfer of appreciated property to a Virgin Islands trust by a U.S. citizen who is a permanent resident of the Virgin Islands.

Pub. L. 96-330, page 19.
The Veterans' Administration Health-Care Amendments of 1980 provides that any payment to, or on behalf of, a participant in the Veterans' Administration Health Professional Scholarship Program for tuition, education expenses, or a stipend under the program is exempt from taxation.

Announcement 80-151, page 21.
Congressional Joint Resolution 610 provides that no funds may be used to implement or enforce any regulation or ruling in certain areas under

(Continued on page 4)

Finding List begins on page 25.
Announcement of Voluntary Suspension on page 22.
Announcement of Notice of Proposed Rulemaking on page 23.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

section 280A of the Code relating to deductions for business or rental use of dwellings.

EMPLOYEE PLANS

Rev. Rul. 80-314, page 8.

Discrimination; coverage; officer acting in nominal capacity. An employee who was given the title of assistant secretary-treasurer merely to qualify the employee to sign checks in the absence of superior officers and to affix and attest to the corporate seal when necessary and who actually performed these duties on only a few occasions but otherwise had no voice in the management or administration of the corporation is not considered an officer for purposes of sections 401(a)(4) and 410(b) of the Code; Rev. Rul. 68-300 superseded.

Rev. Rul. 80-315, page 9.

Minimum funding; supplementary plan. An employee benefit plan that provides benefits that merely supplement benefits paid to the employees covered by a qualified defined benefit plan must consider the participants of the qualified plan in applying the minimum funding standards of section 302 of ERISA.

EXEMPT ORGANIZATIONS

Rev. Rul. 80-316, page 10.

Hospital service organization; purchasing; legal title. An organization that otherwise qualifies as a cooperative hospital service organization within the meaning of section 501(e) of the Code, that buys hospital equipment for its patron hospitals, and that holds legal title to the equipment while the hospitals repay a commercial lender for the loan used to purchase the equipment is operated solely to perform the service of "purchasing" within the meaning of section 501(e)(1)(A).

ESTATE TAX

Rev. Rul. 80-319, page 12.

Buyer's "points" assumed by seller-decedent. An individual entered into an arm's length agreement to sell a personal residence and to pay mortgage "points" for the buyer that were to be deducted from the sale proceeds, but died before consummating the sale. The amount includible in the individual's gross estate is the sales price of the property less the "points" assumed by the seller, and the "points" are not deductible under section 2053(a)(3) or (a)(4) of the Code.

EXCISE TAXES

T.D. 7726, page 13.

Amendments to the regulations under section 4121 of the Code relate to the tax on coal.

ADMINISTRATIVE

T.D. 7724, page 15.

Amendments to the regulations under section 6103 of the Code relate to the disclosure of certain return information to and by officers and employees of the Bureaus of the Census and Economic Analysis of the Department of Commerce for certain statistical purposes and related activities.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 38.—Investment in Certain Depreciable Property

26 CFR 1.38-1: Investment in certain depreciable property.
(Also Sections 46, 48, 446; 1.46-3, 1.48-2, 1.446-1.)

Investment credit; public utilities; retired items reused. An electric utility's qualified investment in new section 38 property that is public utility property includes minor items that are treated as mass assets recovered for retired electric public utility property and are reused in the construction or reconstruction of electric utility property. A method for valuing the mass assets for detemining basis is explained. A change to the method of valuing such items is a change in accounting method. Rev. Rul. 70-114 modified and superseded.

Rev. Rul. 80-311

ISSUE

Under the facts described below, do certain minor items recovered from retired electric public utility property qualify as "new section 38 property" for investment credit purposes when again used in construction, reconstruction, or erection of electric utility property? Further, what are the proper tax bases for such mass asset type materials?

FACTS

The taxpayer, an electric utility, is engaged in the generation, transmission, distribution, and sale of electric energy. In the course of its operations, the taxpayer recovered reusable items from retirements of its electric utility property, generally from distribution and transmission lines. The reusable items recovered were stored at supply depots maintained by the taxpayer until again placed in service. Largely easily identifiable individual items such as transformers and meters were included in the materials and supplies account at original cost. The small items, numerous in quantity, including insulators, cross arms, brackets, etc., the identity of which could not be ascertained without undue refinement in accounting were included in the materials and supplies account at the average cost of similar items (new and used) already in the account. These items on retirement had been credited to the appropriate depreciation reserve account at the same average cost. This practice had been consistently followed for both regulatory and tax accounting.

In Rev. Rul. 70-114, 1970-1 C.B. 2, the same items of electric public utility property were involved. The taxpayer in that revenue ruling, however, could not determine either the original date of installation or the original cost for such mass assets. In the present case, the taxpayer's property records enable it to determine the original cost and installation date at the time these items are retired. However, the reusable small items are then transferred to a storage yard and are physically intermixed with similar items already on hand. At this point, the taxpayer in this case is in the same position as the taxpayer in Rev. Rul. 70-114 in that it no longer knows the original cost of the reusable small items.

LAW AND ANALYSIS

Section 38 of the Internal Revenue Code allows a credit against federal income tax for qualified investment in section 38 property, and the determination of what property is qualified is made in accordance with rules provided in section 48.

Section 46(a)(2)(B) of the Code provides for a 10 percent investment credit for all taxpayers (including public utilities) for otherwise qualifying property.

Section 48(a)(1) of the Code provides that the term "section 38 property" means, among other things, tangible property subject to depreciation and having a useful life of 3 years or more.

Section 48(b) of the Code defines new section 38 property as section 38 property the construction, reconstruction, or erection of which is completed by the taxpayer, or acquired by the taxpayer, after December 31, 1961, provided the original use of such property commences with the taxpayer after such date (except as provided with respect to "suspension period property" defined in section 48(h) of the Code).

Section 1.46-3(c)(1) of the Income Tax Regulations provides that the basis of any new section 38 property shall be detemined in accordance with the general rules for determining the basis of property. The basis of such property would generally be its cost unreduced by any adjustment to basis, such as for depreciation, and also would include all items properly in the depreciable basis. Therefore, the basis for investment credit purposes is generally the same as the basis for depreciation.

Section 1.48-2(b)(3) of the regulations provides that the materials entering into construction of new property need not be new in use, nor that the materials be acquired after December 31, 1961. Therefore, it is of no consequence that the materials are recovered from the retired plant facilities.

Rev. Rul. 70-114 holds that such items of property are materials entering into construction of new property and need not be new in use nor be acquired after December 31, 1961, in order to qualify for the investment credit. This holding is followed in this revenue ruling. However, incidental replacements of a single pole, cross arm insulator, etc., do not constitute construction, reconstruction, or erection of public utility property and such replacements are not "section 38 property."

Section 1.446-1(a)(2) of the regulations provides that a method of accounting that reflects the consistent application of generally accepted accounting principles in a particular trade or business in accordance with the accepted conditions or practices in that trade or business will ordinarily be regarded as clearly reflecting income. For both regulatory and tax purposes, the taxpayer has consistently valued these reusable small items recovered from retirements of property at the average cost of similar items already in the materials and supplies account, and has used such cost as basis in computing depreciation.

HOLDING

The taxpayer's qualified investment in new section 38 property that is public utility property, with respect to its newly constructed or reconstructed electric utility property, includes the values determined to be the basis of the minor items that were reused in the construction or reconstruction of electric utility property. However, since these items in the present case are accounted for as mass assets, if the requirements of section 1.47-1(e)(2) of the regulations for the treatment of mass assets are met, the taxpayer may substitute data from an appropriate mortality dispersion table to compute or recompute the qualified investment with respect to its reused (and purchased) parts and components used in the construction or reconstruction of electric utility property.

Further, since the basis of property for investment credit purposes follows the general rules regarding basis, the taxpayer's bases for the minor items described above are also deemed to be "cost" for investment credit purposes unless it can be shown that the use of such bases in computing depreciation results in a distortion of income. A change to this method is a change in method of accounting within the meaning of section 446 of the Code.

Rev. Rul. 70-114, providing other rules to be followed in valuing reusable materials recovered from retirements, is modified and superseded since its provisions, as modified, are reflected herein.

This revenue ruling does not apply to taxpayers electing section 1.167(a)-11 of the regulations because that section requires that an asset transferred to a supplies account may not have a basis higher than its unadjusted basis.

Section 46.—Amount of Credit

26 CFR 1.46-3: Qualified investment.

Tax treatment of retired recovered mass asset materials from an electric utility's distribution and transmission systems. See Rev. Rul. 80-311, page 5.

Section 48.—Definitions; Special Rules

26 CFR 1.48-1: Definition of section 38 property.

Investment credit; public utilities; acquisition v. construction. A public utility contracted with a manufacturer of turbine generating units and with a general contractor for an exansion of its generating plant. The manufacturer exercised direction and control over installation, testing, and start-up of the turbine generating unit purchased by the utility, while the utility exercised continuing control over the important details of construction under the general contract for construction of the plant addition. The turbine generating unit was acquired within the meaning of section 1.48-2(b)(6) of the regulations, but the addition was constructed within the meaning of section 1.48-2(b)(1). The Service will not follow the *Public Service Co. of New Mexico* decision.

Rev. Rul. 80-312

ISSUE

Whether an addition to an electrical power plant was "acquired" or "constructed" by the taxpayer for purposes of determining the amount of the investment tax credit.

FACTS

The taxpayer is a public utility corporation in the business of furnishing electrical energy. In 1974 the taxpayer entered into contracts with a general contractor, company *X*, and also with company *Y*, the manufacturer of turbine generating units for the construction of an addition to an electrical generating plant. This addition was built on the taxpayer's land and was to be operated in conjunction with the taxpayer's existing plant facilities.

The contract with *Y* called for *Y* to manufacture a turbine generating unit and exercise technical direction and authoritative control over its installation including the furnishing of all test procedures and their application. The turbine generating unit addition to the plant was installed and made operational by *Y*.

The contract with *X* provided that *X* would furnish the required engineering design, drafting, accounting, purchasing and expediting of materials, supervision, labor, and other requirements necessary for the construction of the addition to the electrical power plant which included mechanical, electrical, concrete, and site work; a railroad spur; and an addition to the generating building. The contract also specified that *X* would furnish the necessary construction facilities and engineering to turn over to the taxpayer a complete addition to the operating plant (with the exception of the turbine generating unit).

The builder's risk policy for the other additions to the electrical generating plant was secured and premiums were paid by the taxpayer. The taxpayer participated in and had the right of final approval over competitive bids from the manufacturers of the other additions of plant components. The specifications for the addition to the power plant, such as the technical data and performance details, were prescribed by the taxpayer. During the construction of the addition, the taxpayer and *X* had many meetings concerning the construction costs, bids, and design details affecting the operation of the addition to the plant. A representative of the taxpayer was at the construction site daily and acted as a liaison between the taxpayer and *X*. This resulted in the taxpayer having continuing control over important details of the construction. The construction of the addition to the plant began in 1974 and was not completed until mid-1975.

LAW AND ANALYSIS

Section 38 of the Internal Revenue Code allows a credit against federal income tax for qualified investment in section 38 property and the determination of what property is qualified is made in accordance with the rules provided in section 48.

Section 46(a)(2)(B) of the Code provides for a 10 percent investment credit for all taxpayers (including public utilities) for otherwise qualifying property that was acquired after January 21, 1975. For property acquired prior to that date the credit is 4 percent. The Tax Reduction Act of 1975, Pub. L. 94-12, 1975-1 C.B. 545, provided that, when the qualifying property was constructed, the 10 percent credit applied only to the portion of the basis of the property that was attributable to construction occurring after January 21, 1975. A 4 percent investment credit for public utility property applied to the portion of the basis attributable to construction before such date.

Section 48(a) of the Code, in defining the term "section 38 property," includes tangible personal property, or other tangible property (not including a building and its structural components) if such other tangible property is used as an integral part of certain specified activities, including the furnishing of electrical energy.

Section 48(b) of the Code which governs the extent to which particular items may be treated as "new section 38 property," states that "new section 38 property" means section 38 property, the construction, reconstruction, or erection of which is completed by the taxpayer after December 31, 1961, or acquired after December 31, 1961, if the original use of such property commences with the taxpayer and commences after such date.

Section 1.48-2(b)(1) of the Income Tax Regulations provides that property is considered as constructed, reconstructed, or erected by the taxpayer if the work is done for the taxpayer in accordance with the taxpayer's specifications.

Section 1.48-2(b)(6) of the regulations provides that property is deemed to be acquired when reduced to physical possession or control.

In *Madison Newspapers, Inc. v. Commissioner,* 47 T.C. 630 (1967), *acq.*, 1975-2 C.B. 2, the issue of whether the taxpayer was entitled to the investment credit depended on whether the printing press units in question were acquired as new section 38 property after December 31, 1961. To the Tax Court of the United States the critical question in *Madison Newspapers* was of *what* did the taxpayer acquire possession and control. The installation of the printing press units was a complex operation that required extensive time. The installation was conducted under the technical directions of persons designated by the seller but paid for by the taxpayer separately from the costs of delivered units. The Court concluded that the taxpayer acquired installed printing presses and hence the taxpayer was entitled to the credit because it found the property was built and installed in accordance with the seller's rather than the taxpayer's specifications.

A number of factors must be considered in determining whether the construction of property built by another may be attributed to a taxpayer as having been done for the taxpayer in accordance with taxpayer's specifications or whether the property was acquired by the taxpayer. The degree of control a taxpayer has over a planned construction project is an indication of whether property is constructed or acquired by the taxpayer. A taxpayer's control is indicated by ownership of the major components, ownership of the land upon which the construction took place, the carrying of builder's risk insurance, and the daily presence of the taxpayer's technical representative. Other factors are the taxpayer's participation in the bidding process, the purchase of certain major units by the taxpayer, and the taxpayer's right of final approval on all major units.

When a facility is acquired, the control by the taxpayer is minimal, as in the instant case where the installation and conducting of the generating unit's operational tests were performed by manufacturer *Y*.

Thus, when a taxpayer exercises continuing control of components added to its electrical generating plant, the components are "constructed" by the taxpayer, but where the components added to the plant are installed and made operational by a manufacturer, the components are "acquired" by the taxpayer. The facts of this case establish that, except for the turbine generator unit, the taxpayer had sufficient control over the construction project to conclude that it was built according to the taxpayer's specifications.

HOLDINGS

The turbine generating unit was acquired by the taxpayer within the meaning of section 1.48-2(b)(6).

The addition to the electric generating plant with the exception of the turbine generating unit under the continuing control of the taxpayer was "constructed" by the taxpayer within the meaning of section 1.48-2(b)(1) of the regulations. Therefore, the full 10 percent investment credit applies to the turbine generating unit and that portion of the addition constructed after January 21, 1975; however, only the 4 percent investment credit applies to that portion of the addition constructed prior to such date.

The Internal Revenue Service will not follow *Public Service Co. of New Mexico v. United States,* 431 F. 2d 980 (10th Cir. 1970), which reached a different conclusion based on similar facts.

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26 CFR 1.48-2: New section 38 property.

Investment credit; computer using reconstructed circuit boards. New computers that contain reconstructed circuit boards that conform to design characteristics similar to new unused components and that had been used in, and salvaged from, old scrapped computers qualify as "new section 38 property" when leased to customers.

Rev. Rul. 80-313

ISSUE

Do new computers that use reconstructed circuit boards that had been used in, and salvaged from, old computers qualify as new section 38 property when leased to customers?

FACTS

During 1975, the taxpayer was in the business of manufacturing, selling, and leasing computers. A computer product line generally becomes obsolete because of improvements in computer design. At the time of construction, the taxpayer's computers were estimated to have a useful life of 3 or more years.

After a computer is determined to be obsolete, the taxpayer withdraws it from leasing and scraps the computer, salvaging any reusable or serviceable parts. For accounting purposes, the scrapping of the computer is treated as an extraordinary retirement. When gain is not recognized on retirement, the adjusted basis is used as the basis in the materials and supply account when the parts are retired; however, if a loss is recognized on the retirement, the estimated salvage value, or the fair market value if greater at the time of retirement, is capitalized as the cost of such parts in the materials and supply account.

A major component used in the manfacture of a computer is its printed circuit boards, the configuration of which is dictated by the design of the computer. The printed circuit boards are salvaged from scrapped computers by the taxpayer for further use in newly designed computers.

These circuit boards are made up of integrated printed circuits. After being salvaged, these boards are reconstructed by rewiring or adding new circuitry to them so that they are able to perform their newly designed function in the same way that a wholly new board would perform the same function. Therefore, the reconstructed circuit board is equivalent to a new circuit board.

The reconstructed circuit boards are then used in association with other new components in the construction of new computers.

LAW AND ANALYSIS

Section 38 of the Internal Revenue Code allows a credit against the federal income taxes for qualified investment in new section 38 property. The determination of what property qualifies and whether it is new or used section 38 property is made in accordance with rules provided in section 48.

Section 48(a)(1) of the Code defines section 38 property as including tangible personal property with respect to which depreciation is allowable and having a useful life of 3 or more years.

Section 48(b) of the Code and section 1.48-2(a) of the Income Tax Regulations define new section 38 property as property, the construction, reconstruction, or erection of which was completed by the taxpayer after December 31, 1961, or was acquired by the taxpayer after that date provided the original use commences with the taxpayer after that date.

Section 1.48-2(b)(3) of the regulations provides that it is not necessary that materials entering into construction, reconstruction, or erection be new in use.

Section 1.48-2(b)(7) of the regulations provides that property will not be treated as reconditioned or rebuilt merely because it contains used parts.

Rev. Rul. 68-111, 1968-1 C.B. 29, concerns a railroad company that purchased and placed in service a current model diesel-electric locomotive to replace a locomotive that it had used in its trade or business for more than 8 years. In the purchase transaction, the replaced locomotive was traded in and its value allowed as a part of the purchase price of the replacement locomotive. The replacement locomotive was constructed by the manufacturer with some used materials and parts from its inventory. The ruling holds that the locomotive is new section 38 property within the meaning of section 48(b) of the Code and section 1.48-2(b) of the regulations.

Rev. Rul. 70-114, 1970-1 C.B. 2, holds that the basis of recovered parts and components accounted for as mass assets salvaged from retired plant facilities and reused to construct new section 38 property to be taken into account for investment credit purposes is (1) for normal retirements, the estimated salvage value, and (2) for abnormal retirements, when gain is not recognized on retirements the basis shall be their adjusted basis when retired, and when loss is recognized on retirement the basis is the estimated salvage value or the fair market value if greater at the time of abnormal retirement. Such basis for such salvaged parts and components may be charged to the constructed property by applying a consistent averaging convention. However, a change from valuing such parts and components at the current price of similar new items is a change in method of accounting within the meaning of section 446 of the Code.

In this case, the newly designed computers, containing the salvaged and reconditioned circuit boards, go through a complete assembly process. The reconstructed circuit boards are reworked, tested and modified to perform a specific function. These circuit boards conform to design characteristice similar to new unused components that are to be incorporated into the new computer.

As recognized in section 1.48-2(b)(7) of the regulations, the presence of used circuit boards does not require the computers to be treated as reconditioned or rebuilt property. The new computers have different performance characteristics, are newly manufactured with new and used parts after December 31, 1961, and the original use will occur with the taxpayer after that date.

HOLDING

The new computers that are manufactured using reconstructed printed circuit boards that have been used in, and salvaged from, old computers qualify as new section 38 property when leased to customers.

26 CFR 1.48-2: New section 38 property.

Tax treatment of retired recovered mass asset materials from an electric utility's distribution and transmission systems. See Rev. Rul. 80-311, page 5.

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401-3: Requirements as to coverage.

Whether an employee who is given the title "assistant secretary-treasurer" is an officer for purposes of section 401(a)(3) and (4) of the Code. See Rev. Rul. 80-314, below.

26 CFR 1.401-4: Discrimination as to contributions or benefits.

Whether an employee who is given the title "assistant secretary-treasurer" is an officer for purposes of section 401(a)(4) of the Code. See Rev. Rul. 80-314, below.

Section 410.—Minimum Participation Standards

26 CFR 1.410(b)-1: Minimum coverage requirements.
(Also Section 401; 1.401-3, 1.401-4.)

Discrimination; coverage; officer acting in nominal capacity. An employee who was given the title of assistant secretary-treasurer merely to qualify the employee to sign checks in the absence of superior officers and to affix and attest to the corporate seal when necessary and who actually performed these duties on only a few occasions but otherwise had no voice in the management or administration of the

corporation is not considered an officer for purposes of sections 401(a)(4) and 410(b) of the Code; Rev. Rul. 68-300 superseded.

Rev. Rul. 80-314

The purpose of this revenue ruling is to restate Rev. Rul. 68-300, 1968-1 C.B. 159, in view of the enactment of the Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 1974-3 C.B. 1.

The issue in Rev. Rul. 68-300 is whether an employee is an officer within the purview of sections 401(a)(4) and 410(b) of the Internal Revenue Code under the circumstances stated below.

An employee in the parts department of a company was given the title of assistant secretary-treasurer to qualify such employee to sign checks, in the absence of superior officers of the corporation, and to affix and attest to the corporate seal when necessary. The employee executed documents in such employee's official capacity on a few occasions but otherwise had no voice in the management or administration of the corporation.

Sections 401(a)(4) and 410(b) of the Code set forth certain coverage and benefit or contribution requirements that are intended to assure that an employee benefit plan will not be qualified if it discriminates in favor of employees who are officers, shareholders, or highly compensated.

The status of officers should be determined upon the basis of all the facts including, for example, the source of their authority, the term for which elected or appointed, and the nature and extent of their duties. As generally accepted in connection with corporations, the term "officer" means an administrative executive who is in regular and continued service. It implies continuity of service and excludes those employed for a special and single transaction.

The facts in this case indicate that the employee's administrative duties are nominal and are exercised in a substitute capacity on some occasions.

Accordingly, the employee is not considered an officer within the purview of sections 401(a)(4) and 410(b) of the Code. However, such an employee, although not included in the officer group, may be a shareholder or a highly compensated employee.

The principles and conclusion stated herein are applicable to those plans described in section 410(c) of the Code.

Rev. Rul. 68-300 is superseded because the position stated therein is restated under current law in this revenue ruling.

Section 412.—Minimum Funding Standards

Minimum funding; supplementary plan. **An employee benefit plan that provides benefits that merely supplement benefits paid to the employees covered by a qualified defined benefit plan must consider the participants of the qualified plan in applying the minimum funding standards of section 302 of ERISA.**

Rev. Rul. 80-315

Advice has been requested regarding how the minimum funding standards of section 412 of the Internal Revenue Code and section 302 of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 1974-3 C.B. 1, 38, apply under the circumstances described below, to a plan which provides benefits which merely supplement benefits paid to employees covered by a qualified defined benefit plan.

Corporation *B* maintains Plan *Y*, a qualified defined benefit plan. *B* established Plan *X*, an employee benefit plan within the meaning of section 3(2) of ERISA, *supra* at 2, which provides that employees who receive benefits under Plan *Y* will also receive benefits supplementing their benefits under Plan *Y* to reflect post-retirement cost-of-living increases. In addition, Plan *X* provides a social security supplement, as described in section 1.411(a)-7(b)(4) of the Income Tax Regulations. Plan *X* contains no other provisions indicating which employees are considered participants or how benefits under Plan *X* accrue and vest. Plan *X* is subject to the minimum funding requirements of section 302 of ERISA.

Section 412 of the Code and section 302 of ERISA describe the minimum funding standards applicable to most pension plans. Section 412 applies only to certain qualified pension plans, and under section 4 of ERISA section 302 applies, in general, to most employee pension benefit plans. Consequently, certain pension plans which are not subject to the qualification requirements of the Code, or which do not satisfy those requirements, must, nevertheless, comply with the minimum funding standards of section 302 of ERISA.

The minimum funding standard imposed by section 412 of the Code or section 302 of ERISA requires that a determination be made of which employees are covered by the plan and, therefore, may be entitled to receive benefits according to the terms of the plan.

Plan *X* specifies only that benefits will be paid by Plan *X* to supplement benefits received under Plan *Y*. Although benefits from Plan *X* are thus paid in conjunction with those of Plan *Y*, Plan *X* and Plan *Y* are nevertheless considered distinct plans. As such, the minimum funding requirements are determined separately for each. However, absent any specific plan provisions specifying participants, the participants in Plan *Y* are also the participants in Plan *X*. This treatment is necessary to satisfy the requirement that the plan provisions may not impose, directly or indirectly, a minimum age or service requirement, that does not independently satisfy section 202(a) of ERISA, *supra* at 22. See section 1.420(a)-(3)(e)(1) of the Income Tax Regulations.

Accordingly, Plan *X* must consider the participants of Plan *Y* in applying the minimum funding standards of section 302 of ERISA.

Section 446.—General Rule for Methods of Accounting

26 CFR 1.446-1: General rule for methods of accounting.

Tax treatment of retired recovered mass asset materials from an electric utility's distribution and transmission systems. See Rev. Rul. 80-311, page 5.

Section 501.—Exemption from Tax on Corporations, Certain Trusts, Etc.

Hospital service organization; purchasing; legal title. An organization that otherwise qualifies as a cooperative hospital service organization within the meaning of section 501(e) of the Code, that buys hospital equipment for its patron hospitals, and that holds legal title to the equipment while the hospitals repay a commercial lender for the loan used to purchase the equipment is operated solely to perform the service of "purchasing" within the meaning of section 501(e)(1)(A).

Rev. Rul. 80-316

ISSUE

Is the organization described below, which otherwise qualifies for exemption from federal income tax as a cooperative hospital service organization described in section 501(e) of the Internal Revenue Code, operated solely to perform the service of "purchasing" within the meaning of section 501(e)(1)(A)?

FACTS

The organization buys hospital equipment from suppliers when requested to do so by one or more of its patron hospitals that constitute its governing body and operate it on a cooperative basis. However, it holds legal title to the equipment while a patron hospital, which as the equitable owner of the equipment, pays the principal and interest payments on the equipment. Such payments are transmitted to a commercial lender whose funds were used by the organization to finance the buying of the equipment. Each patron hospital makes payments only on the equipment it is buying.

LAW AND ANALYSIS

Section 501(e) of the Code defines a cooperative hospital service organization, and treats it as described in section 501(c)(3) for purposes of exemption from federal income tax under section 501(a).

Section 501(e)(1)(A) of the Code provides that a cooperative hospital service organization may perform on a centralized basis the service of "purchasing" which, if performed by a hospital exempt from federal income tax under section 501(c)(3), would constitute performance of the hospital's exempt purpose.

Although the organization described above holds legal title to the equipment it purchases for its patron hospitals, that arrangement is used merely as a convenience to its patron hospitals that are the beneficial owners of and solely responsible for paying for the equipment.

HOLDING

The organization described above is operated solely to perform the service of "purchasing" within the meaning of section 501(e)(1)(A) of the Code and, because it otherwise qualifies as a cooperative hospital service organization described in section 501(e), is exempt from federal income tax under section 501(a).

APPLICATION INSTRUCTIONS

Even though an organization considers itself within the scope of this revenue ruling, it must file an application on Form 1023, Application for Recognition of Exemption, in order to be recognized by the Service as exempt under section 501(e) of the Code. See section 1.501(a)-1 of the Income Tax Regulations. In accordance with the instructions to Form 1023, the application should be filed with the District Director of Internal Revenue for the key district indicated therein.

Section 613.—Percentage Depletion

26 CFR 1.613-5: Taxable income from the property.

Percentage depletion; taxable income from property; damages. Damages paid as a result of a breach of contract suit by a mineowner who was unable to deliver the mineral required by the contract because of a decrease in production are not deductible from gross income from mining for purposes of computing percentage depletion.

Rev. Rul. 80-317

ISSUE

Is the amount of damages paid by the taxpayer deductible from gross income from mining in computing the taxable income from mining pursuant to section 613 of the Internal Revenue Code under the circumstances described below?

FACTS

A entered into a contract with *B*, an unrelated purchaser of mineral mined from *A*'s mine. The contract provided for the sale and delivery to *B* of a specified amount of *A*'s production each year for 5 years. *A* delivered the mineral to *B* for the first 2 years. After that, *A* was unable to deliver any mineral to *B* because of a decrease in production. Therefore, *B* had to acquire the mineral from other sources. *B* sued *A* for breach of contract and was awarded *x* dollars as damages.

LAW AND ANALYSIS

Section 611(a) of the Code provides that in the case of mines there shall be allowed as a deduction in computing taxable income a reasonable allowance for depletion according to the peculiar circumstances in each case, made under regulations prescribed by the Secretary. In the case of certain natural deposits, section 613 provides that the allowance for depletion shall be a specified percentage of the gross income from the property. Such allowance for depletion shall not exceed 50 percent of the taxpayer's taxable income from the property.

Section 613(c)(1) of the Code defines the term "gross income from the property," in the case of a property other than an oil or gas well, as the gross income from mining.

Section 1.613-4(a) of the Income Tax Regulations defines the term "gross income from mining" as that amount of income attributable to the extraction of ores or mineral from the ground and the application of mining processes, including mining transportation.

Section 1.613-5(a) of the regulations defines the term "taxable income from the property," as used in section 613, to mean "gross income from the property" less all allowable deductions that are attributable to mining processes with respect to which depletion is claimed.

In *Island Creek Coal Co. v. Commissioner,* 382 F.2d 35 (4th Cir. 1967), the Fourth Circuit determined that premiums paid for business interruption insurance were not deductible for percentage depletion purposes because the relationship of the processes of extraction and mining treatment was too remote. Income received from business interruption insurance is also not includible in gross income from mining because the receipts are not occasioned by the production of a mineral with consequent depletion of that mineral deposit but are paid in lieu of lost profits. *Guthrie v. United States,* 323 F.2d 142 (6th Cir. 1963). Similarly, amounts received in settlement of a breach of contract are not includible in gross income from mining. Rev. Rul. 77-57, 1977-1 C.B. 166.

Rev. Rul. 60-74, 1960-1 C.B. 253, provides that charitable contributions made by mining corporations which are deductible under section 170 of the Code need not be deducted in computing taxable income from the property, but payments to charitable organizations which constitute ordinary and necessary business expenses attributable to the mineral property must be deducted in computing the limitation on the percentage depletion allowance.

In the instant case, the payment of damages for breach of contract is not attributable to mining processes. The expenditure was not an ordinary and necessary cost of extracting and mining a depletable mineral product and was not related to production of income from an extracted mineral. Rather than a cost of production of a mineral, the payment of damages was occasioned by the lack of production.

HOLDING

The amount of damages paid by *A* is not deductible from gross income from mining in computing taxable income from the property for percentage depletion purposes of section 613.

Section 1491.—Imposition of Tax [Tax on Transfers to Avoid Income Tax]

26 CFR 1.1491-1: Imposition of tax.

Tax on transfer to foreign trust; Virgin Islands resident. Section 1491 of the Code does not apply to the transfer of appreciated property to a Virgin Islands trust by a U.S. citizen who is a permanent resident of the Virgin Islands.

Rev. Rul. 80-318

ISSUE

Does section 1491 of the Internal Revenue Code apply to a transfer of appreciated property, by a United States citizen who is a permanent resident of the United States Virgin Islands, to a revocable United States Virgin Islands trust?

FACTS

A is a United States citizen who is a permanent resident of the United States Virgin Islands. *A* has created a revocable United States Virgin Islands trust. *A* proposes to transfer appreciated real estate that is located in the Virgin Islands and stocks and securities in domestic corporations to the trust in 1980. *A* files an income tax return with, and pays the tax into, the treasury of the United States Virgin Islands. The trust is a foreign trust for purposes of section 7701(a)(31) of the Code.

LAW AND ANALYSIS

Section 1491 of the Code provides that an excise tax will be imposed on the transfer of property by a citizen or resident of the United States, or by a domestic corporation or partnership, or by an estate or trust which is not a foreign estate or trust, to a foreign corporation as paid-in surplus or as a contribution to capital, or to a foreign estate or trust, or to a foreign partnership. The excise tax imposed is equal to 35 percent of the excess of (1) the fair market value of the property transferred over (2) the sum of (A) the adjusted basis (for determining gain) of such property in the hands of the transferor, plus (B) the amount of the gain recognized to the transferor at the time of the transfer. Section 1491 is part of Chapter 5 of Subtitle A of the Code, which relates to income taxes.

The Naval Appropriations Act of 1921, 48 U.S.C.A. section 1397 (1976), provides that the income tax laws in force in the United States of America, and those which may hereafter be enacted, shall be held to be likewise in force in the Virgin Islands of the United States, except that the proceeds of such taxes shall be paid into the treasuries of said islands.

Section 28(a) of the Revised Organic Act of the Virgin Islands, 48 U.S.C.A. section 1642 (Supp. 1979), Pub. L. 517, 1954-2 C.B. 595, provides that the proceeds of customs duties, the proceeds of the United States income tax, the proceeds of any taxes levied by the Congress on the inhabitants of the Virgin Islands, and the proceeds of all quarantine, passport, immigration, and naturalization fees collected in the Virgin Islands, less the cost of collecting all of said duties, taxes, and fees, shall be covered into the treasury of the Virgin Islands, and shall be available for expenditure as the Legislature of the Virgin Islands may provide. The Revised Organic Act further provides that the term "inhabitants of the Virgin Islands" as used in this section shall include all persons whose permanent residence is in the Virgin Islands, and such persons shall satisfy their income tax obligations under applicable taxing statutes of the United States by paying their tax on income derived from all sources, both within and outside the Virgin Islands, into the treasury of the Virgin Islands.

The income tax laws in force in the Virgin Islands are the same as the United States income tax laws although the United States and the Virgin Islands are separate and distinct taxing jurisdictions. This duplication or "mirror" tax scheme was established for the Virgin Islands by the Naval Appropriations Act of 1921. In construing the Internal Revenue Code, as in effect in the Virgin Islands, it is necessary in some sections of the law to substitute the words "Virgin Islands" for the words "United States" in order to give the law the proper effect. Rev. Rul. 73-315, 1973-2 C.B. 225, and Rev. Rul. 80-40, 1980-1 C.B. 175.

United States citizens domiciled in the Virgin Islands, who qualify as inhabitants of the Virgin Islands, as defined in section 28(a) of the Revised Organic Act of the Virgin Islands (for example, a permanent resident), are required to satisfy their income tax obligations to the United States by filing their returns with, and paying tax on income derived from all sources, both within and without the Virgin Islands, into the treasury of the Virgin Islands. Rev. Rul. 60-291, 1960-2 C.B. 407.

While section 1491 of the Code may impose an excise tax on the transfer of appreciated property by a United States citizen to a foreign trust, it is part of the income tax laws of the United States within the meaning of the Naval Appropriations Act of 1921, since it is part of Chapter 5 of Subtitle A of the Code, which is entitled "Income Taxes," and it was specifically enacted as a tax on transfers to avoid income tax. See H. Rep. No. 708, 72nd Cong., 1st Sess. 51 (1932); S. Rep. No. 665, 72nd Cong., 1st Sess. 56 (1932). Thus, it is part of the Virgin Islands tax code. A transfer of appreciated property by a United States citizen, who is a permanent resident of the Virgin Islands, to a Virgin Islands trust is a domestic transaction that is not subject to section 1491 of the Virgin Islands code.

HOLDING

Section 1491 of the Code is part of the "income tax laws" of the United States within the meaning of the Naval Appropriations Act of 1921, and thus part of the Virgin Islands tax code. *A* satisfies all United States income tax obligations by filing a return with, and paying the taxes due into, the treasury of the Virgin Islands, in accordance with the Revised Organic Act of the Virgin Islands. Therefore, section 1491 of the Code does not apply to *A*'s transfer of appreciated Virgin Islands real estate and stocks and securities in domestic corporations to *A*'s revocable Virgin Islands trust. Further, section 1491 of the Virgin Islands code does not apply to *A*'s transfer since it is a domestic transaction for Virgin Islands purposes.

Section 2031.—Definition of Gross Estate

26 CFR 20.2031-1: Definition of gross estate; valuation of property.
(Also Section 2053; 20.2053-4.)

Buyer's "points" assumed by seller-decedent. An individual entered into an arm's length agreement to sell a personal residence and to pay mortgage "points" for the buyer that were to be deducted from the sale proceeds, but died before consummating the sale. The amount includible in the individual's gross estate is the sales price of the property less the "points" assumed by the seller, and the "points" are not deductible under section 2053(a)(3) or (a)(4) of the Code.

Rev. Rul. 80-319

ISSUE

Under section 2031(a) of the Internal Revenue Code, should the contract sales price of a decedent's residence be reduced by the points that the decedent agreed to pay a mortgage lender under a contract of sale executed prior to the decedent's death?

FACTS

On June 1, 1977, the decedent, *D*, entered into an arm's length written sales agreement with *A*. Pursuant to the agreement, *D*'s residence was to be conveyed to *A* within 90 days for 80*x* dollars. *A* was to pay 20*x* dollars as a down payment. In addition, *A* was to obtain a home mortgage loan of 60*x* dollars.

With respect to the fee payable in connection with the acquisition of the mortgage (normally measured as a percentage of the face amount of the mortgage, each one percent being referred to as a "point"), the contract stated that *A* was to pay one point. Any additional amount, not exceeding five points, was to be borne by *D*. *D* and *A* agreed that the points assumed by *D* would be deducted from the proceeds that would be paid to *D*. *A* secured a loan commitment providing for the payment of six points.

D died on June 20, 1977. After *D*'s death, the executor completed the sale to *A* according to the terms of the agreement. The cost of the points assumed by *D* was 3*x* dollars. Consequently, the amount received by the executor upon the sale of the property was 77*x* dollars.

Under applicable local law, ownership of real property is regarded as vested in the seller at the time of death if the seller died after executing a contract of sale but before actual conveyance of the property. Local law also provides that, unless and until the contract of sale is consummated, the seller is not obliged to pay the points. When the contract is consummated, the points are merely an offset to the consideration. Therefore, the seller is never personally obligated to pay the points.

LAW AND ANALYSIS

Section 2031(a) of the Code provides generally that the value of a decedent's gross estate shall be determined by including the value, at the time of death, of all property, real or personal, tangible or intangible, wherever situated. In computing the value of the taxable estate, section 2053(a)(3) and (a)(4) allows as deductions from the value of the decedent's gross estate amounts for claims against the estate and mortgages and indebtednesses in respect of property, subject to certain limitations.

The value of property includible in the gross estate is the fair market value at the time of the decedent's death. Generally, the fair market value of the decedent's property can be established by a sale of the property around the date of the decedent's death if the consideration for the property was arrived at by arm's length negotiations. See, for example, *Estate of Ballas v. Commissioner*, T.C. Memo. 1975-103.

In the present situation, the interest includible in *D*'s gross estate is the real property because *D* was regarded as the owner of the property under local law. Inasmuch as *D* and *A* negotiated the sale of the residence in an arm's length transaction immediately before the date of *D*'s death, the value agreed upon by *D* and *A* is regarded as the fair market value of the property.

For purposes of the federal income tax, points paid by a seller of a residence as a condition to the acquisition of a mortgage loan by the buyer of the residence reduce the amount realized by the seller. See Rev. Rul. 68-650, 1968-2 C.B. 78. This principle is applicable in determining the fair market value of a decedent's residence for purposes of section 2031(a) of the Code. Consequently, if a contract of sale negotiated by the decedent is regarded as establishing the value of the residence and the decedent, as seller, agreed or local law provides that the points assumed by the decedent would be an offset to the sale price, the fair market value of the residence is computed by reducing the sale price by the cost of the points.

Because the points offset the amount actually received in exchange for the property pursuant to a contract entered into by the decedent prior to the decedent's death and neither the decedent nor the property would be liable for the payment of such points, the amount of these points is not deductible under section 2053(a)(3) or (a)(4) of the Code.

HOLDING

The amount includible under section 2031(a) of the Code with regard to *D*'s residence is 77*x* dollars, and no deduction is allowable under section 2053 (a)(3) or (a)(4) with regard to the points.

Section 2053.—Expenses, Indebtedness, and Taxes

26 CFR 20.2053-4: Deduction for claims against the estate; in general.

Whether buyer's points assumed by the seller-decedent prior to death are deductible by the estate. See Rev. Rul. 80-319, page 12.

Section 4121.—Imposition of Tax [Coal]

26 CFR 48.4121-1: Imposition and rate of tax on coal.

T.D. 7726 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 48.—MANUFACTURERS AND RETAILERS EXCISE TAXES

Excise tax on coal

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to the excise tax on coal. Changes to the applicable law were made by the Black Lung Benefits Revenue Act of 1977 [Pub. L. 95-227, 1978-1 C.B. 494]. The regulations provide the public with the guidance needed to comply with the Act and affect all producers who mine or reclaim coal in the United States.

DATE: The regulations are effective for coal sold or used by the producer in other than a mining process after March 31, 1978.

FOR FURTHER INFORMATION CONTACT: Robert H. Waltuch of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3287, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On August 27, 1979, the Federal Register published proposed amendments to the Excise Tax Regulations (26 CFR Part 48) under section 4121 of the Internal Revenue Code of 1954 (44 FR 50065). The amendments were proposed to conform the regulations to section 2 of the Black Lung Benefits Revenue Act of 1977 (Pub. L. 95-227; 92 Stat. 11) [*supra*]. A public hearing was held on January 10, 1980. After consideration of all comments regarding the proposed amendments, those amendments are adopted as revised by this Treasury decision.

SUMMARY OF
FINAL REGULATIONS

Under section 4121 of the Code, an excise tax is imposed on the sale or use of coal by the producer. The proposed regulation defined the term "producer" as the person who owns the coal immediately after extraction from the mine. One commentator disagreed with this approach and requested that the Treasury adopt a rule apportioning the excise tax between the royalty owner and the operator of the mine. The requested change has not been made regarding the definition of the term "producer" because the tax imposed under section 4121 is on the first sale of coal by the producer. However, the definition of the term "producer" has been expanded to include any person who extracts coal from coal waste refuse piles. Several examples have been added to illustrate the application of the definition of the term "producer."

Several comments were received criticizing the method used in determining the existence of lignite. The proposed regulation defined lignite in accordance with the standard specification for the classification of coals by rank of the American Society for Testing and Materials (Annual Book of ASTM Standards, Part 26, D 388). The criticism was based on the high cost involved and the inaccurate results that may be obtained. Despite these criticisms the legislative history is clear that the ASTM classification is to be used. Therefore, the regulation has not been revised as it relates to the definition of lignite.

Paragraph (c) of § 48.4121-1 of the proposed regulations has been revised to clarify two other issues raised at both the public hearing and in the written comments. The first issue clarified is that silt waste is not subject to the excise tax on coal. The second issue is that in determining whether all or a portion of a particular mine contains lignite, all the facts and circumstances will be considered. For example, the Service will examine the contract price, contract specifications and will also determine whether lignite is commonly found in the area. Furthermore, to claim the exemption, the producer must maintain records which clearly identify the portion of the mineral from the mine that is lignite.

The final issue raised at the hearing and in the comments was the inequity that arises when the small mining company sells raw coal to a cleaning plant and must pay the tax based upon the uncleaned weight. After carefully considering this problem, the proposed regulation has not been revised because under section 4121, the tax is imposed on the first sale of coal, not upon the first sale after the coal has been cleaned.

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[1] This publication of the Treasury Decision contains the complete text of the amendments to the regulations. The instruction for modifying the notice of proposed rulemaking have been omitted.

DRAFTING INFORMATION

The principal author of this regulation is Robert H. Waltuch of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Parts 48 and 139 are amended as follows:

Paragraph 1. § 48.4121-1 is added to read as set forth below.

§ 48.4121-1 Imposition and rate of tax on coal.

(a) *Imposition of tax.*—(1) *In general.* Section 4121(a) imposes a tax on coal mined at any time in this country if the coal is sold or used by the producer after March 31, 1978 (see section 4218 and the regulations under that section for rules relating to the use of coal being treated as a sale of coal). For purposes of this section, the term "producer" means the person in whom is vested ownership of the coal under state law immediately after the coal is severed from the ground, without regard to the existence of any contractual arrangement for the sale or other disposition of the coal or the payment of any royalties between the producer and third parties. The term includes any person who extracts coal from coal waste refuse piles or from the silt waste product which results from the wet washing (or similar processing) of coal. However, the excise tax does not apply to a producer who sells the silt waste product without extracting the coal from it, or to the producer who uses the silt waste product without extracting the coal from it. Furthermore, the excise tax does not apply to the sale or use of the silt waste product after any coal has been extracted from it.

(2) *Examples.* Paragraph (a)(1) of this section may be illustrated by the following examples:

Example (1). A, a limited partnership, is the owner of land on which a coal mine is located. A contracts with XYZ Company to extract the coal for a set price per ton. XYZ Company is an independent contractor and has no ownership interest in the coal mined. Under state law, A is the owner of the coal immediately after severance. After XYZ extracts the coal from the mine, A sells the coal. A is the producer of the coal and is responsible for the payment of the excise tax.

Example (2). A, a limited partnership, is the owner of land on which a coal mine is located. A leases the land to XYZ Company, and XYZ Company extracts coal from the mine and sells it. Under state law, XYZ is the owner of the coal immediately after the coal is severed from the ground. XYZ Company is the producer and must pay the excise tax. This is true even though the lease agreement requires XYZ to pay a royalty to A.

Example (3). XYZ Company purchases a coal waste refuse pile from B and extracts the coal from the waste refuse pile and sells the coal. XYZ is the producer and must pay the excise tax.

Example (4). XYZ Company is a producer of coal and operates its own cleaning plant. After wet washing the coal, it sells the coal and the silt waste product. The sale of the coal is subject to the excise tax whereas the sale of the silt is not.

Example (5). Assume the same facts as in example (4) except that before selling the silt waste product XYZ Company extracts a small quantity of finely sized coal from the silt waste product and then sells both the finely sized coal and the silt waste product. The sale of the finely sized coal is subject to the excise tax whereas the sale of the silt is not.

(b) *Rate of tax.*—(1) *Underground mines; surface mines.* The rate of tax imposed on coal from underground mines located in the United States is the lower of 50 cents per ton (2,000 pounds), or 2 percent of the sale price. The rate of tax imposed on coal from surface mines located in the United States is the lower of 25 cents per ton (2,000 pounds) or 2 percent of the sale price. If a sale or use includes a portion of a ton, the tax is applied proportionately. Thus, if 1,200 pounds of coal from an underground mine are sold for $35.00, the tax is 30 cents.

(2) *Combination.* If a single mine yields coal from both surface and underground mining, the producer must determine the rate (50 cents or 25 cents per ton) for each ton of coal mined. It is presumed that coal is mined from underground mines (50 cents per ton) unless the producer keeps sufficient records to establish to the satisfaction of the Secretary that the coal was mined from a surface mine.

(c) *Exemptions.*—(1) *Lignite or imported coal.* The excise tax on coal does not apply to lignite or imported coal. Lignite is defined in accordance with the standard specification for classification of coals by rank of the American Society for Testing and Materials (Annual Book of ASTM Standards, Part 26, D 388). The procedures specified in D 388 must be followed. If a producer extracts both taxable coal and lignite, then the producer must maintain adequate records to establish the portion of the mineral mined that is exempt from the tax. In determining whether all or a portion of the mineral extracted is lignite, the Service will consider all the facts and circumstances. For example, if a producer sells lignite and coal, the Service will examine all the facts and circumstances, including the contract price, contract specifications, and the amount of lignite extracted as it compares to the amount of lignite sold.

(2) *Other exemptions not applicable.* There are no exemptions for sales for further manufacture, for export, for use as supplies for vessels or aircraft, for the use of a State or local government, or for the use of a nonprofit educational organization. Furthermore, the Secretary does not have discretion to exempt sales of coal for use of the United States from the tax. There is also no exemption from the coal excise tax when the coal is used in further manufacture of another article that is subject to manufacturers excise tax. For example, if a producer of coal converts coal into gasoline which the producer then sells, the producer is liable for the coal excise tax when the coal is converted into gasoline and also liable for the manufacturers excise tax on gasoline when the gasoline is sold.

(d) *Definitions and special rules.*—(1) *Coal produced from surface mine.* Coal is treated as produced from a surface mine if all of the geological matter (e.g. trees, earth, rock) above the coal is removed before the coal is mined. In addition, both coal mined by auger and coal that is reclaimed from coal waste refuse piles are treated as produced from a surface mine.

(2) *Coal produced from underground mine.* Coal is treated as produced from an underground mine if it is not produced from a surface mine.

(3) *Coal used by the producer.* For purposes of this section, the term "coal used by the producer" means use by the producer in other than a mining process. A mining process is determined the same way it is determined for percentage depletion purposes. For example, a producer who mines coal does not "use" the coal and thereby becomes liable for the tax merely because, before selling the coal, the producer breaks it, cleans it, sizes it, or applies one of the other processes listed in section 613(c)(4)(A) of the Code. In such a case, the producer will be liable for the tax only when he sells the coal. On the other hand, a producer who mines coal does become liable for the tax when he uses the coal as fuel, as an ingredient in making coke, or in another process not treated as "mining" under section 613(c).

(4) *Tonnage sold and sales price.* For purposes of determining both the amount of coal sold by a producer and the sales price of the coal, the point of sale is f.o.b. mine, or f.o.b. cleaning point if the producer cleans the coal before selling it. This is true even if the producer sells the coal on the basis of a delivered price. Accordingly, f.o.b. mine or cleaning point is the point at which the number of tons sold is to be determined for purposes of applying the applicable tonnage rate, and the point at which the sales price is to be determined for purposes of the tax under the 2 percent rate.

(5) *Constructive sale price.* If a producer uses coal mined by the producer in other than a mining process, a constructive sale price must be used in determining the tax under the 2 percent rate. This constructive price is determined under sections 613(c) and 4218(e) of the Code, and is based on sales of like kind and grade of coal by the producer or other producers made f.o.b. mine (if the coal is used without first being cleaned) or f.o.b. cleaning plant (if the coal is cleaned before it is used). Normally, this constructive price will be the same as the constructive price used in determining the producer's percentage depletion deduction.

(e) *Due date of tax returns; payment of tax, and tax deposits.* For information relating to the due date of tax returns and the time and place for the payment of the tax see § 48.6011(a)-1, § 48.6151-1 and § 48.6071(a)-1 of the Manufacturers and Retailers Excise Tax Regulations. The return form is Form 720, Quarterly Federal Excise Tax Return. For information relating to tax deposits, see § 48.6302(c)-1 of the Manufacturers and Retailers Excise Tax Regulations and Form 720 (Quarterly Federal Excise Tax Return) and the accompanying instructions.

Par. 2. Section 139.4121-1 is revoked.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved September 22, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on October 6, 1980, 8:45 a.m., and published in the issue of the Federal Register for October 7, 1980, 45 F.R. 66452)

Section 6103.—Confidentiality and Disclosure of Returns and Return Information

26 CFR 301.6103(j)(1)-1: Disclosures of return information to officers and employees of the Department of Commerce for certain statistical purposes and related activities.

T.D. 7724[1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART 301.—REGULATIONS ON PROCEDURE AND ADMINISTRATION; PART 404.—TEMPORARY REGULATIONS ON PROCEDURE AND ADMINISTRATION UNDER THE TAX REFORM ACT OF 1976

Disclosure of return information to and by officers and employees of the Department of Commerce for certain statistical purposes and related activities

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document contains final regulations relating to the disclosure of certain return information to and by officers and employees of the Department of Commerce for certain statistical purposes and related activities. They affect all disclosures to and by the Bureaus of the Census and Economic Analysis.

DATE: The regulations apply to disclosures of return information after December 31, 1976.

FOR FURTHER INFORMATION CONTACT: David E. Dickinson of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3218.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On March 24, 1980, the Federal Register published proposed regulations relating to disclosure of return information to and by the Bureaus of the Census and Economic Analysis of the Department of Commerce for certain statistical purposes under section 6103(j)(1) of the Internal Revenue Code of 1954. A public hearing was requested, but the request was withdrawn. After considering the two comments received, those proposed regulations are adopted as revised by this Treasury decision.

These regulations provide rules governing disclosures of return information to certain officers and employees of the Department of Commerce for statistical purposes and related activities authorized by section 6103(j)(1) of the Code.

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[1] This publication of the Treasury Decision contains the complete text of the amendments to the regulations. The instructions for modifying the notice of proposed rulemaking have been omitted.

The regulations describe in detail the particular return information which the Service will disclose to officers and employees of the Bureaus of the Census and Economic Analysis for use in statistical programs and related activities authorized by law. The regulations also prescribe the procedures to be followed with respect to requested disclosures of return information and the limited extent to which such return information can be redisclosed and provide that the confidentiality of return information disclosed as provided by the regulations must be protected to the satisfaction of the Service.

Two comments were received with respect to the proposed regulations. One objected on principle to the disclosure of any return information to the Bureaus of the Census and Economic Analysis. This objection fails to recognize that section 6103(j)(1) of the Code specifically authorizes such disclosures.

The second comment came from the Bureau of the Census and relates to a technical flaw in the proposed regulations. Prior to February 21, 1980, the temporary disclosure regulations authorized the disclosure of return information to the Bureau for purposes of conducting statistical programs "authorized by law." This authority permitted Bureau access to return information for both mandated statistical programs described in chapter 5 of Title 13, United States Code, and discretionary statistical programs conducted by the Bureau at the request of other agencies and persons under the authority of chapter 1 of Title 13. On February 21, 1980, however, the temporary regulations were amended to restrict Bureau use of return information to mandated statistical programs under chapter 5. At the time of this amendment, the fact was overlooked that the Bureau was in the process of conducting an important chapter 1 study requested by another Federal agency and was using employment tax data for this purpose. The effect of the amendment was to deny the Bureau further access to employment tax data to complete the study.

Because the Bureau undertook this chapter 1 study in reliance on regulatory authority in existence at the time, these final regulations effectively permit the Bureau to continue using employment tax data in order to complete its chapter 1 study. See § 301.6103 (j)(1)-1(b)(5).

Finally, these final regulations make minor technical amendments to § 301.6103(j)(1)-1(b)(3)(ii) and (iii), as proposed, to authorize disclosure of a consolidated return indicator and to conform the description of return information to be disclosed to business related information readily available from Form 1040, Schedule F.

DRAFTING INFORMATION

The principal author of these regulations was David E. Dickinson of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of the regulations

Accordingly, the following amendments to the regulations are hereby adopted:

REGULATIONS ON PROCEDURE AND ADMINISTRATION (26 CFR PART 301)

Paragraph 1. The following new section is added immediately after § 301.6103(i)-1:

§ 301.6103(j)(1)-1 Disclosures of return information to officers and employees of the Department of Commerce for certain statistical purposes and related activities.

(a) *General rule.* Pursuant to the provisions of section 6103(j)(1) of the Internal Revenue Code and subject to the requirements of paragraph (d) of this section, officers or employees of the Internal Revenue Service will disclose return information (as defined by section 6103(b)(2) but not including return information described in section 6103(o)(2)) to officers and employees of the Department of Commerce to the extent, and for such purposes as may be, provided by paragraphs (b) and (c) of this section. Further, in the case of any disclosure of return information so provided by paragraphs (b) and (c), the tax period or accounting period to which such return information relates will also be disclosed.

(b) *Disclosure of return information to officers and employees of the Bureau of the Census.* (1) Officers or employees of the Service will disclose the following return information reflected on returns of an individual taxpayer to officers and employees of the Bureau of the Census for purposes of, but only to the extent necessary in, conducting and preparing, as authorized by chapter 5 of Title 13, United States Code, intercensal estimates of population and per capita income for all geographic areas included in the general revenue sharing program and demographic statistics programs, censuses and related program evaluation—

(i) Taxpayer identity information (as defined in section 6103(b)(6) of the Code), validity code with respect to the taxpayer identifying number (as described in section 6109), and taxpayer identifying number of spouse, if reported;

(ii) District office and service center codes;

(iii) Marital status;

(iv) Number and classifications of reported exemptions;

(v) Adjusted gross income;

(vi) Wage and salary income;

(vii) Dividend income;

(viii) Interest income;

(ix) Gross rent and royalty income;

(x) Entity code;

(xi) Residence information from the revenue sharing question;

(xii) Code indicators for Form 1040; Schedules C, D, E, F, and SE;

(xiii) Julian date relative to filing; and

(xiv)(A) Earned income credit, and

(B) Advance earned income credit payments received.

(2) Officers or employees of the Service will disclose to officers and employees of the Bureau of the Census for purposes of, but only to the extent

necessary in, conducting, as authorized by chapter 5 of Title 13, United States Code, demographic, economic, and agricultural statistics programs and censuses and related program evaluation—

(i) From the business master files of the Service, the taxpayer name directory and entity records consisting of taxpayer identity information (as defined in section 6103(b)(6)) with respect to taxpayers engaged in a trade or business, the principal industrial activity code, and monthly corrections of, and additions to, such entity records.

(ii) From Form SS-4, all return information reflected on such return;

(iii) From an employment tax return—

(A) Taxpayer identifying number (as described in section 6109) of the employer and any employee identified on such return,

(B) Total compensation reported,

(C) Total number of employees reflected on such return,

(D) Master file tax account number,

(E) Taxable period covered by such return,

(F) Employment code,

(G) Final return indicator,

(H) Document locator number,

(I) Record code,

(J) Total number of individuals employed in the taxable period covered by the return,

(K) Taxable wages paid for purposes of chapter 21 to each such employee,

(L) Taxable tip income for purposes of chapter 21 reported on the return with respect to each such employee,

(M) Total taxable wages paid for purposes of chapter 21, and

(N) Total taxable tip income reported for purposes of chapter 21; and

(iv) From Form 1040, Schedule SE—

(A) Taxpayer identifying number of self-employed individual,

(B) Business activities subject to the tax imposed by chapter 21,

(C) Net earnings from farming,

(D) Net earnings from nonfarming activities,

(E) Total net earnings from self-employment, and

(F) Taxable self-employment income for purposes of chapter 2.

(3) Officers or employees of the Service will disclose the following business related return information reflected on the return of a taxpayer to officers and employees of the Bureau of the Census for purposes of, but only to the extent necessary in, conducting and preparing, as authorized by chapter 5 of Title 13, United States Code, demographic, economic, and agricultural statistics programs and censuses—

(i) From Form 1040, Schedule C, taxpayer identity information (as defined in section 6103(b)(6)), the principal industrial activity code, reported gross receipts, returns and allowances, cost of labor, and salaries and wages;

(ii) From Form 1120F, Section II, and Forms 1065, 1120, 1120S, 990C, and 990T, the taxpayer identifying number (as described in section 6109), the principal industrial activity code, the consolidated return indicator (if any), and reported gross receipts less returns and allowances;

(iii) From Form 1040, Schedule F, taxpayer identity information, reported gross profits, and labor hired;

(iv) From Form 1040, Schedule C, and Forms 1065, 1120, and 1120S, answers to the business activity questions;

(v) From Form 1040, Schedule C, business address and answer to the question relating to Form 941;

(vi) From Form 990PF, the taxpayer identifying number, the principal industrial activity code, and reported total receipts;

(vii) From Form 1065, the names and taxpayer identifying numbers of no more than 10 members of the partnership; and

(viii) From Form 1120S, the names and taxpayer identifying numbers of, and the number of shares of stock owned by, no more than 10 shareholders of the corporation.

(4) Officers or employees of the Service will disclose return information relating to a taxpayer contained in the exempt organization master files of the Service to officers and employees of the Bureau of the Census for purposes of, but only to the extent necessary in, conducting and preparing, as authorized by chapter 5 of Title 13, United States Code, economic censuses. This return information consists of taxpayer identity information (as defined in section 6103(b)(6)), activity codes, and filing requirement code, and monthly corrections of, and additions to, such return information.

(5) Subject to the requirements of paragraph (d) of this section and § 301.6103(p)(2)(B)-1, officers or employees of the Social Security Administration to whom the following return information has been disclosed as provided by section 6103(l)(1)(A) or (5) may disclose such return information to officers and employees of the Bureau of the Census for necessary purposes described in subparagraph (2) or (3) of this paragraph (or for purposes of conducting, as authorized by chapter 1 of Title 13, United States Code, a demographic or economic statistics program or census and related program evaluation in progress as of February 21, 1980)—

(i) From Form SS-4, all return information reflected on such return;

(ii) From an employment tax return—

(A) Taxpayer identifying number (as described in section 6109) of the employer and any employee identified on such return,

(B) Total number of employees reflected on the return,

(C) Total number of individuals employed in the taxable period covered by the return,

(D) Total compensation reported,

(E) Taxable wages paid for purposes of chapter 21 to each such employee,

(F) Taxable tip income for purposes of chapter 21 reported on the return with respect to each such employee,

(G) Total taxable wages paid for purposes of chapter 21, and

(H) Total taxable tip income reported for purposes of chapter 21,

(I) Employment code; and

(iii) From Form 1040, Schedule SE—

(A) Taxpayer identifying number of self-employed individual,

(B) Business activities subject to the tax imposed by chapter 21,

(C) Net earnings from farming,

(D) Net earnings from nonfarming activities,

(E) Total net earnings from self-employment, and

(F) Taxable self-employment income for purposes of chapter 2.

(c) *Disclosure of return information to officers and employees of the Bureau of Economic Analysis.* Officers or employees of the Service will disclose to officers and employees of the Bureau of Economic Analysis for purposes of, but only to the extent necessary in, conducting and preparing, as authorized by law, statistical analyses return information consisting of Statistics of Income transcript—edit sheets containing return information reflected on returns of designated classes or categories of corporations with respect to the tax imposed by chapter 1 and microfilmed records of return information reflected on such returns where needed for further use in connection with such conduct or preparation.

(d) *Procedures and restrictions.* Disclosure of return information by officers or employees of the Service or the Social Security Administration as provided by paragraphs (b) and (c) of this section will be made only upon written request to the Commissioner of Internal Revenue by the Secretary of Commerce describing—

(1) The particular return information to be disclosed,

(2) The taxable period or date to which such return information relates, and

(3) The particular purpose for which the return information is to be used,

and designating by name and title the officers and employees of the Bureau of the Census or the Bureau of Economic Analysis to whom such disclosure is authorized. No such officer or employee to whom return information is disclosed pursuant to the provisions of paragraph (b) or (c) shall disclose such return information to any person, other than the taxpayer to whom such return information relates or other officers or employees of such bureau whose duties or responsibilities require such disclosure for a purpose described in paragraph (b) or (c), except in a form which cannot be associated with, or otherwise identify, directly or indirectly, a particular taxpayer. If the Service determines that the Bureau of the Census or the Bureau of Economic Analysis, or any officer or employee thereof, has failed to, or does not, satisfy the requirements of section 6103(p)(4) of the Code or regulations or published procedures thereunder, the Service may take such actions as are deemed necessary to ensure that such requirements are or will be satisfied, including suspension of disclosures of return information otherwise authorized by section 6103(j)(1) and paragraph (b) or (c) of this section, until the Service determines that such requirements have been or will be satisfied.

TEMPORARY REGULATIONS ON PROCEDURE AND ADMINISTRATION UNDER THE TAX REFORM ACT OF 1976 (26 CFR PART 404)

Par. 2. Section 404.6103(j)(1)-1 is deleted.

This Treasury decision is issued under the authority contained in sections 6103(j)(1) and (q) and 7805 of the Interval Revenue Code of 1954 (90 Stat. 1678 and 1685, 68A Stat. 7805; 26 U.S.C. 6103(j)(1) and (q), 7805).

JEROME KURTZ,
Commissioner of Internal Revenue.

Approved September 19, 1980.

DONALD C. LUBICK,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on October 2, 1980, 8:45 a.m., and published in the issue of the Federal Register for October 3, 1980, 45 F.R. 65561)

Part II. Treaties and Tax Legislation

Subpart B.—Legislation and Related Committee Reports

Public Law 96-330
96th Congress, H.R. 7102[1]
August 26, 1980

An Act to amend title 38, United States Code, to promote the recruitment and retention of physicians, dentists, nurses, and other health-care personnel in the Department of Medicine and Surgery of the Veterans' Administration, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That (a) this Act may be cited as the "Veterans' Administration Health-Care Amendments of 1980".

(b) Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of title 38, United States Code.

* * * * *

TITLE II—VETERANS' ADMINISTRATION HEALTH PROFESSIONAL SCHOLARSHIP PROGRAM

ESTABLISHMENT OF HEALTH PROFESSIONAL SCHOLARSHIP PROGRAM

SEC. 201. (a)(1) Chapter 73 is amended by adding at the end thereof the following new subchapter

"SUBCHAPTER IV—VETERANS' ADMINISTRATION HEALTH PROFESSIONAL SCHOLARSHIP PROGRAM

"§ 4141. Establishment of program; purpose; duration

"(a) There is hereby established a program to be known as the Veterans' Administration Health Professional Scholarship Program (hereinafter in this subchapter referred to as the 'Scholarship Program'). The purpose of the Scholarship Program is to assist in providing an adequate supply of trained physicians and nurses for the Veterans' Administration and for the Nation and, if needed by the Veterans' Administration, other health-care professionals appointed under subchapter I of this chapter.

* * * * *

"4145. Exemption of scholarship payments from taxation

"Notwithstanding any other law, any payment to, or on behalf of, a participant in the Scholarship Program for tuition, education expenses, or a stipend under this subchapter shall be exempt from taxation.

* * * * *

IN THE HOUSE OF REPRESENTATIVES, U.S.,

August 26, 1980.

The House of Representatives having proceeded to reconsider the bill (H.R. 7102) entitled "An Act to amend title 38, United States Code, to promote the recruitment and retention of physicians, dentists, nurses, and other health-care personnel in the Department of Medicine and Surgery of the Veterans' Administration, and for other purposes", returned by the President of the United States with his objections, to the House of Representatives, in which it originated, it was

Resolved, That the said bill pass, two-thirds of the House of Representatives agreeing to pass the same.

EDMUND L. HENSHAW, JR.
Clerk.

By Thomas E. Ladd
Assistant to the Clerk.

I certify that this Act originated in the House of Representatives.

EDMUND L. HENSHAW, JR.
Clerk.

By W. Raymond Colley
Deputy Clerk.

IN THE SENATE OF THE UNITED STATES,

August 26 (legislative day, June 12), 1980.

The Senate having proceeded to reconsider the bill (H.R. 7102) entitled "An Act to amend title 38, United States Code, to promote the recruitment and retention of physicians, dentists, nurses, and other health-care personnel in the Department of Medicine and Surgery of the Veterans' Administration, and for other purposes", returned by the President of the United States with his objections, to the House of Representatives, in which it originated, and passed by the House of Representatives on reconsideration of the same, it was

Resolved, That the said bill pass, two-thirds of the Senators present having voted in the affirmative.

Attest:

J. S. KIMMITT
Secretary.

House Report No. 96-958
2d Session

[Bracketed numerals indicate official report page numbers]

VETERANS' ADMINISTRATION HEALTH-CARE PERSONNEL ACT OF 1980

MAY 14, 1980.

Mr. ROBERTS, from the Committee on Veterans' Affairs, submitted the following report to accompany H.R. 7102.[1]

* * * * *

TITLE II—VETERANS ADMINISTRATION HEALTH PROFESSIONAL SCHOLARSHIP PROGRAM

Section 201(a) of the bill would amend chapter 73 of title 38 by adding thereto a new subchapter IV. This new subchapter would create the Veterans Administration Health Personnel Scholarship Program.

The first section of the proposed new subchapter (section 4141) would establish the Scholarship Program "to assist in providing an adequate supply of trained health care personnel for the

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[1] This publication of the law and House Report No. 96-958, this page, is restricted to excerpts involving tax matters. Senate Report No. 96-747 is not published.

[1] Public Law 96-330, this page.

Veterans' Administration and the Nation." The main purpose of the bill would be to enhance the Veterans Administration's ability to recruit and retain physicians, dentists, and certain other health care professionals. An incidental effect of the bill would be to increase the number of health professionals nationwide. Scholarships to new participants in this program would not be furnished after the last day of the tenth fiscal year following the fiscal year in which the program is initiated. The date of initiation of the program would be the date the first scholarship is approved by the Administrator.

* * * * *

Section 4145 of the proposed new subchapter would, notwithstanding any other provision of law, exempt from taxation any payments to, or on behalf of, a participant for tuition, reasonable education expenses, or monthly stipend under the Scholarship Program.

* * * * *

Part IV. Items of General Interest

Business or Rental Use of Dwellings

Announcement 80-151 [1]

The provisions of the Internal Revenue Code will continue to govern the extent to which taxpayers may claim deductions for the business or rental use of dwellings.

On October 1, 1980, Congressional Joint Resolution 610, involving continuing appropriations for various departments of the Federal Government for the fiscal year 1981, became law. Section 123 of that Joint Resolution provides that:

"No funds appropriated by this Act may be used to implement or enforce provisions of any regulation or ruling with respect to section 280A of the Internal Revenue Code of 1954 which relate to—

(1) the rental of a dwelling unit to a member of the family of a taxpayer,

(2) the determination of the principal place of business of the taxpayer, or

(3) the circumstances under which use of the dwelling unit for repairs and maintenance constitutes personal use by the taxpayer."

Because this section prohibits implementing or enforcing any regulation or ruling in the described areas, existing Internal Revenue Code section 280A will govern the items referred to in the Joint Resolution. Therefore, taxpayers may claim deductions relating to these items to the extent they are permitted under the provisions of the Code.

In determining whether the rental of a dwelling unit to a member of the family of the taxpayer constitutes personal use for purposes of section 280A of the Code, subsection (d) (2) of that section provides:

". . . the taxpayer shall be deemed to have used a dwelling unit for personal purposes for a day if, for any part of such day, the unit is used—

(A) for personal purposes by the taxpayer or any other person who has an interest in such unit, or by any member of the family (as defined in section 267(c) (4)) of the taxpayer or such other person;"

Section 267(c) (4) provides,

"The family of an individual shall include only his brothers and sisters, (whether by the whole or half blood), spouse, ancestors, and lineal descendants;"

Section 280A(d) concerning use of a dwelling unit for repairs and maintenance provides,

"The Secretary shall prescribe regulations with respect to the circumstances under which use of the unit for repairs and annual maintenance will *not* constitute personal use under this paragraph." (emphasis supplied)

Section 280A(c) (1) (A) provides no definition of "the taxpayer's principal place of business" in determining whether deductions may be claimed.

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[1] Based on News Release IR-80-104, dated October 9, 1980.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individual has been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Vincent E. Heyworth	Hagerstown, MD	Enrolled Agent	Six months effective September 30, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 150.4989-1(c), 150.4995-1(b)(2) revised; published as temporary regulations in T.D. 7721, 1980-42 I.R.B. 13.	Base prices of tier 2 and tier 3 oil and withholding in the absence of effective operator's certificate.	Sept. 30, 1980	Dec. 1, 1980
26 CFR 31.6205-1(b)(2) amended.	Interest-free adjustment with respect to erroneous filing of FICA and RRTA returns.	Sept. 26, 1980	Nov. 25, 1980
26 CFR 1.507-2(c)(1)(IV)(A), 1.509(a)-3, 1.509(a)-4(k)(2), 1.509(a)-5 as proposed in the Federal Register for July 24, 1979, 44 F.R. 43290, withdrawn; 1.507-2(c)(1)(IV)(A), 1.509(a)-3, 1.509(a)-4(k)(2), 1.509(a)-5, amended.	Definition of a private foundation.	Oct. 10, 1980	Dec. 9, 1980
26 CFR 1.44C-6 revised; 601.601 amended.	Secretarial authority to add items to the list of items eligible for the residential energy credit.	Oct. 15, 1980	Dec. 15, 1980

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

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______	1930–1	7.30
______	1930–2	9.50
______	*1931–1*	*3.60*
______	1931–2	13.00
______	*1932–1*	*2.80*
______	1932–2	8.65
______	*1933–1*	*3.35*
______	*1933–2*	*3.45*
______	*1934–1*	*3.70*
______	1934–2	14.00
______	1935–1	6.90
______	*1935–2*	*14.00*
______	*1936–1*	*3.55*
______	*1936–2*	*14.00*
______	*1937–1*	*13.00*
______	1937–2	7.70
______	*1938–1*	*16.00*
______	*1938–2*	*13.00*
______	1939–1–1	8.25
______	1939–1–2	10.90
______	1939–2	9.40
______	1940–1	5.55
______	1940–2	14.00
______	1941–1	*$6.95*
______	*1941–2*	*3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
______	*1944*(*)	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*12.00*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$16.00
______	1957–2	13.00
______	1958–1	9.60
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______	1959–2	9.60
______	1960–1	19.00
______	1960–2	11.50
______	1961–1	14.00
______	1961–2	10.00
______	1962–1	14.00
______	1962–2	13.00
______	1962–3	20.00
______	1963–1	9.00
______	1963–2	10.75
______	1964–1–1	10.00
______	1964–1–2	11.00
______	1964–2	9.80
______	1965–1	10.70
______	1965–2	12.25
______	1966–1	14.00
______	1966–2	14.05
______	1967–1	10.00
______	1967–2	14.00
______	1968–1	14.00
______	1968–2	11.75
______	1969–1	14.00
______	1969–2	6.50
______	1969–3	$12.50
______	1970–1	11.00
______	1970–2	14.00
______	1971–1	10.55
______	1971–2	8.50
______	1972–1	13.50
______	1972–2	13.70
______	1973–1	16.00
______	1973–2	8.30
______	1974–1	11.00
______	1974–2	9.95
______	*1974–3*	*8.20*
______	1974–3 Supp.	10.00
______	1975–1	13.25
______	1975–2	13.00
______	1976–1	11.00
______	1976–2	10.25
______	1976–3–1	9.50
______	1976–3–2	16.00
______	1976–3–3	10.00
______	1977–1	10.75
______	1977–2	11.75
______	1978–1	11.75
______	1978–2	13.00
______	1978–3–1	12.25
______	1978–3–2	9.00
______	1979–1	14.00
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December 1, 1980
Bulletin No. 1980-48

Internal Revenue bulletin

Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-321, page 6.
Lifetime services assigned to trust. A corporation's employee assigned "lifetime services" to a trust, and the trust contracted to provide services to the corporation for a monthly fee equal to what otherwise would be the employee's gross monthly salary. The employee continued to perform the same tasks for the corporation, under the same conditions, and with the same amount of control as before the assignment. The assignment is ineffective as a means of avoiding the employee's income tax liability with respect to the payments for the services.

Rev. Rul. 80-322, page 7.
Suits leased for corporate executives. A corporation leases custom-tailored suits for its executives for a two-year period and, at the end of the lease term, returns the suits to the lessor, who sells them for a nominal amount. The corporation is charged a rental fee and a consulting fee, which together equal the normal purchase price of the suits. The fair market value of the suits is includible in the executives' gross incomes, and the corporation may deduct the entire amount paid to lease the suits.

Rev. Rul. 80-323, page 8.
Transfer to controlled corporation; limited partnership interest; partnership liabilities. A limited partnership interest that is transferred in a transaction qualifying under section 351 of the Code is transferred subject to its share of partnership liabilities for purposes of sections 357(c) and 358(d). The transferor recognizes gain to the extent that the transferor's share of partnership liabilities exceeds the adjusted basis of the interest transferred.

Rev. Rul. 80-324, page 20.
Evidence of loss; confirmation statements from foreign broker. The Service is not required to assume the existence of a loss from a futures transaction in U.S. Government interest-bearing certificates carried out on a foreign exchange that is evidenced by an investment prospectus, cancelled checks, and confirmation statements from a foreign investment firm whose records are not available for examination by the Service.

Rev. Rul. 80-326, page 9.
Residence; replacement period; suspension of running of time; Puerto Rico. An individual who is transferred to Puerto Rico for a two-year period does not qualify under section 1034(k) of the Code for the suspension of the running of the period of time within which a new residence must be purchased in order for the nonrecognition of gain provisions to apply to the gain from the sale of the indvidual's old residence.

Rev. Proc. 80-51, page 23.
Change of accounting methods; application for approval. Procedures are provided under section 1.446-1(e) of the regulations for obtaining the

(Continued on page 4)

Finding Lists begin on page 36.
Announcement Relating to Decisions of the Tax Court on page 5.
Announcement of Voluntary Suspension on page 33.
Announcement of Notice of Proposed Rulemaking on page 34.
Monthly Index for November begins on page 38.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

Commissioner's consent to requests for changes of methods of accounting; Rev. Procs. 71-16, 71-16 Amendment I, 74-51, and 76-8 modified and superseded; and Rev. Procs. 70-27, 72-24, and 75-18 superseded. Various effective dates and supersedure dates are provided.

Pub. L. 96-369, page 22.
Congressional Joint Resolution 610 provides that no funds may be used to implement or enforce any regulation or ruling in certain areas under section 280A of the Code relating to deductions for business or rental use of dwellings.

Announcement 80-152, page 32.
Various areas of the States of California, New Jersey, and Texas have been declared disaster areas in which losses qualify for the special tax treatment under section 165(h) of the Code.

Announcement 80-155, page 32.
The Treasury Department invites comments on the desirability of establishing an advisory committee on issues concerning tax shelter opinions.

EXEMPT ORGANIZATIONS

Announcement 80-153, page 32.
A listing is given of organizations now classified as private foundations.

EMPLOYMENT TAXES

Rev. Rul. 80-321, page 6.
Lifetime services assigned to trust. A corporation's employee assigned "lifetime services" to a trust, and the trust contracted to provide services to the corporation for a monthly fee equal to what otherwise would be the employee's gross monthly salary. The employee continued to perform the same tasks for the corporation, under the same conditions, and with the same amount of control as before the assignment. The corporation's payments under the contract are wages for purposes of the FICA and income tax withholding.

EXCISE TAXES

Rev. Rul. 80-320, page 15.
Windfall profit tax; base price; adjustments to posted price. The effect on the determination of base price under the interim rule is described in situations in which a purchaser of crude oil adjusts the posted price.

T.D. 7727, page 10.
Amendments to the regulations under section 4042 of the Code relate to the excise tax on the use of fuel in commercial waterway transportation.

T.D. 7732, page 17.
Amendments to the temporary regulations under sections 4995, 4997, and 6402 of the Code relate to windfall profit tax deposits, returns, and refunds based on the net income limitation.

Announcement Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issue or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the tax court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decision:

Taxpayer	Docket No.	Report	
		Volume	Page
Edmonds, Dean S., Est. of, Bank of New York, executor[1]	10164-75	72	970

The Commissioner does NOT ACQUIESCE in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Hills, Liston F., et ux[2]	4723-77	72	958
Marsh, Charles E., II, et ux[3]	6126-77	73	317
Voss, Edward G., et ux[2]	4724-77	72	958

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[1] Acquiescence relating to whether decedent retained at his death the power to alter or amend an inter vivos trust so that the value of the trust would be includible in his estate under section 2036(a)(2) or 2038(a)(1).

[2] Nonacquiescence relating to whether petitioners may exclude from gross income reimbursements paid to them for moving expenses pursuant to section 911.

[3] Nonacquiescene relating to whether petitioners recognized income from the interest-free use of money advanced to them.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-1: Gross income.

The federal income tax consequences to a corporation and its executives when the corporation "leases" suits for its executives. See Rev. Rul. 80-322, page 7.

26 CFR 1.61-2: Compensation for services, including fees, commissions, and similar items.
(Also Sections 3101, 3111, 3401, 3402; 31.3101-1, 31.3111-1, 31-3401(c)-1, 31.3402(a)-1.)

Lifetime services assigned to trust. A corporation's employee assigned "lifetime services" to a trust, and the trust contracted to provide services to the corporation for a monthly fee equal to what otherwise would be the employee's gross monthly salary. The employee continued to perform the same tasks for the corporation, under the same conditions, and with the same amount of control as before the assignment. The assignment is ineffective as a means of avoiding the employee's income tax liability with respect to the payments for the services, and the payments are wages for purposes of the FICA and income tax withholding.

Rev. Rul. 80-321 [1]

ISSUE

What are the federal tax consequences to both an employer and an employee where the employee's "lifetime services" are assigned to a trust in the circumstances described below?

FACTS

In March, 1980, the taxpayer, a U.S. citizen, was approached by the promoter of a trust arrangement under which an assignment of the taxpayer's "lifetime services" would be made to the trust. Shortly thereafter, the taxpayer paid the promoter a fee and entered into the trust arrangement.

Prior to the assignment of the taxpayer's lifetime services to the trust, the taxpayer was employed in the United States by the *M* corporation, a domestic corporation. *M* treated the taxpayer's salary as wages subject to withholding of federal income tax and FICA taxes (imposed by the Federal Insurance Contributions Act, chapter 21, subtitle C, Internal Revenue Code). *M* corporation also made direct payments of the FICA tax on employers due because of the taxpayer's employment. After the assignment to the trust, the promoter, as trustee of the trust, and *M* corporation entered into a "services contract" requiring the trust to provide services to *M* corporation for a monthly fee equal to what would otherwise be the taxpayer's gross monthly salary. As a result, instead of paying salary to the taxpayer, *M* corporation made monthly payments under the "services contract" without withholding federal income tax or FICA tax from the payments. *M* also discontinued its payments of the employer's FICA tax due because of the taxpayer's employment.

The trust, after the subtraction of the trustee's fees, paid the income to the taxpayer and to other persons or accumulated it.

The taxpayer continued to perform the same tasks for the *M* corporation, under the same conditions, with the same amount of control, as before the assignment of "lifetime services" was made.

LAW AND ANALYSIS

Section 61 of the Internal Revenue Code provides that the term "gross income" includes, among other things, compensation for services.

Under section 3401 of the Code, the term "wages" means, with certain exceptions not relevant to this case, all remuneration "for services performed by an employee for his employer," and the term "employer" means the person for whom an individual performed any service as the employee of such person. Section 3402(a) imposes a general requirement that every employer making payment of wages shall deduct and withhold federal income tax from the wages.

Section 3101 of the Code imposes FICA tax on an individual on wages received with respect to employment. Section 3102 provides for deducting such tax from the wages of the employee. Section 3111 imposes FICA tax on an employer on wages paid with respect to employment.

Section 3121(a) of the Code provides that for purposes of the FICA taxes the term "wages" means all remuneration for employment with certain exceptions not relevant in this case. Section 3121(b) provides that for purposes of the FICA taxes the term "employment" means any service of whatever nature performed by an employee for a person employing such employee.

Section 31.3121(d)-1 (relating to the Federal Insurance Contributions Act) and section 31.3401(c)-1 (relating to collection of income tax at source on wages) of the Employment Tax Regulations provide that, generally, the relationship of employer and employee exists when the person for whom the services are performed has the right to control and direct the individual who performs the services not only as to the result to be accomplished by the work, but also as to the detail and means by which the result is accomplished.

Rev. Rul. 75-257, 1975-2 C.B. 251, deals with a "family estate trust," to which a taxpayer assigned "lifetime services." The revenue ruling concludes that the attempt to assign "lifetime services" to a trust is inffective as a means of avoiding the taxpayer's personal income tax liability on income the taxpayer has earned. Similar conclusions were reached in *Vnuk v. Commissioner,* Civil No. 79-1925 (8th Cir., July 11, 1980), *aff'g* T.C.M. 1979-164; *Wesenberg v. Commissioner*, 69 T.C. 1005 (1978); *Morgan v. Commissioner,* T.C.M. 1978-401; and *Horvat v. Commissioner,* T.C.M. 1977-104, *aff'd* 582 F.2d 1282 (7th Cir. 1978), *cert. denied* 440 U.S. 959 (1979). The conclusion of Rev. Rul. 75-257 is equally applicable to the facts of this case.

The payments made by *M* after the taxpayer attempted the assignment of "lifetime services" were wages. *M* did not lose its status as employer by virtue of the contract requiring direct payments to the trust. Accordingly, the wages paid with respect to the taxpayer's services in the form of the lifetime services fee are subject to income tax withholding requirements and FICA taxes to the same extent as the wages paid directly to the taxpayer before the taxpayer entered into the contract.

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[1] Also released as News Release IR-80-114, dated October 30, 1980.

HOLDINGS

(1) The taxpayer's assignment of "lifetime services" is ineffective as a means of avoiding the taxpayer's income tax liability with respect to payments made by M in connection with the taxpayer's services.

(2) The payments by M under the lifetime services contract are wages for the purposes of federal income tax withholding requirements and FICA taxes. M has failed properly to withhold such taxes with respect to the taxpayer's employment. M has also failed properly to pay the employer's FICA tax.

The holdings of this revenue ruling are equally applicable when the lifetime services are assigned to a foreign trust.

Section 83.—Property Transferred in Connection with Performance of Services

26 CFR 1.83-1: Property transferred in connection with the performance of services.
(Also Sections 61, 162; 1.61-1, 1.162-7.)

Suits leased for corporate executives. A corporation leases custom-tailored suits for its executives for a two-year period and, at the end of the lease term, returns the suits to the lessor, who sells them for a nominal amount. The corporation is charged a rental fee and a consulting fee, which together equal the normal purchase price of the suits. The fair market value of the suits is includible in the executives' gross incomes, and the corporation may deduct the entire amount paid to lease the suits.

Rev. Rul. 80-322 [1]

ISSUE

What are the federal income tax consequences to a corporation and its executives when the corporation "leases" suits for its executives, under the circumstances described below?

FACTS

Corporation X offers to "lease" business suits for use by executives of its corporate customers. Forty percent of the cost to a customer will be billed as consulting fees for X's advice on the appropriate number and style of suits and which executives should receive suits. X represents that the customer can deduct the consulting fee as a business expense in the year it is paid. A customer cannot "lease" suits from X without obtaining the consulting services.

The "leases" are for a two-year period, and at the end of the lease term the suits will be returned to X, who will sell them for a nominal amount. In April 1980 Corporation Y "leases" from X ten suits, five of which are to be custom tailored for A, an executive of Y. Upon the execution of the agreement, Y pays X $50x$ dollars (the full amount called for by the contract), of which $20x$ dollars is billed as a consulting fee for the advice given by X and $30x$ dollars is billed as the rental for the suits. Each suit is appropriate for ordinary wear and could be purchased for approximately $5x$ dollars. Y and A are calendar-year taxpayers.

LAW AND ANALYSIS

Section 61 of the Internal Revenue Code defines gross income as income from whatever source derived, except as otherwise provided.

Section 83(a) of the Code provides that when property is transferred to a person in connection with the performance of services, the person who performed the services must include in gross income the excess of (1) the fair market value of the property at the time the rights of the person having the beneficial interest in the property are transferable or not subject to a substantial risk of forfeiture, over (2) any amount paid for the property. The taxable year of inclusion is generally the first taxable year in which the rights of the person receiving the property are transferable or not subject to a substantial risk for forfeiture.

Section 83(h) of the Code provides that, in the case of a transfer of property, a deduction is allowed under section 162 to the person for whom the services were performed. Section 1.83-6(a)(1) of the regulations provides that the amount of the deduction is equal to the amount includible as compensation in the gross income of the person who performed the services, but only to the extent the amount meets the requirements of section 162 and the regulations thereunder.

Section 162(a)(1) of the Code provides in general that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered.

Y purportedly leased the suits from X. Whether an agreement is a lease or a sale depends upon the intent of the parties as evidenced by the provisions of the agreement, read in light of the facts and circumstances existing at the time the agreement was executed. *See* Rev. Rul. 55-540, 1955-2 C.B. 39. The fact that the suits were custom tailored for particular individuals and have little value at the end of the "lease term" establishes that Y has for federal income tax purposes purchased, rather than leased, the suits.

The advice provided by X as part of the arrangement consisted of services that are typically provided, at no additional cost, to customers by tailors and other sales representatives in the course of selling suits. The amount designated as consulting fees is properly treated as part of the purchase price of the suits, so that the cost of the ten suits is the total amount paid by Y to X.

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[1] Also released as News Release IR-80-114, dated October 30, 1980.

An amount paid by an employer to an employee for reimbursement of the employee's cost of acquiring uniforms is includible in the employee's gross income under section 61 of the Code. *See* Rev. Rul. 72-110, 1972-1 C.B. 24. Similarly, an amount paid by an employer to an employee to defray the cost of a wardrobe is includible in the employee's gross income. *See* Rev. Rul. 68-20, 1968-1 C.B. 55.

Because *Y* has provided additional compensation to its executives by furnishing suits to them, they must include in gross income, under section 83(a) of the Code, the fair market value of the suits. The fair market value is equal to the purchase price. One-half the purchase price, or 25*x* dollars, is attributable to the suits provided to *A*. Pursuant to section 83(h), *Y* may deduct the total amount paid to *X* as a business expense under section 162(a)(1).

The cost of acquisition and maintenance of clothing is deductible by an employee as a business expense under section 162 of the Code only if the clothing is specifically required as a condition of employment and is not a type adaptable to general or continued usage. *See* Rev. Rul. 70-474, 1970-2 C.B. 34. Thus, because the business suits are appropriate for ordinary wear, the executive may not deduct the fair market value of the suits as a business expense.

HOLDINGS

1. Under section 83(a) of the Code, *A* must include in gross income for 1980 the fair market value of the suits provided to *A* in the amount of 25*x* dollars. *A* may not deduct this amount as a business expense under section 162.

2. Under section 162(a)(1) of the Code, *Y* may deduct in 1980 the total amount paid to *X* for the suits provided to *Y*'s executives.

Section 162.—Trade or Business Expenses

26 CFR 1.162-7: Compensation for personal services.

The federal income tax consequences to a corporation and its executives when the corporation "leases" suits for its executives. See Rev. Rul. 80-322, page 7.

Section 165.—Losses

26 CFR 1.165-1: Losses.

Whether an investment prospectus, cancelled checks, and confirmation statements are sufficient to substantiate a loss deduction claimed by the taxpayer under the circumstances described. See Rev. Rul. 80-324, page 20.

Section 351.—Transfer to Corporation Controlled by Transferor

26 CFR 1.351-1: Transfer to corporation controlled by transferor.

Whether a limited partnership interest that is transferred in a section 351 exchange is transferred subject to its share of partnership liabilities for purposes of sections 357(c) and 358(d) of the Code. See Rev. Rul. 80-323, this page.

Section 357.—Assumption of Liability

26 CFR 1.357-2: Liabilities in excess of basis.
(Also Sections 351, 358, 741, 751, 752; 1.351-1, 1.358-1, 1.741-1, 1.751-1, 1.752-1.)

Transfer to controlled corporation; limited partnership interest; partnership liabilities. A limited partnership interest that is transferred in a transaction qualifying under section 351 of the Code is transferred subject to its share of partnership liabilities for purposes of sections 357(c) and 358(d). The transferor recognizes gain to the extent that the transferor's share of partnership liabilities exceeds the adjusted basis of the interest transferred.

Rev. Rul. 80-323 [1]

ISSUE

Is a limited partnership interest that is transferred in a section 351 exchange transferred subject to its share of partnership liabilities for purposes of sections 357(c) and 358(d) of the Internal Revenue Code?

FACTS

P, a widely held corporation, is engaged directly and through *S*, its wholly owned subsidiary, in the business of acquiring film rights and exhibiting motion pictures. *S* is the general partner in a limited partnership also engaged in acquiring film rights and exhibiting motion pictures. The limited partnership was formed and began business activities in 1971. In its operation, the limited partnership has incurred bona fide indebtedness. At all times since the inception of the limited partnership, the fair market value of its assets has exceeded the sum of its liabilities. In many instances, however, the share of nonrecourse partnership liabilities allocated to a limited partner exceeds the limited partner's adjusted basis of the partnership interest.

For valid business reasons, an offer was made to the limited partners to transfer their partnership interests to Newco, a corporation to be organized for the purpose of the offer, in exchange for Newco stock. Limited partners holding, in total, a 35 percent interest in the partnership's capital and profits accepted the offer. No Newco stock other than the shares to be issued pursuant to the offer will be issued. The proposed transaction will qualify as a transfer of property to a controlled corporation within the meaning of section 351 of the Code.

The principal production of motion picture property owned by the partnership began before September 11, 1975.

LAW AND ANALYSIS

Section 741 of the Code provides that in the case of a sale or exchange of an interest in a partnership gain or loss will be recognized to the transferor partner. However, section 1.741-1(c) of the Income Tax Regulations refers to section 351 for nonrecognition of gain or loss upon the transfer of a partnership interest to a corporation controlled by the transferor.

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[1] Also released as News Release IR-80-114, dated October 30, 1980.

Section 351(a) of the Code provides that no gain or loss will be recognized if property is transferred to a corporation solely in exchange for its stock and immediately after the exchange the transferor or transferors are in control of the corporation. Under section 357(c), if the sum of the amount of liabilities assumed by the corporation and the amount of liabilities to which the property is subject exceeds the transferor's total adjusted basis of the property transferred, then the excess will be considered as gain from the sale or exchange of a capital asset or of property that is not a capital asset, as the case may be.

Section 1.752-1(e) of the regulations provides that where none of the partners has any personal liability with respect to a partnership liability (as in the case of a mortgage on real estate acquired by the partnership without the assumption by the partnership or any of the partners of any liability on the mortgage), then all partners, including limited partners, shall be considered as sharing such liability under section 752(c) of the Code in the same proportion as they share the profits.

Section 1.752-1(d) of the regulations provides that where there is a sale or exchange of an interest in a partnership, liabilities shall be treated in the same manner as liabilities in connection with the sale or exchange of property not associated with partnerships. For example, if a partner sells his interest in a partnership for $750 cash and at the same time transfers to the purchaser his share of partnership liabilities amounting to $250, the amount realized by the seller on the transaction is $1,000.

Each transferring limited partner's share of partnership nonrecourse liabilities shall be considered as a liability to which the partnership interest is subject for purposes of section 357(c). Consequently, each such limited partner will recognize gain as provided in section 357(c) of the Code to the extent that the partner's share of nonrecourse partnership liabilities exceeds the adjusted basis of the interest transferred. That gain will be ordinary or capital pursuant to the application of sections 741 and 751.

As provided in section 358(d) of the Code, the amount of the liabilities to which each transferred partnership interest is subject will be treated as money received by the transferor partner on the exchange, and, therefore, pursuant to section 358(a)(1), the basis in the Newco stock received will be the same as the basis of the partnership interest exchanged therefor, decreased by the share of the partnership liabilities allocated to the partnership interest and increased by the gain recognized, if any.

HOLDING

Each partnership interest exchanged for Newco stock will be transferred subject to its share of partnership liabilities, and gain will be recognized to the extent that each partner's share of partnership liabilities exceeds the adjusted basis of the interest transferred.

The holding in this ruling does not preclude the application of section 357(b) of the Code, if warranted.

Section 358.—Basis to Distributees

26 CFR 1.358-1: Basis to distributees.

Whether a limited partnership interest that is transferred in a section 351 exchange is transferred subject to its share of partnership liabilities for purposes of sections 357(c) and 358(d) of the Code. See Rev. Rul. 80-323, page 8.

Section 446.—General Rule for Methods of Accounting

26 CFR 1.446-1: General rule for methods of accounting.

Procedures for requesting consent to change method of accounting. See Rev. Proc. 80-51, page 23.

Section 481.—Adjustments Required by Changes in Method of Accounting

26 CFR 1.481-1: Adjustments in general.

Procedures for determining the adjustment period when consent to change a method of accounting is granted. See Rev. Proc. 80-51, page 23.

Section 741.—Recognition and Character of Gain or Loss on Sale or Exchange

26 CFR 1.741-1: Recognition and character of gain or loss on sale or exchange.

Whether a limited partnership interest that is transferred in a section 351 exchange is transferred subject to its share of partnership liabilities for purposes of sections 357(c) and 358(d) of the Code. See Rev. Rul. 80-323, page 8.

Section 751.—Unrealized Receivables and Inventory Items

26 CFR 1.751-1: Unrealized receivables and inventory items.

Whether a limited partnership interest that is transferred in a section 351 exchange is transferred subject to its share of partnership liabilities for purposes of sections 357(c) and 358(d) of the Code. See Rev. Rul. 80-323, page 8.

Section 752.—Treatment of Certain Liabilities

26 CFR 1.752-1: Treatment of certain liabilities.

Whether a limited partnership interest that is transferred in a section 351 exchange is transferred subject to its share of partnership liabilities for purposes of sections 357(c) and 358(d) of the Code. See Rev. Rul. 80-323, page 8.

Section 1034.—Rollover of Gain on Sale of Principal Residence

26 CFR 1.1034-1: Sale or exchange of residence.

Residence; replacement period; suspension of running of time; Puerto Rico. An individual who is transferred to Puerto Rico for a two-year period does not qualify under section 1034(k) of the Code for the suspension of the running of the period of time within which a new residence must be purchased in order for the nonrecognition of gain provisions to apply to the gain from the sale of the individual's old residence.

Rev. Rul. 80-326

ISSUE

Does a taxpayer, under the circumstances described below, qualify under section 1034(k) of the Internal Revenue Code for the suspension of the running of the period of time within which a new residence must be purchased in order for the nonrecognition provisions of section 1034(a) to apply to the gain realized from the sale of an old residence?

FACTS

The taxpayer, a civilian employee of the federal government, was transferred to the Commonwealth of Puerto Rico for a two-year tour of duty. Prior to the transfer, the taxpayer sold the taxpayer's principal residence and realized a gain from the transaction. The taxpayer proposes to apply the nonrecognition provisions of section 1034(a) of the Code to the gain realized from the sale of the principal residence since the taxpayer plans to purchase a replacement residence at a cost in excess of the adjusted sales price of the old residence within 18 months after the completion of the taxpayer's tour of duty in the Commonwealth of Puerto Rico.

LAW AND ANALYSIS

Section 1034(a) of the Code provides that if property ("old residence") used by the taxpayer as a principal residence is sold by the taxpayer and, within a period beginning 18 months before the date of such sale and ending 18 months after such date, property ("new residence") is purchased and used by the taxpayer as a principal residence, gain (if any) from such sale shall be recognized only to the extent that the taxpayer's adjusted sales price (as defined in section 1034(b)) of the old residence exceeds the taxpayer's cost of purchasing the new residence.

Section 1034(k) of the Code provides that the running of any period of time specified in section 1034(a) shall be suspended during any time that the taxpayer (or the taxpayer's spouse if the old residence and the new residence are each used by the taxpayer and the taxpayer's spouse as their principal residence) has a tax home (as defined in section 913(j)(1)(B)) outside the United States after the date of the sale of the old residence; except that any such period of time as so suspended shall not extend beyond the date four years after the date of the sale of the old residence.

Section 913(j)(1)(B) of the Code provides that an individual shall not be treated as having a tax home in a foreign country for any period for which the taxpayer's abode is within the United States.

Section 913(j)(1)(E) of the Code provides that the term "United States," when used in a geographical sense, includes possessions of the United States.

Section 5b.913-3(d) of the Temporary Income Tax Regulations provides that the term "foreign country" means any territory under the sovereignty of a government other than that of the United States. It does not include a possession or territory of the United States.

For purposes of section 1034(k) of the Code the Commonwealth of Puerto Rico is treated as a possession or territory of the United States. Thus, an individual residing in Puerto Rico is not considered to have a tax home outside the United States within the meaning of that section. See section 7701(c), which provides that for purposes of the Internal Revenue Code the term "possession of the United States" generally includes the Commonwealth of Puerto Rico, and Rev. Rul. 78-23, 1978-1 C.B. 79, which holds that for purposes of section 274(h), relating to deductions of an individual for attending foreign conventions, the Commonwealth of Puerto Rico is treated as a possession of the United States.

HOLDING

The taxpayer does not qualify under section 1034(k) of the Code for the suspension of the running of the period of time within which a new residence must be purchased in order for the nonrecognition provisions of section 1034(a) to apply to the gain realized from the sale of the taxpayer's old residence.

Section 3101.—Rate of Tax

26 CFR 31.3101-1: Measure of employee tax.

Whether payments to a trust to which the taxpayer's lifetime services have been assigned, by a corporation for which the taxpayer performs such services, are wages for purposes of federal income tax withholding and FICA taxes. See Rev. Rul. 80-321, page 6.

Section 3111.—Rate of Tax

26 CFR 31.3111-1: Measure of employer tax.

Whether payments to a trust to which the taxpayer's lifetime services have been assigned, by a corporation for which the taxpayer performs such services, are wages for purposes of federal income tax withholding and FICA taxes. See Rev. Rul. 80-321, page 6.

Section 3401.—Definitions

26 CFR 31.3401(a)-1: Wages.

Whether payments to a trust to which the taxpayer's lifetime services have been assigned, by a corporation for which the taxpayer performs such services, are wages for purposes of federal income tax withholding and FICA taxes. See Rev. Rul. 80-321, page 6.

Section 3402.—Income Tax Collected at Source

26 CFR 31.3402(a)-1: Requirement of withholding.

Whether payments to a trust to which the taxpayer's lifetime services have been assigned, by a corporation for which the taxpayer performs such services, are wages for purposes of federal income tax withholding and FICA taxes. See Rev. Rul. 80-321, page 6.

Section 4042.—Tax on Fuel Used in Commercial Transportation on Inland Waterways

26 CFR 48.4042-1: Tax on fuel used in commercial waterway transportation.

T.D. 7727

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 48.—MANUFACTURERS AND RETAILERS EXCISE TAXES

Excise tax on fuel used in commercial waterway transportation

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final rulemaking.

SUMMARY: This document provides final regulations relating to the new excise tax on the use of fuel in commercial waterway transportation. Changes to the applicable tax law were made by section 202 of the Inland Waterways Revenue Act of 1978 [Pub. L. 95-502, 1978-2 C.B. 393]. The regulations affect all operators of commercial vessels used on certain inland and intracoastal waterways.

EFFECTIVE DATE: These regulations apply to fuel consumed after September 30, 1980.

FOR FURTHER INFORMATION CONTACT: John R. Harman of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, LR-175-78, 202-566-4351, not a toll-free call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

Section 202 of the Inland Waterways Revenue Act of 1978 (the "Act"), Pub. L. 95-502, 92 Stat. 1996, imposes an excise tax on the use of liquid fuel in commercial waterway transportation. It taxes only fuel used by certain types of commercial vessels along particular inland and intracoastal waterways.

On June 9, 1980, the Federal Register published a proposed amendment to the Excise Tax Regulations (26 CFR 48) under section 4042 of the Internal Revenue Code of 1954 (Code) (45 FR 38411). The amendment was proposed to conform the regulations to the amendment of the Code made by the Act. A correction to the initially published proposal was published on July 29, 1980 (45 FR 50368). A public hearing on the proposed regulations was held on September 25, 1980. After consideration of all comments regarding the proposed amendment, final regulations are adopted by this Treasury decision.

These regulations meet the Treasury criteria for significant regulations.

SUMMARY OF COMMENTS AND SUBSTANTIVE REVISIONS

Twenty-two organizations submitted comments in response to the invitation in the notice. Several organizations objected to implementation of the Act on constitutional grounds, claiming the Act conflicts with the tax uniformity clause, the ports preference clause, and the due process clause. *See generally* U.S. CONST. art. 1, § 8, cl. 1; U.S. CONST. art. 1, § 9, cl. 6; U.S. CONST. amend. V.

Several commentators expressed concern that the statement regarding the general purpose of the fuel tax, contained in the supplementary information to the proposal, might be misapplied. They were concerned that the statement could be construed to impose a restriction on the ultimate uses of the tax collected, a result which was not intended. The statement was not substantive. As a result of the comments, it has been deleted from the supplementary information to these final regulations.

The tax only applies to vessels used in commercial transportation. Several commentators requested clarification of whether commercial transportation vessels will be subject to the tax while fleeting barges into a single tow and while used to dislodge a tow grounded on a sandbar. The final regulations clarify that they are. *See* § 48.4042-1 (f)(1). Congress intended to tax fuel consumed in vessels used for commercial waterway transportation, but not to limit the tax to fuel consumed by vessels while actually transporting property. Vessel operators seeking a ruling as to whether other uses of vessels constitute commercial waterway transportation, within the meaning of § 48.4042-1(f)(1), should consult Rev. Proc. 80-20, 1980-26 I.R.B. 7.

Only fuel used on waterways specified in section 206 of the Act [Pub. L. 95-502, 1978-2 C.B. 393, 394] is taxable. Several comments pointed out ambiguities in the descriptions of three of the specified waterways; namely, the Atlantic Intracoastal Waterway, the Gulf Intracoastal Waterway, and the Illinois Waterway. Those descriptions are clarified by the final regulations to better apprise operators of where fuel consumption is taxable. *See* § 48.4042-1(g)(6), (g)(11), and (g)(12).

By imposing a tax on the use of liquid fuel, Congress intended to impose a tax similar to a preexisting tax on liquid fuel used in motor vehicles (Code section 4041), which had been interpreted to apply only to propulsion fuels. Accordingly, § 48.4042-2(a)(1), as proposed, provided that only fuel used in the propulsion system of the vessel is taxed. That section has been modified in response to several requests to define what constitutes a propulsion system. The final regulations clarify that a propulsion system means any engine generating movement of a vessel, including bow thrusters used for steering.

Several commentators expressed concern that § 48.4042-2(b) might be interpreted to require vessel operators to install fuel gauges and that § 48.4042-2(c) might be interpreted to require operators to maintain a second set of records duplicating records already contained in vessel logs and invoices of fuel purchases. Such expenditures are not required by the regulations.

Many comments pointed out situations where, because of an operator's circumstances, maintaining certain records listed in § 48.4042-2(c)(1) would serve little or no purpose—such as (1) requiring fuel refining firms operating barges to maintain records of fuel acquired for all purposes and (2) requiring records of arrival and departure times for a vessel used exclusively in taxable waterways. Section 48.4042-2(c)(1) has been changed to clarify that a vessel operator is only required to maintain records sufficient to establish to the satisfaction of the district director the amount of fuel used for taxable purposes.

Several comments pointed out the fact that many vessels do not have identification numbers, but rather are assigned names. Section 48.4042-2(c)(1) has been changed to allow operators to maintain records for each vessel under either a vessel name or identification number.

Several commentators requested clarification of whether interim deposits will be required and whether filing can be delayed until a later date when the operator is allowed until that later date to report another tax with the Form 720—such as the windfall profits tax. The final rules, §§ 48.4042-2(d) and 48.6302(c)-1(f), clarify that interim deposits are not required. *See* Rev. Proc. 80-23, 1980-26 I.R.B. 30, for the extension currently allowed taxpayers using Form 720 to report taxes subject to different reporting deadlines.

Many changes were requested which would be contrary to Congress' intent or the language of the statute itself and for that reason have not been made. Those requests include: collecting the tax from persons selling fuel; making lessees and charterers pay the tax regardless of who operates the vessel; excluding fuel used in the propulsion engine to create energy for nonpropulsion purposes; excluding fuel used by private operators transporting property destined for a State or local government's use; excluding fuel used by tugs to move LASH and SEABEE barges regardless of whether the tow is comprised exclusively of such barges.

DRAFTING INFORMATION

The principal author of these regulations is John R. Harman of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly 26 CFR Part 48 is amended as follows:

Paragraph 1. There are added immediately after § 48.4041-14 the following new sections:

§ 48.4042-1 Tax on fuel used in commercial waterway transportation.

(a) *In general.* Section 4042(a) imposes an excise tax on the use of liquid fuel in the propulsion system of commercial transportation vessels while traveling on certain inland and intracoastal waterways (*see* § 48.4042-1(f)). The tax applies generally to all types of vessels, including ships, barges, and tugboats. It is in addition to all other taxes imposed on the sale or use of fuel.

(b) *Amount of tax.* The tax imposed by section 4042(a) shall be determined from the following table:

If the use occurs—	The tax is—
After Sept. 30, 1980 and before Oct. 1, 1981	4 cents a gallon
After Sept. 30, 1981 and before Oct. 1, 1983	6 cents a gallon
After Sept. 30, 1983 and before Oct. 1, 1985	8 cents a gallon
After Sept. 30, 1985	10 cents a gallon

(c) *Person liable for tax.* The person operating the vessel in which the propulsion fuel is consumed is the user of liquid fuel for purposes of section 4042(a). Thus, a person who operates (or whose employees operate) a vessel is responsible for filing returns and paying the tax. If a vessel owner (or lessee) contracts with an independent contractor to operate the vessel, the independent contractor is the user of liquid fuel for purposes of section 4042(a), regardless of who purchases the fuel.

(d) *Time of use.* Fuel is not taxed by section 4042(a) when put into a vessel's tanks. For purposes of section 4042(a), fuel is used when it is actually consumed by a vessel's engine.

(e) *Liquid fuels.* For purposes of section 4042(a), liquid fuel includes any liquid fuel, including—

(1) Diesel fuel, or

(2) Bunker C residual fuel oil, or

(3) Special motor fuel as defined in paragraph (f) of § 48.4041-7, or

(4) Gasoline as defined in paragraph (b) of § 48.4082-1.

(f) *Commercial waterway transportation*—(1) *In general.* For purposes of section 4042(a) and § 48.4042-2(c)(1), the term "commercial waterway transportation" means the use of a vessel on the waterways specified in paragraphs (g)(1) through (26) of this section if—

(i) Use of the vessel is in the business of transporting property for compensation or hire, or

(ii) Use of the vessel is in transporting property in the business of the owner, lessee, or operator of the vessel (whether or not a fee is charged).

Except for the operation of certain fishing vessels, the operation of all vessels satisfying the requirements of paragraphs (f)(1)(i) or (1)(ii) of this section will be deemed "commercial waterway transportation," regardless of whether the vessel is actually engaged in the transportation of property on a particular voyage. Thus, "commercial waterway transportation" includes the operation of vessels while moving empty of cargo, while awaiting passage through locks, while dislodging vessels grounded on a sandbar, while moving to or from a repair facility, while maneuvering around loading and unloading docks, and while fleeting barges into a single tow.

(2) *Fishing vessels exception.* A vessel does not transport property in the business of the owner, lessee, or operator, for purposes of paragraph (f)(1)(ii) of this section, by merely transporting fish or other aquatic animal life caught on the voyage. The tax imposed by section 4042(a) does not apply to fuel used by a fishing vessel while traveling to a fishing site, while engaged in fishing, or while returning from the fishing site with its catch. However, the tax applies to fuel used by a commercial vessel along the taxable waterways while traveling to pick up aquatic animal life caught by another vessel and while transporting the catch of such other vessel.

(g) *Specified waterways.* Only fuel used on those waterways specified in section 206 of the Inland Waterways Revenue Act of 1978 (specified waterways) is taxable. The specified waterways are as follows:

(1) Alabama-Coosa Rivers: From junction with the Tombigbee River at river mile (hereinafter referred to as RM) 0 to junction with the Coosa River at RM 314.

(2) Allegheny River: From confluence with the Monongahela River to form the Ohio River at RM 0 to the head of the existing project at East Brady, Pennsylvania, RM 72.

(3) Apalachicola-Chattahoochee and Flint Rivers: Apalachicola River from mouth at Apalachicola Bay (intersection with the Gulf Intracoastal Waterway) RM 0 to junction with Chattahoochee and Flint Rivers at RM 107.8. Chattahoochee River from junction with Apalachicola and Flint Rivers at RM 0 to Columbus, Georgia, at RM 155 and Flint River, from

junction with Apalachicola and Chattahoochee Rivers at RM 0 to Bainbridge, Georgia, at RM 28.

(4) Arkansas River (McClellan-Kerr Arkansas River Navigation System): From junction with Mississippi River at RM 0 to port of Catoosa, Oklahoma, at RM 448.2.

(5) Atchafalaya River: From RM 0 at its intersection with the Gulf Intracoastal Waterway at Morgan City, Louisiana, upstream to junction with Red River at RM 116.8.

(6) Atlantic Intracoastal Waterway (A.I.W.W.): Two inland water routes approximately paralleling the Atlantic coast between Norfolk, Virginia, and Miami, Florida, for 1,192 miles via both the Albermarle and Chesapeake Canal and Great Dismal Swamp Canal routes. For vessels traveling along the A.I.W.W. no matter how short the distance, the A.I.W.W. includes the main channel, all alternate channels, and all adjoining bays and sounds, regardless of depth. However, vessels merely crossing the A.I.W.W. on route either to a coastal port or to a nonspecified waterway will not be treated as traveling on the A.I.W.W.

(7) Black Warrior-Tombigbee-Mobile Rivers: Black Warrior River System from RM 2.9, Mobile River (at Chickasaw Creek) to confluence with Tombigbee River at RM 45. Tombigbee River (to Demopolis at RM 215.4) to port of Birmingham, RM's 374—411 and upstream to head of navigation on Mulberry Fork (RM 429.6), Locust Fork (RM 407.8), and Sipsey Fork (RM 430.4).

(8) Columbia River (Columbia-Snake Rivers Inland Waterways): From The Dalles at RM 191.5 to Pasco, Washington (McNary Pool), at RM 330, Snake River from RM 0 at the mouth to RM 231.5 at Johnson Bar Landing, Idaho.

(9) Cumberland River: Junction with Ohio River at RM 0 to head of navigation, upstream to Carthage, Tennessee, at RM 313.5.

(10) Green and Barren Rivers: Green River from junction with the Ohio River at RM 0 to head of navigation at RM 149.1.

(11) Gulf Intracoastal Waterway (G.I.W.W): From the mouth of St. Mark's River, Florida, to Brownsville, Texas, 1,134.5 miles. For vessels traveling along the G.I.W.W. no matter how short the distance, the G.I.W.W. includes the main channel, all alternate channels, and all adjoining bays and sounds, regardless of depth. However, vessels merely crossing the G.I.WW. on route either to a coastal port or to a nonspecified waterway will not be treated as traveling on the G.I.W.W.

(12) Illinois Waterway: Illinois River from junction with the Mississippi River at RM 0 to the Des Plaines River and along the Des Plaines River to Lockport Lock and Dam at RM 291. Chicago Sanitary and Ship Canal from Lockport Lock and Dam at RM 291 to the South Branch Chicago River and along the South Branch Chicago River to Lake Street, Chicago at RM 325.5 near Chicago Harbor. Calumet-Sag Channel from junction with the Chicago Sanitary and Ship Canal to the Little Calumet River and along the Little Calumet and Calumet Rivers to turning basin 5, near the entrance to Lake Calumet, an additional 23.8 RMS. Total waterway distance approximately 350 RMs.

(13) Kanawha River: From junction with Ohio River at RM 0 to RM 90.6 at Deepwater, West Virginia.

(14) Kaskaskia River: From junction with the Mississippi River at RM 0 to RM 36.2 at Fayettville, Illinois.

(15) Kentucky River: From junction with Ohio River at RM 0 to confluence of Middle and North Forks at RM 258.6.

(16) Lower Mississippi River: From Baton Rouge, Louisiana, RM 233.9 to Cairo, Illinois, RM 953.8.

(17) Upper Mississippi River: From Cairo, Illinois, RM 953.8 to Minneapolis, Minnesota, RM 1,811.4.

(18) Missouri River: From junction with Mississippi River at RM 0 to Sioux City, Iowa, at RM 734.8.

(19) Monongahela River: From junction with Allegheny River to form the Ohio River at RM 0 to junction of the Tygart and West Fork Rivers, Fairmont, West Virginia, at RM 128.7.

(20) Ohio River: From junction with the Mississippi River at RM 0 to junction of the Allegheny and Monongahela Rivers at Pittsburgh, Pennsylvania, at RM 981.

(21) Ouachita-Black Rivers: From the mouth of the Black River at its junction with the Red River at RM 0 to RM 351 at Camden, Arkansas.

(22) Pearl River: From junction of West Pearl River with the Rigolets at RM 0 to Bogalusa, Louisiana, RM 58.

(23) Red River: From RM 0 to the mouth of Cypress Bayou at RM 236.

(24) Tennessee River: From junction with Ohio River at RM 0 to confluence with Holstein and French Rivers at RM 652.

(25) White River: From RM 9.8 to RM 255 at Newport, Arkansas.

(26) Willamette River: From RM 21 upstream of Portland, Oregon, to Harrisburg, Oregon, at RM 194.

§ 48.4042-2 Special rules.

(a) *Dual use of liquid fuels*—(1) *Dual use by the propulsion engine.* The tax imposed by section 4042(a) applies to all taxable liquid used as a fuel in the propulsion system of the vessel, regardless of whether the engine (or other propulsion system) is used for a purpose other than propulsion of the vessel. For purposes of this section, any engines generating movement of a vessel (including bow thrusters used for steering) are part of the propulsion system. The tax does not apply to fuel consumed in engines which are not used to generate movement of a vessel. When the propulsion engine operates special equipment by means of a power take-off or power transfer, the tax applies to all liquid fuel consumed by that engine. For example, the tax applies to all fuel used in the engine operating an alternator, a generator, or pumps, if that engine is used to generate movement of a vessel.

(2) *Common tank.* If the liquid fuel consumed by a nonpropulsion engine is drawn from the same tank as fuel consumed by a propulsion engine, a reasonable determination of the quantity of fuel used in such a separate engine will be acceptable for purposes of excluding from taxation a

portion of the fuel consumed by the vessel. The determination of the amount of fuel consumed by the nonpropulsion engine may be based primarily on the operating experience of the person using the fuel; however, in order to exclude fuel from taxation under the rule set out in this paragraph (a)(2), the taxpayer must maintain records which will support the allocation used.

(b) *Voyages crossing boundaries of the specified waterways.* Fuel consumed by a vessel traveling along the specified waterways is taxable only to the extent of fuel consumed for propulsion while on the specified waterways. Generally, the operator may calculate the amount of fuel consumed while on the specified waterways during a particular voyage by multiplying total fuel consumed in the propulsion engine by a fraction. The numerator of the fraction is the time spent operating on the specified waterways; the denominator is the total time spent operating on the specified and nonspecified waterways during the voyage. This calculation may not be used when it is unreasonable. It may be determined to be unreasonable by:

(1) Better evidence of fuel consumed (*e.g.*, readings from an accurate fuel gauge or records from similar voyages); or

(2) The existence of factors causing a substantial discrepancy between the rate of fuel consumption on the specified and nonspecified waterways.

(c) *Records required.* (1) All operators of vessels used in commercial waterway transportation must maintain records sufficient to establish to the satisfaction of the district director the amount of fuel used for taxable purposes. Those records may include, when relevant to establish liability:

(i) Quantity of fuel and date of acquisition of all liquid fuels acquired for both taxable and nontaxable purposes, whether delivered to storage tanks or tanks on a vessel;

(ii) Date and quantity of fuel pumped into tanks on each vessel;

(iii) Identification number or name of each vessel using fuel; and

(iv) Departure time, departure point, route traveled, destination, and arrival time for each vessel.

(2) Vessel operators seeking a tax exemption provided by section 4042 (c) must maintain records which will support any exemption claimed. Where applicable, the records shall contain:

(i) The draft of the vessel on each voyage (for exemption under section 4042(c)(1));

(ii) The type of vessel in which fuel is consumed and the type of vessel in which cargo is transported (for exemption under section 4042(c)(1), (2) or (4)); and

(iii) The ultimate use of cargo transported (for exemption under section 4042(c)(3)).

(d) *Date for filing return.* In general, the return (Form 720, Quarterly Federal Excise Tax Return) must be filed and the tax paid by the last day of the first month following the quarter in which tax liability has accrued. Thus, for the first taxable quarter (October through December 1980) the return is due and the tax must be paid by January 31, 1981. Notwithstanding any provisions in this part to the contrary, the tax imposed by section 4042 (a) need not be deposited with a government depository.

§ 48.4042-3 Certain types of commercial waterway transportation excluded.

(a) *Deep draft ocean-going vessels*—(1) *In general.* Under section 4042 (c)(1), there is no tax imposed by section 4042(a) if:

(i) The vessel was designed primarily for use on the high seas; and

(ii) The vessel has a draft of more than 12 feet on the voyage for which the fuel tax exclusion is sought (*e.g.* 12 feet 1 inch).

(2) *Meaning of "designated primarily for use on the high seas."* Section 4042(c)(1) requires a determination of the primary of the design features rendering the vessel useful for service on the high seas, as opposed to the features which render the vessel useful for service on all less turbulent waters. Thus, whether a ship is "designed primarily for use on the high seas" must be determined from all the facts, including structural features and equipment. If the predominant use of a vessel is on the high seas, it shall be presumed to be "designed primarily for use on the high seas." If the predominant use of a vessel is on waters other than the high seas, it shall be presumed not to be "designed primarily for use on the high seas."

(3) *Meaning of "high seas."* For purposes of this section, "high seas" shall mean waters other than the territorial waters of the United States or any other country. Thus, the high seas shall not include the internal waters of any country, the Great Lakes, harbors, or narrow coastal indentations.

(4) *Twelve-foot draft*—(i) *Definition.* For purposes of section 4042(c) (1), "draft" shall mean the maximum vertical distance between the mean water line and the bottom of the keel. In cases where a vessel has a skeg or other appendage extending locally below the line of the keel, the draft shall be measured from the deepest appendage. A separate determination of draft must be made for each voyage when the vessel has its greatest load of cargo and fuel. For purposes of this determination, the term "voyage" means a round trip voyage. Therefore, if a vessel travels into the specified waterway system to pick up cargo and has a draft sufficient to qualify for the exclusion when loaded, then for purposes of section 4042(c)(1) the vessel satisfies the 12 foot draft requirement for the entire voyage. Similarly, if a vessel loaded with cargo travels into the specified waterway system with a draft sufficient to qualify for the exclusion provided by section 4042(c) (1), then the fuel consumed on the entire voyage may be excluded, regardless of the vessel's draft after the cargo is unloaded.

(ii) *Example.* The following example illustrates the application of paragraph (a)(4)(i) of this section:

Example. A ship with a design draft of 20 feet (maximum certified draft when fully loaded) travels into a taxable waterway with only a partial load, such that the draft is 12 feet. The ship unloads and departs the waterway empty. The portion of the fuel consumed for propulsion of the vessel on the specified waterway is taxable because only vessels with a draft greater than 12 feet are eligible for the section 4042(c)(1) exemption from tax.

(b) *Commercial passenger vessels.* Under section 4042(c)(2), the tax imposed by section 4042(a) does not apply to fuel consumed by vessels used primarily for the transportation of persons. Thus, commercial passenger vessels while being operated as passenger vessels are not subject to tax, even if such vessels in fact transport property in addition to transporting passengers. Similarly, ferry boats carrying passengers are not subject to tax, even if such vessels carry the passengers' automobiles.

(c) *Exemption for State or local governments*—(1) *In general.* Under section 4042(c)(3), there is no tax imposed by section 4042(a) if:

(i) The vessel is being used by a State or local government; and

(ii) The vessel is being used in transporting property in the State or local government's business.

(2) *State or local government.* For purposes of paragraph (c)(1)(i) of this section a "vessel is being used by a State or local government" if it is operated by any State, the District of Columbia, or any political subdivision of a State. If a private party is contracted to haul for a State or local government, the vessel is not "being used by a State or local government." Similarly, if a person other than a State or local government is contracted to supply vessel operators, the fuel consumed by the vessel is not used "by a State or local government," regardless of ownership of the vessel. However, when a local government leases barges and employees of the local government operate the barges, the vessel is being used by the local government.

(3) *Government business.* The test for whether a vessel is being used "in transporting in a State or local government's business," within the meaning of paragraph (c)(1)(ii) of this section, is whether the ultimate use of the cargo is for a function which is ordinarily carried out by governmental units. For example, when the cargo transported is salt to be spread on icy roads, the vessel is being used "in transporting in a State or local business" because the use to which the cargo will be put (road maintenance) is a function ordinarily performed by governmental units. Fuel consumed in a vessel transporting property for compensation or in furtherance of a business not ordinarily carried out by a governmental unit is not exempt from taxation by section 4042(c)(3).

(d) *Ocean-going barges.* Under section 4042(c)(4), the tax imposed by section 4042(a) does not apply to fuel consumed by tugs moving exclusively barges released by ocean-going carriers solely to pick up or deliver international cargoes. The tax exemption provided by section 4042(c)(4) applies to LASH barges, SEABEE barges, and all other ocean-going barges carried aboard ocean-going vessels. There is no exemption under section 4042(c)(4) while:

(1) One or more of the barges in the tow is not a LASH barge, SEABEE barge, or other ocean-going barge carried aboard an ocean-going vessel; or

(2) One or more of the barges in the tow is not on an international voyage; or

(3) Part of the cargo in the tow is not being transported internationally.

Par. 2. Section 48.6302(c)-1 is amended by adding a new paragraph (f) as set forth below.

§ 48.6302(c)-1 Use of Government depositaries.

* * * * *

(f) *Special rule for the tax imposed by section 4042(a).* For purposes of the computations provided by this section, the tax imposed by section 4042(a) shall be disregarded.

(This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).)

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved October 16, 1980.

DONALD C. LUBICK,
Assistant Secretary
of the Treasury.

(Filed by the Office of the Federal Register on October 22, 1980, 11:39 a.m, and published in the issue of the Federal Register for October 27, 1980, 45 F.R. 70860)

Section 4986.—Imposition of Tax

26 CFR 150.4986-1: Imposition of tax.

Whether certain price adjustments are taken into account in determining base prices under section 4989(d)(2) of the Code. See Rev. Rul. 80-320, below.

Section 4988.—Windfall Profit; Removal Price

Section 150.4988-1: Windfall profit; removal price.

Whether certain price adjustments are taken into account in determining base prices under section 4989(d)(2) of the Code. See Rev. Rul. 80-320, below.

Section 4989.—Adjusted Base Price

26 CFR 150.4989-1: Adjusted base price. (Also Sections 4986, 4988, 4991; 150.4986-1, 150.4988-1, 150.4991-1.)

Windfall profit tax; base price; adjustments to posted price. The effect on the determination of base price under the interim rule is described in situations in which a purchaser of crude oil adjusts the posted price.

Rev. Rul. 80-320 [1]

ISSUE

In the situations described below what price adjustments, if any, are taken into account in determining base prices under section 4989(d)(2) of the Internal Revenue Code?

FACTS

Situation 1

On December 1, 1979, *P*, a purchaser of crude oil, circulated publicly among sellers and buyers of crude oil in a certain geographical area a written offer to purchase newly discovered oil of a particular grade and quality at a specific price, effective for all purchases in the geographical area on and after November 1, 1979. On January 1, 1980, *P* publicly circulated a written adjustment to the above price, effective for all purchases on and after December 1, 1979.

Situation 2

The facts are the same as in *Situation 1* except that the written adjustment of January 1, 1980, was effective with respect to only two of the fields in the geographical area and was circulated publicly only among buyers and sellers of crude oil in those fields.

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[1] Also released in News Release IR-80-116, dated November 3, 1980.

Situation 3

The facts are the same as in *Situation 1* except that the adjustment of January 1, 1980, was made orally and written confirmation of the adjustment was not circulated until January 16, 1980.

LAW AND ANALYSIS

Section 4986(a) of the Code imposes an excise tax on the windfall profit from taxable crude oil removed from the premises during each taxable period. Section 4986(b) provides that the tax imposed by this section shall be paid by the producer of the crude oil.

Section 4988(a) of the Code defines the term "windfall profit" as the excess of the removal price of the barrel of crude oil over the sum of the adjusted base price of the barrel and the amount of the severance tax adjustment.

Section 4989(a) of the Code defines the term "adjusted base price" as the base price for the barrel of crude oil plus an amount equal to the base price multiplied by the inflation adjustment for the calendar quarter in which the crude oil is removed from the premises, such amount to be rounded to the nearest cent.

Section 4989(d)(2) of the Code provides that for months beginning before October 1980 (or such earlier date as may be provided in the regulations) the base prices for tier 2 and tier 3 oil shall be the product of—

(A)(i) the highest posted price for December 31, 1979, for uncontrolled crude oil of the same grade, quality, and field, or

(ii) if there is no posted price described in clause (i), the highest posted price for such date for uncontrolled crude oil at the nearest domestic field for which prices for oil of the same grade and quality were posted for such date, multiplied by

(B) a fraction the denominator of which is $35, and the numerator of which is—

(i) $15.20 for purposes of determinitng base prices for tier 2 oil, and

(ii) $16.55 for purposes of determining base prices for tier 3 oil.

For purposes of the preceding sentence, no price which was posted after January 14, 1980, shall be taken into account.

Section 4991(d) of the Code provides that tier 2 oil is any oil from a stripper well property within the meaning of the June 1979 energy regulations, and any oil from an economic interest in a National Petroleum Reserve held by the United States. Section 4991(e) defines tier 3 oil as (a) newly discovered oil, (b) heavy oil and (c) incremental tertiary oil.

Section 150.4989-1(c)(2) of the Temporary Excise Tax Regulations under the Crude Oil Windfall Profit Tax Act of 1980, as amended by T.D. 7720, 1980-42 I.R.B. 12, 45 F.R. 63263, provides that for purposes of determining the highest posted price for December 31, 1979, "posted price" means a written statement of crude oil prices constituting an offer to purchase oil at that price circulated publicly among sellers and buyers of crude oil in a particular field in accordance with historic practices. Although the formality of a printed price bulletin such as is published by major purchasers is not necessary for a price to be a valid posted price, the formality of a publicly circulated written offer is necessary. The requirement that the offer be in writing and publicly circulated eliminates oral offers and offers made only to specified producers.

That section further provides that in determining the "highest posted price," a producer should first determine which offers qualify as posted prices for December 31, 1979. An offer does not constitute a posted price for December 31, 1979, unless the offer was initially made on or before December 31, 1979, and was in effect for oil purchased on that date. However, in determining the highest posted price for December 31, 1979, a valid posted price that was adjusted on or before January 14, 1980, shall be considered to be an offer made at the price as adjusted so long as the adjusted price applies to all oil purchased pursuant to the initial offer.

An offer made on or before December 31, 1979, to purchase crude oil at a specific price that is adjusted after December 31, 1979, constitutes a posted price for December 31, 1979, at the price as adjusted, provided that 1) the initial offer meets all the requirements for a valid posted price, 2) the adjustment is in effect for December 31, 1979, 3) the adjustment meets all the requirements for a valid posted price for the field or area to which it applies on or before January 14, 1980, and 4) the adjustment applies to all oil in the applicable field or area purchased during the effective period of the adjustment.

HOLDING

Situation 1

P's adjusted price of January 1, 1980, constitutes a "posted price for December 31, 1979," for the named geographical area for purposes of determining base price under section 4989(d)(2) of the Code.

Situation 2

P's adjusted price of January 1, 1980, constitutes a "posted price for December 31, 1979," for purposes of determining base price in the two fields subject to the adjustment. *P*'s initial offer price of December 1, 1979, constitutes a "posted price for December 31, 1979," for purposes of determining base price in the remainder of the geographic area.

Situation 3

Since *P*'s adjusted price was made orally and was not reduced to writing until after January 14, 1980, the adjusted price does not constitute a "posted price for December 31, 1979." Rather, *P*'s price circulated on December 1, 1979, is a "posted price for December 31, 1979," in the geographic area for purposes of determining base price.

Section 4991.—Taxable Crude Oil; Categories of Oil

26 CFR 150.4991-1: Taxable crude oil; tiers of oil.

Whether certain price adjustments are taken into account in determining base prices under section 4989(d)(2) of the Code. See Rev. Rul. 80-320, page 15.

Section 4995.—Withholding; Depositary Requirements

26 CFR 150.4995-3: Depositary requirements.
(Also Sections 4997, 6402; 150.4997-1, 150.6402-1.)

T.D. 7732

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER D, PART 150.—TEMPORARY EXCISE TAX REGULATIONS UNDER THE CRUDE OIL WINDFALL PROFIT TAX ACT OF 1980

Tax deposits and refunds based on the net income limitation

AGENCY: Internal Revenue Service, Treasury.

ACTION: Amendment of temporary regulations.

SUMMARY: This document amends temporary excise tax regulations relating to the windfall profit tax on domestic crude oil imposed by title I of the Crude Oil Windfall Profit Tax Act of 1980 [Pub.L. 96-223, 1980-3 C.B. 2]. The new temporary regulations provide rules to be followed by producers of domestic crude oil. In addition, the text contained in the temporary regulations set forth in this document serves as the text of the proposed regulations cross-referenced in the notice of proposed rulemaking in the Proposed Rules section of the issue of the Federal Register for November 5, 1980, 45 F.R. 73467.

DATES: These temporary regulations are effective with respect to oil removed after February 29, 1980.

FOR FURTHER INFORMATION CONTACT: David B. Cubeta of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, DC 20224 (Attention: CC:LR:T) (202-566-3297).

SUPPLEMENTARY INFORMATION

BACKGROUND

On April 4, 1980, the Federal Register published temporary regulations (45 FR 23384) under sections 4986, 4987, 4988, 4989, 4991, 4992, 4993, 4994, 4995, 4996, 4997, 6050C, 6076, and 6402 of the Internal Revenue Code of 1954. The temporary regulations were required to implement various sections of the Crude Oil Windfall Profit Tax Act of 1980. Certain amendments to the temporary regulations were published on April 25, 1980 (45 FR 27929). This document contains amendments to §§ 150.4995-3, 150.4997-1, and 150.6402-1 of those temporary regulations (relating to windfall profit tax deposits, returns, and refunds).

EXPLANATION OF PROVISIONS

Numerous commentators on the proposed windfall profit tax regulations published on April 4, 1980 expressed concern over the operation of the tax deposit and refund rules in situations involving the application of the net income limitation on windfall profit provided in section 4988(b). Several commentators suggested that in order to avoid overpayments of tax, the deposit rules should be amended to clarify that producers may take the net income limitation into account in depositing their own tax under § 150.4995-3(a) or (f) when the first purchaser is not required to withhold. This suggestion has been adopted, and § 150.4995-3(a) and (f) is amended to specifically provide that the net income limitation may be taken into account by producers depositing their own tax liability. The amendment is effective with respect to oil removed after February 29, 1980. Therefore, producers may reduce future deposits if more than the tax imposed by section 4986, computed with regard to the net income limitation, has been deposited for past periods. However, refund claims may not be filed until after the end of the producer's taxable year (for Federal income tax purposes).

Most of the commentators recognized that section 4995(a)(2)(B) precludes the first purchaser from taking the net income limitation into account in determining the amount to be withheld from producers. However, it was requested that the regulations be amended to expedite refunds to producers from whom tax has been overwithheld due to the net income limitation.

These regulations amend § 150.6402-1 to permit refund claims to be filed as soon as the statute permits and the amount of the overpayment can be determined. Producers whose taxable year (for Federal income tax purposes) is the calendar year may file a claim for credit or refund any time after the last day of February following the year of removal (the date that section 4995(a)(4)(B) deems the tax to have been paid). Producers whose taxable year is not the calendar year may file two claims for credit or refund each year. First, after the last day of February following the calendar year of removal, the producer may file a claim for credit or refund of overpayments attributable to the portion of the calendar year that is within the taxable year that ended during that calendar year. Second, after the end of the following taxable year, the producer may file a claim for credit or refund of overpayments attributable to the remainder of the calendar year.

WAIVER OF PROCEDURAL REQUIREMENTS OF TREASURY DIRECTIVE

The expeditious adoption of the provisions contained in this document is necessary because of the need for immediate guidance to taxpayers liable for the windfall profit tax on domestic crude oil. For this reason, Jerome Kurtz, Commissioner of Internal Revenue, has determined that the provisions of paragraphs 8 through 14 of the Treasury Department directive implementing Executive Order 12044 must be waived.

DRAFTING INFORMATION

The principal author of these regulations is David B. Cubeta of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, part 150, Temporary Excise Tax Regulations under the Crude Oil Windfall Profit Tax Act of 1980, is amended as follows:

Paragraph 1. Section 150.4995-3 is amended by revising so much of paragraph (a)(1) as precedes subdivision (i), by revising so much of paragraph (f)(1) as precedes subdivision (i), and by redesignating paragraphs (g) and (h) as (h) and (i) and inserting new paragraph (g) immediately after paragraph (f). These revised, redesignated, and added provisions read as follows:

§ 150.4995-3 Depositary requirements.

(a) *Deposits by integrated oil companies other than independent refiners*—(1) *In general.* Every integrated oil company (as defined in § 150.4996-1(g)) other than an independent refiner (as defined in § 150.4996-1(h)) that is either liable as a producer for the tax imposed by section 4986 (unless such tax is required by § 150.4995-1 to be deducted and withheld by the purchaser) or is required as a purchaser to deduct and withhold tax pursuant to § 150.4995-1 shall make deposits with respect to semimonthly periods (as defined in subparagraph (3)(i) of this paragraph). The amount to be deposited for each semimonthly period is the amount of tax imposed by section 4986 (computed with regard to the net income limitation provided in section 4988(b), if applicable) that is not required to be withheld under § 150.4995-1 on oil removed from the premises during that semimonthly period for which the company is liable as a producer, plus the amount required to be withheld by the company as a purchaser pursuant to § 150.4995-1 from payments that have been or will be made for oil removed from the premises during that semimonthly period. The deposits shall be made on or before the depositary date (as defined in subparagraph (3)(ii) of this paragraph) for the semimonthly period in which the oil is removed. These depositary requirements will be considered to have been met for a semimonthly period with respect to estimated deposits, including deposits based upon the producer's estimate of the effect of the net income limitation provided in section 4988(b), only if—

* * * * *

(f) *Deposits by producers of tax due on oil not subject to withholding*—(1) *In general.* Except as provided in paragraph (a) (relating to certain integrated oil companies), every producer shall deposit for each calendar month the tax imposed by section 4986 (computed with regard to the net income limitation provided in section 4988(b), if applicable) on the removal in that month of oil that is not subject to withholding under § 150.4995-1. The deposits shall be made not later than 45 days after the close of the month in which the oil was removed (or deemed removed under section 4988(c)(4)) from the premises. These deposit requirements will be considered to have been met for a month with respect to estimated deposits, including deposits based upon the producer's estimate of the effect of the net income limitation provided in section 4988(b), only if—

* * * * *

(g) *Special rules applicable if the net income limitation is taken into account in depositing tax*—(1) *Reporting requirements.* For the requirement that the producer file quarterly and annual statements if windfall profit tax deposits have been based on an application of the net income limitation provided in section 4988(b), see § 150.4997-1.

(2) *Treatment of deposits by a producer in excess of liability due to the net income limitation*—(i) *In general.* Under §150.6402-1, a producer who deposits for a taxable period an amount that exceeds the tax imposed by section 4986 but does not exceed the tax imposed by section 4986 computed without regard to the net income limitation provided by section 4988(b) may not claim a credit or refund of the excess until the end of the producer's taxable year (for Federal income tax purposes) with respect to which the limitation is computed. However, the excess (if any) of a producer's deposits for a semimonthly period (calendar month in the case of producers depositing under paragraph (f) of this section) over the tax imposed by section 4986 (computed with regard to the net income limitation) for that period (or month) shall be applied in order of time to each of the producer's succeeding semimonthly periods (or months), to the extent that the amount by which the taxes for that period (or month) exceed the deposit for such subsequent period (or month), until such excess is exhausted. The preceding sentence shall not apply to any amount for which the producer files a claim for credit or refund pursuant to § 150.6402-1. Furthermore, no amount shall be applied to a deposit for a subsequent semimonthly period (or month) that occurs in a taxable period beginning in a different taxable year (for Federal income tax purposes).

(ii) *Examples.* The rules of this paragraph and their relationship to the rules of § 150.6402-1 may be illustrated by the following examples:

Example (1). A, whose taxable year (for Federal income tax purposes) ends September 30, is the producer of oil from property X. For each taxable period (calendar quarter) within his taxable year ending September 30, 1981, A's windfall profit tax liability, determined without taking the net income limitation into account, is $1,000. The purchaser of A's oil is not required to withhold any windfall profit tax, and for the last taxable period of 1980 A has deposited $1,000. At the beginning of the first taxable period of 1981, A determines that the net income limitation will reduce the windfall profit tax with respect to the oil removed from property X during the taxable year ending September 30, 1981, by approximately 10 percent. Therefore, A concludes that the tax paid for the preceding taxable period (calendar quarter) exceeds his liability for tax for that period, although the exact amount of the excess cannot be determined until the taxable year ends. Under § 150.6402-1, A may not claim a refund for the amount of any such excess until the taxable year ends on September 30, 1981. However, paragraphs (a) and (f) of § 150.4995-3 do not require deposit of more than the tax imposed by section 4986. Therefore, A may estimate the effect of the net income limitation in determining the amount of windfall profit tax to be deposited for each taxable period. Furthermore, the amount by which the tax deposited by A for a preceding deposit period exceeds the actual liability for that period is treated as deposited for the next period. Accordingly, A deposits a total of $800 for the first taxable period of 1981 and $900 for each of the next two taxable periods.

Thus, at the end of the four taxable periods ending within A's taxable year, A has made the following deposits:

Oct.-Dec. 1980	*Jan.-Mar. 1981*	*Apr.-June 1981*	*July-Sept. 1981*
$1,000	$800	$900	$900

After September 30, 1981, A computes his net income limitation for property X and determines that his actual tax liability was $850 for each taxable period. A has satisfied the deposit requirements and is entitled to file a claim for credit or refund of $200.

Example (*2*). Assume the same facts as in example (1), except that A overestimates the effect of the net income limitation and deposits a total of $600 for the first taxable period of 1981 and $800 for each of the next two taxable periods. After September 30, 1981, A's deposits are as follows:

Oct.-Dec. 1980	*Jan.-Mar. 1981*	*Apr.-June 1981*	*July-Sept. 1981*
$1,000	$600	$800	$800

$150 of the deposits for October, November, and December 1980 is treated as carried over to and deposited in the next taxable period, bringing the total deposit required for Jan.-Mar. 1981 to $700 (the amount equal to the $850 actual liability less $150 carried from the preceding period). However, due to the overestimation of the effect of the net income limitation, A has not deposited the total liability for that period or the next two taxable periods. Therefore, A is liable for $200 in undeposited tax (the amount equal to $3,400 total liability less $3,200 total deposits) plus interest and penalties (unless A's error was due to reasonable cause).

(h) *Government depositories.* * * *

(i) *Depositary forms.* * * *

Par. 2. Section 150.4997-1 is amended by revising the portion of paragraph (a) that follows subparagraph (2) to read as follows:

§ 150.4997-1 Returns and recordkeeping.

(a) *Returns.* * * *

Every producer taking the net income limitation provided by section 4988 (b) into account in making windfall profit tax deposits shall file quarterly and annual statements in accordance with forms and instructions provided for that purpose. See § 150.6076-1 for the rules relating to the time for filing the returns required by this section.

* * * * *

Par 3. Section 150.6402-1 is amended by revising paragraphs (b) and (c) and by adding new paragraphs (e) and (f) immediately after paragraph (d). These added and revised paragraphs read as follows:

§ 150.6402-1 Credit or refund of overpayment of windfall profit tax.

* * * * *

(b) *Overpayments not attributable to amounts deducted and withheld*—(1) *In general.* If, for any taxable period, a producer has paid more than the amount of tax imposed by section 4986 (computed without regard to the net income limitation on windfall profit provided in section 4988 (b)) that is attributable solely to tax paid on crude oil not subject to withholding, the producer may file a claim for refund of that overpayment on or after the date for filing the return of such tax for such taxable period under section 6076 or may claim credit for such overpayment against any liability for a tax imposed by Chapter 1 or 45 in accordance with the forms and instructions provided for that purpose.

(2) *Net income limitation.* Except as provided in paragraph (b)(1), if, for any taxable period, a producer has paid more than the amount of tax imposed by section 4986 (computed with regard to the net income limitation provided in section 4988(b)) that is attributable solely to tax paid on crude oil not subject to withholding, the producer may file a claim for credit or refund of that overpayment only after the end of the producer's taxable year (for Federal income tax purposes) with respect to which the limitation is computed. At that time, the producer may claim a credit or refund of the overpayment as provided in paragraph (b)(1) of this section.

(c) *Overpayments attributable to amounts deducted and withheld*—(1) *In general.* Under section 4995(a) (4), the producer of oil is treated as having paid any amount withheld on the last day of the first February after the calendar year in which the oil was removed from the premises. Therefore, if the sum of the producer's liability for the tax imposed by section 4986 (computed without regard to the net income limitation provided in section 4988(b)) on oil subject to withholding under § 150.4995-1 for all taxable periods of a calendar year is less than the amount deducted and withheld from the producer under § 150.4995-1 with respect to oil removed during the calendar year, an overpayment of tax exists after such last day of February. The producer may file a claim for refund of the overpayment or may claim credit for the overpayment against any liability for a tax imposed by chapter 1 or 45 in accordance with the forms and instructions provided for that purpose. The producer shall attach to the claim a copy of all Forms 6248 furnished to the producer pursuant to § 150.4997-2.

(2) *Net income limitation.* Except as provided in paragraph (c)(1), if the sum of the producer's liability for the tax imposed by section 4986 (computed with regard to the net income limitation provided in section 4988 (b)) on oil subject to withholding under § 150.4995-1 for any taxable period is less than the sum of the amounts deducted and withheld from the producer under § 150.4995-1 with respect to oil removed in that taxable period, the excess may be claimed as a credit or refund only after the later of—

(A) The last day of the first February after the end of the taxable period, or

(B) The last day of the producer's taxable year (for Federal income tax purposes) with respect to which the limitation is computed.

Thereafter, the producer may file a claim for credit or refund of the overpayment as provided in paragraph (c) (1) of this section.

* * * * *

(e) *Examples.* The rules of this section may be illustrated by the following examples:

Example (*1*). Under § 150.4995-1, the purchaser of oil from producer A is not required to deduct and withhold any tax from payments made to A. Consequently, A deposited a total of $1,100 for a certain taxable period. After the end of the taxable period, it is determined that the tax imposed by section 4986, computed without regard to the net income limitation, is $1,000. A estimates that, due to the net income limitation, the actual liability is only $900. Under paragraph (b)(1) of this section, A may file a claim for credit or refund of $100 (the amount by which the $1,100 deposit exceeds the $1,000 tax imposed by section 4986, computed without regard to the net income limitation). Under paragraph (b)(2) of this section, A may claim credit or refund of any overpayment due to the application of the net income limitation only after A's taxable year (for Federal income tax purposes) has ended. However, see § 150.4995-3(g)(2) for rules relating to estimated tax deposits.

Example (2). Producer B's taxable year for income tax purposes is the calendar year. Due to the application of the net income limitation, the amount of windfall profit tax withheld from B exceeds B's liability for each of the four taxable periods of the calendar year. B may file a claim for credit or refund of the overwithheld tax after the last day of February following the end of the calendar year.

Example (3). Producer C's taxable year for income tax purposes ends on June 30. Due to the application of the net income limitation, C's windfall profit tax has been overwithheld for each of the four taxable periods within C's taxable year ending June 30, 1981. C may claim credit or refund after June 30, 1981, for the overpayment attributable to oil removed during the last two taxable periods of calendar year 1980 (July-September and October-December 1980), because by that time C has been deemed, under section 4995(a)(4), to have paid the tax with respect to those taxable periods, and the taxable year in which the oil was removed has ended. However, C must wait until after February 28, 1982, to claim credit or refund for the overpayment attributable to oil removed during the first two taxable periods of calendar year 1981 (January-March and April-June 1981).

Example (4). Assume the same facts as in example (3), except that the purchaser of C's oil made an error and overwithheld tax during the last taxable period of calendar year 1980. The error remained unadjusted when the purchaser furnished C the annual information statement under § 150.4997-2. After February 28, 1981, C may file a claim for credit or refund of the amount overwithheld due to the withholding error. However, C may not claim a credit or refund for the overpayment due to the application of the net income limitation until the dates specified in example (3).

Example (5). Assume the same facts as in example (3), except that C's taxable year ends on August 31, and the overpayment due to the net income limitation relates to C's taxable year ending August 31, 1981. C may claim a credit or refund after August 31, 1981, for the overpayment attributable to oil removed during the last two taxable periods of calendar year 1980. After February 28, 1982, C may claim credit or refund for the overpayment attributable to oil removed during the first three taxable periods of calendar year 1981. However, that claim may only reflect overpayments due to the application of the net income limitation for oil removed through August 1981 because the last month of the third taxable period of 1981 (September 1981) is in C's next income tax year.

(f) *Cross-reference.* For examples illustrating the interrelationship of § 150.4995-3 (relating to depositary requirements) and this section, see § 150.4995-3(g)(2)(ii).

There is need for the immediate guidance provided by the provisions contained in this Treasury decision. For this reason, it is found impracticable to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d) of that section.

This Treasury decision is issued under the authority contained in sections 4997 and 7805 of title 26 of the United States Code (94 Stat. 249 and 68A Stat. 917; 26 U.S.C. 4997 and 7805).

JEROME KURTZ,
Commissioner of
Internal Revenue.

Approved October 31, 1980.

ROBERT CARSWELL,
Deputy Secretary
of the Treasury.

(Filed by the Office of the Federal Register on October 31, 1980, 11:59 a.m., and published in the issue of the Federal Register for November 5, 1980, 45 F.R. 73467)

Section 4997.—Records and Information; Regulations

26 CFR 150.4997-1: Returns and recordkeeping.

Statements required by producers taking the net income limitation provided by section 4988(b) of the Code. See T.D. 7732, page 17.

Section 6001.—Notice or Regulations Requiring Records, Statements, and Special Returns

26 CFR 1.6001-1(a): Records.
(Also Section 165; 1.165-1(b).)

Evidence of loss; confirmation statements from foreign broker. The Service is not required to assume the existence of a loss from a futures transaction in U.S. Government interest-bearing certificates carried out on a foreign exchange that is evidenced by an investment prospectus, cancelled checks, and confirmation statements from a foreign investment firm whose records are not available for examination by the Service.

Rev. Rul. 80-324 [1]

ISSUE

Are an investment prospectus, cancelled checks, and confirmation statements sufficient to substantiate a loss deduction claimed by the taxpayer under the circumstances described below?

FACTS

A taxpayer, responding to an investment prospectus, invested money with a foreign investment firm (a foreign corporation) located in a foreign country. The money was to be used to engage in certain transactions involving futures contracts in United States Government interest-bearing certificates. These futures transactions were carried out on a foreign exchange not subject to regulatory supervision similar to that existing in the United States. During the taxable year, a foreign broker, on behalf of the taxpayer, purportedly covered a "short position" on some of these certificates, which resulted in a loss to the taxpayer. To discharge the resulting liability to the broker, the taxpayer allegedly borrowed money from the foreign corporation and purportedly assumed personal liability to repay this debt.

On the federal income tax return for the year in question, the taxpayer claimed a 100,000*x* dollar loss deduction on account of this transaction. Upon audit of the taxpayer's return, the taxpayer, to substantiate this loss, presented (1) the investment prospectus of the foreign corporation, (2) a cancelled check in the amount of 12,500*x* dollars made payable to the foreign corporation (and with which the taxpayer claimed to have opened the trading account), and (3) confirmation certificates prepared by the foreign corporation evidencing the claimed loss. The foreign investment corporation's records of the taxpayer's transactions are not available for examination by the Internal Revenue Service because the foreign country's secrecy laws preclude such examination.

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[1] Also released as News Release IR-80-114, dated October 30, 1980.

LAW AND ANALYSIS

Section 165(a) of the Internal Revenue Code provides that there shall be allowed as a deduction any loss sustained during the taxable year and not compensated for by insurance or otherwise.

Section 1.165-1(b) of the Income Tax Regulations provides, in part, that to be allowable as a deduction under section 165(a) of the Code, a loss must be evidenced by closed and completed transactions, fixed by identifiable events, and actually sustained during the taxable year. This provision further provides that only a bona fide loss is allowable.

Section 6001 of the Code provides that every person liable for any tax imposed by the Code, or for the collection thereof, shall keep records as the Secretary of the Treasury or the Secretary's delegate may from time to time prescribe.

Section 1.6001-1(a) of the regulations provides that any person subject to income tax shall keep such permanent books of account or records, including inventories, as are sufficient to establish the amount of gross income, deductions, credits, or other matters required to be shown by such person in any return of such tax or information.

Thus, on audit, a taxpayer can be required to supply sufficient information to permit the Service to determine the bona fides of any claimed deduction or credit. A taxpayer is not relieved of his obligation to establish the bona fides of any claimed deduction or credit because the transaction giving rise to the deduction or credit is carried out through a foreign investment vehicle (foreign partnership, corporation, or trust, for instance) that operates in a foreign jurisdiction whose laws or practices prohibit or restrict disclosure to the Service.

HOLDING

Because the foreign futures transactions are not subject to regulatory supervision equal to that provided in the United States, the Service is not required to assume the existence of these transactions merely because the taxpayer produces some documentation (e.g., investment prospectus, cancelled checks, and confirmation statements) purporting to evidence such transactions.

Section 6402.—Authority to Make Credits or Refunds

26 CFR 150.6402-1: Credit or refund of overpayment of windfall profit tax.

Time for filing of refund or credit claims for overpayments. See T.D. 7732, page 17.

Part II. Treaties and Tax Legislation

Subpart B.—Legislation and Related Committee Reports

Public Law 96-369
96th Congress, H. J. Res. 610[1]
October 1, 1980

Joint Resolution

Making continuing appropriations for the fiscal year 1981, and for other purposes.

* * * * *

Sec. 123. No funds appropriated by this Act may be used to implement or enforce provisions of any regulation or ruling with respect to section 280A of the Internal Revenue Code of 1954 which relate to—

(1) the rental of a dwelling unit to a member of the family of a taxpayer,

(2) the determination of the principal place of business of the taxpayer, or

(3) the circumstances under which use of the dwelling unit for repairs and maintenance constitutes personal use by the taxpayer.

* * * * *

Approved October 1, 1980.

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[1] This publication of the law is restricted to excerpts involving tax matters. House Report Nos. 96-1327 and 96-1443 are not published.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.602: Forms and instructions. (Also Part I, Sections 446, 481; 1.446-1, 1.481-1.)

Rev. Proc. 80-51

SECTION 1. PURPOSE

The purpose of this revenue procedure is to provide general procedures under section 1.446-1(e) of the Income Tax Regulations for obtaining the consent of the Commissioner of Internal Revenue to requests for changes in methods of accounting for federal income tax purposes.

This revenue procedure modifies and/or supersedes Rev. Proc. 70-27, 1970-2 C.B. 509; Rev. Proc. 71-16, 1971-1 C.B. 682; Rev. Proc. 71-16 Amendment I, 1971-2 C.B. 527; Rev. Proc. 72-24, 1972-1 C.B. 749; Rev. Proc. 74-51, 1974-2 C.B. 507; Rev. Proc. 75-18, 1975-1 C.B. 687; and Rev. Proc. 76-8, 1976-1 C.B. 547.

SEC. 2. BACKGROUND

.01 Section 446(e) of the Internal Revenue Code and section 1.446-1(e) of the regulations provide that in order to change a method of accounting for federal income tax purposes, the taxpayer must obtain the consent of the Commissioner. Section 1.446-1(e)(3)(i) requires that in order to obtain such consent, an application must be made within 180 days after the beginning of the taxable year in which the proposed change is requested to be made. Section 1.446-1(e)(3)(ii) authorizes the Commissioner to prescribe administrative procedures setting forth the limitations, terms, and conditions deemed necessary to permit a taxpayer to obtain consent to a change in its method of accounting in accordance with section 446(e).

.02 Section 481(a) of the Code requires that those adjustments necessary to prevent amounts from being duplicated or omitted be taken into account when the taxpayer's taxable income is computed under a method of accounting different from the method used to compute taxable income for the preceding taxable year. Section 481(c) and section 1.481-5 of the regulations provide that the adjustment required by section 481(a) may be taken into account in determining taxable income in the manner and subject to the conditions agreed to by the Commissioner and the taxpayer.

.03 Methods of accounting should clearly reflect income on a continuing basis, and the Internal Revenue Service administers its discretion under sections 446(e) and 481(c) of the Code so that, in general, any distortion of income on an annual basis is minimized. When there is a change in method of accounting, income for the year preceding the year of change must be determined under the method of accounting that was then employed, and income for the year of change and the following years is determined under the new method of accounting. The section 481(a) adjustment, while necessary to prevent duplications or omissions of income or deductions, by its nature is distortive since it does not reflect the economic income of the year. An adjustment period for the section 481(a) adjustment is provided for in sections 5.05 and 5.06 of this revenue procedure and is intended to reduce the possibility of a change in method of accounting from itself creating a material distortion in income in the year of change and to reduce any distortion when it does exist. Also, amounts attributable to changes in methods of accounting are taken into account in determining earnings and profits in a manner consistent with the provisions of this revenue procedure.

.04 While the adjustment period is designed to ameliorate, at least in part, the otherwise distortive effect of the section 481(a) adjustment, the Service believes that in order to further compliance with proper methods of accounting, situations exist when allowing an adjustment period of more than 1 year is not appropriate. In such cases, a period of only 1 year is available. (See section 4.012 of this revenue procedure.) Similarly, the Service believes that certain situations exist when it is not appropriate to allow more than a 5-year period. (See section 5.11.) In addition, the Service believes as a general matter that it is appropriate that the adjustment period not be greater than the period that gave rise to the section 481(a) adjustment. (See section 5.06.)

SEC. 3. CHANGES

.01 This revenue procedure contains several major changes and amplifications in the procedures for obtaining the Commissioner's consent to a change in method of accounting. These changes and amplifications are made to encourage compliance with proper methods of accounting when a taxpayer is determining taxable income in accordance with one or more methods of accounting that are proscribed by the Code, regulations, decisions of the Supreme Court of the United States, revenue rulings and revenue procedures. This section highlights the major changes and amplifications.

.02 Section 4.012 provides new procedures that preclude a taxpayer that is using a Category A method of accounting from applying for a change in such method of accounting under this revenue procedure after the taxpayer is contacted in any manner by a representative of the Service for the purpose of scheduling an examination. A Category A method of accounting is defined in section 6.02 as a method of accounting that is specifically not permitted by the Code, regulations, or by a decision of the Supreme Court of the United States.

.03 Section 5, in general, amplifies the procedures to be followed in requesting consent to change a method of accounting.

.04 Section 5.02 expands the rules and procedures to be followed when a taxpayer files an application for change in method of accounting before and after the first 180 days of the taxable year for which the change is requested. Early applications filed up to 6 months before the beginning of the taxable year of change will be processed in accordance with section 5.03 of this revenue procedure. Late applications not accepted by the Service under the provisions of section 1.9100-1 of the regulations may be considered to apply to the subsequent taxable year.

.05 Section 5.06 explains the section 481(a) adjustment periods for the purpose of taking into account the appropriate adjustment resulting from the change in method of accounting. These adjustment periods are similar to the "spread periods" referred to in Rev. Proc. 80-5, 1980-1 C.B. 582. The period of years over which a section 481(a) adjustment is to be made now depends upon the facts and circumstances in each case. However, the adjustment period may not exceed 10 taxable years and in some cases may be 1 taxable year.

.06 Section 5.10 eliminates the 20-year adjustment period provided for by Rev. Proc. 71-16, Rev. Proc. 71-16, Amendment I, and Rev. Proc. 72-24, with respect to the discontinuance of the last-in, first-out (LIFO) inventory method. The adjustment period over which the section 481(a) adjustment is to be taken will be determined under the rules set forth in section 5.06. The adjustment period will not exceed 10 taxable years and once the change has been made to discontinue the use of the LIFO inventory method the taxpayer will be required to stay on the new method of accounting for a period of at least 10 taxable years unless the Commissioner consents to a change at an earlier time.

.07 Sections 5.11, 10.02 and 11.03 modify and supersede Rev. Proc. 74-51 and allow an adjustment period for the section 481(a) adjustment of up to 5 taxable years with respect to certain changes to the full absorption method of inventory costing prescribed by section 1.471-11(a) of the regulations. During the transition period prescribed by section 1.471-11(e)(3), taxpayers were allowed an adjustment period not to exceed the lesser of 10 taxable years commencing with the year of transition or the number of years the taxpayer had been on the inventory method from which it was changing. Since the transitional rules of section 1.471-11(e) do not apply to taxable years beginning after September 19, 1975, the Service issued Rev. Proc. 74-51 to prevent taxpayers from applying under Rev. Proc. 70-27 for an adjustment period that would tend to frustrate the purpose of the transitional rules. Rev. Proc. 74-51 modified Rev. Proc. 70-27 to provide that it will not apply to a taxpayer changing to the full absorption method of inventory costing as required by section 1.471-11(e)(1)(i). Now, applications filed in accordance with the procedures set forth in Rev. Proc. 75-40, 1975-2 C.B. 571, will be allowed an adjustment period of up to 5 taxable years.

.08 Section 5.12 modifies the procedures that apply to taxpayers under examination by providing that a taxpayer using a Category B method of accounting (defined in section 6.03) may change its method of accounting while under examination. However, certain conditions (such as year of change) are imposed, and in the case of certain types of changes of methods of accounting (generally those designated by a revenue ruling or revenue procedure) the adjustment period is limited to 5 taxable years.

.09 Section 5.121 changes the year of change for which a change is granted with respect to taxpayers under examination. If the method being changed involves an issue raised by the Service during such examination, the year of change will be the most recent taxable year that is being examined by the Service, but not later than the most recent taxable year for which a federal income tax return has been filed as of the date such examination began.

.10 Section 11 is a new provision that sets forth the effective dates. Generally the provisions of this revenue procedure will be effective on December 1, 1980. However, except for changes in method of accounting to which Rev. Proc. 80-5 and Rev. Proc. 74-51 applied, the provisions of sections 4.012 and 5.12 are effective with respect to applications for change in accounting method (Form 3115) filed on or after December 1, 1982. Special effective dates are provided with respect to the elimination of the 20-year adjustment period provided when LIFO is discontinued and for the allowance of a 5-year adjustment period when changing the full absorption method of inventory costing.

SEC. 4. SCOPE

.01 This revenue procedure applies to Form 3115, Application for Change in Accounting Method, filed by all taxpayers except those cases:

1 Under examination by the Service in which the year or years under examination encompass the taxable year in which the erroneous method was initiated by the taxpayer or in which the taxpayer changed to a method of accounting without consent of the Commissioner;

2 In which the method to be changed is a Category A method of accounting (as defined in section 6.02 of this revenue procedure), and the taxpayer has been contacted in any manner by a representative of the Service for the purpose of scheduling an examination of its federal income tax return(s) and such examination has not been completed (but see section 4.02);

3 When at the time of filing Form 3115 the taxpayer is:

(a) Under examination by the district director, except as provided in sections 4.02, 5.12 and 7.03 of this revenue procedure;

(b) Under consideration by an appeals office of the Service with respect to an examination; or

(c) Before any federal court with respect to an income tax issue, unless the taxpayer has obtained an agreement from counsel for the Government that there is no objection to the proposed change in method of accounting;

4 Involving a termination of a taxpayer's use of the LIFO inventory method by the Service (see section 3.01 of Rev. Proc. 79-23, 1979-1 C.B. 564); or

5 In which there is pending a criminal investigation or proceeding concerning, (a) directly or indirectly the taxpayer's federal tax liability, or (b) the possibility of false or fraudulent statements made by the taxpayer with respect to its federal tax liability.

.02 Section 4.01 2 will not apply during a 90-day period following the date of issuance by the Service of either a letter stating that there is no change in the tax liability or a basic report form (a report of Individual

Income Tax Examination Changes, a report of Income Tax Examination Changes, a report of Income Tax Audit Changes, or an Unagreed and Excepted Agreed report) signifying notice of results of an examination by the Service of the taxpayer's liability for certain taxable years. The examination of cases placed or held in suspense under subsection 4559 of the Internal Revenue Manual should be completed for all issues not in suspense and a partial agreement requested. The issuance of a basic report form in such cases begins the 90-day period specified above. However, section 4.01 2 will be applied and the 90-day rule set forth above will not apply with respect to a Category A method of accounting that is included as an item of adjustment as a result of the examination by the Service or the method of accounting (Category A) issue is placed in suspense by the Service.

.03 Should a Category B method of accounting (defined in section 6.03 of this revenue procedure) be an issue that is placed in suspense by the Service and the taxpayer desires to change such Category B method of accounting to a proper method of accounting, the taxpayer may file an application for change in accounting method under the provisions of this revenue procedure.

.04 If section 4.012 applies, the change in method of accounting shall be made by the district director.

.05 Except as provided in section 5.12, this revenue procedure does not provide for retroactive changes for a taxable year for which a federal income tax return has been filed.

.06 The Service reserves the right to decline to process an application for change in accounting method filed under this revenue procedure in situations in which it would not be in the best interest of sound tax administration to permit the requested change. In this regard the Service will consider whether such change in method of accounting would clearly and directly frustrate compliance efforts of the Service in administering the income tax laws.

Sec. 5. Procedures

.01 *Submission of application for change in method of accounting.*

In general, an application for a change in method of accounting should be filed on Form 3115 within 180 days after the beginning of the taxable year for which the change in method of accounting is requested to be made.

.02 *Late applications for change in method of accounting.*

1 The purpose of the 180-day rule is to provide the Service adequate time to process the numerous applications prior to the original due date of taxpayers' returns. A Form 3115 that is not filed within the 180-day period may, under section 1.9100-1 of the regulations, nevertheless be considered as timely filed upon the showing of good cause in accordance with the requirements of Rev. Proc. 79-63, 1979-2 C.B 578. However, for purposes of this revenue procedure, applications received beyond 9 months after the beginning of the year of change will be considered to jeopardize the interests of the Government (see section 1.9100-1(a)(3) of the regulations and section 2 of Rev. Proc. 79-63) except in very unusual and compelling circumstances.

2 If a Form 3115 has been filed after the 180-day period and the Service does not grant relief under section 1.9100-1 of the regulations, the taxpayer may choose to have the application apply to the subsequent taxable year under the procedures prescribed in section 5.03 below. Such choice must be made within 30 days after the issuance by the Service of a denial of relief under section 1.9100-1, by filing a statement with the National Office addressed in accordance with section 7.01 of this revenue procedure. If such choice is timely made and the requirements of section 5.03 are met, the application will be considered a qualified application timely filed for purposes of this revenue procedure at the time Form 3115 was filed for which relief under section 1.9100-1 was requested.

.03 *Early applications for change in method of accounting.*

A qualified application for a change in method of accounting filed within a 6-month period before the beginning of the year of change will be considered as being timely filed for purposes of this revenue procedure. To qualify, (a) the Form 3115 must be complete in all respects except for the amount of the adjustment under section 481(a) for the year of change, and (b) the amount of such section 481(a) adjustment be furnished to the Service within the first 90 days after the beginning of the year of change. The filing of a qualified application for change in method of accounting in this manner will be considered to be an application for a change in method of accounting at the time of the original filing of the Form 3115. The processing order of a Form 3115 filed under the provisions of this subsection will be determined by the date all information (including the amount of the section 481(a) adjustment) has been furnished. In order to assist in the processing of Forms 3115 filed under this early filing procedure, and to insure proper handling, reference to this special procedure should be made a part of the Form 3115 by putting at the top of the Form 3115: **"FILED UNDER SEC. 5.03 of REV. PROC. 80-51."**

.04 *Processing applications (Form 3115).*

In processing applications for change in method of accounting the Service will consider all facts and circumstances. Such consideration will include:

1 Whether the method of accounting requested is consistent with the Code, regulations, revenue rulings, revenue procedures and decisions of the Supreme Court of the United States;

2 Whether the use of that method will clearly reflect income;

3 The taxpayer's reason(s) for the change; and

4 The tax effect of the adjustment under section 481(a) of the Code.

.05 *Approval.*

Approval of an application for change in method of accounting will normally be conditioned on the taxpayer proposing and agreeing as one of the conditions to the change to take the adjustment required under section 481(a) of the Code ("adjustment") into account in computing taxable income and earnings and profits (see Rev. Proc. 79-47, 1979-2 C.B. 528) over a period considered appropriate by the Commissioner, and proposing and agreeing to those other terms and conditions deemed appropriate by the Commissioner to clearly reflect, or prevent a distortion of, income. Such an approved change shall be considered to be a change in method of accounting initiated by the taxpayer.

.06 *Section 481(a) adjustment period.*

1 The appropriate period for taking into account an adjustment, whether positive or negative, referred to in section 5.05 ("adjustment period") is generally determined as follows:

(a) When the entire net amount of an adjustment is attributable to the taxable year immediately preceding the year of change (first preceding year), the total net adjustment is to be taken into account in computing taxable income for the year of change. The amount attributable to the taxable year immediately preceding the year of change is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount of the adjustment that would have been required under section 481(a) if the same change in method of accounting had been made in such preceding year.

(b) When (a) does not apply and 67 percent or more of the net amount of an adjustment is attributable to the 1-taxable year period, 2-taxable year period, or 3-taxable year period immediately preceding the year of change, the highest percent attributable to such 1, 2, or 3-taxable year period is to be taken into account ratably over a 3-taxable year period beginning with the year of change. Any remaining balance is to be taken into account ratably over an additional period equal to the remainder of the number of taxable years the taxpayer has used the method of accounting that is being changed. However, the total adjustment period shall not exceed 10 taxable years. This subparagraph 5.06 1(b) only applies if the taxpayer has used the method being changed for more than 3 taxable years. If the method of accounting being changed has been used for no more than 4 taxable years, 75 percent shall be substituted for 67 percent. An amount attributable to such 1, 2, or 3-taxable year period is the difference in the amount of the adjustment determined under section 481(a) of the Code for the year of change and the amount that would have been required under section 481(a) if the same change had been made at the beginning of such preceding 1, 2, or 3-taxable year period.

(c) In all other situations in which (a) and (b) above do not apply, the total net adjustment is to be taken into account ratably over the number of taxable years (not to exceed 10) the taxpayer has used the method of accounting that is being changed.

2 In applying sections 5.061(a) or (b), if a taxpayer's books and records do not contain sufficient information to compute the section 481(a) adjustment attributable to the 1, 2, or 3-taxable year period immediately preceding the year of change, the taxpayer may reasonably estimate such amounts and attach and sign (or have signed by an officer who has personal knowledge of the facts) the following statement to the Form 3115:

Under penalty of perjury, I hereby certify that:

(a) the books and records of [name of the taxpayer] do not contain sufficient information to permit a computation of the section 481(a) adjustment attributable to the 1-taxable year period, 2-taxable year period, or 3-taxable year period immediately preceding the year of change as required by section 5.061(b) of Rev. Proc. 80-51.

(b) Based on the information that is contained in such records, to the best of my information and belief, the entire amount of the section 481(a) adjustment for the year of change [indicate either "is" or "is not," as the case may be] attributable to the taxable year immediately preceding the year of change, and 67 percent [or "75 percent," in applicable cases] or more of the section 481(a) adjustment for the year of change [indicate "is" or "is not," as the case may be] attributable to the 1-taxable year period, 2-taxable year period, or 3-taxable year period immediately preceding the year of change.

3 A cooperative within the meaning of section 1381(a) of the Code shall generally take the total net amount of an adjustment into account in computing taxable income for the year of change. See Rev. Rul. 79-45, 1979-1 C.B. 284. The Service in its discretion may, however, require the adjustment to be taken into account ratably over a period of taxable years when it determines such action is appropriate.

.07 *LIFO Election.*

If a taxpayer elects the LIFO method of inventory valuation during the adjustment period referred to in section 5.06, the balance of the unamortized section 481(a) adjustment referred to in sections 5.05 and 5.06 attributable to a change in inventory valuation from a method with respect to which an adjustment under section 472(d) of the Code would have been required, must be taken into account in full in computing taxable income in the year for which such election is made. This subsection shall only apply to the portion of the unamortized section 481(a) adjustment attributable to the portion of the inventory with respect to which LIFO is elected.

.08 *Reduction in Inventory Value.*

1 If the change in method of accounting involves a change in method of inventory valuation and on the last day of any taxable year during the adjustment period referred to in section 5.06 the value of the taxpayer's inventory to which the section 481(a) adjustment relates is reduced by more than 33⅓ percent of such inventory value at the beginning of the first taxable year in the adjustment period (see sections 5.05 and 5.06), the balance of the net section 481(a) adjustment must be taken into account in full in determining taxable income in the year of such inventory reduction.

2 Section 5.081 shall not apply if the taxpayer has shown to the satisfaction of the Commissioner that such

reduction is attributable to a strike, involuntary conversion, or involuntary interruption of the availability of goods. This paragraph 5.082 shall apply only if the taxpayer has obtained the consent of the Commissioner. Such consent must be requested no later than 90 days after the end of the taxable year in which section 5.081 would otherwise apply.

.09 *Ceasing to engage in the trade or business.*

1 With respect to a corporation:

If the taxpayer ceases to engage in the trade or business, to which the adjustment (sections 5.05 and 5.06) relates, at any time prior to the expiration of the adjustment period referred to in section 5.06, the taxpayer shall take into account in such year the balance of the adjustment not previously taken into account in computing taxable income. See Rev. Rul. 80-39, 1980-1 C.B. 112, which holds that if a division of a corporation, for which a change in method of accounting had been granted, ceases to operate the trade or business for which the change in method was granted, the remaining section 481(a) adjustment applicable to the business conducted by that division of the corporation must be taken into income in the year the corporation ceases to engage in that trade or business. For purposes of this condition, the taxpayer is not considered to have ceased the trade or business if such cessation is the result of a transaction to which section 381 of the Code applies, but in such case the acquiring corporation shall continue to be subject to this revenue procedure as though it were the acquired corporation.

2 With respect to a partnership:

In the event a partnership terminates or ceases to engage in the trade or business (within the meaning of section 708 of the Code), to which the adjustment (sections 5.05 and 5.06) relates, at any time prior to the expiration of the adjustment period referred to in section 5.06, the balance of the adjustment not previosuly taken into account in computing ordinary income shall be taken into account in such year. A partnership ceasing to engage in the trade or business includes the incorporation of such trade or business in a transaction to which section 351 applies (see Rev. Rul. 77-264, 1977-2 C.B. 187).

3 With respect to a sole proprietor:

If the taxpayer ceases to engage in the trade or business, to which the adjustment (sections 5.05 and 5.06) relates, at any time prior to the expiration of the adjustment period referred to in section 5.06, the balance of the adjustment not previously taken into account in computing taxable income shall be taken into account in such year. A sole proprietor ceasing to engage in the trade or business includes the incorporation of such trade or business in a transaction to which section 351 of the Code applies (see Rev. Rul. 77-264). A sole proprietorship does not cease to engage in that trade or business when the individual taxpayer sells a partial interest in the proprietorship and continues to be actively engaged in the management of the business that is subsequently operated as a partnership. The section 481(a) adjustment remaining at the time the partnership is formed is taken into account by the partnership as though there had been no change in ownership (see Rev. Rul. 66-206, 1966-2 C.B. 206).

.10 *Discontinuance of LIFO.*

Rev. Proc. 71-16, Rev. Proc. 71-16 Amendment I and Rev. Proc. 72-24 concern a taxpayer's request to discontinue the use of the LIFO inventory method. Such a change is a change in method of accounting within the meaning of sections 446 and 481 of the Code and is subject to the provisions of this revenue procedure. Consent to discontinue the use of the LIFO inventory method and change to another acceptable method of inventory accounting that the Service determines will clearly reflect income normally will be granted subject to the requirements of section 1.472-6 of the regulations and the provisions of this revenue procedure, provided the taxpayer agrees to:

1 an adjustment period determined in accordance with the rules set forth in section 5.06 of this revenue procedure;

2 not to elect the LIFO inventory method of accounting for a period of at least 10 taxable years beginning with the year of change, unless consent is granted by the Commissioner to change the method of accounting at an earlier time based on a showing of extraordinary circumstances; and

3 to comply with any other terms and conditions that may be prescribed by the Commissioner (see section 5.05).

.11 *Full absorption method of inventory costing.*

With respect to applications filed by manufacturers and producers for consent to change to the full absorption method of inventory costing prescribed by section 1.471-11(a) of the regulations, the adjustment period otherwise determined in section 5.06 shall not exceed 5 taxable years.

.12 *Taxpayer under examination.*

A taxpayer that has been contacted by a representative of the Service for the purpose of scheduling an examination of its federal income tax return may obtain consent to change its method of accounting under this revenue procedure provided the method to be changed is a Category B method as defined in section 6.03 of this revenue procedure. Consent to make the requested change will normally be granted provided the taxpayer proposes and agrees:

1 That the year of change shall generally be,

(a) if the method being changed involves an issue raised by the Service during such examination, the most recent taxable year that is being examined by the Service during the examination of the taxpayer's returns, but not later than the most recent taxable year for which a federal income tax return has been filed as of the date the examination began, or,

(b) in other cases, the applicable taxable year that would apply at the time the application is filed if the taxpayer had not been under examination;

2 If the method to be changed has been designated by a revenue ruling or revenue procedure that was published in the Internal Revenue Bulletin more than 2 years prior to the date the

Form 3115 is filed, as a change in method of accounting with respect to which section 5.12 2 applies, the adjustment period otherwise determined under section 5.06 shall not exceed 5 taxable years; and

3 To comply with any other terms and conditions that may be prescribed by the Commissioner (see section 5.05).

.13 Examples of the rules prescribed in section 5.061 with respect to the section 481(a) adjustment.

Example A:

Z timely files an application to change its method of accounting for a specific item of expense to a method that the Service determines will clearly reflect income beginning with the taxable year ending December 31, 1981 (year of change). *Z* has used the method of accounting that is being changed for 12 taxable years. The adjustment required under section 481(a) of the Code for the year of change is $60,000. If *Z* had made the requested change in method of accounting for the taxable years ended December 31, 1978, 1979 or 1980, the amount of the adjustment would have been $42,000, $5,400 or $48,500, respectively. The percent of the section 481(a) net adjustment attributable to the 1, 2, or 3-taxable year period preceding the year of change is determined as follows:

1-Taxable Year Period

Adjustment as of January 1, 1981	$60,000
Less: Hypothetical adjustment as of January 1, 1980	48,500
Amount attributable to 1-taxable year period	$11,500

Percent of adjustment attributable to 1-taxable year period: $\frac{\$11,500}{60,000} = 19\%$

2-Taxable Year Period

Adjustment as of January 1, 1981	$60,000
Less: hypothetical adjustment as of January 1, 1979	5,400
Amount of adjustment attributable to the 2-taxable year period	$54,600

Percent of adjustment attributable to the 2-taxable year period:

$$\frac{\$54,600}{60,000} = 91\%$$

3-Taxable Year Period

Adjustment as of January 1, 1981	$60,000
Less: hypothetical adjustment as of January 1, 1978	42,000
Amount of adjustment attributable to the 3-taxable year period	$18,000

Percent of adjustment attributable to the 3-taxable year period:

$$\frac{\$18,000}{60,000} = 30\%$$

Because 91 percent of the adjustment is attributable to the 2 taxable year period preceding the year of change, *Z* will take such 91 percent of the adjustment ($54,600) into account ratably over 3 taxable years beginning with the year of change (the taxable year ending December 31, 1981) and the remaining balance of the adjustment ($5,400) into account ratably over the next 7 taxable years beginning with the taxable year ending December 31, 1984.

Example B

Y timely files an application to change its method of accounting for valuing inventory to a method that is in accord with the provisions of section 1.471-4 of the regulations, beginning with its taxable year ending November 30, 1981. The information furnished shows that *Y* used its present method of valuing inventory for 9 taxable years prior to the year of change and that the net adjustment required under section 481(a) of the Code for the year of change is $300,000. The information furnished further shows that had the change been made for the taxable year ending November 30, 1980, the adjustment required under section 481(a) would have been zero or a negative amount. Thus, the entire amount of the adjustment is attributable to the taxable year immediately preceding the proposed year of change. Under these circumstances and based on the provisions of section 5.061(a) of this revenue procedure, *Y* will take the entire $300,000 net adjustment into account in computing its taxable income for the taxable year ending November 30, 1981. If the information furnished had shown that had the change been made for the taxable year ending November 30, 1980, the adjustment required under section 481(a) would have been $300,000 and had the change been made for the taxable year ending November 30, 1979, the adjustment required under section 481(a) would be zero or a negative amount, the $300,000 would be taken into account ratably over the 3 taxable years beginning with the taxable year ending November 30, 1981.

Example C

W timely files an application to change its method of accounting for reporting income from long-term contracts from the percentage of completion method to the completed contract method, beginning with its taxable year ending September 30, 1981. The information furnished shows that *W* used the percentage of completion method for 4 taxable years prior to the year of change and the net negative adjustment required under section 481(a) of the Code for the year of change is $55,000. The information furnished further shows that the highest percent of the net negative adjustment attributable to the 1, 2, or 3-taxable year peiod preceding the proposed year of change was 63 percent. Under these circumstances and based on the provisions of section 5.061(c) of this revenue procedure, *W* will take the $55,000 adjustment into account ratably over 4 taxable years beginning with the taxable year ending September 30, 1981.

Example D

The taxpayer, a wholesaler, has for the past 10 years omitted freight-in from the computation of inventories and now desires to correct this practice. The year of change is the taxable year beginning January 1, 1981. The value of the taxpayer's inventory as of December 31, 1980 (the end of the year preceding the year of change), was $365,000, which did not include freight-in. The amount of freight-in omitted from that inventory was $45,000. The value of the inventory as of January 1, 1981 (the beginning of the year of change), computed in accordance with the new method of accounting to be adopted by the taxpayer is $410,000. The change in method of accounting is treated as a change initiated by the taxpayer, and thus the net section 481(a) adjustment is $45,000 ($410,000 — $365,000).

The hypothetical section 481(a) adjustments that would have been required if made in the 1, 2, or 3-taxable year period immediately preceding the year of change are as follows:

1-taxable year period (Ending December 31, 1980)	$30,000
2-taxable year period (Ending December 31, 1979)	$25,000
3-taxable year period (Ending December 31, 1978)	$35,000

Computation of percentage of adjustment attributable to the 1, 2, or 3-taxable year period preceding the year of change.

	1-taxable year period	2-taxable year period	3-taxable year period
Section 481(a) adjustment as of 1-1-81	$45,000	$45,000	$45,000
Less: Hypothetical section 481(a) adjustment	30,000	25,000	35,000
Amount attributable to each taxable year period	$15,000	$20,000	$10,000
Percentage of adjustment attributable to each taxable year period	$\frac{\$15,000}{\$45,000} = 33\%$	$\frac{\$20,000}{\$45,000} = 44\%$	$\frac{\$10,000}{\$45,000} = 22\%$

Under the provisions of section 5.06 1(c) of this revenue procedure the $45,000 will be taken into income over 10 taxable years beginning January 1, 1981. Thus, the taxable income for the year ended December 31, 1981, based on the foregoing and the amounts indicated below, should be computed as follows:

Sales		$800,000
Inventory at beginning of year (freight-in of $45,000 included)	$410,000	
Purchases (including freight-in)	585,000	
	$995,000	
Inventory at end of year including freight-in	335,000	
Cost of Goods Sold		660,000
Gross Profit		140,000
Less deductions		85,000
		55,000
Agreed-to section 481(a) adjustment to be taken over the adjustment period of 10 years (1/10 × $45,000)		4,500
Taxable income December 31, 1981		$ 59,500

SEC. 6. DEFINITIONS

.01 *Year of change.*

The taxable year for which a change is effective is the year of change. The year of change is the first taxable year for taking the adjustment referred to in section 5.06 of this revenue procedure into account and for complying with any other terms and conditions set forth in the Commissioner's consent letter (see section 1.446-1(e)(3)(ii) of the regulations). See also section 5.12 of this revenue procedure.

.02 *Category A method of accounting.*

A Category A method of accounting is a method of accounting that is specifically not permitted to be used by the taxpayer by the Code, regulations, or by a decision of the Supreme Court of the United States. Examples of methods within Category A are:

1 Methods of inventory valuation listed in sections 1.471-2(f)(1) through (7) of the regulations.

2 A write-down of goods in inventory that does not comply with section 1.471-2(c) of the regulations. For example, goods are written down without being sold or offered for sale.

3 A write-down of any goods in inventory that does not comply with section 1.471-4(b) of the regulations. For example, see Rev. Rul. 77-364, 1977-2 C.B. 183, in which a taxpayer determined the market value of goods in inventory by dividing the inventory into classes based upon sales activities and then reducing the value of each class by a percentage of cost assigned thereto.

4 The write-down of what is regarded as "excess" inventory by a taxpayer to a net realizable value although such inventory has not been scrapped, sold, or offered for sale at the reduced price. (*Thor Power Tool Co. v. Commissioner,* 439 U.S. 522 (1979), 1979-1 C.B. 167, and section 1.471-4(b) of the regulations.)

5 In the absence of a specific statutory or regulatory exception, the use of the cash receipts and disbursements method of accounting for the sale of merchandise when such merchandise is an income-producing factor and therefore inventories are required. (Section 1.446-1(c)(2) and Example 1 of section 1.446-1(e)(2)(iii) of the regulations.)

6 The use of a long-term contract method of accounting for income from contracts that clearly do not involve building, installation, construction or manufacturing. (Section 1.451-3(b) of the regulations.)

7 The use by a manufacturer of a method of inventory costing that does not conform to the requirements of section 1.471-11 of the regulations relating to the full absorption method of inventory costing.

8 The use of a method of accounting other than that prescribed by section 447 of the Code by a farming corporation subject to that section.

9 The use, in taxable years beginning on or after September 19, 1979, of a method of accounting under section 1.163-4(a) of the regulations, which provides for the deduction of interest as original issue discount, with respect to obligations with a term of 1 year or less. (Section 1.1232-3(b)(1)(iii).)

.03 *Category B method of accounting.*

Category B methods are all methods other than those specifically not permitted to be used by the taxpayer by the Code, regulations or decisions of the Supreme Court of the United States.

.04 *Filed.*

For purposes of this revenue procedure, a Form 3115 is filed at the time it is mailed (under the rules of section 7502 of the Code) or delivered to, and received by, the Service.

SEC. 7. APPLICATION

.01 A taxpayer wishing to invoke the provisions of this revenue procedure should complete and file a current Form 3115 with the Commissioner of Internal Revenue, Attention: T:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, and request the application of Rev. Proc. 80-51. The taxpayer must provide all the information required on such application (current Form 3115) and state that it proposes to take the adjustment into account over the appropriate period required by section 5.06 above. If the Service receives an application that is not properly completed in accordance with the instructions on the Form 3115, it will notify the taxpayer. Such notification will specify those items that need to be corrected and, when appropriate, transmit a current blank Form 3115 for the taxpayer's use. For example: The General Instructions contained on page 4 of the Form 3115 require a taxpayer to set forth all relevant facts regarding its present and proposed methods (as set forth in the application), including an explanation of why the taxpayer believes the application should be approved. In its notification, the Service will allow the taxpayer a reasonable period of time, ordinarily not more than 30 days, in which to submit the necessary information. If such information is submitted within the period of time granted by the Service, the application will be considered properly completed as of the date of original filing. If the information is not submitted within the time allowed, the application will be closed. If the information is received after the application is closed, it will be reopened and treated as a new application filed as of the date the information is received. The preceding four sentences shall not apply in the case of early applications submitted in accordance with section 4.03 of this revenue procedure.

.02 The signature of the individual or person preparing the application for the taxpayer must appear in the space at the bottom of page 1 on the Form 3115. An application made by an agent on behalf of a taxpayer must be accompanied by a power of attorney authorizing the agent to sign for the taxpayer. If the agent is also authorized to represent the taxpayer before the Service, receive the original or a copy of correspondence concerning the request, or perform any other act(s) regarding the application on behalf of the taxpayer, the power of attorney must reflect such authorization(s). If the taxpayer is a member of an affiliated group that has elected to file a consolidated federal income tax return, a Form 3115 submitted on behalf of the taxpayer must be signed by a duly authorized officer of the common parent. (See section 1.1502-77 of the regulations.)

.03 A request for the application of this revenue procedure under section 5.12 of this revenue procedure shall be made by the taxpayer in a letter addressed to the Commissioner of Internal Revenue, Attention: T:C:C:1. This request together with a properly completed current Form 3115 should be sent to the district director for the district in which the return is being examined. The district director will forward the application and pertinent comments to the National Office and suspend examination action on the accounting method issue pending completion of action by the National Office on the taxpayer's request. The district director should verify that the amount of the section 481 (a) adjustment is correct, that it has not been reduced by an amount attributable to taxable years prior to 1954, and that the adjustment period and year of change have been determined in accordance with section 5.12. The Form 3115 should not be sent to the National Office unless the taxpayer and district director are in agreement with respect to the year of change, the amount of the section 481(a) adjustment and the adjustment period. If the taxpayer and district director cannot agree as to these items, a technical advice request may be submitted to the National Office in accordance with Rev. Proc. 80-26, 1980-1 C.B. 671.

.04 Sections 9 (specifically subsections 9.10, 9.11, 9.15 and 9.21), 11, 15, 16 and 17 of Rev. Proc. 80-20, 1980-2 C.B. 633, pertaining respectively to Instructions to Taxpayers, Conference in the National Office, Withdrawal of Requests, Oral Advice to Taxpayers, and Effect of Rulings, are applicable to applications for changes in accounting methods (Form 3115) filed under this revenue procedure.

SEC. 8. MISCELLANEOUS

.01 *Conferences in the National Office.*

1 The taxpayer should state in writing at the time the Form 3115 is filed under this revenue procedure whether the taxpayer or the taxpayer's authorized representative desire a conference if an adverse response is contemplated by the Service. If a conference is not specifically requested in writing at the time the taxpayer files Form 3115 under this revenue procedure or in a later written communication, the Service will presume that the taxpayer does not desire a conference.

2 If the taxpayer specifically states in writing that a conference is desired if an adverse response is contemplated by the Service, a conference will be arranged in the National Office prior to the Service's formal reply to the taxpayer's application. See section 11, Rev. Proc. 80-20.

.02 *Other offices of the Service.*

The provisions of this revenue procedure are not intended to preclude an appropriate representative of the Service (including an appeals officer) from settling a particular taxpayer's case involving an accounting method issue by means of agreeing to terms and conditions in the best interest of the Government. In such case, the terms and conditions used for this purpose may not contain a provision that:

1 Permits an adjustment period of more than 10 taxable years or more years than the method has been used by the taxpayer, whichever is shorter;

2 Permits an adjustment period of more than 5 taxable years when the change is to the full absorption method of inventory costing; or

3 Establishes the year of change as a year later than the year specified in section 5.121(a).

However, the terms and conditions may be more restrictive than those provided by this revenue procedure.

SEC. 9. INQUIRIES

Inquiries in regard to this revenue procedure should refer to its number and be addressed to the Commissioner of Internal Revenue, Attention: T:C:C:1, 1111 Constitution Avenue, N.W., Washington, D.C. 20224.

SEC. 10. EFFECT ON OTHER DOCUMENTS

.01 Rev. Proc. 74-11, 1974-1 C.B. 420 (pertaining to changes in method of depreciation accounting); Rev. Proc. 64-51, 1964-2 C.B. 1003 (pertaining to procedures for changing the method of accounting for bad debts from the specific charge-off method to the reserve method) as amplified by Rev. Proc. 70-15, 1970-1 C.B. 441 and as modified by Rev. Proc. 77-39, 1977-2 C.B. 573; and Rev. Proc. 80-5, 1980-1 C.B. 582 (pertaining to the decision of the Supreme Court of the United States in *Thor Power Tool Co. v. Commissioner*), are not affected by this revenue procedure. Form 3115 submitted by the taxpayer with respect to Rev. Proc. 74-11 is to be filed with the appropriate Internal Revenue Service Center and is not to be sent to the National Office.

.02 Rev. Proc. 76-8, and Rev. Proc. 74-51 are modified and superseded effective December 1, 1980.

.03 Rev. Proc. 72-24 is superseded effective December 1, 1980.

.04 Rev. Proc. 71-16 and Rev. Proc. 71-16 Amendment I are modified and superseded effective for applications for changes in accounting method (Form 3115) filed after December 1, 1980.

.05 Section 4.03 of Rev. Proc. 70-27 and section 2.03 of Rev. Proc. 75-18 are superseded effective December 1, 1982. All other provisions of Rev. Proc. 70-27 and Rev. Proc. 75-18 are superseded effective December 1, 1980.

Sec. 11. Effective Date

.01 The provisions of section 4.012 (taxpayer using a Category A method of accounting scheduled for an examination) and section 5.12 (taxpayer under examination, Category B method of accounting involved) of this revenue procedure are effective with respect to applications for change in accounting method (Form 3115) filed on or after December 1, 1982. However, the provisions of section 4.01 2 are effective with respect to Forms 3115 filed on or after December 1, 1980 with respect to changes in method of accounting to which: (1) Rev. Proc. 80-5 (which waives the 180-day rule and grants consent to taxpayers' applications to change from a method of accounting for inventory valuation of excess inventory, which is not in accordance with the prescribed method, to such prescribed method for the first taxable year ending on or after December 25, 1979) applies, or (2) Rev. Proc. 74-51 (full absorption inventory costing) applied.

.02 The provisions of section 5.10 (concerning discontinued use of the LIFO inventory method) are effective with respect to applications for change in accounting method (Form 3115) filed on or after December 1, 1980.

.03 The provisions of section 5.11 (concerning changes to the full absorption method) are effective with respect to changes granted after December 1, 1980. However, taxpayers who applied for and received the Commissioner's consent to change to the full absorption method of inventory costing prescribed by section 1.471-11(a) of the regulations and, pursuant to Rev. Proc. 74-51, an adjustment period of only 1 year was provided, may resubmit an application by March 1, 1981, requesting the adjustment period under section 5.06 (limited to 5 taxable years). This subsection 11.03 shall apply only if the taxable year the change to the full absorption method was originally granted is an open year under provisions of section 6501 of the Code and the taxpayer's change to the full absorption method of inventory costing was not in connection with an examination by the Service of the taxpayer's federal income tax return. Taxpayers that contemplate resubmitting an application under this subsection 11.03 may wish to protect the period of limitations for the year in which the change in method of accounting was first granted.

The application, a new Form 3115, should be filed with the National Office (see section 7 of this revenue procedure), together with a copy of the previous Form 3115 and a copy of the letter granting the full absorption change in method of accounting. As a condition to the granting of a revised Commissioner's consent letter, the taxpayer must propose and agree to pay the additional federal income tax due for the taxable years involved in the adjustment period. Upon the receipt of a revised Commissioner's consent letter granted pursuant to this subsection 11.03, the taxpayer must file an amended federal income tax return for the year of change with the appropriate Internal Revenue Service Center. Such amended return must be accompanied by a copy of the revised Commissioner's consent letter and amended returns prepared in accordance with the Commissioner's revised consent letter for all taxable years during the adjustment period with respect to which the original return has already been filed at the time of the filing of the amended return for the year of change. In order to assist in the processing of these amended returns, the taxpayer should include a covering letter clearly indicating that the amended returns are being filed in accordance with the provisions of subsection 11.03 of Rev. Proc. 80-51 and put at the top of each amended return: **"FILED UNDER SECTION 11.03 OF REV. PROC. 80-51."**

.04 All other provisions of this revenue procedure are effective December 1, 1980.

Part IV. Items of General Interest

Disaster Areas

Announcement 80-152

The President of the United States has determined that the areas listed below were adversely affected by disasters of sufficient severity and magnitude to warrant federal disaster assistance.

Taxpayers who suffered losses in these areas as a result of these disasters may elect the special tax treatment provided under section 165(h) of the Internal Revenue Code. Section 1.165-11 of the Income Tax Regulations sets forth the procedure for making this election. Losses not incurred with respect to a trade or business or any transaction entered into for profit will not qualify for treatment under section 165(h) unless such losses qualify as casualty losses.

State: California
Areas affected: Upper and Lower Jones Tracts in San Joaquin Delta of San Joaquin County
Type of disaster: Flooding
Begun on or about: September 26, 1980

State: New Jersey
Area affected: Entire state
Type of disaster: Water shortage
Date declared: October 19, 1980

State: Texas
Area affected: Precinct One of Nolan County
Type of disaster: Tropical Storm Danielle, intermittent rains, and flooding
Begun on or about: September 5, 1980

Foundation Status of Certain Organizations

Announcement 80-153

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the [illegible]g of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

American Measures and American Standards Association, Birmingham, AL
Central Wisconsin Workshop, Inc., Nekoosa, WI
Committee to Save New College, San Francisco, CA
Florida Christian Fellowship, Inc., Eustis, FL
Friends of Kamper Park & Zoo, Hattiesburg, MI
Friends of the Charles Allis Art Library Focal Ltd., Milwaukee, WI
Girl Scout Trust Fund, Artesia, NM
Great Pretenders, The, Grafton, WI
His House, Inc., Powell, WY
Historic Gettsyburg-Adams County, Inc., Gettysburg, PA
Houma Alliance, The, Houma, LA
Jackson Family Organization, George Dobbs, Ogden, UT
Live Wire Christian Youth Ministries, Inc., Sapulpa, OK
Meson Cancer Research Foundation, Inc., Albuquerque, NM
Metaphysical Co-op Love, Inc., Philadelphia, PA
Mimbres Museum Research Center, Inc., Silver City, NM
Missionary Auto-Truck Service, Inc., Philadelphia, PA
Montgomery County Literacy Council, Blue Bell, PA
Neighborly Pre-School Day Care Family Base, Inc., Louisville, MI
Nor-Cal Research Foundation, San Francisco, CA
Pennsylvania Association on Probation, Parole and Correction, The, Camp Hill, PA
Region Five Council on Aging, Fargo, ND
Village Playhouse of Wauwatosa, Wauwatosa, WI
Virginia Area Historical Society, Virginia, MN

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Proposed Tax Shelter Advisory Committee

Announcement 80-155

The Treasury Department has invited public comment on the desirability of establishing an advisory committee on issues concerning tax shelter opinions.

Proposed amendments to the regulations governing practice before the Internal Revenue Service for the purpose of setting standards for opinions used in tax shelter promotions were published in the Federal Register of September 4, 1980.

Treasury is considering the establishment of a committee to advise the Director of Practice on issues arising in the review of tax shelter opinions for compliance with the standards contained in the regulations. The committee would be established under the Federal Advisory Committee Act and would comprise a representative cross-section of individuals outside the government who are conversant with the tax shelter area.

Persons wishing to submit comments on the desirability of such an advisory committee and suggestions as to the scope of its duties, and any other relevant matters for the Treasury's consideration, are invited to write in triplicate, by December 19, 1980, to the Director of Practice, Department of the Treasury, Washington, D.C. 20220.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individual has been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
Vincent E. Heyworth	Hagerstown, MD	Enrolled Agent	Six months effective September 30, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.507-2(c)(1)(IV)(A), 1.509(a)-3, 1.509(a)-4(k)(2), 1.509(a)-5 as proposed in the Federal Register for July 24, 1979, 44 F.R. 43290, withdrawn; 1.507-2(c)(1)(IV)(A), 1.509(a)-3, 1.509(a)-4(k)(2), 1.509(a)-5, amended.	Definition of a private foundation.	Oct. 10, 1980	Dec. 9, 1980
26 CFR 1.44C-6 revised; 601.601 amended.	Secretarial authority to add items to the list of items eligible for the residential energy credit.	Oct. 15, 1980	Dec. 15, 1980
26 CFR 25.2514-3(e) amended.	Transfer of a life income interest by the possessor of that interest.	Oct 22, 1980	Dec. 22, 1980
26 CFR 48.4041 through 48.4041-10 deleted; 48.4041-11 through 48.4041-14 redesignated as 48.4041-14 through 48.4041-17; 48.4041-1 through 48.4041-13 added.	Manufacturers and retailers excise taxes on special fuels.	Oct. 22, 1980	Dec. 22, 1980
26 CFR 1.671-4, 1.6012-3, 301.6109-1 amended.	Modification of reporting requirements for certain grantor trusts.	Oct. 24, 1980	Dec. 23, 1980
26 CFR 301.7701-2 amended.	Tax classification of limited partnerships.	Oct. 27, 1980	Dec. 26, 1980
26 CFR 1.46-4(d), 1.48-1, 1.48-2, amended; 1.48-11 added.	Investment credit for qualified rehabilitated buildings.	Oct. 28, 1980	Dec. 29, 1980
26 CFR 150.4995-3, 150.4997-1, 150.6402-1 amended; published as temporary regulations in T.D. 7732, page 17, this Bulletin.	Tax deposits and refunds based on net income limitation.	Nov. 5, 1980	Jan. 5, 1981

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27, dated July 7, 1980.

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Key to Abbreviations:

RR	Revenue Ruling
RP	Revenue Procedure
TD	Treasury Decision
CD	Court Decision
PL	Public Law
EO	Executive Order
DO	Delegation Order
TDO	Treasury Department Order
TC	Tax Convention
SPR	Statement of Procedural Rules
PTE	Prohibited Transaction Exemption

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  Foreign trust, U.S. citizen, Virgin Islands resident (RR 318) 47, *11*
Trusts:
  Employees' (*See:* Employee plans)
  Foreign (*See:* Foreign trusts)
Unrelated income (*See:* Exempt organizations)

INTERNAL REVENUE CUMULATIVE BULLETINS

______	1927–1	$6.90
______	*1927–2*	*2.95*
______	1928–1	6.95
______	1928–2	9.50
______	1929–1	12.00
______	*1929–2*	*3.15*
______	1930–1	7.30
______	1930–2	9.50
______	*1931–1*	*3.60*
______	1931–2	13.00
______	*1932–1*	*2.80*
______	1932–2	8.65
______	*1933–1*	*3.35*
______	*1933–2*	*3.45*
______	*1934–1*	*3.70*
______	1934–2	14.00
______	1935–1	6.90
______	*1935–2*	*14.00*
______	*1936–1*	*3.55*
______	*1936–2*	*14.00*
______	*1937–1*	*13.00*
______	1937–2	7.70
______	*1938–1*	*16.00*
______	*1938–2*	*13.00*
______	1939–1–1	8.25
______	1939–1–2	10.90
______	1939–2	9.40
______	1940–1	5.55
______	1940–2	14.00
______	1941–1	*$6.95*
______	*1941–2*	*3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
______	*1944*(*)	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*12.00*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
______	1955–2	13.00
______	1956–1	15.00
______	1956–2	18.00
______	1957–1	$16.00
______	1957–2	13.00
______	1958–1	9.60
______	1958–2	13.00
______	1958–3	15.00
______	1959–1	15.00
______	1959–2	9.60
______	1960–1	19.00
______	1960–2	11.50
______	1961–1	14.00
______	1961–2	10.00
______	1962–1	14.00
______	1962–2	13.00
______	1962–3	20.00
______	1963–1	9.00
______	1963–2	10.75
______	1964–1–1	10.00
______	1964–1–2	11.00
______	1964–2	9.80
______	1965–1	10.70
______	1965–2	12.25
______	1966–1	14.00
______	1966–2	14.05
______	1967–1	10.00
______	1967–2	14.00
______	1968–1	14.00
______	1968–2	11.75
______	1969–1	14.00
______	1969–2	6.50
______	1969–3	$12.50
______	1970–1	11.00
______	1970–2	14.00
______	1971–1	10.55
______	1971–2	8.50
______	1972–1	13.50
______	1972–2	13.70
______	1973–1	16.00
______	1973–2	8.30
______	1974–1	11.00
______	1974–2	9.95
______	*1974–3*	*8.20*
______	1974–3 Supp.	10.00
______	1975–1	13.25
______	1975–2	13.00
______	1976–1	11.00
______	1976–2	10.25
______	1976–3–1	9.50
______	1976–3–2	16.00
______	1976–3–3	10.00
______	1977–1	10.75
______	1977–2	11.75
______	1978–1	11.75
______	1978–2	13.00
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December 8, 1980
Bulletin No. 1980-49

Internal Revenue bulletin

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Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-327, page 6.

Investment credit; engraved plates and right to reproduce and distribute books. Limited partners in a partnership that purchased engraved plates and the right to reproduce and distribute books made from the plates may claim investment credit based only on the distinct cost of the engraved plates.

Rev. Rul. 80-328, page 9.

Arbitrage bonds; contemporaneous issuance of notes and bonds. Factual situations illustrate circumstances under which a political subdivision's short-term notes that are issued contemporaneously with long-term bonds will be arbitrage bonds.

Rev. Rul. 80-329, page 14.

Charitable contributions; bibles. A promoter offers investors a choice of two plans to purchase bibles and donate them to charities. Under one plan, investors purchase the bibles and donate them to charity 12 months later. The investors are told that they may deduct the "retail" price, which is three times as high as the purchase price. Under the other plan, investors purchase the bibles at the "retail" price, put down the same amount as the purchase price in the first plan, and execute promissory notes for the balance. Principal and interest on the notes is payable in 12 years. The investors then donate the bibles to charity. The deduction is limited to the cash paid in the second plan.

Rev. Rul. 80-330, page 6.

National Historic Preservation Act of 1966. Payments received by a taxpayer under section 101 of the National Historic Preservation Act of 1966 are includible in the taxpayer's gross income.

Rev. Rul. 80-331, page 7.

Surplus campaign funds transferred to office account. Surplus campaign funds transferred to an officeholder's office account are includible in gross income for the year the funds are transferred. Amounts disbursed from the office account for ordinary and necessary expenses of serving as an officeholder are deductible under section 162(a) of the Code, provided the expenses otherwise qualify under that section and are not reimbursable.

Rev. Rul. 80-332, page 8.

Gross income; members of religious organization; outside earnings remitted to organization. A member of a religious organization who has taken a vow of poverty and is instructed by the organization's superiors to obtain outside employment must include the remuneration remitted to the organization in gross income. Another member of the organization who has taken a vow of poverty and is instructed to perform services in the business office of the church that supervises the organization is not required to include the remuneration remitted to the organization in gross income. Rev. Rul. 77-290 amplified.

(Continued on page 4)

Finding Lists begin on page 46.
Announcement of Voluntary Suspension on page 43.
Announcement of Notice of Proposed Rulemaking on page 44.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

Rev. Rul. 80-333, page 11.

Commuting expenses; construction worker. The Service will not follow the **Frederick** decision, which held that daily commuting expenses incurred over a three-year period by a construction worker who reasonably expected to be laid off when winter came were ordinary and necessary business expenses.

Rev. Rul. 80-334, page 11.

Business expenses; settlement payment; Department of Energy consent order. A payment to the U.S. Treasury, under a consent order specifically precluding imposition of civil or criminal penalties, that is made in settlement of claims and disputes resulting from a Department of Energy examination of a taxpayer's books and records is not a fine or similar penalty for purposes of section 162(f) of the Code and is deductible as an ordinary and necessary business expense. Such a payment made pursuant to a consent order requiring the imposition of a penalty for willful violation of the petroleum pricing statutes, however, is not deductible.

Rev. Rul. 80-335, page 15.

"Pay by phone" accounts; when deductible. The date to be used in determining when allowable deductions may be taken by a cash method taxpayer using a "pay by phone" account is the date the financial institution paid the amount, as reported on a monthly statement sent to the taxpayer.

Rev. Proc. 80-54, page 40.

Classification as liquidating trust; ruling requirements. Revised conditions are specified that must be met before the Service will consider issuing advance rulings concerning the classification of organizations as liquidating trusts; Rev. Proc. 79-1 modified and superseded.

T.D. 7728, page 15.

Amendments to the regulations relate to the changes in the holding period required for long-term capital gain or loss treatment and to changes in certain terms relating to capital asset transactions.

EXEMPT ORGANIZATIONS

Rev. Rul. 80-332, page 8.

Religious organization dependent on wages of members. An organization that is substantially dependent on wages earned by some of its members from outside employment, rather than on an internally operated business, does not qualify for exemption under section 501(d) of the Code; Rev. Rul. 77-290 amplified.

ESTATE TAX

Rev. Rul. 80-336, page 18.

Transfers within 3 years of death; stock dividend declared during transferee's ownership. Prior to death a decedent gratuitously transferred 500 shares of stock in a publicly traded corporation to an individual. After the transfer, the corporation declared a stock dividend of one share for every two shares owned, giving the individual 750 shares. The decedent died during the next year. The fair market value of the 750 shares of stock is includible in the decedent's gross estate.

EMPLOYMENT TAXES

Rev. Rul. 80-332, page 8.

Members of religious organizations; outside earnings remitted to organization. Remuneration remitted to a religious organization by a member of the organization who has taken a vow of poverty and is instructed by the organization's superiors to obtain outside employment is subject to FICA and income tax withholding. Remuneration remitted to the organization by another member who has also taken a vow of poverty and is instructed to perform services in the business office of the church that supervises the organization is not subject to FICA or income tax withholding. Rev. Rul. 77-290 amplified.

Rev. Rul. 80-337, page 18.

Exempt organization; waiver certificate; constructive filing. An exempt organization that began withholding FICA taxes from its employees at the beginning of the year and filed Forms 941 and paid the tax for the first three quarters during the fourth quarter is deemed to have filed a waiver certificate under section 3121(k)(4) of the Code.

ADMINISTRATIVE

Rev. Proc. 80-52, page 20.

Magnetic tape reporting for information returns.

(Continued on page 5)

Highlights of this Issue—Continued

(Continued from page 4)

ADMINISTRATIVE—Cont'd

The requirements and conditions for filing information returns in the Forms 1099 and 1087 series on magnetic tape instead of paper returns are set forth; Rev. Proc. 79-66 superseded.

Rev. Proc. 80-53, page 40.
Reporting requirements; fringe benefits not subject to withholding. Procedures are provided for reporting fringe benefits that total $600 or more and are includible in gross income on Form W-2, even if they are not subject to withholding pursuant to the decision of the Supreme Court in **Central Illinois Public Service Company v. United States.**

Announcement 80-154, page 42.
Form 4255, Recapture of Investment Credit, has been revised to provide for the recapture of business energy investment credit.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 38.—Investment in Certain Depreciable Property

26 CFR 1.38-1: Investment in certain depreciable property.

Whether a partnership is entitled to use as its basis for the investment tax credit the amount paid to acquire engraved plates and the right to reproduce and distribute books made from the plates. See Rev. Rul. 80-327, below.

Section 48.—Definitions; Special Rules

26 CFR 1.48-1: Definition of section 38 property.
(Also Section 38; 1.38-1.)

Investment credit; engraved plates and right to reproduce and distribute books. Limited partners in a partnership that purchased engraved plates and the right to reproduce and distribute books made from the plates may claim investment credit based only on the distinct cost of the engraved plates.

Rev. Rul. 80-327 [1]

ISSUE

Is a partnership entitled to use as its basis for the investment tax credit the amount paid to acquire engraved plates and the right to reproduce and distribute books made from the plates, under the circumstances described below?

FACTS

In March 1979 *P*, a corporation, contracted with certain book publishers to acquire the engraved plates necessary to print the text of hardcover and softcover books for 32 different literary works and the rights to print, publish, distribute, and sell the books in the English language. *P* paid 1,080*x* dollars in cash for these assets.

In August 1979 *P* offered to sell to individuals 24 units of a limited partnership, *X*, in which *P* would be the general partner. The purchase price of each unit of the limited partnership was 45*x* dollars, payable with a cash downpayment of 30*x* dollars and a promissory note of 15*x* dollars. The investor was personally liable on the promissory note, which was payable to *P* on February 15, 1980, with interest at the rate of 10 percent per annum.

P represented that each partner would be entitled to (1) a share of the investment tax credit based upon the purchase price of 1,080*x* dollars and (2) a share of the partnership losses, subject to the amount each is at risk within the meaning of section 465 of the Internal Revenue Code.

X acquired the engraved plates and the publication rights from *P*. From each set of plates, a number of books were printed and distributed for sale prior to December 31, 1979. *A*, who purchased one of the partnership units, deducted on *A*'s 1979 income tax return a share of the partnership losses limited to *A*'s at risk amount of 30*x* dollars and claimed a share of the investment tax credit based on the investment in the book properties.

LAW AND ANALYSIS

Section 38 of the Internal Revenue Code allows a credit against federal income tax for qualified investment in "section 38 property" as defined in section 48. Section 48(a)(1) provides that only certain tangible property, which is depreciable and has a useful life of 3 years or more qualifies as section 38 property. Section 1.48-1(f) of the Income Tax Regulations provides that intangible property does not qualify as section 38 property.

The investment tax credit is allowed only for tangible property. Engraved plates are tangible property that is necessary to produce hardcover and softcover books. The legal right to print, publish, distribute and sell books is an item of property separate and distinct from the plates necessary for the mechanical production of those books. The particular plates in question do not, in themselves, carry the right to print the work. Similar plates could be produced once the legal right to print, produce, distribute and sell the work is acquired. The right to reproduce and distribute hardcover and softcover books in the English language is one of several reproduction rights that emanate from the copyright of a literary work. That right is an intangible. *See* Rev. Rul. 70-403, 1970-2 C.B. 3. The investment tax credit, therefore, is applicable only to the tangible assets, which are the engraved plates. Thus, the maximum basis for purposes of computing the credit would be the distinct cost of the engraved plates.

During 1979, *A*'s amount at risk is limited to the cash invested of 30*x* dollars. *A* is not at risk with respect to the amount of the promissory note payable to *P*, because *P* has an interest in the activity other than that of a creditor. *See* Section 465(b)(3)(A) of the Code.

HOLDING

X may claim the investment tax credit based on the cost of the engraved plates only.

Section 61.—Gross Income Defined

26 CFR 1.61-1: Gross income.
(Also Sections 167, 191.)

National Historic Preservation Act of 1966. Payments received by a taxpayer under section 101 of the National Historic Preservation Act of 1966 are includible in the taxpayer's gross income.

Rev. Rul. 80-330

ISSUE

Are payments received by taxpayers pursuant to the National Historic Preservation Act of 1966, section 101, 16 U.S.C. sections 470 to 470t (1976), as amended, includible in their gross incomes?

FACTS

Under 16 U.S.C. section 470a, the Secretary of the Interior is authorized to establish a program of matching grants-in-aid to states for projects having as their purpose the preservation for public benefit of properties that are significant in American history, architecture, archeology, and culture. The term "project" means programs of state and local governments and other public bodies and private organizations and individuals for the acquisition of title or interests in, and for the development of, any district, site, building, structure, or object that is significant in American history, architecture, archeology, and culture, or property used in connection therewith, and for its development in order to assure the preservation for public benefit of any such historical properties. The term "historic preservation" includes the protection, rehabilitation, restoration, and reconstruction of districts, sites, buildings, structures, and objects significant in American history, architecture, archeology, or culture.

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[1] Also released as News Release IR 80-118, dated November 14, 1980.

Upon approval of an application submitted to the Department of the Interior, grant funds, not exceeding 50 percent of the total cost of the project, are awarded by the Department to the state. The state distributes the federal funds to the persons responsible for the various programs for which the federal funds are awarded. Properties for which funds are provided must be included in or eligible for inclusion in the National Register of historic places.

A, a professional person, purchased a house that is included in the National Register and received grant funds from the state to restore the house, which *A* intended to use only as an office.

LAW AND ANALYSIS

Section 61 of the Internal Revenue Code and the Income Tax Regulations thereunder provide that, except as otherwise provided by law, gross income means all income from whatever source derived.

The Internal Revenue Service has consistently held that payments made under legislatively provided social benefit programs for the promotion of general welfare are not includible in the recipients' gross incomes. See, for example, Rev. Rul. 76-395, 1976-2 C.B. 16, concerning home rehabilitation grants received under the Housing and Community Development Act of 1974, Pub. L. 93-383, 1974-2 C.B. 418, and Rev. Rul. 76-144, 1976-1 C.B. 17, concerning grants received under the Disaster Relief Act Amendments of 1974, Pub. L. 93-288, 1974-2 C.B. 414.

The payments in this case are distinguished from welfare program payments such as those involved in Rev. Rul. 76-395 and Rev. Rul. 76-144. The ultimate recipients of the payments in this case can be governmental units and other organizations exempt from federal income taxation and they can be taxpayers, including individuals, corporations, and unincorporated entities. Payments made to individuals can be made with respect to the individual's personal residence, and they can be made with respect to property used in the individual's trade or business or for the production of income. Thus, the payments are not based on an individual recipient's personal financial status, health, educational background, or employment status, nor are they intended to improve the living conditions of low-income homeowners. Rather, the purpose of the payments is to preserve historically significant structures. Thus, the payments are not made under a social benefit program for the promotion of general welfare.

HOLDING

The payments received by *A* are includible in *A*'s gross income under section 61 of the Code. Because the house is used in *A*'s trade or business, *A* is entitled to a deduction under section 191, concerning amortization of certain rehabilitation expenditures for certified historic structures, or section 167(o) concerning depreciation with respect to such structures.

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26 CFR 1.61-1: Gross income.
(Also Sections 162, 527; 1.162-1.)

Surplus campaign funds transferred to office account. Surplus campaign funds transferred to an officeholder's office account are includible in gross income for the year the funds are transferred. Amounts disbursed from the office account for ordinary and necessary expenses of serving as an officeholder are deductible under section 162(a) of the Code, provided the expenses otherwise qualify under that section and are not reimbursable.

Rev. Rul. 80-331

ISSUE

What are the federal income tax consequences to an officeholder of transfers of excess campaign funds to an office account?

FACTS

The transfer of excess campaign funds to an office account is specifically permitted under the Federal Election Campaign Act (FECA), 2 U.S.C. section 439a (1976), which is implemented by regulations issued by the Federal Election Commission (FEC), 11 CFR 113.

Section 113.2 of the FEC regulations provides, in part, that excess campaign funds may be used to defray any ordinary and necessary expenses incurred in connection with the recipient's duties as a holder of federal office.

Section 113.1(e) of the FEC regulations provides that the term "excess campaign funds" means amounts received by a candidate as contributions that the candidate determines are in excess of any amount necessary to defray the candidate's campaign expenditures.

Section 113.1(b) of the FEC regulations provides, in part, that the term "office account" means an account established for the purposes of supporting the activities of a federal officeholder that contains excess campaign funds and funds donated for the purpose of supporting the activities of the officeholder. An office account does not include (1) an account used exclusively for funds appropriated by Congress, (2) an account of the officeholder that contains only the personal funds of the officeholder, or (3) an account containing only appropriated funds and personal funds of the officeholder.

LAW AND ANALYSIS

Section 61(a) of the Internal Revenue Code and the Income Tax Regulations thereunder provide that, except as otherwise provided by law, gross income means all income from whatever source derived.

Section 162(a) of the Code provides that a taxpayer may deduct all the ordinary and necessary expenses incurred during the taxable year in carrying on any trade or business.

Section 527(a) of the Code provides that a political organization is subject to income taxation only to the extent provided in section 527.

Section 527(e)(1) of the Code provides that the term "political organization" means a party, committee, association, fund, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function.

Section 527(e)(2) of the Code provides that the term "exempt function" means the function of influencing or attempting to influence the selection, nominating, election, or appointment of any individual to any federal, state, or local public office or office in a political organization, or the election of presidential or vice-presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed.

Section 527(d) of the Code provides that an amount is not treated as diverted for the personal use of a candidate or any other person if any political organization contributes the amount to or for the use of another qualifying political organization or certain charitable organizations or deposits the amount in the general fund of the Treasury or in the general fund of any state or local government.

In discussing the provisions of section 527(d) of the Code, Rep. No. 93-1357, 93rd Cong., 2d Sess. 30 (1974), 1975-1 C.B. 517, 534, states: "As under present law, when amounts are diverted from a political organization by a candidate for his personal use, the amount diverted is taxable income to the candidate in the year in which the funds are diverted."

When excess campaign funds are transferred to an office account, they are diverted for the personal use of the officeholder because the transfer is not an expenditure for an exempt function as defined in section 527(e)(2) of the Code and because the transfer is not a contribution or deposit described in section 527(d).

HOLDINGS

(1) Excess campaign funds transferred to an officeholder's office account are includible in the gross income of the officeholder under section 61 of the Code for the year in which the funds are transferred.

(2) Amounts disbursed from the office account for ordinary and necessary expenses paid or incurred by the officeholder during the taxable year in carrying on the officeholder's trade or business as an officeholder are deductible under section 162(a) of the Code, provided the requirements of that section are otherwise satisfied and the expenses are not reimbursable.

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26 CFR 1.61-2: Compensation for services, including fees, commissions, and similar items.
(Also Sections 501, 3121, 3401; 1.501(d)-1, 31.3121(b)(8)-1, 31.3401(a)(9)-1.)

Earnings of members remitted to religious organization. A member of a religious organization who has taken a vow of poverty and is instructed by the organization's superiors to obtain outside employment must include the remuneration remitted to the organization in gross income, and the remuneration is subject to FICA and income tax withholding. Another member of the organization who has also taken a vow of poverty and is instructed to perform services in the business office of the church that supervises the organization is not required to include the remuneration remitted to the organization in gross income, and the remuneration is not wages subject to FICA. An organization that is substantially dependent on wages earned by some of its members from outside employment does not qualify for exemption under section 501(d) of the Code. Rev. Rul. 77-290 amplified.

Rev. Rul. 80-332

ISSUE

Is Rev. Rul. 77-290, 1977-2 C.B. 26, applicable to members of an organization described in section 501(d) of the Internal Revenue Code?

LAW AND ANALYSIS

Rev. Rul. 77-290 holds that a member of a religious order, who has taken a vow of poverty and is instructed by the order's superiors to obtain employment with a law firm in the state is an agent of the law firm, not the religious order, and must include the remuneration remitted to the order in gross income. The remuneration is wages subject to the taxes imposed by the Federal Insurance Contributions Act and income tax withholding.

Rev. Rul. 77-290 also holds that another member of the same order who has also taken a vow of poverty and is instructed by the order's superiors to perform services in the business office of the church that supervises the order is an agent of the religious order and is not required to include the remuneration remitted to the order in gross income. In this situation the remuneration is not wages subject to the FICA and income tax withholding.

Section 501(d) of the Code provides for the exemption from federal income tax of religious or apostolic associations or corporations, if such associations or corporations have a common treasury or community treasury, even if such associations or corporations engage in business for the common benefit of the members.

HOLDING

Although Rev. Rul. 77-290 deals with members of religious orders, the reasoning set forth in Rev. Rul. 77-290 equally applies to members of organizations described in section 501(d) of the Code and of other religious organizations who have taken a vow of poverty.

Furthermore, it should be noted that if an organization is substantially dependent on wages earned by some of its members from outside employment, rather than on an internally operated business, it does not qualify for exemption from federal income tax under section 501(d) of the Code. See Rev. Rul. 78-100, 1978-1 C.B. 162.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 77-290 is amplified.

26 CFR 1.61-2: Compensation for services, including fees, commissions, and similar items.

Whether fringe benefits are includible in gross income. See Rev. Proc. 80-53, page 40.

26 CFR 1.61-7: Interest.

Whether interest on obligations of a political subdivision will be exempt from tax. See Rev. Rul. 80-328, below.

Section 103.—Interest on Certain Governmental Obligations

26 CFR 1.103-13: Arbitrage bonds. (Also Section 61; 1.61-7.)

Arbitrage bonds; contemporaneous issuance of notes and bonds. Factual situations illustrate circumstances under which a political subdivision's short-term notes that are issued contemporaneously with long-term bonds will be arbitrage bonds.

Rev. Rul. 80-328 [1]

ISSUE

Will notes of political subdivisions of states be arbitrage bonds within the meaning of section 103(c)(2) of the Internal Revenue Code in the situations described below?

FACTS

Situation 1

On November 14, 1980, authority M, a political subdivision of state O, proposes to issue $185x$ dollars of 5-year notes. Of the note proceeds, $176x$ dollars will be used to acquire newly created mortgages on single-family residences; $6x$ dollars will be deposited into a "reasonably required" reserve fund; and $3x$ dollars will be used to pay for the issuance costs of the notes. The notes will be issued at a yield of 7 percent. Note proceeds of $176x$ dollars are to be invested in United States Treasury Obligations at an unrestricted yield of 8.25 percent for a temporary period until used to acquire the mortgages. The mortgages to be acquired with the $176x$ dollars of note proceeds will have a yield of 8.5 percent while subject to the lien of the notes and 10.5 percent thereafter.

Also, on November 14, 1980, M will issue $204x$ dollars of 30-year bonds. Of the bond proceeds, $176x$ dollars will be deposited in a note retirement fund; $24x$ dollars will be deposited into a reasonably required reserve fund; and $4x$ dollars will be used to pay issuance costs of the bonds. The bonds were issued at a yield of 9 percent and will be invested at a yield of 9 percent in United States Treasury Obligations — State and Local Government Series (SLGS) until the note retirement date. On the note retirement date the mortgages that are not more than 90 days delinquent in payment of the principal and interest will be transferred from the lien of the notes to the lien of the bonds. At that time an amount of bond proceeds from the note retirement fund equal to the outstanding principal amount of the transferred mortgages will be used for retirement of an equivalent portion of the notes. Any amount remaining in the note retirement fund after the mortgages are transferred will be used to redeem a portion of the bonds. The trustee under the note indenture will either sell or foreclose on mortgages not transferred to the lien of the bonds.

Based on the national experience with mortgages and the issuer's prior experience with similar mortgage purchase programs, the issuer reasonably expects that more than 99 percent of the mortgages will be transferred to the lien of the bonds on note retirement date.

Situation 2

On November 14, 1980, authority N, a political subdivision of state P, proposes to issue $76x$ dollars of 3-year notes yielding 7 percent. The proceeds of the notes will be used to make construction mortgage loans to developers of various multi-family housing projects. The projects to be financed out of note proceeds will be eligible for housing assistance payments under section 8 of the United States Housing Act of 1937, as amended, 42 U.S.C. section 1437f. N anticipates that construction of the projects will be completed within 3 years of the date of issue of the notes. Note proceeds will be invested for a temporary period pending disbursement in Treasury Obligations at an unrestricted yield of 8.50 percent.

In addition, N proposes to issue on December 1, 1980, $80x$ dollars of 30-year bonds yielding 9 percent. The note proceeds will not be expended until bonds are issued. Of the bond proceeds, $76x$ dollars will be deposited into the Bond Proceeds Account and $4x$ dollars will be deposited into the Debt Service Reserve Fund. All of the bond proceeds will be held as security for the bondholders until construction on the projects is completed, at which time proceeds in the Bond Proceeds Account will be used to pay the principal on N's notes. While the notes are outstanding, bond proceeds held in the Bond Proceeds Account will be invested in SLGS yielding 9 percent.

If a project is not completed within 3 years of the date of issuance of the notes, amounts in the Bond Proceeds Account will be used to redeem bonds on that date.

All mortgage loans will be insured under the cash payment mortgage insurance program administered by the Federal Housing Administration (FHA), whether the construction mortgage loans are provided by the notes or the bonds. This insurance program will provide for payments of approximately 99 percent of the principal amount of an outstanding mortgage loan in the event of default by a mortgagor.

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[1] Also released as News Release IR-80-117, dated November 7, 1980.

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include interest on the obligations of a state, a territory, or a possession of the United States, or any political subdivision of the foregoing, or of the District of Columbia.

Section 103(c)(1) of the Code provides that, with certain minor exceptions, the interest on any arbitrage bond will not be excludable from gross income.

Section 103(c)(2) of the Code provides that the term "arbitrage bond" means any obligation that is issued as part of an issue all or a major portion (more than 15 percent) of the proceeds of which are reasonably expected to be used directly or indirectly (A) to acquire securities or obligations that may be reasonably expected at the time of issuance of such issue, to produce a yield over the term of the issue that is materially higher than the yield on obligations of such issue, or (B) to replace funds that were used directly or indirectly to acquire securities or obligations described in section 103(c)(2)(A).

Section 1.103-13(a)(2)(i) of the Income Tax Regulations provides, in part, that the determination whether an obligation is an arbitrage bond depends on the issuer's reasonable expectations, as of the date of issue, regarding the amount and the use of proceeds of the issue.

Section 1.103-13(b)(5)(iv) of the regulations defines the term "materially higher" in those situations in which it is reasonably expected that the original proceeds of an issue will exceed the amount necessary for the governmental purpose or purposes of the issue by more than 5 percent of such amount. Any portion of the issue issued solely for the purpose of investing such portion at a materially higher yield as less than a major portion is not issued for a governmental purpose. The yield produced by acquired obligations acquired with the proceeds of such issue (including any acquired obligations held during the temporary periods described in section 1.103-14(b), any amounts invested in the reserve or replacement fund as defined in section 1.103-14(d), and any investments of less than a major portion of such proceeds as described in section 1.103-13(b)(1)) is materially higher than the yield produced by an issue of governmental obligations if the yield produced by the acquired obligations is higher than $Y+[(\$5,000 \times Y) \div P]$ where "Y" stands for the yield on the issue and "P" stands for the amount of the original proceeds of the issue. Nothing in this subdivision implies that a deliberate over-issuance of less than 5 percent will not be treated as an artifice or device under section 1.103-13(j).

Section 1.103-13(j) of the regulations provides that if an artifice or device is employed in connection with the issuance of a governmental obligation, such obligation will be considered an arbitrage bond within the meaning of section 103(c)(2) of the Code. For purposes of this section, the term "artifice or device" means a transaction or a series of transactions that attempts to circumvent the provisions of section 103(c) of the Code or sections 1.101-13, -14, or -15 of the regulations—(1) enabling the issuer to exploit the difference between tax-exempt and taxable interest rates to gain a material financial advantage and (2) increasing the burden on the market for tax-exempt obligations.

Section 1.103-13(j) of the regulations further provides that examples of increased burdens on the market for tax-exempt obligations include selling obligations that would not otherwise be sold, selling more obligations than would otherwise be necessary, and issuing obligations sooner or allowing them to remain outstanding longer than would otherwise be necessary.

As a general rule, the term "arbitrage bond" includes any obligation which is issued as part of an issue all or a major portion of the proceeds of which are reasonably expected to be used directly or indirectly to replace funds that were used directly or indirectly to acquire securities that may be reasonably expected to produce a yield that is materially higher than the yield on the obligations of such issue. When an issuer issues long-term bonds and short-term notes contemporaneously to provide for the same project, and the proceeds of the notes are used to finance the construction costs of the project while the bond proceeds are invested, the notes replace the bonds within the meaning of section 103(c)(2)(B) of the Code. Thus, the bond proceeds are replaced proceeds and have the same status and are subject to the same yield restrictions as the note proceeds. See Example (1) of section 1.103-14(e)(7) of the regulations. In *Situation 1* and *Situation 2,* the bond proceeds will be invested in securities of a materially higher yield than the yield on the notes.

In addition, as a general rule, short-term notes are issued in connection with a project to provide interim financing until market conditions are conducive to the issuance of long-term bonds to provide permanent financing for that project. If an issuer reasonably expects to issue long-term bonds as permanent financing for the project at the commencement of the project, then interim financing in the form of short-term notes is not necessary for the purpose of providing the project. In *Situation 1, M* will issue short-term notes and long-term bonds. *M*'s notes will not be issued to acquire the mortgage loans because permanent financing will already have been placed. In *Situation 2, N* will issue long-term bonds on a date certain on or before the commencement of its project of providing low-cost, multi-family housing. *N* will also issue short-term notes two weeks earlier than the date on which it reasonably expects to issue its bonds. Although *N*'s notes will be issued before its bonds, the notes will not provide interim financing for *N*'s project, because *N* reasonably expects to issue its long-term financing on a date certain on or before the commencement of its project. Thus, *N*'s notes will not be issued to provide the project.

Consequently, in *Situation 1,* the issuance by *M* of 176*x* dollars of notes contemporaneously with the issuance of 204*x* dollars of bonds will exceed the amount necessary for the governmental purpose of acquiring newly created mortgages on single-family residences by more than 5 percent. Similarly, in *Situation 2,* the issuance by N of $76x$ dollars of notes that are issued contemporaneously with the issuance of the $80x$ dollars of bonds will exceed the amount necessary for the governmental purpose of providing low-cost family housing by more than 5 percent. Thus, M's notes and N's notes are an over-issuance within the meaning of section 1.103-13(b)(5)(iv) of the regulations. Because M and N have made an over-issuance the yield restrictions of section 1.103-13(b)(5)(iv) apply to the investment of note proceeds. In *Situation 1* and *Situation 2* the applicable yield restrictions will be exceeded.

In *Situation 1* and *Situation 2,* the issuance of the 7 percent notes contemporaneously with the issuance of the 9 percent bonds will permit M and N to exploit the difference between the tax-exempt and taxable interest rates to gain a material financial advantage within the meaning of section 1.103-13(j)(1) of the regulations. By using the proceeds of the 7 percent notes to provide the projects (instead of the proceeds of the 9 percent bonds) and investing the bond proceeds in taxable securities yielding 9 percent, during the term of the notes the overall cost of borrowing to M and N will be 2 percentage points lower than it would have been if the notes had not been issued and the bond proceeds had been used to provide the projects. This reduced cost of borrowing is a material financial advantage that M and N will be able to gain as a result of having issued notes at the tax-exempt rate of 7 percent to carry the investment of the bond proceeds in taxable securities yielding 9 percent. In other words, the economic effect of the contemporaneous issuance of the notes and bonds is the same as if M and N had used the proceeds of the 9 percent bonds to provide the projects, invested the proceeds of the tax-exempt notes yielding 7 percent in taxable securities yielding 9 percent during the term of the notes, and used the arbitrage profits on this investment to lower the overall cost of borrowing during the term of the notes by 2 percentage points. See also Rev. Rul. 80-13, 1980-1 C.B. 27, in which the issuance of unnecessary bonds and the investment of the bond proceeds at a materially higher yield is an artifice or device. Furthermore, by issuing both notes and bonds contemporaneously in an aggregate principal amount of approximately twice the actual cost of their respective projects to gain this financial advantage, M and N will have sold more obligations, and allowed them to remain outstanding longer, than otherwise would be necessary. Thus, both M and N will have entered into a series of transactions that will have the effect of increasing the burden on the market for tax-exempt obligations within the meaning of section 1.103-13(j)(2). Consequently, in both situations M and N will issue their notes in connection with an artifice or device within the meaning of section 1.103-13(j).

HOLDING

In *Situation 1* and *Situation 2* the notes will be arbitrage bonds within the meaning of section 103(c)(2) of the Code. Therefore, interest on M's notes and N's notes will not be excludable from the gross income of the noteholders under section 103(a)(1).

Section 162.—Trade or Business Expenses

26 CFR 1.162-1: Business expenses.

Whether disbursements from an officeholder's office account are deductible. See Rev. Rul. 80-331, page 7.

26 CFR 1.162-2: Traveling expenses.

Commuting expenses; construction worker. The Service will not follow the **Frederick** decision, which held that daily commuting expenses incurred over a three-year period by a construction worker who reasonably expected to be laid off when winter came were ordinary and necessary business expenses.

Rev. Rul. 80-333

The Internal Revenue Service will not follow the decision of the United States Court of Appeals for the Eighth Circuit in *Frederick v. United States,* 603 F.2d 1292 (8th Cir. 1979), as a precedent in the disposition of similar cases.

In *Frederick,* the court held that the transportation expenses incurred over a three-year period by the taxpayer in traveling daily from the taxpayer's home to a missile site where the taxpayer was employed as a carpenter were deductible as ordinary and necessary business expenses. The court held that because the taxpayer expected to be laid off when winter came and only a very small crew was needed for indoor construction work, the taxpayer was reasonable in expecting to be employed on the project only for a temporary period of time.

The Eighth Circuit's approach conflicts in principle with a long line of judicial authority holding that such expenses are not deductible. See *Commissioner v. Flowers,* 326 U.S. 465 (1946), *Peurifoy v. Commissioner,* 254 F.2d 483 (4th Cir. 1957), *aff'd per curiam,* 358 U.S. 59 (1958), *Boone v. United States,* 482 F.2d 417 (5th Cir. 1973), and *Babeaux v. Commissioner,* 601 F.2d 730 (4th Cir. 1979). It is also contrary to the published position of the Internal Revenue Service on the matter. See Rev. Rul. 60-189, 1960-1 C.B. 60. Accordingly, similar cases that arise in all circuits other than the Eighth Circuit will be disposed of in conformity with established judicial doctrine and the prior published ruling, and the Service will continue to hold that such expenses are not deductible.

26 CFR 1.162-21: Fines and penalties.

Business expenses; settlement payment; Department of Energy consent order. A payment to the U.S. Treasury, under a consent order specifically precluding imposition of civil or criminal penalties, that is made in settlement of claims and disputes resulting from a Department of Energy examination of a taxpayer's books and records is not a fine or similar penalty for purposes of section 162(f) of the Code and is deductible as an ordinary and necessary business expense. Such a payment made pursuant to a consent order re-

quiring the imposition of a penalty for willful violation of the petroleum pricing statutes, however, is not deductible.

Rev. Rul. 80-334

ISSUE

Is a payment made by a taxpayer to the United States Treasury in a settlement of claims and disputes resulting from the examination of the taxpayer's books and records by the Department of Energy a fine or similar penalty for purposes of section 162(f) of the Internal Revenue Code and therefore not deductible as a business expense under section 162(a)?

FACTS

The taxpayer, a domestic corporation dealing in petroleum products, is subject to the jurisdiction of the United States Department of Energy with respect to petroleum pricing. The taxpayer's books and records were examined by the Department of Energy to determine whether the taxpayer was in compliance with their regulations.

Section 205.199J(a) and (e) of the Department of Energy Regulations (10 CFR 202.199J), provides as follows:

> (a) Notwithstanding any other provision of this subpart, the DOE [Department of Energy] may at any time resolve an outstanding compliance investigation or proceeding, or a proceeding involving the disallowances of costs pursuant to § 205.119E with a Consent Order. A Consent Order must be signed by the person to whom it is issued, or a duly authorized representative, and must indicate agreement to the terms contained therein. A Consent Order need not constitute an admission by any person that DOE regulations have been violated, nor need it constitute a finding by the DOE that such person has violated DOE regulations. A Consent Order shall, however, set forth the relevant facts which form the basis for the Order.
>
> * * * * *
>
> (e) Notwithstanding the issuance of a Consent Order, the DOE may seek civil or criminal penalties or compromise civil penalties pursuant to Subpart P concerning matters encompassed by the Consent Order, unless the Consent Order by its terms expressly precludes the DOE from so doing.

The taxpayer and the Department of Energy entered into a consent order to settle all claims and disputes resulting from the examination. The consent order specifically states that the Department of Energy has determined that the imposition of civil or criminal penalties would be inappropriate because the violation was unintentional, and that such penalties would not be sought from the taxpayer with respect to the period covered by the consent order.

The consent order requires the taxpayer to refund to its purchasers 5,000x dollars, of which 3,200x dollars is to be made available to purchasers of gasoline; 900x dollars to purchasers of No. 2 oils, 600x dollars to purchasers of general refinery products, and 300x dollars to purchasers of aviation jet fuel.

The first of three refund procedures set forth in the consent order provides that a specified portion of the 3,200x dollars will be refunded to purchasers of gasoline from the taxpayer's proprietary stations through a price reduction that will remain in effect until the specified amount has been refunded.

The second refund procedure involves refunds to nonretail and large volume retail customers of the taxpayer during the period covered by the consent order. These customers will be given the opportunity to obtain individual refunds by entering into a participation agreement with taxpayer within a specified time period.

Under the terms of a participation agreement a customer will receive the refund attributable to it under the consent order in return for its waiver and release of any and all claims against the taxpayer with respect to any possible regulatory violations that may have been committed during the period covered by the consent order. The agreement also will require the customer to submit to its own nonretail customers, if any, an application for secondary participation in the refund. The secondary participation agreement also will require the secondary participant to submit to its own nonretail customers, if any, a similar application for participation in the refund. This is to insure that the refund under this provision be passed on to the end-users or ultimate consumers.

If a customer fails to execute a timely participation agreement, the amount of the refund attributable to such customer is to be transferred to a common fund. Also, amounts withheld by or returned to the taxpayer because of the inability of its customers to pass through refunds in accordance with the terms of the participation agreements and secondary participation agreements to the end-users or ultimate consumers are to be deposited in this common fund. Interest earned on such fund will also be added as part of the fund.

The amount of any judgements or settlements paid by the taxpayer after the effective date of the consent order on account of alleged violations of federal petroleum price and allocation statutes or regulations committed during the period covered by the consent order will be subtracted from the common fund.

Subsequent to the expiration of a specified time period after the effective date of the consent order, there will be subtracted from the common fund an amount to serve as a reserve sufficient to cover the taxpayer's maximum creditable exposure to liability in civil actions based upon alleged regulatory violations during the period covered by the consent order.

The third refund procedure (this procedure will be invoked after the second refund procedure has been complied with) will distribute any monies remaining in the common fund, created as a result of the second refund procedure, through a price reduction on gasoline to purchasers from the taxpayer's proprietary stations until such fund is exhausted.

Under the terms of the consent order monies remaining in the reserve described above after the termination of all civil actions will be remitted to the United States Treasury. Thus, the unclaimed portion of the reserve fund would be paid to the United States Treasury, rather than to the party to whom the inventory item was sold because such party failed to take any action. The consent order does not indicate that the payment to the United States Treasury would be considered to be a fine or penalty. It is a method of closing out such reserve fund by a single payment. The other alternative for the disposition of the reserve fund would be to refund such amount through a price reduction on gasoline to purchasers from the taxpayer's proprietory stations until such reserve fund is exhausted.

LAW AND ANALYSIS

Section 162(a) of the Code provides that there shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business.

Section 162(f) of the Code provides that no deduction shall be allowed under section 162(a) for any fine or similar penalty paid to a government for the violation of any law.

Section 1.162-21(b)(1) of the Income Tax Regulations provides that for purposes of section 1.162-21 a fine or similar penalty includes an amount—

> (i) paid pursuant to conviction or a plea of guilty or nolo contendere for a crime (felony or misdemeanor) in a criminal proceeding;
>
> (ii) paid as a civil penalty imposed by federal, state, or local law, including additions to tax and additional amounts and assessable penalties imposed by chapter 68 of the Internal Revenue Code of 1954;
>
> (iii) paid in settlement of the taxpayer's actual or potential liability for a fine or penalty (civil or criminal); or
>
> (iv) forfeited as collateral posted in connection with a proceeding which could result in imposition of such a fine or penalty.

Section 162(f) was added to the Code by section 902(a) of the Tax Reform Act of 1969, Pub. L. 91-172, 1969-3 C.B. 10, 147.

The legislative history of section 162(f) indicates that the purpose of adding section 162(f) to the Code was to codify the general court position with respect to fines and penalties. S. Rep. No. 91-552, 91st Cong., 1st Sess. 1645, 2311-12 (1969), 1963-3 C.B. 423, 597, provides as follows:

> First, the committee amendments provide that no deduction is to be allowed for any fine or similar penalty paid to a government for the violation of any law. This provision is to apply in any case in which the taxpayer is required to pay a fine because he is convicted of a crime (felony or misdemeanor) in a full criminal proceeding in an appropriate court. This represents a codification of the general court position in this respect.

The general court position referred to above is that set forth by the Supreme Court of the United States in *Tank Truck Rentals v. Commissioner,* 356 U.S. 30 (1958), Ct. D. 1819, 1958-1 C.B. 502, the only Supreme Court case on this subject. The rule announced by the Supreme Court in *Tank Truck Rentals* denied a deduction for any fine or penalty if the allowance of the deduction would severely frustrate a sharply defined national policy. The purpose of this rule was to prevent favorable tax treatment from "blunting the sting" of a validly imposed penalty by allowing the taxpayer a deduction for federal income tax purposes.

S. Rep. No. 91-552 further indicates:

> The provision for the denial of the deduction for payments in these situations [including fines or similar penalties] which are deemed to violate public policy is intended to be *all inclusive*. Public policy, in other circumstances, generally is not sufficiently clearly defined to justify the disallowance of deductions. [Emphasis added.]

The Senate Finance Committee, in explaining Section 310 of the Revenue Act of 1971, Pub. L. 92-178, 1972-1 C.B. 443, discussed section 162(f) of the Code. The Committee stated:

> In connection with the proposed regulations relating to the disallowance of deductions for fines and similar penalties (sec. 162(f)), questions have been raised as to whether the provision applies only to criminal "penalties" or also to civil penalties as well. In approving the provisions dealing with fines and similar penalties in 1969, it was the intention of the committee to disallow deductions for payments of sanctions which are imposed under civil statutes but which in general terms serve the same purpose as a fine exacted under a criminal statute. The provision was intended to apply, for example, to penalties provided for under the Internal Revenue Code in the form of assessable penalties (subchapter B of chapter 68) as well as to additions to tax under the internal revenue laws (subchapter A of chapter 68) in those cases where the government has the fraud burden of proof (i.e., proof by clear and convincing evidence). It was also intended that this rule should apply to similar type payments under the laws of a state or other jurisdiction. S. Rep. 92-437, 92nd Cong., 1st Sess. 73, 74 (1971), 1972-1 C.B. 559, 600.

Here, although the consent order provides for the balance remaining in the reserve fund to be paid over to the United States Treasury, the consent order initially requires the taxpayer to make refunds to the purchasers of its products on which the overcharge occurred because of the alleged pricing violation. A reserve fund was established by setting aside unrefunded monies (unrefunded because claims were not filed or monies were unable to be refunded because of the inability of its customers to pass through the refunds to the ultimate consumers) for the purpose of covering the taxpayer's liability in civil actions based upon alleged pricing violations. By requiring the taxpayer to make refunds to its customers and paying the remaining balance in the reserve fund to the United States Treasury, the consent order prohibited the taxpayer from retaining any part of the agreed amount of refund.

Therefore, the payment made to the United States Treasury by the taxpayer as a result of a consent order entered into by the taxpayer and the Department of Energy does not come within the provisions of section 162(f) of the Code. Also, the consent order specifically states that the Department of Energy has determined that the imposition of civil or criminal penalties would be inappropriate, and that such penalties would not be sought from the taxpayer with respect to the period covered by the consent order.

HOLDING

The payment made by the taxpayer in the instant case to the United States Treasury pursuant to a consent order in settlement of claims and disputes resulting from the examination of the taxpayer's books and records by the Department of Energy is not a fine or similar penalty for purposes of section 162(f) of the Code. Thus, such amount is deductible as an ordinary and necessary business expense under section 162(a).

However, where the consent order specifically states that the taxpayer is required to pay a penalty for willful or intentional violation of the petroleum pricing statutes such amount falls under the provision of section 162(f) of the Code and is not deductible as an ordinary and necessary business expense.

Section 167.—Depreciation

Whether payments received pursuant to the National Historic Preservation Act of 1966 are includible in the gross incomes of the recipients. See Rev. Rul. 80-330, page 6.

Section 170.—Charitable, Etc., Contributions and Gifts

26 CFR 1.170A-1: Charitable, etc., contributions and gifts; allowance of deduction.

Charitable contributions; bibles. A promoter offers investors a choice of two plans to purchase bibles and donate them to charities. Under one plan, investors purchase the bibles and donate them to charity 12 months later. The investors are told that they may deduct the "retail" price, which is three times as high as the purchase price. Under the other plan, investors purchase the bibles at the "retail" price, put down the same amount as the purchase price in the first plan, and execute promissory notes for the balance. Principal and interest on the notes is payable in 12 years. The investors then donate the bibles to charity. The deduction is limited to the cash paid in the second plan.

Rev. Rul. 80-329 [1]

ISSUE

What is the fair market value of bibles that are contributed to a charitable organization, under the circumstances described below?

FACTS

P, a promotor, offers to sell bibles to individuals. Depending on when an investor desires the purported tax advantages, the investor has a choice of two purchase plans. If the investor is willing to wait 12 months for a charitable deduction, *P* advises that the customer can purchase bibles at a considerable discount from "retail" price and, by donating them to a qualified charitable organization more than 12 months after purchase, claim a charitable deduction based on the "retail" price. Under this plan, the purchase price is one-third of the "retail" price. *See* Rev. Rul. 80-233, 1980-35 I.R.B. 6, which holds that the charitable contribution is limited to the price at which similar lots of bibles were sold and were still being sold to others at the time of the contribution.

If the investor wants a charitable deduction within a year of purchase, *P* advises that the customer can purchase bibles at the "retail" price on a deferred payment basis and claim a charitable deduction based on the "retail" price, upon donating them to a qualified charitable organization. Under the latter plan, the investor pays for the bibles with cash in the amount of the discounted price and with a note for the balance. The note provides for interest at the rate of 8 percent per annum, and it matures in twelve years. Principal and interest are not due until the twelfth year.

In 1980 *A* contracted with *P* to purchase 500 copies of a single edition of a modern translation of the bible. *A* had the option to pay 100*x* dollars in cash under the first plan or to pay 100*x* dollars in cash and execute a promissory note for 200*x* dollars under the second plan. *A*, who wanted to make a charitable contribution in 1980, purchased the bibles under the second plan. On August 1, 1980, *A* donated the bibles to *X*, which was an organization described in section 170(c) of the Internal Revenue Code and for which the use of the books would be related to *X*'s exempt purposes.

LAW AND ANALYSIS

Section 170 of the Code provides, subject to certain limitations, a deduction for contributions and gifts to or for the use of organizations described in section 170(c), payment of which is made within the taxable year.

Section 1.170A-1(c)(1) of the Income Tax Regulations provides generally that if a charitable contribution is made in property other than money, the amount of the contribution is the fair market value of the property at the time of the contribution reduced as provided in section 170(e)(1) of the Code.

Section 170(e)(1)(A) of the Code provides that if a taxpayer contributes property that would have resulted in gain which would not have been long-term capital gain if the property had been sold at its fair market value on the date of contribution, the amount of the contribution must be reduced by the amount of such gain. Section 1222(3) defines "long-term capital gain" as gain from the sale or exchange of a capital asset held for more than 1 year.

Section 1.170A-1(c)(2) of the regulations provides that fair market value is the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts.

The definition of fair market value depends upon a knowledgeable willing buyer and a knowledgeable willing seller. The most probative evidence of fair market value is the prices at which similar quantities of bibles are actually sold in arm's-length transactions. *See* Rev. Rul. 80-233. *P* was selling similar lots of bibles for either 100*x* dollars or 300*x* dollars. Neither the quantity nor the quality of the bibles varied with the price; rather, the difference between the two prices was solely at the discretion of the buyer. *P* was a willing seller for 100*x* dollars. The fair market value of the bibles is 100*x* dollars, the amount at which similar lots of bibles could be purchased from *P* by members of the general public.

If *P* were not offering bibles for 100*x* dollars, the fair market value of the bibles contributed would be determined by all the relevant facts and circumstances including the sales price of comparable bibles by others; the sales price by *P* of 300*x* dollars would not conclusively determine the value of the bibles.

HOLDING

The fair market value of the bibles contributed to *X* is 100*x* dollars.

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[1] Also released as News Release IR 80-118, dated November 14, 1980.

Section 191.—Amortization of Certain Rehabilitation Expenditures for Certified Historic Structures

Whether payments received pursuant to the National Historic Preservation Act of 1966 are includible in the gross incomes of the recipients. See Rev. Rul. 80-330, page 6.

Section 461.—General Rule for Taxable Year of Deduction

26 CFR 1.461-1: General rule for taxable year of deduction.

"Pay by phone" account; when deductible. The date to be used in determining when allowable deductions may be taken by a cash method taxpayer using a "pay by phone" account is the date the financial institution paid the amount, as reported on a monthly statement sent to the taxpayer.

Rev. Rul. 80-335

ISSUE

What is the date of payment when a taxpayer uses a "pay by phone" account maintained at a financial institution to pay creditors?

FACTS

A, who uses the cash receipts and disbursements method of accounting, maintains a "pay by phone" account with *M*, a financial institution, whereby *A*, by telephoning *M*, can authorize *M* to make payments to *A*'s creditors as *A*'s agent. According to the agreement between *A* and *M*, if *A* calls *M* before noon on a weekday that is not a holiday, *M* will pay the bill that afternoon. If the call is made after noon or on a weekend or holiday, the bill will be paid on the next working day. *M* pays the bills by charging *A*'s account and either mailing checks to the creditors, transferring funds to the creditors' accounts if the creditors maintain them with *M*, or actually delivering checks to the creditors. At the end of the month, *M* mails to *A* a statement listing all the payments *M* has made for *A* during that month. The statement lists the names of the creditors, the amounts of the payments, the dates of the mailings, transfers or deliveries, and the balance remaining in *A*'s account.

LAW AND ANALYSIS

Section 461 of the Internal Revenue Code provides the general rule that the amount of any allowable deduction shall be taken for the taxable year that is the proper year under the method of accounting used by the taxpayer in computing taxable income.

Section 1.461-1(a)(1) of the Income Tax Regulations provides that under the cash receipts and disbursements method of accounting, amounts representing allowable deductions are taken into account for the taxable year in which paid.

If a taxpayer, who uses the cash receipts and disbursements method of accounting, mails checks to creditors, the taxpayer is entitled to allowable deductions therefor on the day the checks are placed in the mail, provided the checks are subsequently paid by the bank. *Estate of Witt v. Fahs*, 160 F. Supp. 521 (S.D. Fla. 1956).

If the taxpayer, who uses the cash receipts and disbursements method of accounting, authorizes payment by the taxpayer's agent, payment occurs on the date the agent, on behalf of the taxpayer, delivers a check to the payee. See *Commissioner v. Bradley*, 56 F.2d 728 (6th Cir. 1932). In the present case *M* is acting as the agent of *A*, and therefore, if *M* mails checks to *A*'s creditors, transfers funds to creditors' accounts, or actually delivers checks to creditors, the payments are made on the date of the mailings, transfers, or deliveries, as the case may be.

HOLDING

The date reported by *M* on the monthly statement indicating when payment was made is the date of payment by *A* for purposes of determining when an allowable deduction may be taken.

Section 501.—Exemption from Tax on Corporations, Certain Trusts, Etc.

26 CFR 1.501(d)-1: Religious and apostolic associations or corporations.

Whether Rev. Rul. 77-290, 1977-2 C.B. 26, is applicable to members of an organization described in section 501(d) of the Code. See Rev. Rul. 80-332, page 8.

Section 527.—Political Organizations

Whether disbursements from an officeholder's office account are deductible and whether the transfer of surplus campaign funds to the office account is includible in gross income. See Rev. Rul. 80-331, page 7.

Section 1222.—Other Terms Relating to Capital Gains and Losses

26 CFR 1.1222-1: Other terms relating to capital gains and losses.

T.D. 7728 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER A, PART 1.—INCOME TAX; TAXABLE YEARS BEGINNING AFTER DECEMBER 31, 1953; PART 3.—CAPITAL CONSTRUCTION FUND; SUBCHAPTER D, PART 53.—FOUNDATION EXCISE TAXES

Holding period required for treatment of long-term capital gain or long-term capital loss; changes in terms relating to transactions in capital assets

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations relating to changes in the holding period required for gains or losses on transactions in capital assets to be treated as long-term capital gains or long-term capital losses and to changes in certain terms relating to transactions in capital assets. Changes to the applicable tax law were made by the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1]. The regulations affect the tax treatment of sales or exchanges of capital assets and provide the public with needed guidance.

DATES: The amendments pertaining to the change in the holding period from 6 months to 9 months are effective for taxable years beginning in 1977. The amendments pertaining to the change in the holding period from 9 months to 1 year are effective for taxable years beginning after December 31, 1977. The amendments pertaining to the new terms "capital gain net income" and "net capital gain" are effective for taxable years beginning after December 31, 1976.

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[1] This publication of the Treasury Decision contains the complete text of the amendments to the regulations. The instructions for modifying the notice of proposed rulemaking have been omitted.

FOR FURTHER INFORMATION CONTACT: Claudine Ausness of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224. (Attention: CC:LR:T (202-566-3459)).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On April 9, 1980, the Federal Register published proposed amendments to the Income Tax Regulations, the Regulations on Capital Construction Fund, and the Regulations on Foundation Excise Taxes (26 CFR Parts 1, 3, and 53) under numerous sections of the Internal Revenue Code of 1954 (45 FR 24205). These amendments were proposed to conform the regulations to sections 1402(a)(1) and (2), and 1901(a)(136)(A) and (B) of the Tax Reform Act of 1976 (90 Stat. 1731, 1787) [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1, 207, 263]. A public hearing was neither requested nor held. One written comment was received suggesting a technical amendment to the proposed regulation. The proposed amendments are adopted by this Treasury decision with one technical change.

EXPLANATION

Section 1402(b)(3) of the Tax Reform Act of 1976 [*supra* at 209] makes a technical amendment to section 631(a) (relating to gain or loss in the case of timber) by deleting the requirement that the holding period be satisfied before the beginning of the taxable year in which the timber was cut. Technical amendments are made to § 1.631(a)(4) and § 1.631-1(b)(1) to reflect this change.

The regulations adopted by this Treasury decision impose no new reporting burdens or recordkeeping requirements. Evaluation of the effectiveness of these regulations will be based upon comments received from members of Congress, offices within Treasury and the Internal Revenue Service, other governmental agencies, and the public.

DRAFTING INFORMATION

The principal author of these regulations is Claudine Ausness of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing these regulations, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to 26 CFR Parts 1, 3, and 53 are hereby adopted:

INCOME TAX REGULATIONS
(26 CFR Part 1)

Paragraph 1. The following regulation sections are amended by substituting "1 year (6 months for taxable years beginning before 1977; 9 months for taxable years beginning in 1977)" for "6 months" and "six months" each place "6 months" or "six months" appears in such regulation sections:

1. Section 1.123-1(a)(3).
2. Section 1.166-5(a)(2).
3. Section 1.170A-4(b)(1).
4. Section 1.272-1(b)(3).
5. Section 1.333-5(d)(1) and (d)(2).
6. Section 1.341-4(a).
7. Section 1.341-6(b)(2)(iii) and (b)(5).
8. Example (1) of § 1.357-2(b).
9. Section 1.421-5(a)(1), (c)(2), (d)(1) and (e).
10. Section 1.423-1(a)(1).
11. Section 1.424-1(a)(1)(i).
12. That portion of § 1-614-6(b) other than the example.
13. Section 1.631-1(a)(4), (b)(1) and (d)(4).
14. Section 1.631-2(a)(1), (a)(2), (b)(1), (c)(2), (d)(1), (d))(3)(i) and (d)(3)(iii).
15. Section 1.631-3(a)(1), (a)(2), (b)(1) and (c)(3).
16. Section 1.691(a)(3)(b)(1).
17. Section 1.702-1(a)(1) and (a)(2).
18. Section 1.817-2(b)(1)(i), (b)(3)(i) and (b)(3)(ii).
19. Section 1.852-4(b)(1), (b)(2)(i), (b)(3) and (d)(1).
20. Section 1.856-2(c)(1)(iii)(*a*).
21. Section 1.857-4(b) and (c)(1).
22. Section 1.1012-1(e)(3), (e)(4)(i) and (e)(4)(ii).
23. Section 1.1222-1(a) and (c).
24. Section 1.1223-1(j).
25. Section 1.1231-1(a), (b), (c)(1), (c)(2), (c)(5), (e)(1) and (e)(3).
26. Section 1.1232-1(a).
27. Section 1.1232-3(a)(1) and (b)(1)(ii).
28. Section 1.1233-1(a)(4), (c)(2), (c)(4), (c)(5) and (e).
29. Section 1.1234-2(a).
30. Section 1.1235-1(a).
31. Section 1.1235-2(d)(2).
32. Section 1.1245-4(a)(4).
33. Section 1.1247-3(b)(4) and (d)(1).
34. Section 1.1248-1(e)(3).
35. Section 1.1251-3(a)(1)(i)(*a*).
36. Section 1.1385-1(c)(2)(ii)(*a*).

Par. 2. Paragraphs (a)(2) and (b)(1)(i) of § 1.421-5, paragraph (k)(1)(i) of § 1.423-2, and paragraph (b)(1(i) of § 1.424-2 are amended by substituting "1-year (6-month for taxable years beginning before 1977; 9-month for taxable years beginning in 1977)" for "6-month" each place "6-month" appears in such regulation sections.

Par. 3. Paragraph (e)(3) of § 1.1012-1 is amended by substituting "1-year (6-month for taxable years beginning before 1977; 9-month for taxable years beginning in 1977)" for "6-months" each place "6-months" appears in such paragraph.

Par. 4. The caption of paragraph (e)(3)(iii) of § 1.1012-1 is amended by substituting "*1-year*" for "*6-months*".

Par. 5. The caption of paragraph (d) of § 1.1247-3 is amended by substituting "*1 year*" for "*6 months.*"

Par. 6. The following regulation sections are amended by substituting "capital gain net income (net capital gain for taxable years beginning before January 1, 1977)" for "net capital gain" and "net capital gains" each place "net capital gain" or net "capital gains" appears in such regulation sections.

1. Section 1.381(c)(3)-1(c)(1), (d)(1), (d)(1)(ii), (d)(2), (e)(1), (e)(5), (e)(6), and (e)(7).
2. Section 1.852-10(b)(1).
3. Section 1.1202-1(a).
4. Section 1.1212-1(a)(2)(i), (a)(3)(ii), (a)(3)(iii)(*a*), and (a)(3)(iii)(*f*).
5. Section 1.1222-1(d)(1).
6. Section 1.1248-4(d)(5)(ii) and (g)(2).
7. Section 1.1502-4(d)(1)(ii).
8. Section 1.1502-11(a)(3).
9. Section 1.1502-15(a)(1).
10. Section 1.1502-21(f)(2).
11. Section 1.1502-22(a)(1), (c)(2)(i) and (d)(2)(i).
12. Section 1.1502-25(c)(2)(ii).
13. Section 1.1502-27(b)(2).
14. Section 1.1502-79(a)(3)(ii) and (b)(2)(i).
15. Section 1.1552-1(a)(1)(ii)(*b*).

Par. 7. The following regulation sections are amended by adding the parenthetical phrase "(capital gain net income for taxable years beginning after December 31, 1976)", directly after the phrases "net capital gain" and "net capital gains" each place the phrases "net capital gain" or "net capital gains" appears in such regulation sections:

1. Section 1.381(c)(3)-1(c)(4), (d)(4) and (e)(8).
2. Examples (3) and (5) of § 1.642(c)-3(c).
3. Example (2) of § 1.643(a)-6(b).
4. Examples (6), (7) and (8) of § 1.1211-1(b)(8).
5. Section 1.1212-1(a)(1)(i), examples (a), (b) and (c) of paragraph (a)(1)(ii), example (2) of paragraph (a)(2)(iii), examples (1), (2), (3), (4) and (5) of paragraph (a)(3)(iv), and example (7) of paragraph (b)(5).
6. Example (2) of § 1.1248-4(d)(5)(iii).
7. Examples (4) and (5) of § 1.1375-1(f).
8. Example (2) of § 1.1502-4(j).
9. Examples (1), (2), and (3) of § 1.1502-11(b)(6).

Par. 8. The captions of paragraphs (d)(1) and (e)(5) of § 1.381(c)(3)-1, of § 1.1502-22, and of paragraph (a)(1) of § 1.1502-22 are amended by substituting "*capital gain net income*" for "*net capital gain*" each place "*net capital gain*" appears in such captions.

Par. 9. The following regulation sections are amended by substituting "net capital gain (net section 1201 gain for taxable years beginning before January 1, 1977)" for "net section 1201 gain" each place "net section 1201 gain" appears in such regulation sections:

1. Section 1.665(d)-1A(c)(2).
2. Section 1.1201-1(a)(1)(i), (a)(2)(i), (a)(4), (b)(1), (b)(2)(i), (b)(2)(ii)(*a*), (b)(2)(ii)(*b*), (e)(1) and (e)(2).
3. Section 1.1222-1(h).
4. Section 1.1348-2(d)(1).

Par. 10. The following regulation sections are amended by adding the parenthetical phrase "(net capital gain for taxable years beginning after December 31, 1976)" directly after the phrase "net section 1201 gain" each place the phrase "net section 1201 gain" appears in such regulation sections:

1. Example (1) of §1.21-1(n).
2. Example (3) of § 1.514(b)-1(b)(1)(iii) and example (2) of paragraph (b)(3).
3. Section 1.1201-(a)(3)(i), (a)(3)(ii)(*a*), (a)(3)(ii)(*b*), (a)(3)(iii), (a)(3)(iv), (b)(2)(iii) and examples (2), (3) and (4) of paragraph (g).

Par. 11. Example (1) of § 1.21-1(n) is amended by adding the parenthetical phrase "(net capital gain for taxable years beginning after December 31, 1976)" directly after the phrase "section 1201 gain".

Par. 12. Section 1.631-1 is amended as follows:

1. The first sentence of paragraph (a)(4) is amended by deleting the phrase "the beginning of the taxable year in which" and inserting in lieu thereof "when".
2. The first sentence of paragraph (b)(1) is amended by deleting the phrase "before the beginning of the taxable year" and inserting in lieu thereof "prior to when the timber is cut".

REGULATIONS ON CAPITAL CONSTRUCTION FUND
(26 CFR Part 3)

Par. 13. Paragraphs (c) and (d)(2) of § 3.4 are amended by substituting "1 year (6 months for taxable years beginning before 1977, 9 months for taxable years beginning in 1977)" for "6 months" each place "6 months" appears in such paragraphs.

REGULATIONS ON FOUNDATION EXCISE TAXES
(26 CFR Part 53)

Par. 14. Paragraphs (c)(1)(i) and (f)(1) of § 53.4940-1 are amended by substituting "capital gain net income (net capital gain for taxable years beginning before January 1, 1977)" for "net capital gain" each place "net capital gain" appears in such regulation section.

Par. 15. Example (2) of § 53.4940-1(f)(4) is amended by adding the parenthetical phrase "(capital gain net income for taxable years beginning after December 31, 1976)" directly after the phrase "net capital gain" each place the phrase "net capital gain" appears in such regulation section.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of Internal Revenue.

Approved October 7, 1980.

Emil M. Sunley,
Acting Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on October 31, 1980, 8:45 a.m., and published in the issue of the Federal Register for November 3, 1980, 45 F.R. 72649).

Section 2035.—Adjustments for Gifts Made Within 3 Years of Decedent's Death

26 CFR 20.2035-1: Transactions in contemplation of death.

Transfers within 3 years of death; stock dividend declared during transferee's ownership. Prior to death a decedent gratuitously transferred 500 shares of stock in a publicly traded corporation to an individual. After the transfer, the corporation declared a stock dividend of one share for every two shares owned, giving the individual 750 shares. The decedent died during the next year. The fair market value of the 750 shares of stock is includible in the decedent's gross estate.

Rev. Rul. 80-336

ISSUE

For purposes of section 2035 of the Internal Revenue Code, what is includible in the gross estate if, within three years of death, the decedent transferred shares of stock upon which a stock dividend was declared during the transferee's ownership?

FACTS

In January 1979, *D*, the decedent, gratuitously transferred 500 shares of stock of *X* Corporation to *A*. The stock of *X* Corporation is publicly traded.

In December 1979, *X* Corporation declared a stock dividend of one share of stock for every two shares owned.

At *D*'s death in 1980 *A* owned 750 shares of *X* Corporation stock. However, on the federal estate tax return, the executor included only 500 shares. The executor stated that the 250 shares acquired from the stock dividend were not part of the original transfer.

LAW AND ANALYSIS

Section 2035 of the Code provides, in part, that the value of all property that the decedent gratuitously transferred during the three-year period ending on the date of the decedent's death is includible in the decedent's gross estate.

The value of property includible in the gross estate under section 2035 is the fair market value as of the decedent's death. Neither income received subsequent to the transfer nor property purchased with such income is considered in determining the value of the property. Section 20.2035-1(e) of the regulations. Rather, only the value of the property originally transferred by the decedent is includible in the gross estate under section 2035. See Rev. Rul. 72-282, 1972-1 C.B. 306.

A stock dividend, in which common stock is proportionately distributed according to the number of common shares held, does not alter the fractional interests of the stockholders. In *Eisner v. Macomber*, 252 U.S. 189, 202 (1920), 1920-3 C.B. 25, 27, a case involving the federal income tax, the Court quoted from a previous case in describing the nature of a stock dividend as follows:

> "A stock dividend really takes nothing from the property of the corporation, and adds nothing to the interests of the shareholders. Its property is not diminished, and their interests are not increased. . . . The proportional interest of each shareholder remains the same. The only change is in the evidence which represents that interest, the new shares and the original share together representing the same proportional interest that the original shares represented before the issue of the new ones. . . . In short, the corporation is no poorer and the stockholder is no richer than they were before."

Similarly, for estate tax purposes, the stock acquired through such a pro rata common stock dividend is regarded as part of the interest held in the corporation prior to the dividend. *See Estate of Schlosser v. Commissioner*, 277 F. 2d 268 (3rd Cir. 1960), *cert. denied*, 364 U.S. 819 (1960), considering the treatment of a common stock dividend for alternate valuation purposes and Rev. Rul. 80-142, 1980-1 C.B. 197, holding that, for purposes of section 2040 of the Code, a common stock dividend declared on jointly owned stock is considered the contribution of the tenant who originally created the tenancy. *Compare McGehee v. Commissioner*, 260 F. 2d 818 (5th Cir. 1958). In *McGehee*, the parties stipulated that the stock dividend was generated by profits that were earned after the transfer. In view of the analysis discussed above, the analysis of *McGehee* would not be followed even if the stock dividend could be attributed to post-transfer income.

In the present situation, since the common stock dividend was distributed to common shareholders on a pro rata basis, the *X* Corporation shares held by *A* at *D*'s death represent the same fractional interest in the corporation transferred by *D*. Thus, the 250 shares are not distinguishable from the 500 original shares, for purposes of section 2035.

HOLDING

The fair market value of the 750 shares of *X* Corporation is includible in *D*'s gross estate as property transferred by *D* within three years of death.

Section 3121.—Definitions

26 CFR 31.3121(b)(8)-1: Services performed by a minister of a church or a member of a religious order.

Whether Rev. Rul. 77-290, 1977-2 C.B. 26, is applicable to members of an organization described in section 501(d) of the Code. See Rev. Rul. 80-332, page 8.

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26 CFR 31.3121(b)(8)-2: Services in employ of religious, charitable, educational, or certain other organizations exempt from income tax.

Whether an exempt organization is deemed to have filed a waiver certificate under section 3121(k)(4) of the Code when it files a Form 941 covering three previous quarters and pays the taxes with respect to such periods. See Rev. Rul. 80-337, below.

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26 CFR 31.3121(k)-1: Waiver of exemption from taxes.
(Also 31.3121(b)(8)-2.)

Exempt organization; waiver certificate; constructive filing. An exempt organization that began withholding FICA taxes from its employees at the beginning of the year and filed Forms 941 and paid the tax for the first three quarters during the fourth quarter is deemed to have filed a waiver certificate under section 3121(k)(4) of the Code.

Rev. Rul. 80-337

ISSUE

Is an exempt organization deemed to have filed a waiver certificate under section 3121(k)(4) of the Internal Revenue Code when it files a Form 941 covering three previous quarters and pays the taxes with respect to such periods?

FACTS

In January 1979 an organization exempt from income tax under section 501(c)(3) of the Code began withholding the taxes imposed under the Federal Insurance Contributions Act from the wages of its employees. The organization never filed a Form 941, Employer's Federal Quarterly Tax Return. In November of 1979 a new treasurer of the organization filed Forms 941 for the first three quarters and made a lump-sum payment of the withheld taxes and the employer taxes for those quarters. The organization had never filed a Form SS-15, Certificate Waiving Exemption from Taxes under the Federal Insurance Contributions Act.

LAW AND ANALYSIS

Services performed by an employee for an organization described in section 501(c)(3) of the Code are excepted from the definition of employment under section 3121(b)(8)(B) of the Code and remuneration for such services is not subject to the taxes imposed by the FICA. However, pursuant to section 3121(k), section 31.3121(k)-1 of the Employment Tax Regulations states that the organization may elect social security coverage by filing a Form SS-15.

Section 3121(k)(4) of the Code provides that if an exempt organization has not filed a certificate it will be deemed for purposes of section 3121(b)(8)(B) to have constructively filed a certificate covering employees for whom the payments were made if it paid the taxes during any period of not less than three consecutive calendar quarters. Although one payment was made in this case, that payment represents FICA taxes on wages for three consecutive quarters.

HOLDING

The organization is deemed to have filed a waiver certificate under section 3121(k)(4) of the Code.

Section 3401.—Definitions [Collection of Income Tax at Source on Wages]

26 CFR 31.3401(a)-1: Wages.

Whether fringe benefits are wages. See Rev. Proc. 80-53, page 40.

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26 CFR 31.3401(a)(9)-1: Remuneration for services performed by a minister of a church or a member of a religious order.

Whether Rev. Rul. 77-290, 1977-2 C.B. 26, is applicable to members of an organization described in section 501(d) of the Code. See Rev. Rul. 80-332, page 8.

Section 6041.—Information at Source

26 CFR 1.6041-1: Return of information as to payments of $600 or more.

Magnetic tape reporting requirements. See Rev. Proc. 80-52, page 20.

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26 CFR 1.6041-2: Return of information as to payments to employees.

Whether fringe benefits that are not wages must be reported on Forms W-2. See Rev. Proc. 80-53, page 40.

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26 CFR 1.6041-4: Returns of information as to foreign items.

Magnetic tape reporting requirements. See Rev. Proc. 80-52, page 20.

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26 CFR 1.6041-5: Information as to actual owner.

Magnetic tape reporting requirements. See Rev. Proc. 80-52, page 20.

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26 CFR 1.6041-7: Permission to submit information required by Form 1099 or W-2 on magnetic tape.

Magnetic tape reporting requirements. See Rev. Proc. 80-52, page 20.

Section 6042.—Returns Regarding Payments of Dividends and Corporate Earnings and Profits

26 CFR 1.6042-2: Returns of information as to dividends paid in calendar years after 1962.

Magnetic tape reporting requirements. See Rev. Proc. 80-52, page 20.

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26 CFR 1.6042-3: Dividends subject to reporting.

Magnetic tape reporting requirements. See Rev. Proc. 80-52, page 20.

Section 6043.—Return Regarding Liquidation, Dissolution, Termination, or Contraction

26 CFR 1.6043-2: Return of information regarding distributions in liquidation.

Magnetic tape reporting requirements. See Rev. Proc. 80-52, page 20.

Section 6047.—Information Relating to Certain Trusts and Annuity and Bond Purchase Plans

26 CFR 1.6047-1: Information to be furnished with regard to employee retirement plan covering an owner-employee.

Magnetic tape reporting requirements. See Rev. Proc. 80-52, page 20.

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26 CFR 301.6047-1: Information relating to certain trusts and annuity and bond purchase plans.

Magnetic tape reporting requirements. See Rev. Proc. 80-52, page 20.

Section 6049.—Returns Regarding Payments of Interest

26 CFR 1.6049-1: Returns of information as to interest paid in calendar years after 1962 and original issue discount for calendar years after 1970.

Magnetic tape reporting requirements. See Rev. Proc. 80-52, page 20.

Section 6109.—Identifying Numbers

26 CFR 1.6109-1: Identifying numbers.

Magnetic tape reporting requirements. See Rev. Proc. 80-52, page 20.

Section 7701.—Definitions

26 CFR 301.7701-4: Trusts.

Specific conditions that must be present before the Service will consider issuing advance rulings concerning the classification of organizations as liquidating trusts. See Rev. Proc. 80-54, page 40.

Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.602: Forms and instructions. (Also Part I, Sections 6041, 6042, 6043, 6047, 6049, 6109; 1.6041-1, 1.6041-4, 1.6041-5, 1.6041-7, 1.6042-2, 1.0642-3, 1.6043-2, 1.6047-1, 301.6047-1, 1.6049-1, 301.6109-1.)

Rev. Proc. 80-52

PART A.—GENERAL

SECTION 1. PURPOSE

.01 The purpose of this revenue procedure is to provide the requirements and conditions for filing information returns in the Forms 1099 and 1087 series, on magnetic tape instead of paper returns. Specifications for filing the following forms are contained in this procedure:

a) Form 1099R, Statement for Recipients of Total Distributions from Profit-Sharing, Retirement Plans, and Individual Retirement Arrangements.

b) Form 1099-DIV, Statement for Recipients of Dividends and Distributions.

c) Form 1099-INT, Statement for Recipients of Interest Income.

d) Form 1099-MISC, Statement for Recipients of Miscellaneous Income.

e) Form 1099-MED, Statement for Recipients of Medical and Health Care Payments.

f) Form 1099-OID, Statement for Recipients of Original Issue Discount.

g) Form 1099-PATR, Statement for Recipients (Patrons) of Taxable Distributions received from Cooperatives.

h) Form 1099L, U.S. Information Return for Distributions in Calendar Year.

i) Form 1099-NEC, Statement for Recipients of Nonemployee Compensation.

j) Form 1099-UC, Statement for Recipients of Unemployment Compensation Payments.

k) Form 1087-DIV, Statement for Recipients of Dividends and Distributions.

l) Form 1087-INT, Statement for Recipients of Interest Income.

m) Form 1087-MISC, Statement for Recipients of Miscellaneous Income.

n) Form 1087-MED, Statement for Recipients of Medical and Health Care Payments.

o) Form 1087-OID, Statement for Recipients of Original Issue Discount.

p) Agriculture Subsidy Payment Report.

.02 This procedure supersedes Rev. Proc. 79-66, 1979-2 C.B. 581.

SEC. 2. NATURE OF CHANGES

.01 Format changes have been made to Form 1099-PATR, Statement for Recipients (Patrons) of Taxable Distributions Received From Cooperatives. Amount Code 5, Investment Credit, and Amount Code 6, Energy Investment Credit, have been deleted.

.02 The Total original issue discount field, Amount Code 1, on Forms 1099-OID and 1087-OID, has been expanded to two fields. Amount Code 1 now contains total original issue discount in 1980 for all holders of discount obligations from financial institutions; Amount Code 2 now contains total original issue discount in 1980 for all holders of corporate obligations.

SEC. 3. WAGE AND PENSION INFORMATION

.01 Section 8(b) of Pub. L. 94-202, 1976-1 C.B. 503, enacted in January 1976, authorized the combined reporting of FICA detailed information (previously reported quarterly on Form 941, Schedule A) and annual W-2 (Copy A), Wage and Tax Statement, information in one consolidated annual W-2 (Copy A) to the Federal Government. As a result, Forms W-2 and W-2P are to be filed with the Social Security Administration (SSA).

.02 SSA will accept magnetic media for filing Forms W-2 and W2P and has issued TIB-4a, *Magnetic Tape Reporting,* Submitting wage and tax data to Federal and State Agencies, TIB-4b, *Magnetic Tape Reporting,* Submitting Annuity, Pension, Retired Pay or IRA Payment to the Federal Government on Magnetic Tape, and TIB-4c, *Diskette and Disk Cartridge Reporting,* Submitting Wage and Tax Data to the Federal Government on Diskette and Disk Cartridge, for this purpose. Applications for filing Forms W-2 and W-2P on magnetic media appear in TIBs-4a, 4b, and 4c.

.03 Copies of Social Security Administration publications TIB-4a, 4b, and 4c are available from any Internal Revenue Service Center or local Social Security Administration office.

SEC. 4. APPLICATION FOR MAGNETIC MEDIA REPORTING

.01 For the purposes of this revenue procedure, the payer is the organization making the payments and the transmitter is the organization which is preparing the tape file. Payers or transmitters who decide to file information returns, in the Forms 1099 and 1087 series, on magnetic tape must complete Form 4419, Application for Magnetic Media Reporting of Information Return (Exhibit "A" attached). Instructions for completing the application appear on the reverse side of the form.

.02 The Service will act on an application and notify the applicant of authorization to file within 30 days of receipt of the application. No magnetic tape returns may be filed with the Service until authorization to file is received.

.03 The Service will assist new filers with their initial magnetic tape submission by encouraging the submission of test tapes for review in advance of the filing season. Approved payers or transmitters who wish to submit a test tape should contact the magnetic media coordinator at the Service Center where the application was filed.

.04 Once authorization to file on magnetic tape has been granted to a payer or transmitter, it will remain in effect in succeeding years, provided that all the requirements of this revenue procedure are met and there are no equipment changes by the filer. If a filer discontinues filing on magnetic tape, a new application must be filed before this method of filing may be resumed.

.05 In accordance with Section 1.6041-7 of the Income Tax Regulations, medical payments from separate departments of a health care carrier may be reported as separate returns on magnetic tape. In this case, the headquarters office will be considered to be the transmitter and the individual departments of the company filing reports will be considered to be payers. A single application form covering all the departments which will be filing on magnetic tape should be submitted.

Sec. 5. Filing of Tape Reports

.01 A magnetic tape reporting package, which includes all the necessary transmittals, labels, and instructions, will be mailed to all approved filers between October and December of each year.

.02 Payers may submit a portion of their information returns on magnetic tape and the remainder on paper forms, provided there is NO DUPLICATE FILING. The magnetic tape records and paper forms must be filed at the same location, but in separate shipments. A Form 1096 must accompany paper submissions and a Form 4804 must accompany magnetic tape submissions.

.03 The affidavit which appears on Forms 1096 and 4804 must be signed by the payer. A transmitter, service bureau, or disbursing agent may, however, sign the affidavit on behalf of the payer if all of these conditions are met:

a. It has the authority to sign the affidavit under an agency agreement (either oral, written, or implied) that is valid under State law; and

b. It has the responsibility (either oral, written, or implied) conferred on it by the payer to request the taxpayer identifying numbers of payees reported on magnetic tape or paper returns; and

c. It signs the affidavit and adds the caption "For: [name of payer]".

.04 Although a duly authorized agent signs the affidavit, the payer is held responsible for the accuracy of the Form 4804 and will be liable for penalties for failure to comply with filing requirements.

.05 These requirements also apply to paper filers submitting Form 1096, Annual Summary and Transmittal of U.S. Information Returns. Paper filers are responsible for the filing of a correct, complete, and timely Form 1096. The failure of duly authorized "agents" of paper filers to comply with the filing requirements of Form 1096 and attachments does not relieve the payers of any penalties that may arise as a result of such failure to comply.

.06 If a portion of the returns are submitted on paper documents, include a statement on the Form 1096 that the remaining returns are being filed on magnetic tapes. Please note that Form 1096 instructions normally apply to the filing of information returns on paper; however, filers of magnetic tape must review the Form 1096 instructions and file Form 1096 if appropriate.

.07 Health care carriers, or their agents, filing Form 1099-MED per Section 4.05 above, may submit part of their returns on paper documents and part on magnetic tape if the records of some departments are not maintained on computer files. However, an information return is required if the aggregate amount paid to a health care service provider from all departments equals $600 or more. For example, Department A pays $200, Department B pays $300, and Department C pays $100 to the same health care service provider. The aggregate amount paid from all departments equals $600. The health care carrier or agent must submit either one information return for the aggregate amount of $600 or three separate returns, one from each department, indicating the amount paid by each department.

Sec. 6. Filing Dates

.01 Magnetic tape reporting to the Service for all types of Forms 1099 and 1087 must be on a calendar year basis.

.02 The dates prescribed for filing paper returns with the Service will also apply to magnetic tape filing. Tapes must be submitted to the Service Center by February 28. The copies of this information required to be furnished to recipients must be furnished by January 31.

Sec. 7. Extensions to File

.01 If a payer or transmiter is unable to submit its tape file by the date prescribed in Section 6.02 above, a letter requesting an extension must be filed before February 28. The letter should be sent to the attention of the magnetic media coordinator at the Service Center which will receive the tape file. The request should include the estimated number of returns which will be filed late and the reason for the delay.

.02 If an extension is granted by the Service, a copy of the letter granting the extension must be attached to the transmittal Form 4804 when the file is submitted.

Sec. 8. Processing of Tape Returns

.01 The Service will process tax information from the tapes. Tapes which are timely received by the Service will be returned to the filers by August 15 of the year in which submitted.

02. All tapes submitted must conform *totally* to this revenue procedure. If tapes are unprocessable, they will be returned to the filer for correction. Corrected tapes must be filed with the Service as soon as possible. Corrected files will be returned by the Service within six months of receipt.

Sec. 9. Corrected Returns

.01 If a large volume of corrected returns is necessary, and the payer or transmitter possesses the capability to provide such corrections on tape, they are encouraged to do so. The filer must contact the magnetic media coordinator for format and shipping instructions. A corrected Form 4804 must accompany the shipment and be marked "Magnetic Media Correction" on the upper portion of the form.

.02 If corrections are not submitted on tape, payers must submit them on official Forms 1099 or 1087 (Copy A) or on approved paper substitutes. Revenue procedures containing specifications for paper returns are available from most Internal Revenue Service offices.

.03 Form 1096 instructions are to be followed when paper returns are filed to correct returns submitted on magnetic media. An "X" must be entered in the box in the left margin and the caption "Magnetic Media Correction" must appear on the top of the form to the left of "FOR OFFICIAL USE ONLY". Corrections must be sent to the attention of the magnetic media coordinator where the original tape file was filed.

SEC. 10. TAXPAYER IDENTIFICATION NUMBERS

.01 Under Section 6109 of the Internal Revenue Code, recipients of dividends, interest, or other payments are required to furnish taxpayer identification numbers (TINs) to the payer. The number must be furnished to the payer whether or not the payee is required to file a tax return or is covered by Social Security.

.02 The Service expects that payers will keep to a minimum those statements submitted without TINs. It is particularly important that correct social security and employer identification numbers for payees be provided on magnetic media or paper forms submitted to the Service.

.03 For each omission of a required TIN, Section 6676 of the Internal Revenue Code provides that the Service charge a $5 penalty, unless the payer or payee responsible for furnishing the number supplies an explanation, upon request from the Service, that establishes reasonable cause for not having done so.

.04 The TIN to be furnished the Service depends primarily upon the manner in which the account is maintained or set up on the record of the payer. The number to be provided must be that of the owner of record. If the account is recorded in more than one name, furnish the TIN and name of one of the holders of the record. The number provided must be associated with the name of the holder provided in the first name line of the Payee "B" Record of Part B of this procedure. For those engaged in a trade or business (including employee trusts, retirement systems, etc.) the TIN is the employer identification number, EIN (00-0000000). For individuals, it is a social security number, SSN (000-00-0000).

.05 Sole proprietors who are payers should show their employer identification numbers in the Payer/Transmitter "A" Record. However, the payer should use the social security number of a sole proprietor in the Payee "B" Record. The table below will help you determine the number to be furnished to the Service.

CHART 1. Guidelines for Social Security Numbers

For this type of account:	*In tape positions 12-20 of the Payee "B" Record, enter the Social Security Number of—*	*In the Payee 1st Name Line of the Payee "B" Record, enter the name of—*
1. An individual's account.	The individual.	The individual.
2. Joint account of:		
a. husband and wife	The actual owner of the account. (If more than one owner, the principal owner.)	The individual whose SSN is entered.
b. adult and minor	The actual owner of the account. (If more than one owner, the principal owner.)	The individual whose SSN is entered.
c. two or more individuals	The actual owner of the account. (If more than one owner, the principal owner.)	The individual whose SSN is entered.
3. Account in the name of a guardian or committee for a designated ward, minor, or incompetent person.	The ward, minor, or incompetent person.	The individual whose SSN is entered.
4. Custodian account of a minor (Uniform Gifts to Minors Acts).	The minor.	The minor.
5. a. The usual revocable savings trust account (grantor is also trustee)	The grantor-trustee.	The grantor-trustee.
b. So-called trust account that is not a legal or valid trust under State law.	The actual owner.	The actual owner.
6. Sole proprietorship.	The owner.	The owner.

CHART 2. Guidelines for Employer Identification Numbers

For this type of account—	*In tape positions 12-20 of the Payee "B" Record enter the Employer Identification Number of—*	*In the Payee 1st Name Line of the Payee "B" Record, enter the name of—*
1. A valid trust, estate, or pension trust.	Legal entity.[1]	The legal trust, estate, or pension trust.
2. Corporate account.	The corporation.	The corporation.
3. Religious, charitable, or educational organization.	The organization.	The organization.
4. Partnership account held in the name of the business.	The partnership.	The partnership.
5. Association, club or other tax-exempt organization.	The organization.	The organization.
6. A broker or registered nominee.	The broker or nominee.	The broker or nominee.
7. Accounts with the Department of Agriculture in the name of a public entity (such as a State or local government, school district or prison that receives agriculture program payments).	The public entity.	The public entity.

[1] Do not furnish the identifying number of the personal representative or trustee unless the legal entity itself is not designated in the account title.

SEC. 11. EFFECT ON PAPER RETURNS

.01 Magnetic tape reporting of the information returns listed in Section 1 above applies only to the original (Copy A).

.02 Payers are permitted considerable flexibility in designing the copy of the information return to be furnished to the payee. The payer may combine the information return data with other reports or financial or commercial notices, or expand them to include other information of interest to a depositor, patron, or shareholder. This is permissible so long as all required information present on the official form is included and the payees' copies are conducive to proper reporting of income on tax returns. Payers must include the message "This information is being furnished on Form 1099 (or 1087) to the Internal Revenue Service" on the recipients' copies.

.03 If a portion of the returns is reported on magnetic tape and the remainder is reported on paper forms, those returns not submitted on magnetic tape must be filed on official forms or on paper substitutes meeting specifications in the revenue procedure on the reproduction of Forms 1099, 1087, and W-2G. Form 1099 BCD, 1099 F, and W-2G cannot currently be filed on magnetic tape.

SEC. 12. ADDITIONAL INFORMATION

Requests for additional copies of this revenue procedure or for additional information on tape reporting should be addressed to the attention of the magnetic media coordinator of one of the following:

(a) Internal Revenue Service
Andover Service Center
Post Office Box 311
Andover, MA 01810

(b) Internal Revenue Service
Brookhaven Service Center
P.O. Box 486
Holtsville, NY 11742

(c) Internal Revenue Service
Philadelphia Service Center
Post Office Box 245
Bensalem, PA 19020

(d) Internal Revenue Service
Atlanta Service Center
Post Office Box 47-421
Doraville, GA 30362

(e) Internal Revenue Service
Memphis Service Center
P.O. Box 1900
Memphis, TN 38101

(f) Internal Revenue Service
Cincinnati Service Center
Post Office Box 267
Covington, KY 41019

(g) Internal Revenue Service
Kansas City Service Center
Post Office Box 1040, Stop 43
Kansas City, MO 64141

(h) Internal Revenue Service
Austin Service Center
Post Office Box 934
Austin, TX 78767

(i) Internal Revenue Service
Ogden Service Center
Post Office Box 9941
Ogden, UT 84409

(j) Internal Revenue Service
Fresno Service Center
Post Office Box 12866
Fresno, CA 93779

PART B.—MAGNETIC TAPE SPECIFICATIONS

SECTION 1. GENERAL

.01 The magnetic tape specifications contained in this Part prescribe the required format and contents of the records to be included in the file. These specifications *must* be adhered to unless deviations have been specifically granted by the Service in writing.

.02 In most instances, the Service will be able to process any compatible tape files. Compatible tape files must meet any one set of the following:

(a) 7 channel BCD (binary coded decimal) with

(1) Either Even or Odd Parity and

(2) A density of 556 or 800 BPI

(b) 9 channel EBCDIC (Extended Binary Coded Decimal Interchange Code) with

(1) Odd Parity and

(2) A density of 800, or 1600.

(c) 9 channel ASCII (American Standard Coded Information Interchange) with

(1) Odd Parity and

(2) A density of 800 or 1600.

.03 Although the Service can process, after translation, tapes created at 6250 BPI, it is preferred that filers submit 1600 PBI tapes if possible. Payers/Transmitters must request permission from the service center magnetic media coordinator before submitting 6250 BPI tapes.

04. All compatible tape files must have the following characteristics:

(a) Type of tape—½ inch Mylar base, oxide coated; and

(b) Interrecord Gap—¾ inch.

.05 Service programs are capable of accommodating some minor deviations. Payers who can substantially conform to these specifications, but do require some minor deviations, must contact the magnetic media coordinator at the service center where the file will be submitted. *Under no circumstances may tapes deviating from the specifications in this revenue procedure be submitted without prior written approval from the Service.*

Sec. 2. Record Length

.01 The tape records prescribed in these specifications may be blocked or unblocked, subject to the following:

(a) *A block must not exceed 4,000 tape positions.*

(b) A record must be a minimum of 200 positions and a maximum of 360 positions.

(c) If the use of blocked records would result in a short block, all remaining positions of the block must be filled with 9's. *Do not pad a block with blanks.*

(d) All records except the Header and Trailer Labels, may be blocked.

.02 Provision is made in the Payee "B" Records for special data entries. These entries are optional. If the field is utilized, it must be present on all Payee "B" Records. The field is intended to serve one or both of these purposes:

(a) Contain information required by state or local governments. Filers who wish to use this option for satisfying state or local reporting requirements should contact their state or local department of revenue for filing instructions.

(b) Facilitate making all records the same length.

Sec. 3. Options for Filing

.01 For filing convenience, this procedure contains two options for using Header Labels and Payer/Transmitter "A" Records. For the purposes of this procedure the following conventions must be used:

Header Label:

1. Payers may use standard headers, provide they begin with 1HDR, HDR1, VOL1 or VOL2.
2. Consist of a maximum of 80 positions.
3. May not contain the letters A, B, C, D, E, or F in position 9.

Trailer Label:

1. Standard trailer labels may be used provided that they begin with 1EOR, 1EOF, EOR1, or EOF1.
2. Consist of a maximum of 80 positions.

Record Mark:

1. Special character used to separate blocked records on tape.
2. Can be written only at the end of a record or block.
3. For odd parity tapes, use BCD bit configuration 011010 ("A82").

Tape Mark:

1. Used to signify the physical end of the recording on tape.
2. For even parity, use BCD configuration 001111 ("8421").
3. May follow the header label and precede and/or follow the trailer label.

Option 1: When using this option, a correct Payer/Transmitter "A" Record, described in Sec. 4 below, is required as the first record on each reel. Filers using this option may have Header Labels preceding the "A" Record, however, headers are not required. The reel sequence number must appear in positions 3-5 of each "A" Record and must be incremented by 1 on each tape reel of the file after the first reel.

Option 2: Requires a Header Label as the first record on each reel. The Header Label must contain the reel sequence number and it must be incremented by 1 on each reel after the first reel. The "A" Record will contain the location of the reel sequence number in the Header Label. If your system generates a four-digit reel sequence number, ignore the first digit when determining the location for the purposes of the "A" Record.

Example: If your Header Label reel sequence is four digits (e.g. 0001) and is in position 28-31, enter 29 as the location in positions 3 and 4 of the "A" Record and also enter an "X" in position 5 of the "A" Record.

Example: If your Header Label reel sequence number is 3 digits (e.g. 001) and is in positions 10-12, enter 10 as the location in positions 3 and 4 of the "A" Record and also enter an "X" in position 5 of the "A" Record. This option requires a Trailer Label at the end of *each* reel. Also, ignore the "D" Record instructions in this Part if you use Option 2.

Sec. 4. Payer/Transmitter "A" Record

Identifies the payer and transmitter of the tape file and provides parameters for the succeeding Payee "B" Records. The Service's computer programs rely on the absolute relationship between the parameters in the "A" Record and the data fields in the "B" Records to which they apply.

The number of "A" Records appearing on a tape reel will depend on the number of payers and the different types of returns being reported. A transmitter may include Payee "B" Records for more than one payer on a tape reel, however, each separate payer's Payee "B" Record(s) must be preceded by an "A" Record. A single tape reel may also contain different types of returns, but the returns may not be intermingled. A separate "A" Record is required for each type of return being reported. An "A" Record may be blocked with "B" Records, however, the "A" Record must appear as the first record in the block.

RECORD NAME: PAYER/TRANSMITTER "A" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	Required. Enter "A".
2	Payment Year	1	Required. Must be the right most digit of the year for which payments are being reported (e.g. if payments were made in 1980, enter 0). This number must be incremented each year.
3-5	Reel Sequence Number	3	Required. Sequence number of the reel in the tape file. (See explanation in Sec. 3 above). Position 5 *must* contain an "X" if you are using Option 2.
6-14	Payer's Federal EIN	9	Required. Must be the valid 9-digit number assigned to the payer by IRS. DO NOT ENTER HYPHENS, ALPHA CHARACTERS OR ALL 9's or ZEROS.
15	Type of Payer	1	Required. Enter the appropriate code from the table below:

Type of Payer	*Code*
Non-government	P
Federal government	F
State or local government	W

Tape Position	Field Title	Length	Description and Remarks
16	Blank	1	Enter blank (Reserved for IRS Use).
17	Type of Return	1	Required. Enter appropriate code from the table below:

Type of Return	*Code*
1099R	9
1099-DIV	1
1099-INT	6
1099-MISC	A
1099L	E
1099-MED	C
1099-OID	D
1099-PATR	7
1099-NEC	Q
1099-UC	P
1087-DIV	2
1087-INT	M
1087-MISC	G
1087-MED	K
1087-OID	H
Agriculture Subsidy Payments	4

Tape Position	Field Title	Length	Description and Remarks
18-24	Amount Indicator	Variable	Required. The amount code entered for a given return indicates the type(s) of payment(s) which were made. Example: If position 17 of the Payer/Transmitter "A" Record is 6 (for 1099-INT) and positions 18-24 are "24bbbbb", this indicates that two amount fields are present in all the following Payee "B" Records. The first field contains interest from Savings and Loan Association and the other contains Amount of forfeiture.
	Amount Indicator Form 1099R		For Reporting Payments on Form 1099R:

Tape Position	Field Title	Length	Description and Remarks

Amount Code	*Amount Type*
1	Amount includable as income (add amounts for codes 2, 3, and 4). *MUST BE GROSS AMOUNT.*
2	Capital gain (for lump-sum distributions only).
3	Ordinary income.
4	Premiums paid by trustee or custodian for current insurance.
5	Employee contributions to profit-sharing or retirement plans.
6	Amount of IRA distributions (do not include code 4 amount).
7	Net unrealized appreciation in employer's securities.
8	Other

Example: If position 17 of the Payer/Transmitter "A" Record is 9 (for 1099R), and positions 18-24 are "1354bbb", this indicates that 4 amount fields are present in all the following Payee "B" Records. The first field represents Amount includable as income; the second, Ordinary income; the third, Premiums paid by trustee or custodian for current insurance; the fourth, Employee contributions to profit-sharing or retirement plans.

Please Note: If you are reporting IRA distributions using amount code 6, only one payment amount may be present—all others *must* be blank.

Amount Indicator Form 1099-DIV

For Reporting Payments on Form 1099-DIV:

Amount Code	*Amount Type*
1	Gross dividends and other distributions on stock (*must* be gross amount).
4	Dividends qualifying for exclusion (included in amount for code 1).
5	Dividends not qualifying for exclusion (included in amount for code 1).
6	Capital gain distributions.
7	Non-taxable distribution (if determinable).
8	Foreign tax paid (if eligible for foreign tax credit).

Example: If position 17 of the Payer/Transmitter "A" Record is 1 (for 1099-DIV) and positions 18-24 are "16bbbbb", this indicates that 2 amount fields are present in all the following Payee "B" Records. The 1st field represents Gross dividends and other distributions on stock; the 2nd, Capital gain distributions.

Please Note: The sum of the amounts for codes 4 and 5 *must* equal that for code 1. Amounts for codes 6 and 7 must be included in that for code 1; however, they will not necessarily equal that for code 1.

Amount Indicator Form 1099-INT

For Reporting Payments on Form 1099-INT:

RECORD NAME: PAYER/TRANSMITTER "A" RECORD—Continued

Tape Position	Field Title	Length	Description and Remarks
			Amount Code — ***Amount Type*** 2 Earnings from savings and loan associations, credit unions, etc. 3 Other interest on bank deposit (Do not include amounts reported for code 2). 4 Amount of forfeiture 9 Foreign tax credit *Example:* If position 17 of the Payer/Transmitter "A" Record is 6 (for 1099-INT), and positions 18-24 are "34bbbbb", this indicates that 2 amount fields are present in all the following Payee "B" Payee Records. The 1st field represents Other interest on bank deposits, etc.; the 2nd, Amount of forfeiture. Please Note: Do not subtract the amount for code 4 from the amount in code 2 or 3 (for certificates of deposit only).
	Amount Indicator Form 1099-MISC		For Reporting Payments on Form 1099-MISC: ***Amount Code*** — ***Amount Type*** 1 Royalties 2 Prizes and awards (No Forms W-2 or 1099-NEC items) 5 Rents 6 Other fixed or determinable income *Example:* If position 17 of the Payer/Transmitter "A" Record is "A" (for 1099-MISC) and positions 18-24 are "125bbbb", this indicates that 3 amount fields are present in all the following Payee "B" Records. The 1st field represents Royalties; the 2nd, Prizes and awards, and the 3rd, Rents.
	Amount Indicator Form 1099L		For Reporting Payments on Form 1099L: ***Amount Code*** — ***Amount Type*** 1 Cash 2 Fair market value at date of distribution *Example:* If position 17 of the Payer/Transmitter "A" Record is "E" (for 1099L) and positions 18-24 are "1bbbbbb", this indicates that 1 amount field is present in all the following Payee "B" Records. This amount field represents Cash.
	Amount Indicator Form 1099-MED		For Reporting Payments on Form 1099-MED: ***Amount Code*** — ***Amount Type*** 1 Total medical and health care payments *Example:* If position 17 of the Payer/Transmitter "A" Record is "C" (for 1099-MED), positions 18-24 must be "1bbbbbb". This indicates one amount field is present in all the following

Tape Position	Field Title	Length	Description and Remarks
			Payee "B" Records and represents Total medical and health care payments. *No other coding is permissible for this type of payment.*
	Amount Indicator Form 1099-OID		For Reporting Payments on Form 1099-OID: *Amount Code* — *Amount Type* 1 Total original issue discount in 1980 for all holders of discount obligations from financial institutions 2 Total original issue discount in 1980 for all holders of corporate obligations 3 Issue price of obligation 4 Stated redemption price at maturity 5 Ratable monthly portion *Example:* If position 17 of the Payer/Transmitter "A" Record is "D" (for 1099-OID), and positions 18-24 are "134bbbb", this indicates that all three amount fields are present in all the Payee "B" Records following. The 1st field represents total original issue discount in 1980 for all holders of discount obligations from financial institutions; the 2nd Issue price of obligation; and the 3rd Stated redemption price at maturity.
	Amount Indicator Form 1099-PATR		For Reporting Payments on Form 1099-PATR: *Amount Code* — *Amount Type* 1 Patronage dividends 2 Nonpatronage dividends 3 Per-unit retain allocations 4 Redemption of nonqualified notices and retain allocations *Example:* If position 17 of the Payer/Transmitter "A" Record is "7" (for 1099-PATR) and positions 18-24 are "134bbbb", this indicates that 3 amount fields are present in all the following Payee "B" Records. The 1st field represents Patronage Dividends; the 2nd, Per-Unit Retain Allocations; the 3rd, Redemption of Nonqualified Notices and Retain Allocations.
	Amount Indicator Form 1099-NEC		For Reporting Payments on Form 1099-NEC: *Amount Code* — *Amount Type* 1 Fees, commissions, and other compensation *Example:* If position 17 of the Payer/Transmitter "A" Record is "Q" (for 1099-NEC), positions 18-24 must be "1bbbbbb". This indicates one amount field is present in all the following Payee "B" Records and represents Fees, commissions and other compensation. *No other coding is permissible for this type of payment.*

RECORD NAME: PAYER/TRANSMITTER "A" RECORD—Continued

Tape Position	Field Title	Length	Description and Remarks
	Amount Indicator Form 1099-UC		For Reporting Payments on Form 1099-UC:

Amount Code	Amount Type
1	Total unemployment compensation payments

Example: If position 17 of the Payer/Transmitter "A" Record is "P" (for 1099-UC), positions 18-24 must be "1bbbbbb". This indicates one amount field is present in all the following Payee "B" Records and represents Total unemployment compensation payments. *No other coding is permissible for this type of payment.*

Tape Position	Field Title	Length	Description and Remarks
	Amount Indicator Form 1087-DIV		For Reporting Payment on Form 1087-DIV:

Amount Code	Amount Type
1	Gross dividends and other distribution on stock
2	Dividends not qualifying for exclusion (included in amount for code 1)
3	Capital gain distributions (included in amount of code 1)
4	Foreign tax paid (if eligible for foreign tax credit)

Example: If position 17 of the Payer/Transmitter "A" Record is "2" (for 1087-DIV) and positions 18-24 are "12bbbbb", this indicates that two amounts fields are present in all the following Payee "B" Records. The 1st field represents Gross dividends and other distributions on stock; the 2nd, Dividends not qualifying for exclusion (included in amount for code 1).

Please Note: The sum of the amounts for codes 2 and 3 must equal that for code 1.

Tape Position	Field Title	Length	Description and Remarks
	Amount Indicator Form 1087-INT		For Reporting Payments on Form 1087-INT:

Amount Code	Amount Type
1	Earnings from savings and loan associations, credit unions, etc.
2	Other interest on bank deposits, etc. (Do not include amounts reportable under Amount Code 1.)
3	Foreign tax paid (if eligible for foreign tax credit)
4	Amount of forfeiture

Example: If position 17 of the Payer/Transmitter "A" Record is "M" (or 1087-INT) and positions 18-24 are "123bbbb", this indicates that all 3 amount fields are present in all the Payee "B" Records. The 1st field represent Earnings from savings and loan associations, credit unions, etc.; the 2nd, Other interest on bank deposits, etc.; and 3rd, Foreign tax paid.

Please Note: Do not subtract the amount for code 4 from the amount in code 2 or 3.

RECORD NAME: PAYER/TRANSMITTER "A" RECORD—Continued

Tape Position	Field Title	Length	Description and Remarks
	Amount Indicator Form 1087-MISC		For Reporting Payments on Form 1087-MISC: *Amount Code* — *Amount Type* 1 Royalties 2 Prizes and awards (No Forms W-2 or 1099-NEC items) 3 Rents 4 Other fixed or determinable income *Example:* If position 17 of the Payer/Transmitter "A" Record is "G" (for 1087-MISC) and positions 18-24 are "13bbbbb", this indicates that 2 amount fields are present in all the following Payee "B" Records. The 1st field represents Royalties; the 2nd, Rents.
	Amount Indicator Form 1087-MED		For Reporting Payments on Form 1087-MED: *Amount Code* — *Amount Type* 1 Total medical and health care payments *Example:* If position 17 of the Payer/Transmitter "A" Record is "K" (for 1087-MED), positions 18-24 must be "1bbbbbb". This indicates one amount field is present in all the following Payee "B" Records and represents Total medical and health care payments. *No other coding is permissible for this type of payment.*
	Amount Indicator Form 1087-OID		For Reporting Amounts on Form 1087-OID: *Amount Code* — *Amount Type* 1 Total original issue discount in 1980 for all holders of discount obligations from financial institutions 2 Total original issue discount in 1980 for all holders of corporate obligations 3 Issue price of obligation 4 Stated redemption price at maturity 5 Ratable monthly portion *Example:* If position 17 of the Payer/Transmitter "A" Record is "H" (for 1087-OID), and positions 18-24 are "134bbbb", this indicates that three amount fields are present in all the Payee "B" Records. The 1st field represents total original issue discount in 1980 for all holders of discount obligations from financial institutions; the 2nd, issue price of obligation; and the 3rd, stated redemption price at maturity.
25	Savings and Loan Code	1	Enter "S" if the payer is a savings and loan, building and loan, mutual savings bank, or credit union. If the payer is none of these, enter blank.
26	Blank	1	Enter blank.

RECORD NAME: PAYER/TRANSMITTER "A" RECORD—Continued

Tape Position	Field Title	Length	Description and Remarks
27	Surname Indicator	1	Enter "1" if the payees' surnames appear first in the name line of the "B" Records. Enter "2" if the payees' names appear last. If business and individual entities are contained in the file, enter blanks.
28-30	"A" Record Length	3	Required. Enter the number of positions allowed for the 'A" Record.
31-33	"B" Record Length	3	Required. Enter the number of positions allowed for the "B" Records. Include positions used for the special data fields, if used.
34	Blank	1	Enter blank.
35-39	Transmitter Control Code	5	Required. Enter the 5-digit Transmitter Control Code assigned by the IRS.
40	Blank	1	Enter blank.
41-120	Payer Name	80	Required. Enter the name of the payer in the manner in which it is used in normal business. *Any extraneous information (such as bond maturity dates)* must *be deleted from the name line* Left justify and fill with blanks.
121-160	Payer Street Address	40	Required. Enter the street address of the payer. Left justify and fill with blanks. If the payer does not have a street address, this field *must* be blank-filled.
161-200	Payer City, State and Zip Code	40	Required. Enter the city, state and zip code of the payer. Left justify and fill with blanks. DO NOT FILL WITH ALL BLANKS OR ALL 9's.
201-280	Transmitter's Name	80	Enter the name of the transmitter in the manner in which it is used in normal business. *The name of the transmitter should be constant through the entire file.* Left justify and fill with blanks.
281-320	Transmitter Street Address	40	Enter the street address of the transmitter. Left justify and fill with blanks. If the transmitter does not have a street address, this field must be blank.
321-360	Transmitter City, State and Zip Code	40	Enter the city, state, and zip code of the transmitter. Left justify and fill with blanks. DO NOT FILL WITH ALL BLANKS OR ALL 9's.

SEC. 5. PAYEE "B" RECORDS

.01 Contains payment record from individual statements. All records must be fixed length. Records may be blocked or unblocked. A block may not exceed 4000 positions. Do not pad unused blocks with blank records.

.02 All payee records must contain correct payee name and address information entered in the fields prescribed in this Part.

.03 The Service must be able to identify the surname associated with the taxpayer identifying number (SSN or EIN) furnished on a statement. The specifications below include a field in the payee records called "Name Control" in which the first four alphabetic characters of the payee surname are to be entered by the payers. In addition, a blank *must* precede the identifying surname in the first name line of all Payee "B" Records unless the surname begins in the first position of the field.

.04 If payers are unable to provide the first four characters of the surname, the specifications permit the submission of statements on magnetic tape with the Name Control Field left blank; however, compliance with the following will facilitate the Service computer programs required to generate the Name Control.

(a) The surname of the payee whose taxpayer identifying number (SSN or EIN) is shown in the Payee "B" Record, *must* be the *only* name in the first name line.

(b) A blank must precede the surname unless the surname begins in the first position of the field.

(c) In the case of multiple payees, only the surname of the payee whose taxpayer identifying number (SSN or EIN) is shown in the Payee "B" Record, must be present in the first name line. Surnames of any other payees in the record must be entered in the second name line.

05. Provision is also made in these specifications for data entries required by state or local governments. This should minimize the Payer/Transmitter's programming burden should payers desire to report on tape to state or local governments.

RECORD NAME: PAYEE "B" RECORD

<table>
<tr><th>Tape Position</th><th>Field Title</th><th>Length</th><th>Description and Remarks</th></tr>
<tr><td>1</td><td>Record Type</td><td>1</td><td>Required. Enter "B".</td></tr>
<tr><td>2-3</td><td>Payment Year</td><td>2</td><td>Required. Must be the two last digits of the year for which payments are being reported (e.g. if payments were made in 1980, enter "80"). Must be incremented each year.</td></tr>
<tr><td>4</td><td>Category of Distribution <i>(for reporting IRA income only)</i></td><td>1</td><td>Use <i>only</i> for Form 1099R. Identify the category of distribution and enter the applicable code from the table below.
<table>
<tr><th><i>Category</i></th><th><i>Code</i></th></tr>
<tr><td>Premature distribution (other than codes 2, 3, 4, or 5 below)</td><td>1</td></tr>
<tr><td>Rollover</td><td>2</td></tr>
<tr><td>Disability</td><td>3</td></tr>
<tr><td>Death</td><td>4</td></tr>
<tr><td>Prohibited transaction</td><td>5</td></tr>
<tr><td>Other</td><td>6</td></tr>
<tr><td>Normal</td><td>7</td></tr>
<tr><td>Excess contributions refunded plus earnings on such excess contributions</td><td>8</td></tr>
<tr><td>Transfers to an IRA for a spouse incident to a divorce</td><td>9</td></tr>
</table></td></tr>
<tr><td>5-6</td><td>Blank</td><td>2</td><td>Enter blanks. (Reserved for Service use).</td></tr>
<tr><td>7-10</td><td>Name Control</td><td>4</td><td>Enter the first 4 letters of the surname of the payee. Last names of less than four (4) letters should be left justified, filling the unused positions with blanks. Special characters and imbedded blanks should be removed. If the Name Control is not determinable by the payer, leave this field blank.</td></tr>
<tr><td>11</td><td>Type of Account</td><td>1</td><td>This field is used to identify the data in 12-20 as to Employer Identification Number, Social Security Number, or the reason no number is shown. Enter a "blank" if a taxpayer identifying number is required but unobtainable due to legitimate cause; e.g., number applied for but not received.
1) Enter the digit "1" if the payee is a business or any organization for which an EIN was provided.
2) Enter the digit "2" if the payee is an individual and an SSN is provided in positions 12-20.</td></tr>
<tr><td>12-20</td><td>Taxpayer Identifying Number</td><td>9</td><td>Required. Enter the valid 9-digit taxpayer identifying number of the payee (SSN or EIN, as appropriate). Where an identifying number has been applied for but not received or any other legitimate cause for not having an identifying number, enter blanks.
DO NOT ENTER HYPHENS, ALPHA CHARACTERS, OR ALL 9's OR ALL ZEROS.</td></tr>
<tr><td>21-30</td><td>Account Number</td><td>10</td><td>Optional. Payers may use this field to enter the payee's account number. Although this item is optional, its use will facilitate easy reference to specific records in the payer's file, should any questions arise. <i>Do Not Enter a Customer Identification Number in This Field.</i></td></tr>
</table>

RECORD NAME: PAYEE "B" RECORD—Continued

Tape Position	Field Title	Length	Description and Remarks
31-110	Payment Amount Fields		The number of payment amounts is dependent on the number of Amount Indicators in positions 18-24 of the "A" Record. Each payment amount field *must* contain 10 characters. Do not provide a payment amount field when the Amount Indicator is blank. Each payment amount must be entered in dollars and cents. *Do not enter dollar signs, commas, decimal points, or negative payments.* Example: The Amount Indicator contains 123bbbb. Payee "B" Records in this field should have only three payment amount fields. If Amount Indicator contains 12367bb, the "B" Records should have 5 payment amount fields. Payment amounts MUST be right-justified and unused portions MUST be zero-filled.
31-40	Payment Amount Field 1	10	This amount is identified by the amount code in position 18 of the Payer/Transmitter "A" Record. This entry must always be present.
41-50	Payment Amount Field 2	10	This amount is identified by the amount code in position 19 of the Payer/Transmitter "A" Record. If position 19 of the Payer/Transmitter "A" Record is blank, do not provide for this payment field.
51-60	Payment Amount Field 3	10	This amount is identified by the amount code in position 20 of the Payer/Transmitter "A" Record. If position 20 of the Payer/Transmitter "A" Record is blank, do not provide for this payment field.
61-70	Payment Amount Field 4	10	This amount is identified by the amount code in position 21 of the Payer/Transmitter "A" Record. If position 21 of the Payer/Transmitter "A" Record is blank, do not provide for this payment field.
71-80	Payment Amount Field 5	10	This amount is identified by the amount code in position 22 of the Payer/Transmitter "A" Record. If position 22 of the "A" Record is blank, do not provide for this payment field.
81-90	Payment Amount Field 6	10	This amount is identified by the amount code in position 23 of the Payer/Transmitter "A" Record. If position of the "A" Record is blank, do not provide for this payment field.
91-100	Payment Amount Field 7	10	This amount is identified by the amount code in position 24 of the "A" Record. If position 24 of the "A" Record is blank, do not provide for this payment field.
Next 40 positions after the last Payment Amount Field used	Payee-Name (1st name line) (A blank must precede the surname unless the surname begins in the first position of the field)	40	Required. Enter the name of the payee whose taxpayer identifying number appears in tape positions 12-20 above. If fewer than 40 characters are required, left justify and fill unused positions with blanks. If more space is required, utilize the 2nd Name Line field below. If there are multiple payees, *only* the name of the payee whose taxpayer identifying number has been provided can be entered in this field. The names of the other payees may be entered in the 2nd Name Line field. The order in which the payee's name appears in this field must correspond with the Surname Indicator entered in tape position 27 of the Payer/Transmitter "A" Record. No descriptive or other data is to be entered in this field.

RECORD NAME: PAYEE "B" RECORD—Continued

Tape Position	Field Title	Length	Description and Remarks
Next 40 positions after the 1st Name Line	Payee Name (2nd Name Line)	40	If the payee name requires more space than is available in the 1st Name Line, enter the remaining portion of the name in this field. If there are multiple payees, this field may be used for those payees' names who are *not* associated with the taxpayer identifying number provided in tape positions 12-20 above. Left justify and fill unused positions with blanks. Fill with blanks if this field is not required.
Next 40 positions after 2nd Name Line	Payee Street Address	40	Enter street address of payee. Left justify and fill unused positions with blanks. Address *must* be present. This field *must not* contain any data other than the payee's street address.
Next 40 positions after the street address	Payee City, State and Zip Code	40	Required. Enter the city, state and ZIP code of the payee, in that sequence. Use U.S. Postal Service abbreviations for states. Left justify and fill unused positions with blanks. City, state and ZIP code *must* be present.
Next field after City, State and Zip Code	Special Data Entries		Optional. The last portion of the "B" Record may be used to record information required for State or local government reporting, or for other purposes. The special data entries will begin in positions 201, 211, 221, 231, 241, 251, or 261, depending on the number of payment amount fields included in the record. Special Data Entries may be used to make all records the same length; however, the record length may not exceed 360 positions. Payers should contact their state or local revenue departments for their filing requirements.

NOTE 1: The first name of the Payee shown as beginning the tape position 101 must be shifted to the field immediately following the last payment amount field used. *For example,* if two payment amount fields are used, the first name line field would be shifted to position 51. Succeeding fields would be shifted accordingly. Also see SEC. 11 below for a record layout reflecting 2 payment amount fields.

SEC. 6. END OF PAYER "C" RECORD

.01 The End of Payer "C" Record is a summary record for a given payer. It must be the same length as the "B" Records in the payer's file.

.02 The "C" Record will contain the totals of the payment amount fields and the payees filed by a given payer. The "C" Record must be written after the last payee record for each payer. For each "A" Record on the file, there must be a corresponding "C" Record.

.03 Payers/transmitters must verify the accurary of the totals in the "C" Record and must enter the totals on the transmittal, Form 4804, which will accompany the shipment.

.04 The "C" Record cannot be followed by a Tape Mark

RECORD NAME: END OF PAYER "C" RECORD

Tape Position	Field Title	Length	Description and Remarks
1	Record Type	1	Required. Enter "C".
2-7	Number of Payees	6	Required. Enter the number of payees covered by the payer on this tape reel. Right justify and zero fill.
	Totals from Payment Amount Fields		Right justify and zero fill each Control Total amount. If less than seven amount fields are being reported, zero fill tape fields for Control Totals 3, 4, 5, 6, and 7. Option 1—Enter the grand total of each payment amount field for the given payer of this reel. Option 2—If the given payer's file is continued on multiple

RECORD NAME: END OF PAYER "C" RECORD

Tape Position	Field Title	Length	Description and Remarks
			reels, enter the grand total of each payment amount field for that payer on this tape reel and on prior reel(s).
8-19	Control Total 1	12	
20-31	Control Total 2	12	
32-43	Control Total 3	12	
44-55	Control Total 4	12	
56-67	Control Total 5	12	
68-79	Control Total 6	12	
80-91	Control Total 7	12	
92-end of record	Blanks		Enter blanks.

Sec. 7. End of Reel "D" Record —Optional

0.1 The End of Reel "D" Record will be present for Option 1 only. It must be the same length as the "B" Records.

.02 Write this record when the end of the normal writing area of the reel has been reached, but all the records of the file have not been written. This record indicates that there are additional reels in the file.

.03 Each "D" Record must contain a count of payees and totals of each payment amount reported for all "B" Records not summarized in the preceding "C" Records on the reel.

.04 If you do not wish to use a "D" Record, or your system is unable to generate it, you may delete it; however, the last "B" Record on the tape reel *MUST* be followed by a Tape Mark.

Sec. 8. End of Transmission "F" Record

.01 The "F" Record is a summary of the number of payers and tapes in the entire file.

.02 This record should be written after the last "C" Record.

.03 Only a Tape Mark or a Tape Mark and Trailer Label may follow the "F" Record.

.04 The "F" Record *must* be the same length as the "B" Records.

RECORD NAME: END OF TRANSMISSION "F" RECORD

Tape Position	Field Type	Length	Description and Remarks
1	Record Type	1	Required. Enter "F".
2-5	Number of Payers	4	Required. Enter the total number of payers in the transmission. Right justify and zero fill.
6-8	Number of Tapes	3	Required. Enter the total number of tapes in the transmission.
9-30		22	Right justify and zero fill.
31-end of record			Required. Enter zeroes. Enter blanks.

SEC. 9. TAPE LAYOUTS—OPTION 1

The following charts show, by type of file, the record types to be used in the first two and the last three records written on a tape reel when only one type of document (file) is reported on a reel or series of reels.*

Type of File	1st record type	2nd record type	2nd from last record type	Next to last record type	Last record type
Single payer, single reel	A	B	B	C[1]	F
Single payer, multiple reels:					
Reel 1	A	B	B	B	TM[2]
Last reel	A	B	B	C[1]	F
Multiple payers, single reel:					
Payer 1	A	B	B	B	C[1]
Payer 2	A	B	B	B	C[1]
Last payer	A	B	B	C[1]	F
Multiple payers, multiple reels: First payer's records split between reel 1 and reel 2; second payer's records split between reel 2 and reel 3:					
Reel 1: Payer 1	A	B	B	B	TM[2]
Reel 2:					
Payer 1	A	B	B	B	C[1]
Payer 2	A	B	B	B	TM[2]
Reel 3:					
Payer 2	A	B	B	B	C[1]
Payer 3	A	B	B	C[1]	TM[2]
Reel 4: Last Payer	A	B	B	C[1]	F
Multiple payers, single transmitter, separate files for each payer:					
File 1: Payer 1: Last reel	A	B	B	C[1]	F
File 2: Payer 2:					
Reel 1	A	B	B	B	TM[2]
Last reel	A	B	B	C[1]	F
File 3: Payer 3: Last reel	A	B	B	C[1]	F
Single payer, multiple transmitter (payer submits files from various locations):					
Payer 1:					
Location 1: Last reel	A	B	B	C[1]	F
Location 2: Last reel	A	B	B	C[1]	F
Single payer, multiple transmitter, etc.:					
Location 3:					
Reel 1	A	B	B	B	TM[2]
Reel 2	A	B	B	B	TM[2]
Last reel	A	B	B	C[1]	F

---

[1] Must contain "Number of Payers" and "Control Totals" summarizing all Payee Records written for this Payer on this reel.

[2] Tape Mark.

*When more than one type of document (file) is reported on a tape reel, there will be a corresponding increase in the series of "A," "B—B" and "C" records since, within a tape reel, a file is equivalent to an "A" record, a series of "B" records and a "C" record for a single payer.

SEC. 10. TAPE LAYOUTS—OPTION 2

(REEL SEQUENCE NUMBER IS IN THE HEADER LABEL).

Where the Header Label is the first record, the following charts show, by type of file, the record types to be used in the 2nd and 3rd records and the last three records written on a tape reel prior to the Trailer label when only one type of document (file) is reported on a reel or series of reels.*

Type of File	1st record type after Header Label	2nd record type after Header Label	2nd from last record type	Next to last record type	Last record type
Single payer, single reel	A	B	B	C[1]!	F
Single payer, multiple reels:					
Reel 1	A	B	B	B	B
Last reel	B	B	B	C[2]	F
Multiple payers, single reel:					
Payer 1	A	B	B	B	C[1]
Payer 2	A	B	B	B	C[1]
Last payer	A	B	B	B	B
Multiple payers, multiple reels; first payer's records split between reel 1 and reel 2; second payer's records split between reel 2 and reel 3:					
Reel 1: Payer 1	B	B	B	B	C[3]
Reel 2:					
Payer 1	A	B	B	B	B
Payer 2	A	B	B	C[1]	F
Reel 3:					
Payer 2	B	B	B	B	C[3]
Payer 3	A	B	B	C[3]	A
Reel 4:					
Payer 4	B	B	B	C[3]	F
Multiple payers, single transmitter, separate files for each payer:					
File 1: Payer 1: Last reel	B	B	B	C[2]	F
File 2: Payer 2:					
Reel 1	A	B	B	B	B
Last reel	B	B	B	C[2]	F
Single payer, multiple transmitter (payer submits files from various locations):					
Each Location:					
1st reel	A	B	B	B	B
Last reel	B	B	B	C[2]	F
Single payer, multiple transmitter, etc.:					
Location 3:					
Reel 1	A	B	B	B	B
Reel 2	B	B	B	B	B
Last reel	B	B	B	C[2]	F

---

[1] Must contain "Number of Payees" and "Control Totals" summarizing all Payee "B" Records written for this payer on this reel.

[2] Must contain "Number of Payees" and "Control Totals" summarizing all Payee "B" Records written for this payer on this reel and on prior reel(s).

[3] Must contain "Number of Payees" and "Control Totals" summarizing all Payee "B" Records written for this payer on this reel and for this payer on the prior reel(s).

*When fore than one type of document (file) is reported on a tape reel, there will be a corresponding increase in the series of "A," "B—B" and "C" records since, within a tape reel, a file is equivalent to an "A" record, a series of "B" records and a "C" record for a single payer.

Sec. 11. Effect on other Documents

Rev. Proc. 79-66 is superseded.

Exhibit "A"

Form **4419**
(Revised October 1980)
Department of the Treasury
Internal Revenue Service

Application for Magnetic Media Reporting of Information Returns

IRS Use Only
TCC:

1. Please fill in this form and send to:

Internal Revenue Service Center

2. Name and address of organization *(street, city, State and ZIP code)*

3. Payment year for which you plan to begin reporting on magnetic media: ________

4. Employer identification number

5. Kind of magnetic media you plan to submit: *(check one)*

☐ Tape ☐ Diskette

☐ Disk pack ☐ Cartridge disk

6. Person to contact about this request

Name:

Title:

Telephone number: *(include area code)*

7. **Documents To Be Reported**

Form	Estimated Volume		Form	Estimated Volume	
	Magnetic media	Paper		Magnetic media	Paper
☐ 1099-DIV			☐ 1087-DIV		
☐ 1099-INT			☐ 1087-INT		
☐ 1099-MISC			☐ 1087-MISC		
☐ 1099-MED			☐ 1087-MED		
☐ 1099-OID			☐ 1087-OID		
☐ 1099-R			☐ 1042S		
☐ 1099-L			☐ 1099-NEC		
☐ 1099-PATR			☐ 1099-UC *(for use by States only)*		

8. **Kind of equipment on which media will be prepared**

Main frame *(all media types)*		Drive unit *(all media)*	
Manufacturer	Model	Manufacturer	Model

Tape only			All media types
Width	Tracks ☐ 7 ☐ 9	Density	Recording code (e.g., EBCDIC, BCD, or ASCII)

9. **Internal Revenue Service office where paper information returns, if any, will be filed**

Form 1099 Series	Form 1087 Series	Form W-2G

10. If your firm is acting as agent, please list the name and employer identification number of each payer on a separate sheet and attach it to this application.

11. Person responsible for preparation of tax reports.	Name *(type or print)*	Title
	Signature	Date

Instructions for Form 4419

Payers or agents who decide to file information returns on magnetic media must complete Form 4419 to receive authorization for filing. Please be sure to complete all appropriate blocks as explained in the following instructions:

Block 2: Enter the name and complete address of the person or organization that will prepare and submit the magnetic media.

Block 3: Show the tax (payment) year for which you intend to begin filing information returns on magnetic media.

Block 5: Check the kind of magnetic media you plan to submit. If you plan to submit more than one kind of magnetic media, you should complete a separate application for each kind.

Block 7: Check the boxes next to all of the information returns you file with the Internal Revenue Service.

a. Magnetic media column: Enter the total number of individual information returns to be reported on magnetic media (an estimate is acceptable).

b. Paper column: Enter the total number of individual information returns to be reported on paper if all returns will not be filed in magnetic media form (an estimate is acceptable). In BLOCK 9 indicate the IRS office where you will file the paper returns.

Block 10: If your firm is preparing information returns on magnetic media for payers other than itself, attach to your application a list of the names and employer identification numbers of the payers. If you add or delete any payers from your file, you *must* submit an updated list of payers.

Block 11: The form must be signed and dated by an official of the company or organization requesting authorization to report on magnetic media.

Filing Your Application

1. The completed application and any attached lists should be mailed to the Internal Revenue Service Center at the address shown in BLOCK 1.

2. Upon receipt of the application, we will review it. If it is acceptable, we will send you an authorization letter within 30 days. Do not submit magnetic media until you receive an authorization letter.

3. We encourage new filers to submit test data on magnetic media for review before the filing season. If you want to submit test data, contact the magnetic media coordinator where you file your application.

4. Your authorization will be valid as long as the magnetic media submitted conforms to the specifications of the applicable revenue procedures. However, a new application is required if:

   a. filing is discontinued and then resumed,

   b. there is any change in the equipment listed on the application,

   c. there is any addition or deletion to the list of information returns to be filed on magnetic media.

26 CFR 601.105: Examination of returns and claims for refund, credit, or abatement; determination of correct tax liability. (Also Part I, Sections 61, 3401, 6041; 1.61-2, 31.3401(a)-1, 1.6041-2.)

Rev. Proc. 80-53

SECTION 1. PURPOSE

The purpose of this revenue procedure is to set forth the procedures the Internal Revenue Service will follow to implement the decision of the Supreme Court of the United States in *Central Illinois Public Service Company v. United States*, 435 U.S. 21 (1978), 1978-1 C.B. 310.

SEC. 2. BACKGROUND

.01 In *Central Illinois*, the Supreme Court of the United States held that cash reimbursements for lunch expenses of employees on nonovernight company travel were not wages for purposes of income tax withholding under section 3401(a) of the Internal Revenue Code. The reimbursements were includible in the gross incomes of the employees, but the Court indicated that the requirement to withhold income tax is narrower than the requirement to include in gross income and that the Service's regulations and rulings did not put the employer on notice that it was obligated to withhold income tax on such payments.

.02 Pub. L. No. 95-427, section 1, 1978-2 C.B. 363, 364, as amended by Pub. L. No. 96-167, section 1, 1980-1 C.B. 483, 484, provides that the Treasury Department (Internal Revenue Service) is precluded from issuing final regulations, under section 61 of the Code, that would govern the income tax treatment of fringe benefits, prior to June 1, 1981. In addition, no regulations relating to the treatment of fringe benefits under section 61 are to be proposed that would be effective prior to June 1, 1981. Pub. L. Nos. 95-427 and 96-167 relate only to the issuance of regulations. However, it was also Congressional intent that no revenue rulings or revenue procedures be issued if they altered, or deviated from, in any significant way, the historical treatment of fringe benefits. See H.R. Rep. No. 95-1232, 95th Cong., 2d Sess. 5 (1978), 1978-2 C.B. 365, 366, and S. Rep. No. 96-433, 96th Cong., 1st Sess. 5 (1979), 1980-1 C.B. 486, 488, respectively.

.03 Section 6041 of the Code provides that all persons engaged in a trade or business and making payments in the course of such trade or business to another person of salaries, wages, compensations, remunerations, or other fixed or determinable gains, profits, and income, of $600 or more, in any taxable year must file a return.

.04 Section 1.6041-2 of the Income Tax Regulations provides that payments of compensation other than wages, as defined in section 3401, including the cash value of payments made in any medium other than cash, to an employee by an employer in the course of the trade or business of the employer must be reported on Form W-2, Wage and Tax Statement, if the total of such payments and the amount of the employee's wages required to be reported on Form W-2 aggregates $600 or more in a calendar year. The employer may elect to report the compensation other than waegs on a separate Form W-2.

SEC. 3. TREATMENT OF FRINGE BENEFITS UNDER SECTIONS 61, 3401, AND 6041 OF THE CODE

.01 The Internal Revenue Service will continue to follow existing regulations, revenue rulings, revenue procedures, and case law in determining whether particular fringe benefits are compensation includible in gross income under section 61 of the Code.

.02 However, those fringe benefits that the Service will continue to treat as includible in gross income under .01 above will not be treated as wages under section 3401(a) of the Code, if

1 the payments are not the type of benefit treated as wages under the statute, a regulation, a revenue ruling, a revenue procedure, or a court decision; and

2 there is a reasonable basis for the belief that such benefits should not be considered as remuneration for services.

.03 Those fringe benefits that are includible in gross income as compensation under section 61 of the Code, but that are not treated as wages under section 3401(a), must be reported by employers as other compensation on a Form W-2 prepared for each employee if the total of such compensation paid to the employee and the amount of the employee's wages to be reported on Form W-2 aggregates $600 or more in a calendar year. Section 1.6041-2 of the regulations. For example, the cash reimbursements for lunch expenses of employees on non-overnight company travel must be reported, if the total of such compensation paid to the employee and the amount of the employee's wages to be reported on Form W-2 aggregates $600 or more in a calendar year.

SEC. 4. FEDERAL INSURANCE CONTRIBUTIONS ACT AND FEDERAL UNEMPLOYMENT ACT

.01 This revenue procedure has no effect upon the rules for determining whether fringe benefits are wages for purposes of the taxes imposed by the Federal Insurance Contributions Act and the Federal Unemployment Tax Act.

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26 CFR 601.201: Rulings and determination letters. (Also Part I, Section 7701; 301.7701-4.)

Rev. Proc. 80-54

SECTION 1. PURPOSE

The purpose of this revenue procedure is to modify and supersede Rev. Proc. 79-1, 1979-1 C.B. 481, by specifying revised conditions that must be present before the Internal Revenue Service will consider issuing advance rulings concerning the classification of organizations as liquidating trusts under section 301.7701-4 of the Procedure and Administration Regulations.

SEC. 2. SCOPE

The operating rules published in this revenue procedure are intended solely to assist taxpayers and their representatives in preparing ruling requests. These operating rules do not define, as a matter of law, the circumstances under which an organization will be classified as a liquidating trust for federal income tax purposes. That determination can be made only after examination of all the facts and circumstances in connection with the operation and activities of the trust. An organization will be considered a liquidating trust if it is organized for the primary purpose of liquidating and distributing assets transferred to it, and if its activities are all reasonably necessary to, and consistent with the accomplishment of that purpose. If the liquidation is unreasonably prolonged or if the liquidation purpose becomes so obscured by business activities that the declared purpose of liquidation can be said to be lost or abandoned, the status of the organization will no longer be that of a liquidating trust.

A ruling requested under this revenue procedure will usually be issued if the operating rules in Section 4 of this revenue procedure and the pertinent provisions of the Internal Revenue Code, Income Tax Regulations, revenue rulings and other revenue procedures are complied with.

The authority and general procedures of the National Office and the Offices of the District Directors of the Internal Revenue Service for the issuance of advance rulings and determination letters are outlined in Rev. Proc. 79-45, 1979-2 C.B. 508, and section 601.201 of the Statement of Procedural Rules (26 CFR section 601.201 (1977)). See also Rev. Proc. 80-22, 1980-1 C.B. 654. Careful attention to all of the requirements of these documents will also serve to minimize delays in processing requests for rulings.

SEC. 3. CHANGES

.01 Section 3, "Operating Rules," has been redesignated Section 4.

.02 Former Section 3.02 has been changed to provide that the trust instrument must contain a fixed termination date "generally" not more than three years from the date of creation of the trust.

.03 Former Section 3.04 has been changed to delete the requirement that deposits need be made in banks or savings institutions that are federally insured and to permit short-term investments such as Treasury bills.

.04 Former Section 3.06 has been changed to provide that the trust may not receive transfers of any unlisted stock of a single issuer that "represents 80 percent or more" of the stock of such issuer.

.05 Former Section 3.07 has been deleted.

.06 Former Section 3.08 has been changed to provide that the trustee is required to distribute at least "annually" to known shareholders any proceeds from the sale of assets or income from investments.

.07 Section 4, "Inquiries," has been redesignated Section 5.

SEC. 4. OPERATING RULES

A ruling generally will be issued that an organization is classified as a liquidating trust if the following conditions are met:

.01 The trust is organized for the primary purpose of liquidating the assets transferred to it with no objective to continue or engage in the conduct of a trade or business and its governing instrument so provides.

.02 The trust instrument contains a fixed termination date that is generally not more than three years from the date of creation of the trust and that is reasonable based on all the facts and circumstances.

.03 In the case of a trust created incident to a corporate liquidation, the trustee is selected by the shareholders of record or a court of competent jurisdiction.

.04 The investment powers of the trustee are limited to powers to invest in demand and time deposits in banks or savings institutions, or temporary investments such as short-term certificates of deposit or Treasury bills.

.05 The trust does not receive transfers of any listed stocks or securities, any readily-marketable assets or any operating assets of a going business. The trust does not receive or retain cash in excess of a reasonable amount to meet claims and contingent liabilities.

.06 The trust does not receive transfers of any unlisted stock of a single issuer that represents 80 percent or more of the stock of such issuer and does not receive transfers of any general or limited partnership interests.

.07 The trust is required to distribute at least annually to known shareholders any proceeds from the sale of assets or income from investments.

.08 The ruling request contains representations that the trustee will make continuing efforts to dispose of the trust assets, make timely distributions, and not unduly prolong the duration of the trust.

SEC. 5. INQUIRIES

Inquiries regarding this revenue procedure should refer to its number and should be addressed to the Assistant Commissioner (Technical), Attention: T:I:I, Internal Revenue Service, Washington, D.C. 20224.

EFFECT ON OTHER DOCUMENTS

Rev. Proc. 79-1, 1979-1 C.B. 481, is modified and superseded.

Part IV. Items of General Interest

Form 4255, Recapture of Investment Credit, Revised

Announcement 80-154

Form 4255, Recapture of Investment Credit, has been revised to provide for the recapture of business energy investment credit. The form is used to figure the increase in tax if regular or energy investment credit property was disposed of or ceased to qualify before the end of the useful life used to figure the original credit.

Form 4255, which has been retitled for 1980, also now follows a vertical format. Since the November 1978 revision does not cover recapture of the energy credit, that revision should no longer be used. The new version (Rev. Oct. 1980) is now available at Internal Revenue Service offices.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individual has been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
H. Jim Uchida	Oakland, CA	Certified Public Accountant	Indefinite effective November 5, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.507-2(c)(1)(IV)(A), 1.509(a)-3, 1.509(a)-4(k)(2), 1.509(a)-5 as proposed in the Federal Register for July 24, 1979, 44 F.R. 43290, withdrawn; 1.507-2(c)(1)(IV)(A), 1.509(a)-3, 1.509(a)-4(k)(2), 1.509(a)-5, amended.	Definition of a private foundation.	Oct. 10, 1980	Dec. 9, 1980
26 CFR 1.44C-6 revised; 601.601 amended.	Secretarial authority to add items to the list of items eligible for the residential energy credit.	Oct. 15, 1980	Dec. 15, 1980
26 CFR 25.2514-3(e) amended.	Transfer of a life income interest by the possessor of that interest.	Oct 22, 1980	Dec. 22, 1980
26 CFR 48.4041 through 48.4041-10 deleted; 48.4041-11 through 48.4041-14 redesignated as 48.4041-14 through 48.4041-17; 48.4041-1 through 48.4041-13 added.	Manufacturers and retailers excise taxes on special fuels.	Oct. 22, 1980	Dec. 22, 1980
26 CFR 1.671-4, 1.6012-3, 301.6109-1 amended.	Modification of reporting requirements for certain grantor trusts.	Oct. 24, 1980	Dec. 23, 1980
26 CFR 301.7701-2 amended.	Tax classification of limited partnerships.	Oct. 27, 1980	Dec. 26, 1980
26 CFR 1.46-4(d), 1.48-1, 1.48-2, amended; 1.48-11 added.	Investment credit for qualified rehabilitated buildings.	Oct. 28, 1980	Dec. 29, 1980
26 CFR 150.4995-3, 150.4997-1, 150.6402-1 amended; published as temporary regulations in T.D. 7732, 1980-48 I.R.B. 19.	Tax deposits and refunds based on net income limitation.	Nov. 5, 1980	Jan. 5, 1981

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] See footnote at end of list.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

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80-237, 1980-35 I.R.B. **9**

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80-294, 1980-44 I.R.B. **9**

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[1] See footnote at end of list.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27, dated July 7, 1980.

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1928–2	9.50	*1942–2*	*5.55*	1958–2	13.00	1971–1	10.55
1929–1	12.00	*1943*(*)	*9.55*	1958–3	15.00	1971–2	8.50
1929–2	*3.15*	*1944*(*)	*7.85*	1959–1	15.00	1972–1	13.50
1930–1	7.30	1945(*)	9.40	1959–2	9.60	1972–2	13.70
1930–2	9.50	*1946–1*	*2.55*	1960–1	19.00	1973–1	16.00
1931–1	*3.60*	1946–2	5.20	1960–2	11.50	1973–2	8.30
1931–2	13.00	*1947–1*	*1.80*	1961–1	14.00	1974–1	11.00
1932–1	*2.80*	1947–2	3.40	1961–2	10.00	1974–2	9.95
1932–2	8.65	*1948–1*	*3.15*	1962–1	14.00	*1974–3*	*8.20*
1933–1	*3.35*	1948–2	7.50	1962–2	13.00	1974–3 Supp.	10.00
1933–2	*3.45*	*1949–1*	*6.90*	1962–3	20.00	1975–1	13.25
1934–1	*3.70*	*1949–2*	*2.80*	1963–1	9.00	1975–2	13.00
1934–2	14.00	1950–1	6.35	1963–2	10.75	1976–1	11.00
1935–1	6.90	*1950–2*	*4.70*	1964–1–1	10.00	1976–2	10.25
1935–2	*14.00*	*1951–1*	*12.00*	1964–1–2	11.00	1976–3–1	9.50
1936–1	*3.55*	*1951–2*	*5.05*	1964–2	9.80	1976–3–2	16.00
1936–2	*14.00*	*1952–1*	*2.55*	1965–1	10.70	1976–3–3	10.00
1937–1	*13.00*	1952–2	7.05	1965–2	12.25	1977–1	10.75
1937–2	7.70	*1953–1*	*4.25*	1966–1	14.00	1977–2	11.75
1938–1	*16.00*	1953–2	12.00	1966–2	14.05	1978–1	11.75
1938–2	*13.00*	1954–1	12.00	1967–1	10.00	1978–2	13.00
1939–1–1	8.25	1954–2	12.00	1967–2	14.00	1978–3–1	12.25
1939–1–2	10.90	1955–1	10.25	1968–1	14.00	1978–3–2	9.00
1939–2	9.40	1955–2	13.00	1968–2	11.75	1979–1	14.00
1940–1	5.55	1956–1	15.00	1969–1	14.00	1979–2	15.00
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Internal Revenue
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Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

INCOME TAX

Rev. Rul. 80-325, page 6.
Credit for the elderly; community property laws. Rev. Ruls. 63-167, 63-168, and 63-169, relating to the effect of community property laws on the computation of retirement income credit for a social security beneficiary, a civil service retiree, and an Armed Forces retiree, are obsoleted with respect to the tax credit for the elderly in the case of a joint return filed for a taxable year beginning after December 31, 1977.

Rev. Rul. 80-338, page 6.
Partner's earnings as executor remitted to partnership. A partner in an accounting firm was appointed executor of an estate in a state whose laws prohibit a partnership from serving as executor. Permission to accept the appointment was granted by the partnership and the fees received were turned over to it. The earnings are partnership income and excluded from the partner's individual gross income. Rev. Rul. 54-167 distinguished.

Rev. Rul. 80-339, page 7.
Industrial development bonds; airline terminals and related facilities. A political subdivision of a state issued bonds to finance the construction of terminals and related airport facilities for several commercial airlines. The bond indenture provided that principal and interest on the bonds would be payable solely from the revenues derived from a toll bridge operated by the subdivision. However, the present value of the long-term lease payments to be made by the airlines is approximately equal to the present value of the debt service on the bonds. The bonds are industrial development bonds within the meaning of section 103(b)(2) of the Code.

Rev. Rul. 80-340, page 8.
Medical expense; visual display audio equipment for television sets. The extra cost of a specially equipped television set that provides deaf individuals with a visual display of the audio portion of television programs and the cost of an adaptor for a conventional television set that performs the same function are medical expenses.

Rev. Rul. 80-342, page 9.
Oil and gas drilling expense; COST well. Several oil companies formed a consortium to drill a Continental Offshore Stratigraphic Test (COST) well, and shared the information developed from the drilling. The purpose of the well was to obtain geological information to be used in determining whether to bid on Government oil and gas leases. The drilling expenses are not intangible drilling and development costs subject to the elective provisions of sections 1.263(c)-1 and 1.612-4(a) of the regulations; they are capital expenditures allocable to any leases that may be acquired based on information obtained from the well.

Rev. Rul. 80-344, page 11.
LIFO; price indexes; department stores. The July 1980 Bureau of Labor Statistics price indexes are accepted for use by department stores employing

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Finding Lists begin on page 27.
Announcement of Voluntary Suspension on page 25.
Announcement of Notice of Proposed Rulemaking on page 26.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

the retail inventory and last-in, first-out inventory methods of valuing inventories for taxable years of 12 months ended June 30, 1980, and July 31, 1980.

Rev. Rul. 80-345, page 11.
Regulated investment companies; dividends; short-term capital gains and unexercised stock options. Short-term capital gains from the sale of stock or securities and unexercised options gains are not excludable from the gross income of a regulated investment company for purposes of section 854(b) of the Code; Rev. Rul. 70-597 modified.

Rev. Proc. 80-55, page 20.
Banks; interest paid; indebtedness for state obligations. Section 265(2) will be applied to disallow deductions for interest paid by commercial banks on certain time deposits made by a state that are secured by pledges of tax-exempt obligations; Rev. Procs. 70-20 and 72-18 amplified.

Rev. Proc. 80-56, page 21.
FICA and self-employment taxes; totalization agreement. Social security payments made to a foreign country under the terms of a totalization agreement are neither allowable as a deduction under section 164(a) of the Code nor as a credit under section 901(b).

Announcement 80-156, page 23.
Comments are invited on a new income tax treaty currently being discussed by representatives of the U.S. and Switzerland.

EMPLOYEE PLANS

T.D. 7730, page 16.
Amendments to the regulations under sections 3401 and 6693 of the Code relate to withholding tax rules with respect to individual retirement plans and penalties for failure to furnish information in connection with such plans.

EXEMPT ORGANIZATIONS

Announcement 80-157, page 23.
A listing is given of organizations now classified as private foundations.

ESTATE TAX

Rev. Rul. 80-346, page 14.
Stock transferred in trust; indirect retention of voting rights. An individual owned 19 shares of a closely held corporation's stock, and the individual's children owned the other 81 shares. On June 30, 1976, the individual transferred the 19 shares to a trust. The trust instrument gave the trustee sole authority to vote the shares, but at the time of the transfer, the trustee agreed to consult the transferor with respect to voting and to vote only with the transferor's consent. The transferor indirectly retained the right to vote the transferred shares, and their value is includible in the transferor's gross estate.

Rev. Rul. 80-347, page 18.
Returns of missing persons. An estate tax return must be filed within 9 months following the period of time state law sets for declaring a missing person dead; Rev. Rul. 66-286 clarified and modified.

ESTATE AND GIFT TAXES

T.D. 7731, page 14.
Amendments to the temporary regulations relate to the filing of a corrected gift tax return by taxpayers who elected to treat their interest in certain jointly held property as a "qualified joint interest" under section 2040(d) of the Code, but failed to comply with the requirements of section 23.1 of the regulations.

EMPLOYMENT TAXES

Rev. Proc. 80-56, page 21.
FICA and self-employment taxes; exemption; totalization agreement. Procedures are set forth for implementing section 317(b) of the Social Security Amendments of 1977, which relates to exemption from social security taxes on certain self-employment income or wages during any period in which there is a totalization agreement in effect between the U.S. and a foreign country.

Notice 80-11, page 23.
Pursuant to sections 3303(b)(1) and 3304(c) of the Code, the Secretary of Labor has certified to the Secretary of the Treasury the states and other jurisdictions that have approved unemployment

(Continued on page 5)

Highlights of this Issue—Continued

(Continued from page 4)

EMPLOYMENT TAXES—Cont'd

compensation laws for the 12-month period ended October 31, 1980.

EXCISE TAXES

T.D. 7729, page 17.

Amendments to the regulations under section 4221 of the Code relate to the excise tax treatment of articles previously sold tax free for exportation upon their subsequent return to the U.S.

Notice 80-10, page 20.

Windfall profit tax; inflation adjustment factor.

For purposes of computing the windfall profit tax, the inflation adjustment for the quarter ending March 31, 1981, is .1187 for tier 1 or tier 2 oil and .1469 for tier 3 oil.

ADMINISTRATIVE

Announcement 80-159, page 24.

Publication 1071, *Supplemental Report, Statistics of Income—1972-1974, International Income and Taxes—Domestic International Sales Corporation Returns,* may be purchased from the Superintendent of Documents, Washington, D.C.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 37.—Credit for the Elderly

Credit for the elderly; community property laws. Rev. Ruls. 63-167, 63-138, and 63-169, relating to the effect of community property laws on the computation of retirement income credit for a social security beneficiary, a civil service retiree, and an Armed Forces retiree, are obsoleted with respect to the tax credit for the elderly in the case of a joint return filed for a taxable year beginning after December 31, 1977.

Rev. Rul. 80-325

The Tax Reform Act of 1976, section 503, 1976-3 C.B. (Vol. 1) 1, 35, amended section 37 of the Internal Revenue Code by replacing the retirement income credit with the credit for the elderly, effective for taxable years beginning after December 31, 1975.

Under section 37 of the Code, as amended, special rules for determining the tax credit for the elderly are available to certain individuals who retire under a federal, state, or local government retirement system.

The Revenue Act of 1978, section 701(a), 1978-3 C.B. (Vol. 1) 1, 131, added a new provision to the Code, section 37(e)(8), effective for taxable years beginning after December 31, 1977. Section 37(e)(8) provides that in the case of a joint return, section 37(e) will be applied without regard to community property laws.

Rev. Rul. 63-167, 1963-2 C.B. 17, Rev. Rul. 63-168, 1963-2 C.B. 9, and Rev. Rul. 63-169, 1963-2 C.B. 14, deal with the application of section 37 of the Code in certain situations.

Rev. Rul. 63-167 holds, in part, that for purposes of section 37 of the Code, the community or separate character of social security benefits is determined by the marital status and domicile of the primary beneficiary at the time the primary beneficiary becomes entitled to receive the payments.

Rev. Ruls. 63-168 and 63-169 concern civil service annuitants and retired military personnel living in certain community property states. These revenue rulings hold, in part, that for purposes of section 37 of the Code the community or separate character of the annuity or military retirement pay is determined by the marital status and domicile of the retired individual when the services to which the annuity or military retirement pay is attributable were performed.

In view of the amendment to section 37(e) of the Code for taxable years beginning after December 31, 1977, Rev. Ruls. 63-167, 63-168, and 63-169 are obsoleted with respect to the holdings under section 37 in the case of a joint return filed for a taxable year beginning after December 31, 1977.

Section 61.—Gross Income Defined

26 CFR 1.61-1: Gross income.

Partner's earnings as executor remitted to partnership. A partner in an accounting firm was appointed executor of an estate in a state whose laws prohibit a partnership from serving as executor. Permission to accept the appointment was granted by the partnership and the fees received were turned over to it. The earnings are partnership income and excluded from the partner's individual gross income. Rev. Rul. 54-167 distinguished.

Rev. Rul. 80-338

ISSUE

Are fees earned by a partner, under the circumstances described below, income of the partnership or of the individual partner?

FACTS

A, an individual, is a partner in accounting firm *P*. *P* requires that its partners obtain permission from *P* before engaging in business activities not directly related to the business of *P*. *A* was named executor of an estate in state *M*. Under the laws of state *M*, letters of administration are not issued to partnerships; therefore, *P* could not be appointed or serve as an executor. *P* approved *A*'s taking the position as executor subject to the requirement that the services provided by *A* would not include those available from *P* and that all fees earned by *A* be turned over to *P*.

LAW AND ANALYSIS

Section 61(a) of the Internal Revenue Code provides that gross income includes compensation for services, including fees, commissions, and similar items and a partner's distributive share of partnership income.

As long as the source of the income earned by a partner has a business nexus with the partnership, the income is included in the partnership's taxable income and excluded from the taxable income of the partner who received it. See *Bufalino v. Commissioner*, T.C.M. 1976-110.

Rev. Rul. 54-167, 1954-1 C.B. 152, holds that if a partnership may not perform the services of an elected public official for which a partner, in the partner's individual capacity, received compensation, the partner is required to report the compensation on his or her individual return, even though such compensation is pooled with the earnings of the partnership as required by the partnership agreement.

Rev. Rul. 69-90, 1964-1 (Part I) C.B. 226, which amplifies Rev. Rul. 54-167, holds that if the services provided by a partner in the partner's individual capacity are similar to those provided by the partnership, then the compensation for those services is partnership income if paid to the partnership in accordance with the partnership agreement.

In this revenue ruling the services provided by *A* as an executor depend on the exercise of *A*'s expertise and are similar to the services provided by *A* for *P*. Therefore, the compensation for the services by *A* as an executor is partnership income if paid to the partnership in accordance with the partnership agreement.

This case is distinguishable from Rev. Rul. 54-167. Although under the laws of state *M*, a partnership cannot be named an executor, such a function is within the range of services undertaken by accountants. It is not unusual in an accounting or legal practice that specific responsibilities must be assumed by an individual partner rather than by the partnership.

HOLDING

The fees that *A* earns as an executor and turns over to *P* are partnership income and are excluded from *A*'s gross income. However, *A*'s distributive share of *P*'s income must be reported on *A*'s U.S. Individual Income Tax Return (Form 1040).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 54-167 is distinguished.

Section 103.—Interest on Certain Governmental Obligations

26 CFR 1.103-7: Industrial development bonds.

Industrial development bonds; airline terminals and related facilities. A political subdivision of a state issued bonds to finance the construction of terminals and related airport facilities for several commercial airlines. The bond indenture provided that principal and interest on the bonds would be payable solely from the revenues derived from a toll bridge operated by the subdivision. However, the present value of the long-term payments to be made by the airlines is approximately equal to the present value of the debt service on the bonds. The bonds are industrial development bonds within the meaning of section 103(b)(2) of the Code.

Rev. Rul. 80-339

ISSUE

Will the bonds issued by a political subdivision of a state to finance the construction of terminals and related airport facilities for commercial airline carriers be "industrial development bonds" within the meaning of section 103(b)(2) of the Internal Revenue Code?

FACTS

The political subdivision issued revenue bonds and used the bond proceeds to construct terminals and related facilities for several commercial airline carriers. The political subdivision also operates a toll bridge that is used by the general public. The bonds are not "arbitrage bonds" as such term is defined in section 103(c) of the Code.

The bond indenture for the bond issue provided that principal and interest on the bonds would be payable solely from a pledge of revenues derived by the political subdivision from the toll bridge. The bond indenture further provided that unpledged revenues derived by the political subdivision from the terminals and related airport facilities might be used for any purpose of the political subdivision, subject to a priority to pay operating expenses and maintenance costs relating to the airport facilities. Revenues from the terminals and related facilities were derived from long-term lease payments.

The total revenues derived from the terminals, related airport facilities, and the toll bridge in 1979 were 100*x* dollars, of which 60*x* dollars were derived from the toll bridge. The long-term lease payments to be made by the airline carriers and the debt service on the revenue bonds are approximately equal in present value.

LAW AND ANALYSIS

Section 103(a)(1) of the Code provides that gross income does not include interest on obligations of a state.

Section 103(b)(1) of the Code provides that, with certain exceptions, the interest on "industrial development bonds" is not excludable from gross income.

Section 1.103-7(b) of the Income Tax Regulations defines industrial development bonds as obligations that meet the "trade or business test" and the "security interest test." The trade or business test is satisfied if a major portion (more than 25 percent) of the bond proceeds is used in the trades or businesses of nonexempt persons. The security interest test is met if a major portion (more than 25 percent) of the payment of the principal or interest on the bonds is secured by any interest in property used in a trade or business or by payments in respect of such property, or is to be derived from payments in respect of property, or borrowed money, used or to be used in a trade or business.

Section 1.103-7(b)(3) of the regulations provides that the trade or business test relates to the use of the proceeds of a bond issue. The test is met if all or a major portion (more than 25 percent) of the proceeds of a bond issue is used in a trade or business carried on by a nonexempt person. For example, if all or a major portion of the proceeds of a bond issue is to be loaned to one or more private business users, or is to be used to acquire, construct, or reconstruct facilities to be leased or sold to such private business users, and such proceeds or facilities are to be used in trades or businesses carried on by them, such proceeds are to be used in a trade or business carried on by persons who are not exempt persons, and the debt obligations comprising the bond issue satisfy the trade or business test.

Section 1.103-7(b)(4) of the regulations provides that the security interest test relates to the nature of the security for, and the source of, the payment of either the principal or interest on a bond issue. The nature of the security for, and the source of, the payment may be determined from the terms of the bond indenture or on the basis of an underlying arrangement. An underlying arrangement can be inferred from all the facts and circumstances.

Example (14) of section 1.103-7(c) of the regulations, which illustrates the existence of an underlying arrangement, reads as follows:

> J, a political subdivision of a State, will issue several series of bonds from time to time and will use the proceeds to rehabilitate urban areas. More than 25 percent of the proceeds of each issue will be used for the rehabilitation and construction of buildings which will be leased or sold to nonexempt persons for use in their trades or businesses. There is no limitation either on the number of issues or the aggregate amount of bonds which may be outstanding. No group of bondholders has any legal claim prior to any other bondholders or creditors with respect to specific revenues of J, and there is no arrangement

whereby revenues from a particular project are paid into a trust or constructive trust, or sinking fund, or are otherwise segregated or restricted for the benefit of any group of bondholders. There is, however, an unconditional obligation by J to pay the principal and interest on each issue of bonds. Further, it is apparent that J requires the revenues from the lease or sale of buildings to nonexempt persons in order to pay in full the principal and interest on the bonds in question. The bonds are industrial development bonds because a major portion of the proceeds will be used in the trades or businesses of nonexempt persons and, pursuant to an underlying arrangement, payment of the principal and interest is, in major part, to be derived from payments in respect of property or borrowed money used in the trades or businesses of nonexempt persons.

An underlying arrangement will always be inferred if the payments to be made by the industrial user or users and the debt service on the bonds are approximately equal in present value. Other facts that tend to show an underlying arrangement are, first, that payments made by the industrial user or users are material to the security for the bonds, and second, that the identity of the industrial user or users can be determined with reasonable certainty at the time of issue.

In this case the bond proceeds will be used in constructing facilities that will be leased to nonexempt persons. Because more than 25 percent of the bond proceeds will be used in the trades or businesses of nonexempt persons, the bond proceeds will be considered used in the trades or businesses of nonexempt persons and the "trade or business test" described in section 1.103-7(b)(3) of the regulations will be satisfied.

For purposes of satisfying the "security interest test," the substance and not the form of the transaction is to control. See section 1.103-7(b)(4) of the regulations. In this case, in order to fail the "security interest test," the political subdivision arranged the terms of the bond indenture to provide that the bonds will be payable only from pledged revenues. Notwithstanding the formal documents, an underlying arrangement can be inferred because the payments to be made by the airline carriers and the debt service on the bonds are approximately equal in present value. Consequently, payment of a major portion of debt service on the political subdivision's bonds will be derived from payments in respect of property used or to be used in a trade or business within the meaning of section 103(b)(2)(B)(ii) of the Code. See example (14) of section 1.103-7(c). Moreover, the use of toll bridge revenues (instead of the revenues derived from the terminals and related airport facilities) to pay debt service on the bonds does not significantly alter the economic consequences of the transaction. The use of toll bridge revenues to pay debt service on the bonds "frees up" the revenues from the terminals and related facilities or uses for which the toll bridge revenues would otherwise have been available. Since the political subdivision would not have issued the bonds in this case without requiring the commercial airline carriers to pay for the use of the bond-financed facilities, the revenues derived from the use of the bond-financed facilities are the true "source" of the debt service payments. Therefore, the "security interest test" described in section 1.103-7(b)(4) will be satisfied.

HOLDING

The bonds issued by the political subdivision to finance the terminals and related airport facilities are industrial development bonds within the meaning of section 103(b)(2) of the Code.

Section 116.—Partial Exclusion of Dividends and Interest Received by Individuals

26 CFR 1.116-1: Partial exclusion of dividends.

Whether the holding of Rev. Rul. 70-597, 1970-2 C.B. 146 that dividends paid by a regulated investment company out of net short-term capital gains qualify for the $100 dividends received individual exclusion under section 116 of the Code subject to the limitations under section 854, is correct; and whether unexercised option gains realized by a regulated investment company are excluded from gross income for purposes of section 854(b). See Rev. Rul. 80-345, page 11.

Section 164.—Taxes

26 CFR 1.164-1: Deduction for taxes.

Whether social security payments made to a foreign country under a totalization agreement are deductible. See Rev. Proc. 80-56, page 21.

Section 213.—Medical, Dental, Etc., Expenses

26 CFR 1.213-1: Medical, dental, etc., expenses.
(Also Section 262; 1.262-1.)

Medical expense; visual display audio equipment for television sets. The extra cost of a specially equipped television set that provides deaf individuals with a visual display of the audio portion of television programs and the cost of an adaptor for a conventional television set that performs the same function are medical expenses.

Rev. Rul. 80-340

ISSUE

Is the cost of special equipment that displays the audio portion of television programs as subtitles on the screen of a television set an expense for medical care for purposes of the deduction allowed by section 213 of the Internal Revenue Code?

FACTS

Through the use of special equipment, television programming can be understood by the deaf. The equipment displays the audio portion of television programs as subtitles on the screen of a television set. Two types of equipment are available. One is a small self-contained unit that can be attached to any conventional television set. The other is a conventional color television set in which the equipment is incorporated during manufacture and for which the cost is more than for the same model color television set that does not contain the equipment.

LAW AND ANALYSIS

Section 262 of the Code provides that, except as otherwise expressly provided, no deduction is allowed for personal, living, or family expenses.

Section 213(a) of the Code allows as a deduction the amount, not compensated for by insurance or otherwise, by which the amount of the expenses paid during the taxable year for medical care of the taxpayer, the taxpayer's spouse, and dependents, exceeds three percent of adjusted gross income.

Section 213(e) of the Code provides that the term "medical care" means amount paid for the diagnosis, care, mitigation, treatment, or prevention of disease, or for the purpose of affecting any structure or function of the body.

Section 1.213-1(e)(1)(ii) of the Income Tax Regulations provides that deductions for expenditures for medical care allowable under section 213 of the Code are confined strictly to expenses incurred primarily for the prevention or alleviation of a physical or mental defect or illness. An expenditure that is merely beneficial to the general health of an individual is not an expenditure for medical care.

Section 1.213-1(e)(1)(iii) of the regulations provides that a capital expenditure that is related only to the sick person and is not related to permanent improvement or betterment of property, if it otherwise qualifies as an expenditure for medical care, is deductible.

Rev. Rul. 71-48, 1971-1 C.B. 99, holds that the cost of specialized equipment that enables a deaf taxpayer to communicate effectively over a regular telephone by means of converted teletype signals is deductible as a medical expense.

Rev. Rul. 75-318, 1975-2 C.B. 88, holds that a taxpayer who purchased braille books and magazines for the taxpayer's child may deduct as expenses for medical care the portion of the purchase price that exceeds the price for regular printed editions.

Rev. Rul. 66-80, 1966-1 C.B. 57, holds that the cost of hand controls and other equipment specially adopted to permit the operation or use of an automobile by a physically handicapped individual and the cost of a mechanical device used to lift and place the individual in an automobile are deductible as medical expenses under section 213 of the Code.

HOLDING

In view of the foregoing, both the cost of the self-contained unit that can be attached to any conventional television set and the excess of the cost of the specially-equipped color television set over the cost of the same model conventional color television set are expenses for medical care for purposes of the deduction allowed by section 213 of the Code.

Section 243.—Dividends Received by Corporations

26 CFR 1.243-2: Special rules for certain distributions.

Whether the holding of Rev. Rul. 70-597, 1970-2 C.B. 146 that dividends paid by a regulated investment company out of net short-term capital gains qualify for the 85 percent dividends received corporate deduction under section 243 of the Code, subject to the limitations under 854, is correct; and whether unexercised option gains realized by a regulated investment company are excluded from gross income for purposes of section 854(b). See Rev. Rul. 80-345, page 11.

Section 262.—Personal, Living, and Family Expenses

26 CFR 1.262-1: Personal, living, and family expenses.

Whether the cost of special decoding equipment that displays the audio portion of television programs as subtitles on a television screen is an expense for medical care. See Rev. Rul. 80-340, page 8.

Section 263.—Capital Expenditures

26 CFR 1.263(a)-1: Capital expenditures; in general.
(Also 1.263(c)-1.)
(Also Section 612; 1.612-4.)

Oil and gas drilling expense; COST well. Several oil companies formed a consortium to drill a Continental Offshore Stratigraphic Test (COST) well, and shared the information developed from the drilling. The purpose of the well was to obtain geological information to be used in determining whether to bid on Government oil and gas leases. The drilling expenses are not intangible drilling and development costs subject to the elective provisions of sections 1.263(c)-1 and 1.612-4(a) of the regulations; they are capital expenditures allocable to any leases that may be acquired based on information obtained from the well.

Rev. Rul. 80-342

ISSUE

What is the proper income tax treatment of expenditures for drilling a Continental Offshore Stratigraphic Test well, under the circumstances described below?

FACTS

Fifteen oil companies formed a consortium and received a permit from the United States Geological Survey (USGS) to drill a Continental Offshore Stratigraphic Test (COST) well off the east coast of the United States in 1978.

The site for drilling the COST well was determined on the basis of geophysical information obtained by the consortium from the interpretation of seismic data gathered under a previous permit from the USGS. Each member of the consortium capitalized its aliquot share of the amount paid for such seismic work to the area or areas of interest identified by the member in accordance with Rev. Rul. 77-188, 1977-1 C.B. 76.

The purpose of drilling the COST well was to obtain geological information on an offshore area that the United States Government was expected to open for leasing in the near future. The COST well was drilled outside the previously identified areas of interest (off stucture) for the purpose of obtaining more information about such areas of interest. The COST well is expected to identify source beds that may have generated oil and gas and to determine the thickness and nature of reservoir rocks having the potential for containing oil and gas. Information gathered in drilling the COST well is also very useful in verifying the geophysical interpretation of the seismic data previously gathered. This information is useful to the members of the consortium when the area is offered for lease.

Under the terms of the permit held by the consortium, any oil or gas that may be discovered in drilling the COST well remains the property of the Government. Also, under the terms of the permit, the USGS and each member of the consortium will share in the geological information developed in drilling the well. This information is proprietary to the members of the consortium for 10 years or until the Government grants a lease within 50 miles of the COST well, whichever is sooner. If a lease is granted within 50 miles of the COST well during the 10 year proprietary period, the geological information developed in drilling the COST well will be made available to the public by the USGS 60 days after such lease is granted.

In this case the 15 companies comprising the consortium paid 150*x* dollars each, for the right to participate in drilling the COST well and sharing the geological information developed therefrom. A drilling contractor was hired and the well was drilled in 1978. After the well was completed, the borehole was permanently plugged and abandoned as required by the terms of the permit.

Each member of the consortium and the USGS received a copy of the geological information developed in drilling the well. No lease was granted by the Government within 50 miles of the well in 1978 or 1979.

LAW AND ANALYSIS

Section 263(a) of the Internal Revenue Code provides that no deduction shall be allowed for capital expenditures. Section 263(c) states that, notwithstanding subsection (a), regulations shall be prescribed that grant an option to deduct as expenses intangible drilling and development costs in the case of oil and gas wells.

Section 1.263(c)-1 of the Income Tax Regulations provides that the rules relating to the option to deduct as expenses intangible drilling and development costs in the case of oil and gas wells are found under section 1.612-4.

Section 1.612-4(a) of the regulations provides that in accordance with the provisions of section 263(c) of the Code, intangible drilling and development costs incurred by an operator (one who holds a working or operating interest in any tract or parcel of land either as a fee owner or under lease or any other form of contract granting working or operating rights) in the development of oil and gas properties may at the operator's option be chargeable to capital or to expense. This option applies to all expenditures made by an operator for wages, fuel, repairs, hauling, supplies, etc., incident to and necessary for the drilling of wells and the preparation of wells for the production of oil and gas.

The consortium is neither the lessee nor owner of the property on which the COST well is drilled. Neither it nor the members of the consortium have an operating or working interest in the property. Furthermore, the COST well was drilled to obtain geological information and not for the production of oil and gas. Thus, the drilling costs paid or incurred by the members of the consortium do not come under the elective provisions of section 1.263(c)-1 and 1.612-4(a) of the regulations.

Rev. Rul. 77-188 holds that geological and geophysical exploration expenditures are allocable to the cost of the property or properties acquired or retained.

The consortium had the COST well drilled to obtain geological information on an offshore area on which they expect the Bureau of Land Management to permit interested parties to bid for leases on which the lessees may drill for oil and gas deposits. The knowledge gained from such geological information is used by the individual members of the consortium in making their decisions to bid on certain tracts offered for lease in the general area of the COST well, and in verifying their interpretation of previously gathered geophysical data. Thus, the geological exploration expenditures for drilling the COST well are paid or incurred by members of the consortium for the purpose of obtaining and accumulating data that will serve as a basis for the acquisition or retention of an oil and gas property. Such exploration expenditures are capital in nature and are not deductible as ordinary and necessary business expenses. *See Louisiana Land and Exploration Co.*, 7 T.C. 507 (1946), *aff'd on other issues*, 161 F.2d 842 (5th Cir. 1947); *Schermerhorn Oil Corporation*, 46 B.T.A. 151 (1942); *G. E. Cotton*, 25 B.T.A. 866 (1932); *C. M. Nusbaum*, 10 B.T.A. 664 (1928); and *Seletha O. Thompson*, 9 B.T.A. 1342 (1928).

HOLDING

The expenditures for drilling the COST wells are not intangible drilling and development costs subject to the elective provisions of section 1.263(c)-1 and section 1.612-4(a) of the regulations. However, similar to the exploration expenditures discussed in Rev. Rul. 77-188, the 150*x* dollars paid to drill the COST well is a capital expenditure. If any member of the consortium is successful in obtaining a lease or leases on the areas of interest to which the information obtained from drilling the COST well is allocable, the 150*x* dollars paid by such member is allocable to such lease or leases. However, any member of the consortium that is unsuccessful in acquiring a lease to which the geological information applies and abandons the area of interest as a potential source of mineral production may deduct the 150*x* dollars or an allocable portion thereof under the provisions of section 165 of the Code in the taxable year in which the abandonment occurs.

26 CFR 1.263(c)-1: Intangible drilling and development costs in the case of oil and gas wells.

Whether the expenditures incurred in drilling a Continental Offshore Stratigraphic Test well are subject to the elective provisions of section 263(c) of the Code and section 1.612-4(a) of the regulations. See Rev. Rul. 80-342, page 9.

Section 265.—Expenses and Interest Relating to Tax-Exempt Income

26 CFR 1.265-2: Interest relating to tax-exempt income.

Whether section 265(2) of the Code will be applied to disallow deductions for interest paid by commercial banks on certain time deposits made by a state when such deposits are made for a specific period of time and are secured by pledges of tax exempt obligations. See Rev. Proc. 80-55, page 20.

Section 318.—Constructive Ownership of Stock

26 CFR 1.318-1: Constructive ownership of stock; introduction.

Whether the constructive ownership rules of section 318 apply to determine whether a decedent possessed voting control over transferred stock, for purposes of section 2036. See Rev. Rul. 80-346, page 14.

Section 472.—Last-In, First-Out Inventories

26 CFR 1.472-1: Last-in, first-out inventories.

LIFO; price indexes; department stores. The July 1980 Bureau of Labor Statistics price indexes are accepted for use by department stores employing the retail inventory and last-in, first-out inventory methods of valuing inventories for taxable years of 12 months ended June 30, 1980, and July 31, 1980.

Rev. Rul. 80-344

The following price indexes for July 1980 published by the Bureau of Labor Statistics on August 29, 1980, for use by department stores employing the retail inventory and last-in, first-out inventory methods, are accepted by the Internal Revenue Service pursuant to section 1.472-1(k) of the Income Tax Regulations and Rev. Proc. 72-21, 1972-1 C.B. 745, for appropriate application to inventories for taxable years of 12 months ended June 30, 1980, and July 31, 1980.

Indexes are given on a national basis for the store total, for 20 major groups of departments, and for two special combinations—soft and durable goods. The store total index covers all departments, including some not listed separately, with the following exceptions: candy, foods, liquor, tobacco, paints, and wallpaper, as well as contract departments.

BUREAU OF LABOR STATISTICS, DEPARTMENT STORE INVENTORY PRICE INDEXES BY DEPARTMENT GROUPS

(January 1941 = 100)

	Department Group	*July 1979*	*July 1980*	*Percent Change from July 1979 to July 1980* [1]
I	Piece Goods	327.7	366.1	11.7
II	Domestics and Draperies	402.0	437.1	8.7
III	Women's and Children's Shoes	468.8	500.8	6.8
IV	Men's and Boys' Shoes	577.9	616.7	6.7
V	Infants' Wear	367.9	408.5	11.0
VI	Women's Underwear	307.5	334.1	8.7
VII	Women's and Girls' Hosiery	189.1	201.8	6.7
VIII	Women's and Girls' Accessories	362.4	383.2	5.7
IX	Women's Outerwear and Girls' Wear	318.9	323.0	1.3
X	Men's Clothing	405.5	404.6	—.2
XI	Men's Furnishings	355.6	389.1	9.4
XII	Boys' Clothing and Furnishings	363.8	380.5	4.6
XIII	Jewelry	518.4	688.3	32.8
XIV	Notions	382.6	406.0	6.1
XV	Toilet Articles and Drugs	426.1	465.8	9.3
XVI	Furniture and Bedding	423.8	460.1	8.6
XVII	Floor Covering	336.6	364.8	8.4
XVIII	Housewares	559.5	620.2	10.8
XIX	Major Appliances	199.6	208.8	4.6
XX	Radio and Television	113.5	115.8	2.0
	Groups I—XV: Soft Goods	377.6	405.2	7.3
	Groups XVI—XX: Durable Goods	360.7	390.8	8.3
	Store Total	372.2	400.6	7.6

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[1] Absence of a minus sign before percentage change in this column signifies price increase.

Section 612.—Basis for Cost Depletion

26 CFR 1.612-4: Charges to capital and to expense in case of oil and gas wells.

Whether the expenditures incurred in drilling a Continental Offshore Stratigraphic Test well are subject to the option provided for in section 263(c) of the Code and section 1.612-4(a) of the regulations. See Rev. Rul. 80-342, page 9.

Section 854.—Limitations Applicable to Dividends Received from Regulated Investment Company

26 CFR 1.854-1: Limitations applicable to dividends received from regulated investment company.
(Also Sections 116, 243, 7805; 1.116-1, 1.243-2, 301.7805-1.)

Regulated investment companies; dividends; short-term capital gains and unexercised stock options. Short-term capital gains from the sale of stock or securities and unexercised options gains are not excludable from the gross income of a regulated investment company for purposes of section 854(b) of the Code; Rev. Rul. 70-597 modified.

Rev. Rul. 80-345

ISSUES

I. Are short term capital gains from the sale or other disposition of stock or securities excluded from the gross income of a regulated investment company for purposes of section 854(b) of the Internal Revenue Code? If not, is the holding of Rev. Rul. 70-597, 1970-2 C.B. 146 that dividends paid by a regulated investment company out of net short-term capital gains qualify for the $100 dividends received individual exclusion under section 116 and the 85 percent dividends received corporate deduction under section 243, subject to the limitations under section 854, correct?

II. Are unexercised option gains realized by a regulated investment company excluded from gross income for purposes of section 854(b) of the Code?

FACTS

The taxpayer is a regulated investment company within the meaning of subchapter M (sections 851-855) of the Code.

Situation I

The taxpayer engages in the sale and other disposition of stock and securities that result in net short-term capital gains that are recognized by the taxpayer for federal income tax purposes. These gains are includible in the taxpayer's gross income under section 61 and are distributed to its shareholders as ordinary income. A regulated investment company's capital gain dividends, defined in section 852(b)(3)(C) of the Code, may only be paid from net capital gain, which is defined in section 1222(11) as the excess of net long-term capital gain over net short-term capital loss for the year. Thus, short-term capital gains are not includible in the taxpayer's capital gain dividends.

Situation II

The taxpayer writes options on stock held in its stock portfolio and sells the options on a national securities exchange. In some instances, the holder of an option permits the option to lapse. In other instances, the taxpayer terminates its obligation for an option it has written by buying an identical option. The termination of the taxpayer's obligation by the purchase of an identical option is called a closing transaction. In either of the above situations, the options are considered as not having been exercised. Gains from unexercised stock options are includible in the taxpayer's gross income under section 61 of the Code.

LAW

Section 854(b)(1) of the Code provides that in the case of a dividend received from a qualifying regulated investment company (other than a capital gain dividend to which section 854(a) applies), if the aggregate dividends received by the regulated investment company for the taxable year during which it paid such dividend are less than 75 percent of its gross income, then, in computing the section 116 exclusion and the section 243 deduction, there shall be taken into account only that portion of the dividend that bears the same ratio to the amount of such dividend as the aggregate dividends received by the regulated investment company during such taxable year bear to its gross income for such taxable year.

Section 854(b)(4)(A) of the Code provides that for purposes of section 854(b), the term "gross income" does not include gain from the sale or other disposition of stock or securities.

ANALYSIS

Situation I

By enacting section 854(b) of the Code, Congress intended to place the shareholders of a regulated investment company in roughly the same position concerning the benefits of sections 116 and 243 as persons investing directly in a taxable corporation instead of through the medium of a regulated investment company. This intent is reflected in section 854(b)(4)(B), excluding dividends received from foreign corporations from the term "aggregate dividends received," and otherwise restricting that term by reference to section 116. S. Rep. No. 1622, 83rd Cong., 2d Sess. 104 (1954), states:

> [Y]our committee has defined dividend income to the investment company so as to exclude dividends which would not be entitled to the dividends-received . . . exclusion in the hands of an individual shareholder. It appears to your committee that it is inappropriate to allow the shareholder of a regulated investment company to treat as a dividend for purposes of the . . . exclusion amounts distributed by the investment companies from sources such as dividends paid by foreign corporations, which if received directly by the shareholder would not be eligible for such treatment.

The 75 percent test and the apportionment formula in section 854(b)(1) of the Code are provisions designed to achieve rough equivalence of treatment under sections 116 and 243 between regulated investment company shareholders and direct investors. The shareholders of a taxable corporation are allowed the section 116 exclusion or the section 243 deduction so as to limit the multiple taxation of corporate earnings. However, a considerable part of a distribution paid by a regulated investment company may represent nondividend income that has not previously been taxed and that, like dividend income, is passed through tax free to the shareholders of a qualifying regulated investment company. To restrict the use of sections 116 and 243 if the regulated investment company has a large proportion of nondividend income, Congress devised section 854(b)(1).

> [I]f more than 25 percent of the income of the regulated investment company is from interest or other nondividend income, both the dividends-received deduction for corporations and the dividend exclusion . . . for individuals . . . are to be available *only on the portion of the regulated investment company's distributions which actually represents dividend income.* If less than 25 percent of the company's income is from interest or other nondividend income, the dividend . . . allowances will apply to the entire distribution by the regulated investment company. Capital-gain dividends distributed by regulated investment companies will not be eligible for either corporate or individual dividend allowances.

S. Rep. No. 1622, at 103-04 (emphasis added); *accord*, H.R. Rep. No. 1337, 83rd Cong., 2d Sess. 74 (1954).

Applying the definition of gross income in section 854(b)(4)(A) of the Code literally to short-term capital gains from the sale or other disposition of stock or securities, such gains would be excluded from gross income for purposes of section 854(b). Hence, they would be disregarded in applying the 75 percent test and the apportionment formula that must be used if the 75 percent test is not met. This would defeat congressional intent because it would give regulated investment company shareholders a substantial tax advantage over direct investors with respect to such gains.

If the regulated investment company's income consisted solely of dividends and such short-term capital gains, the 75 percent test would be met (because gross income would equal aggregate dividends received), no apportionment would be required, and the entire distribution by the regulated investment company would qualify under section 116 of the Code and section 243. This would be the result no matter what portion of the distribution represented such gains, given a literal interpretation of section 854(b)(4)(A).

For example, if the regulated investment company had gross income under section 61 of the Code consisting solely of $100x of qualifying dividends and $100x of short-term capital gains from the sale or other disposition of stock or securities, and such gains were excluded from gross income for purposes of section 854(b)(1), the ratio of aggregate dividends received to gross income would be 100 percent ($100x dividend income / $100x gross income), which is greater than 75 percent, so all of this income (when distributed by the regulated investment company) would be eligible for the exclusion under section 116 and the deduction under section 243. On the other hand, if such gains were included in gross income, an apportionment would be required because the ratio would be 50 percent ($100x dividend income / $200x gross income). As a result of the apportionment, $100x ($200x gross income times 50 percent), the amount of qualifying dividend income received by the regulated investment company, would be the amount eligible under sections 116 and 243.

If the regulated investment company also had other forms of income, for example, interest, an apportionment might be required under a literal interpretation of section 854(b)(4)(A) of the Code. However, the amount of the distribution determined under the apportionment formula to be eligible for the exclusion under section 116 of the Code and the deduction under section 243 would at least partially reflect short-term capital gains from the sale or other disposition of stock or securities, in direct conflict with the underscored language quoted from the committee reports. This would not happen if the short-term capital gains were included in gross income.

Section 854(b)(4)(A) of the Code should be read in conformity with congressional intent. That provision should be interpreted to exclude only long-term capital gains from the sale or other disposition of stock or securities from gross income for purposes of section 854(b). Such gains are distributed as capital gain dividends and are not part of the distribution to which the 75 percent test and the apportionment formula relate. "All statutes must be construed in the light of their purpose. A literal reading of them which would lead to absurd results is to be avoided when they can be given a reasonable application consistent with their words and with the legislative purpose." *Haggar Co. v. Helvering*, 308 U.S. 389, 394 (1940), Ct. D. 1433, 1940-1 C.B. 237.

Situation II

Under section 1234(b) of the Code, the grantor of an option in property must treat gain or loss from any closing transaction with respect to the option, or gain on the lapse of the option, as short-term capital gain or loss.

The regulated investment company in the present case has gains from closing transactions in options, and lapses of options it has written. Under section 1234(b) of the Code, these unexercised option gains are short-term capital gains. As discussed in Situation I, only long-term capital gains from the sale or other disposition of stock or securities are excludable from gross income under section 854(b).

HOLDINGS

I. Short-term capital gains from the sale or other disposition of stock or securities are not excluded from gross income for purposes of section 854(b) of the Code. Therefore, the holding of Rev. Rul. 70-597 that dividends paid by a regulated investment company out of net short-term capital gains qualify for the $100 dividend received individual exclusion under section 116 and the 85 percent dividends received corporate deduction under section 243, subject to the limitations of section 854, is modified.

However, if a regulated investment company has short-term capital losses, in addition to short-term capital gains, represented in its net short-term capital gains, gross income for purposes of section 854(b) of the Code should be reduced by the amount of the short-term capital losses. For example, suppose the regulated investment company has $200x dividends, $200x of short-term capital gains, and $100x of short-term capital losses, and distributed all $300x of its net income. Gross income for purposes of section 854(b), after adjustment for the short-term capital loss, would be $300x ($400x—$100x), so the ratio of aggregate dividends received to gross income would be 66⅔ percent. Using the apportionment formula (because the 75 percent test is not met), $200x ($300x times 66⅔ percent) would be eligible for sections 116 and 243 treatment.

II. Unexercised option gains realized by a regulated investment company are not excluded from gross income for purposes of section 854(b) of the Code.

PROSPECTIVE APPLICATION

Pursuant to the authority contained in section 7805(b) of the Code, the conclusions in this revenue ruling will not be applied adversely to distributions by a regulated investment company out of net short-term capital gains realized from the sale or other disposition of stock or securities purchased by the regulated investment company before December 15, 1980.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 70-597, 1970-2 C.B. 146, involved a regulated investment company with two classes of stock, namely, income shares and capital shares. Holders of the income shares were to receive all distributions of net income from the investment portfolio, and all capital gains were to be allocated to the capital shares. Net short-term capital gains were to be paid to the capital shareholders to the extent necessary to satisfy the 90 percent distribution requirement of section 852(a)(1) of the Code. Rev. Rul. 70-597 concluded that distributions paid out of net short-term capital gains with respect to the capital shares would be eligible for sections 116 and 243 treatment, subject to the limitations of section 854.

Rev. Rul. 70-597 is modified to state that a distribution paid out of net short-term capital gains with respect to the capital shares would qualify for the exclusion under section 116 of the Code and the deduction under section 243 if, but only if, the aggregate dividends received by the regulated investment company for the taxable year during which it paid such distribution constitute at least 75 percent of its gross income (including short-term capital gains from the sale or other disposition of stock or securities), and the other requirements of section 854(b) are satisfied.

Section 901.—Taxes of Foreign Countries and of Possessions of United States

26 CFR 1.901-1: Allowance of credit for taxes.

Whether social security payments made to a foreign country under a totalization agreement are allowable as a credit. See Rev. Proc. 80-56, page 21.

Section 1401.—Rate of Tax

26 CFR 1.1401-1: Tax on self-employment income.

Procedure for exemption from social security taxes under totalization agreements. See Rev. Proc. 80-56, page 21.

Section 2036.—Transfers With Retained Life Estate

(Also Section 318; 1.318-1.)

Stock transferred in trust; indirect retention of voting rights. An individual owned 19 shares of a closely held corporation's stock, and the individual's children owned the other 81 shares. On June 30, 1976, the individual transferred the 19 shares to a trust. The trust instrument gave the trustee sole authority to vote the shares, but at the time of the transfer, the trustee agreed to consult the transferor with respect to voting and to vote only with the transferor's consent. The transferor indirectly retained the right to vote the transferred shares, and their value is includible in the transferor's gross estate.

Rev. Rul. 80-346

ISSUE

Are shares of stock of a closely held corporation includible in a decedent's gross estate under section 2036 of the Internal Revenue Code if the decedent transferred the shares and the voting rights, under the circumstances described below?

FACTS

The decedent, *D*, owned 19 shares of stock of *X* Corporation, a closely held corporation. *D*'s children owned the remaining 81 shares of *X* Corporation stock.

On June 30, 1976, *D* transferred the 19 shares to a trust for the benefit of *D*'s adult children. *A* was designated as trustee. The trust instrument provided that *A* would have sole authority to vote the shares. However, it was agreed, at the time of the transfer, that *A* would consult *D* with respect to voting the stock and would vote only with *D*'s consent. Thereafter, *A* exercised the voting rights only after obtaining *D*'s approval.

D died on July 12, 1979. The transferred shares were not included in *D*'s gross estate on the federal estate tax return filed.

LAW AND ANALYSIS

Section 2036(a) of the Code provides, in part, that the value of the gross estate shall include the value of all property to the extent of any interest therein of which the decedent has made a transfer under which the decedent retained, for any period which does not in fact end before death, the enjoyment of the property.

Section 2036(b) of the Code provides, in part, that the retention of the right to vote, directly or indirectly, shares of stock of a controlled corporation shall be considered to be a retention of the enjoyment of transferred property. A corporation shall be treated as a controlled corporation if, at any time after the transfer of the property and during the three year period ending on the date of death, the decedent owned, with the application of section 318, or had the right to vote stock possessing at least 20 percent of the total combined voting power of all classes of stock.

Section 20.2036-1(a) of the regulations provides that an interest or right will be treated as having been retained or reserved if at the time of the transfer, there was an express or implied understanding that the interest or right would later be conferred.

Section 318(a) of the Code provides, in part, that an individual shall be considered as the owner of the stock owned, directly or indirectly, by the individual's children. Unless otherwise provided, as in section 2036(b), the provisions in section 318(a) apply only to the sections enumerated in section 318(b).

Section 2036(b) of the Code was enacted because Congress believed that voting rights are so significant with respect to corporate stock that the retention of voting rights by a donor should be treated as the retention of the enjoyment of the stock for estate tax purposes. H.R. Rep. No. 94-1380, 94th Cong., 2d Sess. 65 (1976), 1976-3 C.B. (Vol. 3) 735, 799. However, only shares of a controlled corporation are affected by the statute. Section 2036(b) applies only in the case of a controlled corporation.

In the present situation, under section 318, *D* is deemed to have been the owner of at least 20 percent of the total combined voting power of all of *X* Corporation stock. Therefore, *X* Corporation is a controlled corporation within the meaning of section 2036(b).

The constructive ownership rules of section 318 apply solely for the purpose of determining whether a corporation is a controlled corporation, and are not applicable in determining if the decedent possessed ownership or voting control over transferred stock. S. Rep. No. 95-745, 95th Cong., 2d Sess. 90 (1978).

Under section 2036(b), however, the transferor's retention of voting rights need not be direct to cause inclusion of the stock in the transferor's gross estate. The retention may be indirect, such as an agreement or arrangement with a trustee to vote the stock in accordance with directions of the decedent. S. Rep. No. 95-745, *supra.*, at 90.

Under the facts presented, *D*, at the time of the transfer, indirectly retained the voting rights under an oral agreement with the trustee notwithstanding that the trust instrument made no such provision. *Cf. Estate of Beckwith v. Commissioner,* 55 T.C. 242 (1970), acq., 1971-2 C.B. 1.

HOLDING

Since *D* indirectly retained the right to vote the 19 shares of the controlled corporation, the value of the shares is includible in *D*'s gross estate under section 2036 of the Code.

Section 2040.—Joint Interests

26 CFR 23.1: Election and eligibility to treat interests in property held jointly on December 31, 1976, as qualified joint interests.

T.D. 7731

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER B, PART 23.—TEMPORARY ESTATE TAX REGULA-

TIONS UNDER THE ACT OF 1978

Procedure for correction of an incomplete election to treat an interest in certain joint tenancies as a qualified joint interest

AGENCY: Internal Revenue Service, Treasury.

ACTION: Temporary regulations.

SUMMARY: This document provides temporary regulations for taxpayers who elected to treat their interest in certain jointly held property as a "qualified joint interest" under section 2040(d) of the Internal Revenue Code of 1954 (Code) but failed to comply with the requirements of section 23.1 of the Temporary Estate Tax Regulations.

DATE: The regulations apply to elections for certain property held jointly on December 31, 1976.

FOR FURTHER INFORMATION CONTACT: Stephen J. Small of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T, 202-566-3287 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On March 20, 1980, section 23.1 of the Temporary Estate Tax Regulations was published in the Federal Register (45 FR 17983) concerning the procedure for the election to treat an interest in certain joint tenancies as a qualified joint interest for estate tax purposes. The election is available under sec. 2040(d) of the Code.

Those regulations provided, generally, that the spouse who furnished more than one-half the initial consideration for the property must make the election by including the amount of the gift in a timely filed gift tax return and must pay any tax due. The regulations provided a formula for computing the amount of the gift. Under sec. 6075(b) of the Code, the due date for the gift tax return was April 15, 1980, unless the taxpayer received an extension under sec. 6081.

Sec. 23.1(a)(3) of the regulations required that a statement of consent be attached to the gift tax return, signed by the donee spouse and indicating that the donee spouse consents to the election. It has come to the attention of the Treasury Department that in many cases prior to the issuance of the regulations, taxpayers attempted to make the election by timely filing a gift tax return but failed to include a statement of consent.

PROVISIONS OF THE REGULATIONS

This amendment to the regulations provides that in the case of a timely filed election that did not comply with sec. 23.1 of the Temporary Estate Tax Regulations under the Revenue Act of 1978 [Pub. L. 95-600, 1978-3 C.B. (Vol. 1) 1], treatment of the interest as a qualified joint interest from the date of the original filing will be permitted only if a corrected gift tax return is filed that is in compliance with sec. 23.1. The regulations require that the corrected gift tax return must be filed by April 15, 1981.

WAIVER OF CERTAIN PROCEDURAL REQUIREMENTS OF TREASURY DIRECTIVE

A determination has been made by Jerome Kurtz, Commissioner of Internal Revenue, that there is an immediate need for these regulations under section 2040(d) to provide guidance to taxpayers. Compliance with the procedural requirements of paragraphs 8 through 14 of the Treasury directive relating to improved regulations (43 FR 52120) would therefore be impractical and, accordingly, the requirements have been waived.

DRAFTING INFORMATION

The principal author of this regulation was Stephen J. Small of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both in matters of substance and style.

Adoption of amendments to the regulations

Accordingly, 26 CFR Part 23 is amended as follows:

Paragraph 1. Section 23.1 is amended as follows:

1. Paragraph (f) is redesignated as paragraph (g).

2. A new paragraph (f) is inserted to read as set forth below.

§ 23.1 Election and eligibility to treat interests in property held jointly on December 31, 1976, as qualified joint interests.

* * * * *

(f) *Incomplete election*—(1) *Corrected return required.* Where an otherwise valid election, on a timely filed gift tax return for any calendar quarter ending in 1977, 1978, or 1979, failed to satisfy the procedural requirements of this section, the election will be considered effective from the date of the original filing upon the filing of a corrected gift tax return, with the statement of consent attached, at the Internal Revenue Service Office where the original return was filed.

(2) *Due Date.* The corrected gift tax return must be filed by April 15, 1981. The executor or administrator of a spouse who dies (or the guardian or committee of a spouse who becomes legally incompetent) before the corrected gift tax return is filed may file the return or may sign the consent as the case may be.

This Treasury decision adds temporary regulations to enable taxpayers to comply with the new law on the election to treat an interest in property as a qualified joint interest. Because this regulation is necessary to provide immediate guidance to taxpayers, it is impractical to issue this Treasury decision with notice and public procedure under subsection (b) of section 553 of title 5 of the United States Code or subject to the effective date limitation of subsection (d) of this section.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue

Code of 1954 (68A Stat. 917, 26 U.S.C. 7805).

Jerome Kurtz,
Commissioner of Internal Revenue.

Approved October 17, 1980.

Donald C. Lubick,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on November 4, 1980, 8:45 a.m., and published in the issue of the Federal Register for November 5, 1980, 45 F.R. 73467)

Section 3101.—Rate of Tax [Federal Insurance Contributions Act]

26 CFR 31.3101-1: Measure of employee tax.

Procedure for exemption from social security taxes under totalization agreements. See Rev. Proc. 80-56, page 21.

Section 3111.—Rate of Tax [Federal Insurance Contributions Act]

26 CFR 31.3111-1: Measure of employer tax.

Procedure for exemption from social security taxes under totalization agreements. See Rev. Proc. 80-56, page 21.

Section 3401.—Definitions [Collection of Income Tax at Source on Wages]

26 CFR 31.3401(a)(12)-1: Payments from or to certain tax-exempt trusts, or under or to certain annuity plans or bond purchase plans, or to individual retirement plans. (Also Section 6693; 301.6693-1.)

T.D. 7730 [1]

TITLE 26.—INTERNAL REVENUE.—CHAPTER I, SUBCHAPTER C, PART 31.—EMPLOYMENT TAXES; APPLICABLE ON AND AFTER JANUARY 1, 1955; SUBCHAPTER F, PART 301.—PROCEDURE AND ADMINISTRATION

Information return penalties and withholding tax rules concerning individual retirement plans

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final regulations prescribing withholding tax rules for individual retirement plans and penalties for failure to furnish information in connection with such plans. Changes to the applicable tax law were made by the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1] and the Tax Reform Act of 1976 [Pub. L. 94-455, 1976-3 C.B. (Vol. 1) 1]. These regulations would provide the public with additional guidance needed to comply with those Acts and would affect the parties responsible for furnishing or filing certain documents concerning individual retirement plans and employers contributing to such plans.

DATE: The regulations have varying effective dates as indicated. The provisions imposing a penalty tax for the failure to furnish or file documents concerning individual retirement plans are effective January 1, 1975.

FOR FURTHER INFORMATION CONTACT: Kirk F. Maldonado of the Employee Plans and Exempt Organizations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224 (Attention: CC:LR:T), 202-566-3430 (not a toll-free number).

SUPPLEMENTARY INFORMATION:

BACKGROUND

On August 20, 1979, the Federal Register published proposed amendments to the Procedure and Administration Tax Regulations (26 CFR Part 301) under section 6693 of the Internal Revenue Code of 1954 and to the Employment Tax Regulations (26 CFR Part 31) under section 3401 of the Code (44 FR 48719). The amendments were proposed to conform the Regulations to section 2002(f) and (g)(7) of the Employee Retirement Income Security Act of 1974 (88 Stat. 967, 970) [*supra* at 136 and 139] and section 1501(b)(7) of the Tax Reform Act of 1976 (90 Stat. 1736) [*supra* at 212]. A public hearing was neither requested nor held on these regulations. After consideration of all the comments regarding the proposed amendments, those amendments are adopted, as revised by this Treasury decision.

EXCLUSION FROM "WAGES" OF PAYMENTS TO INDIVIDUAL RETIREMENT PLANS

Section 3401 defines the term "wages" for purposes of chapter 24 of the Code (relating to withholding taxes). Section 3401(a)(12)(D) excludes from the definition of "wages" payments to individual retirement plans described in section 219(a) or section 220(a) if, at the time of such payment, it is reasonable for the employer to believe the employee will be entitled to a deduction under section 219 or 220 for the payment. In general, the effect of the exclusion from wages is that the employer does not have to withhold any income taxes for the employee for these payments.

The final regulations make it clear that this exclusion is also available for payments to a simplified employee pension arrangement described in section 408(k).

PENALTIES FOR FAILURE TO FURNISH INFORMATION CONCERNING INDIVIDUAL RETIREMENT PLANS

Section 6693 of the Code imposes a $10 penalty for each failure to furnish or file a report or statement required by the regulations under section 408(i) regarding each individual retirement account or individual retirement annuity. This penalty is assessed against the person required by section 408(i) to furnish or file the report or statement. A penalty shall not be assessed, however, if it is established that there was reasonable cause for the failure.

DRAFTING INFORMATION

The principal author of these regulations is Kirk F. Maldonado of the Employee Plans and Exempt Organizations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and the Treasury Department participated in developing these regulations, both on matters of substance and style.

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[1] This publication of the Treasury decision contains the full text of the regulations. The individual instructions for modifying the notice of proposed rulemaking have been omitted.

Adoption of amendments to the regulations

Accordingly, the following amendments to 26 CFR Parts 31 and 301 are hereby adopted.

EMPLOYMENT TAX REGULATIONS
[26 CFR Part 31]

Paragraph 1. The title of section 31.3401(a)(12)-1 is amended and a new paragraph (d) is added to read as follows:

§ 31.3401(a)(12)-1 Payment from or to certain tax-exempt trusts, or under or to certain annuity plans or bond purchase plans, or to individual retirement plans.

* * * * *

(d) *Payment to individual retirement plans.* (1) The term "wages" does not include any payment to an individual retirement plan described in section 7701(a)(37) by an employer after December 31, 1974, on behalf of an employee, if, at the time of such payment, it is reasonable for the employer to believe that the employee will be entitled to a deduction for such payment under section 219(a).

(2) The term "wages" does not include any payment to an individual retirement plan described in section 7701 (a)(37) by an employer after December 31, 1976, on behalf of an employee, if, at the time of such payment, it is reasonable for the employer to believe that the employee on whose behalf the payment is made will be entitled to a deduction for such payment under section 220(a).

(3) The term "wages" does not include any payment to a simplified employee pension arrangement described in section 408(k) by an employer after December 31, 1978, on behalf of an employee, if, at the time of such payment, it is reasonable for the employer to believe that the employee on whose behalf the payment is made will be entitled to a deduction for such payment under section 219(a).

PROCEDURE AND ADMINISTRATION TAX REGULATIONS
26 CFR Part 301

Par. 2. Section 301.6693-1 is added at the appropriate place to read as follows:

§ 301.6693-1 Penalty for failure to provide reports and documents concerning individual retirement accounts or annuities.

(a) *In general*—(1) *Annual reports, etc.* The trustee of an individual retirement account described in section 408(a), or the issuer of an individual retirement annuity described in section 408(b), who fails to furnish or file a report or any other document required under section 408(i) and § 1.408-5 within the time and in the manner prescribed for furnishing or filing such item shall pay a penalty of $10 for each failure unless it is shown that such failure is due to reasonable cause.

(2) *Disclosure statements.* The trustee of an individual retirement account described in section 408(a), or the issuer of an individual retirement annuity described in section 408(b), who fails to furnish or file a disclosure statement, a governing instrument, an amendment to either, or any other document required under section 408 (i) and § 1.408-6, within the time and in the manner prescribed for furnishing or filing such item, shall pay a penalty of $10 for each failure unless it is shown that such failure is due to reasonable cause.

(b) *Showing of reasonable cause.* The penalty imposed by section 6693 shall not apply to any person with respect to a failure to furnish or file a report, statement, or other document within the time and in the manner prescribed if it is established to the satisfaction of the district director that such failure was due to reasonable cause. An affirmative showing of reasonable cause must be made in the form of a written statement, containing a declaration by such person that it is made under the penalties of perjury and setting forth all the facts alleged to constitute reasonable cause.

(c) *Deficiency procedures not to apply.* The penalty imposed by section 6693 may be assessed and collected without regard to the deficiency procedures provided by subchapter B of chapter 63 of the Code.

(d) *Other penalties.* The penalties of section 6693 and this section are in lieu of any penalty imposed by section 6652(f) for violation of section 6047 (d), with respect to any failure to furnish or file described in this section.

(e) *Effective date.* This section shall take effect on January 1, 1975.

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of Internal Revenue.

Approved October 7, 1980.

EMIL M. SUNLEY,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on October 31, 1980, 8:45 a.m., and published in the issue of the Federal Register for November 3, 1980, 45 F.R. 72651)

Section 4221.—Certain Tax-Free Sales [Manufacturers Excise Taxes]

26 CFR 48.4221-3: Tax-free sale of articles for export, or for resale by the purchaser to a second purchaser for export.

T.D. 7729

TITLE 26.—INTERNAL REVENUE.—CHAPTER 1, SUBCHAPTER D, PART 48.—MANUFACTURERS AND RETAILERS EXCISE TAXES

Excise tax treatment of articles sold tax free for exportation upon their subsequent importation into the United States

AGENCY: Internal Revenue Service, Treasury.

ACTION: Final regulations.

SUMMARY: This document provides final Manufacturers and Retailers Excise Tax Regulations relating to the excise tax treatment of articles previously sold tax free for exportation under section 4221(a)(2) of the Internal Revenue Code of 1954 upon their subsequent return to the United States. These regulations provide necessary guidance to importers of previously exported articles that are returned to the United States in an unused condition.

DATE: The regulations are effective December 1, 1980.

FOR FURTHER INFORMATION CONTACT: Kyllikki Kusma of the Legislation and Regulations Division, Office of the Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, Attention: CC:LR:T:LR-13-80, 202-566-3287, not a toll-free-call.

SUPPLEMENTARY INFORMATION:

BACKGROUND

On June 9, 1980, the Federal Register published proposed amendments to the Manufacturers and Retailers Excise Tax Regulations (26 CFR Part 48) under section 4221(a)(2) of the Code. No written comments were received, and a public hearing was neither requested nor held. After further consideration, those amendments are adopted as revised by this Treasury decision.

EXPLANATION OF THE REGULATIONS

Section 48.4221-3 of the regulations is currently silent with respect to the excise tax treatment of articles that previously were sold tax free for exportation but which subsequently are imported to the United States in an unused and undamaged condition. These regulations provide that the importer of these articles is subject to the excise tax imposed by Chapter 32 of the Code on the subsequent sale or use of the imported article in the United States.

A change has been made in these regulations as proposed. The reference to a bus in example (2) at § 48.4221-3(a)(2) is inappropriate as bus chassis and bodies are now exempt from manufacturers excise taxes by reason of section 4063(a)(6) of the Code. Consequently, this example is amended by changing the subject of the example from a bus to a truck.

DRAFTING INFORMATION

The principal author of this regulation is Kyllikki Kusma of the Legislation and Regulations Division of the Office of Chief Counsel, Internal Revenue Service. However, personnel from other offices of the Internal Revenue Service and Treasury Department participated in developing the regulation, both on matters of substance and style.

Adoption of amendments to the regulations

Accordingly, the following amendments to the regulations (26 CFR Part 48) are hereby adopted:

Paragraph 1. Section 48.4221-3(a) is redesignated as § 48.4221-3(a)(1) and a new § 48.4221-3(a)(2) is added to read as follows:

§ 48.4221-3 Tax-free sales of articles for export, or for resale by the purchaser to a second purchaser for export.

(a) *In general*—(1) * * *

(2) If an article, otherwise taxable under chapter 32 of the Code—

(i) Is sold tax free by the manufacturer pursuant to section 4221(a)(2) and this section, and

(ii) Is returned subsequently to the United States in an unused and undamaged condition,

then the importer is liable for the tax imposed by chapter 32 on the subsequent sale or use of the article in the United States. The provisions of this paragraph (a)(2) may be illustrated by the following examples:

Example (1). Q, a U.S. motor vehicle manufacturer, previously sold a truck chassis to R, a company in Canada. The sale was tax free under section 4221(a)(2). R mounted a truck body on the truck chassis and sold the completed vehicle to S. Thereafter S sold the completed new vehicle to T who imported the vehicle into the United States and sold it. The sale of the completed truck subjects T to an excise tax liability under section 4061(a)(1) with respect to both the body and the chassis.

Example (2). X, a U.S. manufacturer of trucks, sold a trash collection truck to Y, a company in France. The sale was tax free under section 4221(a)(2). The truck was sold by Y to the City of Nice, France. After initial use, the city determined that the truck was not suited for its needs and resold the truck to X. X returned the truck to the United States where it was resold. The resale of the truck by X does not subject X to an excise tax liability under section 4061(a)(1).

* * * * *

This Treasury decision is issued under the authority contained in section 7805 of the Internal Revenue Code of 1954 (68A Stat. 917; 26 U.S.C. 7805).

JEROME KURTZ,
Commissioner of Internal Revenue.

Approved October 23, 1980.

DONALD C. LUBICK,
Assistant Secretary of the Treasury.

(Filed by the Office of the Federal Register on October 31, 1980, 8:45 a.m., and published in the issue of the Federal Register for November 3, 1980, 45 F.R. 72653)

Section 6018.—Estate Tax Returns

26 CFR 20.6018-1: Returns.
(Also Section 6075; 20.6075-1.)

Returns of missing persons. An estate tax return must be filed within 9 months following the period of time state law sets for declaring a missing person dead; Rev. Rul. 66-286 clarified and modified.

Rev. Rul. 80-347

ISSUE

Whether a federal estate tax return must be filed with respect to a missing person's estate within the prescribed period following 7 years from the disappearance or 14 years therefrom when under the law of the state in which the person resided there can be no court adjudication of death until the elapse of 14 years from the disappearance.

FACTS

The taxpayer has been missing for 7 years and has not been seen or heard from since. Under the state law, in the absence of evidence of death, a missing person is presumed to be alive until 14 years have elapsed. Since there is no such evidence with respect to the taxpayer, a state court will not issue a death decree before the end of the 14-year period. Receivers for the taxpayer's property have been appointed by the probate court.

LAW AND ANALYSIS

Section 6018 of the Internal Revenue Code provides that the executor shall make a return with respect to the federal estate tax. Under section 6075 (a), as amended by the Excise, Estate, and Gift Tax Adjustment Act of 1970, section 101(b), 1971-1 C.B. 533, estate tax returns must be filed within 9 months after the date of the decedent's death.

Rev. Rul. 66-286, 1966-2 C.B. 485, sets forth requirements for filing an estate tax return for the estate of a missing person depending upon when the title to the person's property is transferred as if the person was deceased. This may occur by a state court proceeding, the application of a state statute, or the person's property being treated by others as if it were theirs. As Rev. Rul. 66-286 indicates, where the gross estate exceeds the exemption, a return must generally be filed within 15 months following 7 years of continuous and unexplained absence raising the common law presumption of death. The 7-year presumption of death rule referred to in Rev. Rul. 66-286 is a rule that has been adopted by many states, either by statute or court decision. However, where a state statute provides for a different time period, that period will determine when the return is due.

In this case, under state law the taxpayer is presumed to be alive and the taxpayer's property has merely been put into receivership. There is no transfer of title or assets as in Rev. Rul. 66-286. However, if there is a transfer pursuant to a state court decision, the date of death would be indicated thereby. Thus, giving proper regard to the state statutes and court proceedings would allow a period longer than the general rule, and the 7-year requirement of Rev. Rul. 66-286 is not applicable.

HOLDING

The estate tax return is required to be filed within 9 months following the 14-year period specified in the state statute, unless death is established earlier.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 66-286 is clarified, and is modified to indicate the 9-month period for filing a return under section 6075(a) of the Code, as amended.

Section 6075.—Time for Filing Estate and Gift Tax Returns

26 CFR 20.6075-1: Returns; time for filing estate tax return.

Filing of an estate tax return for the estate of a missing person when there can be no court adjudication of death until the elapse of 14 years from the disappearance. See Rev. Rul. 80-347, page 18.

Section 6693.—Failure to Provide Reports on Individual Retirement Accounts or Annuities

26 CFR 301.6693-1: Penalty for failure to provide reports and documents concerning individual retirement accounts or annuities.

Penalties for failure to furnish information in connection with individual retirement plans. See T.D. 7730, page 16.

Section 7805.—Rules and Regulations

26 CFR 301.7805-1: Rules and regulations.

Nonretroactive application of rulings relating to whether the holding of Rev. Rul. 70-597, 1970-2 C.B. 146 that dividends paid by a regulated investment company out of net short-term capital gains qualify for the $100 dividends received individual exclusion under section 116 and the 85 percent dividends received corporate deduction under section 243, subject to the limitations under section 854, is correct. See Rev. Rul. 80-345, page 11.

Part III. Administrative, Procedural, and Miscellaneous

Notice 80-10

Inflation Adjustment for Computation of Windfall Profit Tax

Section 4989(b) of the Internal Revenue Code requires the determination of an inflation adjustment factor for use in computing the windfall profit tax.

The Service has determined that, for oil removed during the January-March quarter of 1981, the inflation adjustments are as follows:

Tier 1 or Tier 2 oil	0.1187
Tier 3 oil	0.1469

Worksheets for computation of the windfall profit tax are included in the Instructions for Form 6047, Windfall Profit Tax, and an explanation of the inflation adjustment may be found in the Specific Instructions for Line 4 of the worksheets.

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26 CFR 601.201: Rulings and determination letters.
(Also Part I, Section 265; 1.265-2.)

Rev. Proc. 80-55

SECTION 1. PURPOSE

The purpose of this revenue procedure is to amplify Rev. Proc. 70-20, 1970-2 C.B. 499 and Rev. Proc. 72-18, 1972-1 C.B. 740, to provide that section 265(2) of the Internal Revenue Code will be applied to disallow deductions for interest paid by commercial banks on certain time deposits made by a state when such deposits are made for a specific period of time and are secured by pledges of tax-exempt obligations.

SEC. 2. BACKGROUND

.01 Rev. Proc. 70-20 sets forth guidelines for taxpayers and field offices of the Internal Revenue Service for the application of section 265(2) of the Code to banks holding tax-exempt state and local obligations. Section 265(2) provides that no deduction shall be allowed for interest on indebtedness "incurred or continued to purchase or carry obligations . . . the interest on which is wholly exempt" from federal income tax.

.02 Section 3.11 of Rev. Proc. 70-20 provides that types of borrowing not specifically dealt with in Rev. Proc. 70-20 are to be decided on the basis of all the facts and circumstances surrounding the borrowings and in light of the general principles set forth in Rev. Proc. 70-20.

.03 A bank deposit secured by tax-exempt obligations is one of the types of borrowings not specifically dealt with in Rev. Proc. 70-20.

.04 Rev. Proc. 72-18 provides guidelines for the application of section 265(2) of the Code to banks in situations not dealt with in Rev. Proc. 70-20. Section 3.01 of Rev. Proc. 72-18 sets forth the general rule that section 265(2) is only applicable where the indebtedness is incurred or continued for the purpose of purchasing or carrying tax-exempt securities. Accordingly, the application of section 265(2) requires a determination, based on all the facts and circumstances, of the taxpayer's purpose in incurring each item of indebtedness. The taxpayer's purpose may be established either by direct evidence or by circumstantial evidence.

.05 Section 3.03 of Rev. Proc. 72-18 provides that direct evidence of a purpose to carry tax-exempt obligations exists where tax-exempt obligations are used as collateral for indebtedness. "[O]ne who borrows to buy tax-exempts and one who borrows against tax-exempts already owned are in virtually the same economic position. Section 265(2) makes no distinction between them." ***Wisconsin Cheeseman v. United States,*** 338 F. 2d 420 at 422 (7th Cir. 1968).

.06 In Rev. Proc. 78-34, 1978-2 C.B. 535, the Service amplified Rev. Proc. 70-20 to provide that section 265(2) of the Code will not be applied to disallow deductions for interest paid by commercial banks on borrowings of Treasury tax and loan funds when those borrowings are secured by pledges of tax-exempt obligations. This treatment afforded to borrowings of Treasury tax and loan funds is permitted because the borrowing of such funds, notwithstanding the pledge of tax-exempt obligations, is in the nature of a demand deposit. Also, the availability of these funds is subject to the exclusive discretion of the Treasury. In addition, access to these funds by depository banks is not subject to negotiated rates of interest or any other market factors that normally influence arm's length money market transactions.

SEC. 3. APPLICATION

.01 State law will often permit state funds to be placed on deposit with local banks. The state law generally requires that a contract be entered into designating the rate of interest to be paid on such deposit and the duration of the deposit. The contract may provide, with respect to the duration of the deposit, that funds will remain on deposit for a specified period of time (30 days to 1 year), or it may provide that the availability of the state funds is subject to the exclusive discretion of the state. In addition, the bank may also be required to deposit with the proper state authority certain securities at least equal in market value to the money deposited by the state in that bank. The state law generally lists those securities that are acceptable for this purpose. A bank receiving such deposits often pledges tax-exempt securities as collateral.

.02 A depository bank that holds demand deposits that it has collateralized with tax-exempt obligations is not in virtually the same economic position as one who borrows to buy tax-exempt obligations. That depository bank does not have the unrestricted use of the amount of the borrowed funds because such amount is subject to immediate withdrawal at any moment in time. See Rev. Proc. 78-34.

.03 A depository bank that holds state funds as time-deposits that it has collateralized with tax-exempt obligations is in virtually the same economic position as one who has borrowed to buy tax-exempt obligations. The depository bank knows with certainty that it will have the amount of deposited funds available to it, without restriction, for a fixed period of time. Accordingly, direct evidence of a purpose to purchase or carry tax-exempt obligations exists under section 3.03 of Rev. Proc. 72-18.

.04 Commercial banks that participate in a state program that requires them to bid for state funds, negotiate the rate of interest, and requires the state to leave such deposits for a specified period of time will create an indebtedness of the type described in section 265(2) of the Code. Thus, the interest paid by commercial banks on such deposit will be disallowed under section 265(2).

.05 Commercial banks that participate in a state program in which funds are awarded in the manner described in Rev. Proc. 78-34 and where the placement of such funds is at the discretion of the state do not create indebtedness of the type described in section 265(2) of the Code. Thus, section 265(2) will not be applied to disallow a deduction for interest paid by the commercial banks on such funds.

SEC. 4. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 70-20 and Rev. Proc. 72-18 are amplified.

SEC. 5. INQUIRIES

Inquiries in regard to this revenue procedure should refer to its number and be addressed to Assistant Commissioner (Technical), Attention TC:C:C, Washington, DC 20224.

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26 CFR 601.602: Forms and instructions. (Also Part I, Sections 164, 901, 1401, 3101, 3111; 1.164-1, 1.901-1, 1.1401-1, 31.3101-1, 31.3111-1; Part III, Section 601.401.)

Rev. Proc. 80-56

SECTION 1. PURPOSE

The purpose of this revenue procedure is to state the procedures for implementing amendments to the Internal Revenue Code that provide for an exemption from social security taxes in cases covered by certain international agreements (sometimes referred to as totalization agreements), and to state the effect that such agreements have on the income tax liability of certain employees and self-employed persons.

SEC. 2. BACKGROUND

.01 Section 1401(c) of the Code, relating to the Self-Employment Contributions Act (SECA), section 3101 (c) of the Code, relating to the employee's share of the taxes imposed by the Federal Insurance Contributions Act (FICA), and section 3111 (c) of the Code, relating to the employer's share of the taxes imposed by the FICA, were added to the Code by section 317(b) of the Social Security Amendments of 1977, 1978-1 C.B. 462, 467.

.02 These provisions grant an exemption from the social security taxes imposed by the SECA and the FICA during any period in which there is in effect an agreement entered into under section 233 of the Social Security Act, 42 U.S.C. section 433 (added by section 317(a) of the Social Security Amendments of 1977) with any foreign country to the extent the wages or self-employment income are subject under such agreement to taxes or contributions under the social security system of such foreign country.

.03 For example, assume that the United States has entered into an international social security agreement with foreign country *X* under section 233 of the Social Security Act. Employee *A*, a citizen of *X*, is employed in the United States by a corporation incorporated in *X* under circumstances that require social security payments to country *X* and that would ordinarily also require payment of the taxes imposed by the FICA. However, because of the agreement between the foreign country and the United States, wages paid to *A* may be exempt from the taxes imposed by sections 3101 and 3111 of the Code.

.04 Section 317(b)(4) of the Social Security Amendments of 1977 provides that, notwithstanding any other provision of law, taxes paid by any individual to any foreign country with respect to any period of employment or self-employment that is covered under the social security system of such foreign country in accordance with the terms of an agreement entered into pursuant to section 233 of the Social Security Act shall not, under the income tax laws of the United States, be deductible by, or creditable against the income tax of, any such individual.

.05 This provision precludes both a deduction from adjusted gross income and a credit against income tax liability under sections 164(a) and 901(b) of the Code, respectively, for taxes paid by any employee or self-employed person with respect to a period of employment or self-employment that is covered under the social security system of such foreign country under the terms of a totalization agreement between the United States and such foreign country.

.06 For example, the social security tax payments made to foreign country *X* in .03 above are neither allowable as a deduction under section 164 (a) nor allowable as a credit under section 901(b) of the Code.

SEC. 3. EXEMPTION FROM SECA TAXES

.01 In order to substantiate an exemption under section 1401(c) of the Code from the taxes imposed by the SECA, the self-employed individual should obtain from a duly authorized official or agency of the foreign country involved a statement—

(1) setting forth the individual's name, address, and taxpayer identifying number,

(2) stating that there is in effect an agreement between the foreign country and the United States under which the self-employment income of the individual is subject to taxes or contributions under the social security system of the foreign country, and

(3) showing the date on which the agreement commenced to apply and, if determined, the ending date.

.02 No particular form is prescribed for this statement. A copy of the statement or other suitable substantiation must be attached to the individual's federal income tax return for each year the agreement is in effect. The taxpayer should enter "Exempt, see attached statement," on the line designated for self-employment tax liability on the taxpayer's income tax return.

.03 The exemption applies to that portion of the taxpayer's net earnings from self-employment that is attributable to that portion of the taxable year that occurs on and after the effective date of the agreement. Thus, for a taxpayer using the cash receipts and disbursements method of accounting the SECA tax liability for the taxable year is determined by computing the taxpayer's net earnings from self-employment for such year without regard to the exemption and then eliminating any of such amount that results from an excess of income received over deductions paid by the taxpayer on and after the date the agreement becomes effective.

SEC. 4. EXEMPTION FROM FICA TAXES

.01 In order to substantiate an exemption from the taxes imposed by the FICA under sections 3101(c) and 3111(c) of the Code, the employer must obtain a statement issued by a duly authrized official or agency of the foreign country involved—

(1) setting forth the employee's name, as well as the employee's address and taxpayer identifying number, if known,

(2) setting forth the employer's name, address, and taxpayer identifying number, if any,

(3) stating that there is in effect an agreement between the foreign country and the United States under which wages received by or paid to the employee by the employer are subject to taxes or contributions under the social security system of such foreign country, and

(4) showing the date on which the agreement commenced to apply and, if determined, the ending date.

.02 No particular form is prescribed for this statement. It should be retained in the employer's files.

.03 The exemption from the FICA taxes applies to wages paid on and after the effective date of the agreement but not to wages paid before that date. For example, if the agreement is approved and becomes effective on November 1, the wages paid on and after that date may be exempt from FICA taxes during the time the agreement is in effect.

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26 CFR 601.401: Employment taxes.

Procedures for exemption from social security taxes under totalization agreements. See Rev. Proc. 80-56, page 21.

Part IV. Items of General Interest

U.S.-Switzerland Income Tax Treaty Discussions

Announcement 80-156

The Treasury Department has announced that representatives of the United States and Switzerland recently concluded a first round of discussions on a new income tax treaty between the two countries. The new treaty would replace the treaty currently in force, which was signed in 1951. Discussions are expected to continue in March 1981.

The new treaty is expected to follow the pattern of the 1977 U.S. and OECD Model treaties. The discussions will cover the full range of issues normally considered in tax treaty negotiations, including the tax treatment of income from business, investment, and personal services, and procedures for administering the treaty. The United States has asked specifically to discuss several areas in which the existing treaty appears imperfect. These include "correlative adjustments" in one country in response to an adjustment made by the other country to reflect arm's-length pricing principles; inappropriate use of the treaty by third country residents; and the narrowness of the existing exchange of information provision. The application of the treaty to the Swiss forfait tax is also under consideration.

The Treasury invites persons wishing to submit comments on any aspect of the proposed treaty, on issues which have arisen under the present treaty or on U.S.-Swiss tax relations generally to write, by December 31, 1980, to H. David Rosenbloom, International Tax Counsel, Department of the Treasury, Room 3064, Washington, D.C. 20220.

Foundation Status of Certain Organizations

Announcement 80-157

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Alaska Way, Inc., The, Eagle River, AK
Begich Scholarship Intern Fund, Nick, Anchorage, AK
Birthplace, The, Seattle, WA
Black Hawk College Sarah W. Lardner Scholarship Trust, Rock Island, IL
Bucks County Alliance for the Achievement of Children's Potential, Holicong, PA
Centralia Police Officers Fund, Centralia, WA
Children of the World, Inc., Fairbanks, AK
Dare to Do, Inc., Winnetka, IL
Delaney, The, Spokane, WA
Dotanz International Dance Company, Eugene, OR
Firefighters Association F.P.D., No. 44, Auburn, WA
Free to Become, Portland, OR
Hi-Line Indian Alliance, Havre, MT
Institute for Island Research and Assistance, Seattle, WA
Job Dynamics, Seattle, WA
Key to Life, The, Rockford, IL
Kotzebue Council of the Arts, Inc., Kotzebue, AK
La Amistad Juvenil, Independence, OR
Lake County Council on Aging, Inc., Ronan, MT
McKinney Foundation for the Arts, The, Topeka, KS
Nautical Society of Oregon, Milwaukie, OR
New Directions Inc., Boise, ID
Okanogan Regional Home Health Care Agency, Okanogan, WA
Order of the Round Table in America, The, Wheaton, IL
Parlasca American Indian Memorial Foundation, Elgin, IL
Present Company, Inc., Chicago, IL
S.Y.M.A. Chicago, Chicago, IL
Seven Gifts, Inc., The, Decatur, GA
Valley Falls Medical Services, Inc., Valley Falls, KS
White Crusade, John Wesley, Helena, MT

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

Notice 80-11 [1]

Certification of Unemployment Compensation Laws

Certification of State Unemployment Compensation Laws to the Secretary of the Treasury Pursuant to Section 3303(b)(1) of the Internal Revenue Code of 1954

In accordance with the provisions of paragraph (1) of Section 3303(b) of the Internal Revenue Code of 1954 (26 U.S.C. 3303(b)(1)), I hereby certify the unemployment compensation laws of the following named States, which heretofore have been certified pursuant to paragraph (3) of Section 3303(b) of the Code, to the Secretary of the Treasury for the 12-month period ending October 31, 1980.

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[1] Filed by the Office of the Federal Register on November 6, 1980, 8:45 a.m., and published in the issue of the Federal Register for November 7, 1980, 45 F.R. 74115.

Alabama
Alaska
Arizona
Arkansas
California
Colorado
Connecticut
Delaware
District of Columbia
Florida
Georgia
Hawaii
Idaho
Illinois
Indiana
Iowa
Kansas
Kentucky
Louisiana
Maine
Maryland
Massachusetts
Michigan
Minnesota
Mississippi
Missouri
Montana
Nebraska
Nevada
New Hampshire
New Jersey
New Mexico
New York
North Carolina
North Dakota
Ohio
Oklahoma
Oregon
Pennsylvania
Rhode Island
South Carolina
South Dakota
Tennessee
Texas
Utah
Vermont
Virginia
Washington
West Virginia
Wisconsin
Wyoming

Certification of States to the Secretary of the Treasury Pursuant to Section 3304 of the Internal Revenue Code of 1954

In accordance with the provisions of Section 3304(c) of the Internal Revenue Code of 1954 (26 U.S.C. 3304(c)), I hereby certify the following named States to the Secretary of the Treasury for the 12-month period ending October 31, 1980, in regard to the unemployment compensation laws of those States which heretofore have been approved under the Federal Unemployment Tax Act:

Alabama
Alaska
Arizona
Arkansas
California
Colorado
Connecticut
Delaware
District of Columbia
Florida
Georgia
Hawaii
Idaho
Illinois
Indiana
Iowa
Kansas
Kentucky
Louisiana
Maine
Maryland
Massachusetts
Michigan
Minnesota
Mississippi
Missouri
Montana
Nebraksa
Nevada
New Hampshire
New Jersey
New Mexico
New York
North Carolina
North Dakota
Ohio
Oklahoma
Oregon
Puerto Rico
Pennsylvania
Rhode Island
South Carolina
South Dakota
Tennessee
Texas
Utah
Vermont
Virginia
Washington
West Virginia
Wisconsin
Wyoming
Virgin Islands

Signed at Washington, D.C., on October 31, 1980.

RAY MARSHALL,
Secretary of Labor.

Statistics of Income—1972-1974—DISCs

Announcement 80-159 [1]

Publication 1071, *Supplemental Report, Statistics of Income—1972-1974, International Income and Taxes—Domestic International Sales Corporation Returns,* may be purchased for $6 from the Superintendent of Documents, U.S. Government Printing Office, Washington, D.C. 20402.

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[1] Based on News Release IR-80-106, dated October 14, 1980.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individual has been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
H. Jim Uchida	Oakland, CA	Certified Public Accountant	Indefinite effective November 5, 1980

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 25.2514-3(e) amended.	Transfer of a life income interest by the possessor of that interest.	Oct 22, 1980	Dec. 22, 1980
26 CFR 48.4041 through 48.4041-10 deleted; 48.4041-11 through 48.4041-14 redesignated as 48.4041-14 through 48.4041-17; 48.4041-1 through 48.4041-13 added.	Manufacturers and retailers excise taxes on special fuels.	Oct. 22, 1980	Dec. 22, 1980
26 CFR 1.671-4, 1.6012-3, 301.6109-1 amended.	Modification of reporting requirements for certain grantor trusts.	Oct. 24, 1980	Dec. 23, 1980
26 CFR 301.7701-2 amended.	Tax classification of limited partnerships.	Oct. 27, 1980	Dec. 26, 1980
26 CFR 1.46-4(d), 1.48-1, 1.48-2, amended; 1.48-11 added.	Investment credit for qualified rehabilitated buildings.	Oct. 28, 1980	Dec. 29, 1980
26 CFR 150.4995-3, 150.4997-1, 150.6402-1 amended; published as temporary regulations in T.D. 7732, 1980-48 I.R.B. 19.	Tax deposits and refunds based on net income limitation.	Nov. 5, 1980	Jan. 5, 1981
26 CFR 150.4989-1(c)(1), 150.4989-1(c)(2), 150.4989-1(c)(3), 150.4989-1(c)(7), revised.	Base prices of tier 2 and tier 3 oil.	Nov. 14, 1980	Jan. 13, 1981

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[1] See footnote at end of list.

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[1] A cumulative List of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

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*** Denotes entry since last publication.**

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27, dated July 7, 1980.

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______	1929–1	12.00
______	*1929–2*	*3.15*
______	1930–1	7.30
______	1930–2	9.50
______	*1931–1*	*3.60*
______	1931–2	13.00
______	*1932–1*	*2.80*
______	1932–2	8.65
______	*1933–1*	*3.35*
______	*1933–2*	*3.45*
______	*1934–1*	*3.70*
______	1934–2	14.00
______	1935–1	6.90
______	*1935–2*	*14.00*
______	*1936–1*	*3.55*
______	*1936–2*	*14.00*
______	*1937–1*	*13.00*
______	1937–2	7.70
______	*1938–1*	*16.00*
______	*1938–2*	*13.00*
______	1939–1–1	8.25
______	1939–1–2	10.90
______	1939–2	9.40
______	1940–1	5.55
______	1940–2	14.00
______	1941–1	*6.95*
______	*1941–2*	*$3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943*(*)	*9.55*
______	*1944*(*)	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*12.00*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
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______	1961–1	14.00
______	1961–2	10.00
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______	1963–2	10.75
______	1964–1–1	10.00
______	1964–1–2	11.00
______	1964–2	9.80
______	1965–1	10.70
______	1965–2	12.25
______	1966–1	14.00
______	1966–2	14.05
______	1967–1	10.00
______	1967–2	14.00
______	1968–1	14.00
______	1968–2	11.75
______	1969–1	14.00
______	1969–2	6.50
______	1969–3	12.50
______	1970–1	$11.00
______	1970–2	14.00
______	1971–1	10.55
______	1971–2	8.50
______	1972–1	13.50
______	1972–2	13.70
______	1973–1	16.00
______	1973–2	8.30
______	1974–1	11.00
______	1974–2	9.95
______	*1974–3*	*8.20*
______	1974–3 Supp.	10.00
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______	1977–1	10.75
______	1977–2	11.75
______	1978–1	11.75
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The Introduction on page 3 describes the purpose and content of this publication. The weekly Internal Revenue Bulletin is sold on a yearly subscription basis by the Superintendent of Documents. Current subscribers are notified by the Superintendent of Documents when their subscriptions must be renewed.

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December 22, 1980
Bulletin No. 1980-51

Internal Revenue bulletin

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Highlights of this Issue

These synopses are intended only as aids to the reader in identifying the subject matter covered. They may not be relied upon as authoritative interpretations.

SPECIAL ANNOUNCEMENT

Announcement 80-164, page 58.
A public hearing will be held January 8, 1981, on proposed regulations relating to the interest rate used to impute interest on loans between related entities and on deferred payments in the case of certain sales of property.

INCOME TAX

Rev. Rul. 80-341, page 5.
Investment credit; fish raising. The commercial raising of fish for food is a production activity within the meaning of section 48(a)(1)(B)(i) of the Code. Concrete raceways and concrete-lined water diversion canals that are designed and constructed to remain permanently in place and that are used as an integral part of the activity of raising fish qualify as section 38 property.

Rev. Rul. 80-343, page 12.
Estimated tax; corporation; year-end dividend from DISC. A corporation using the same accounting period and method as its wholly owned DISC may compute estimated tax under section 6655(d)(3)(A)(iv) of the Code without taking into account the constructive dividend deemed to be received from the DISC on the last day of the corporation's taxable year.

Rev. Rul. 80-348, page 6.
Reimbursed convention expenses and lost salary; labor union members. Amounts paid by an international labor union to reimburse delegates from local chapters for expenses of traveling away from home to attend the annual convention are not includible in gross income, and no deduction is allowable for the reimbursed expenses under section 162 of the Code, even though reimbursement is received in a later year. Amounts received by the delegates as reimbursement for lost salary are includible in gross income. Rev. Rul. 78-209 modified and superseded.

Rev. Rul. 80-352, page 8.
Accounting periods; nonresident alien's first taxable year. A nonresident alien individual engaged in a trade or business in the U.S. may, for the individual's first federal tax return, elect a fiscal year accounting period without obtaining the prior approval of the Commissioner.

Rev. Rul. 80-355, page 11.
Penalty; estimated tax underpayment; joint return following separate returns. The tax shown on a joint return filed after the due date, to replace separate returns filed before the due date, is the basis for computing the addition to tax for underpayment of estimated tax.

EMPLOYEE PLANS

Pub. L. 96-364, page 14.
Pertinent portions of the Multiemployer Pension Plan Amendments Act of 1980 and House Report No. 96-869 Part II are reproduced.

(Continued on page 4)

Findings List begins on page 61.
Announcement of Voluntary Suspensions on page 59.
Announcement of Notice of Proposed Rulemaking on page 60.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

EMPLOYEE PLANS—Cont'd

Rev. Rul. 80-349, page 6.
Duplication of benefits; rehired participants. A defined benefit plan that does not contain any provisions to prevent duplication of benefits for rehired participants will not fail to qualify under section 401(a) of the Code merely because it provides benefits for some participants that duplicate the benefits already provided for those participants under the same plan; Rev. Rul. 62-139 modified and Rev. Ruls. 56-213, 70-126, and 72-351 revoked.

Rev. Rul. 80-350, page 7.
Voluntary employee contributions. An employee benefit plan will not fail to qualify under section 401(a) of the Code merely because it permits total voluntary employee contributions equal to 10 percent of the employee's compensation for all years since the employee became a plan participant; Rev. Ruls. 59-185 and 69-217 superseded.

Rev. Rul. 80-351, page 7.
Coverage; participation waived by low-paid employee. A pension plan established by an employer to cover its two employees—a highly compensated officer and a low-paid secretary—does not meet the coverage requirements of section 410(b) of the Code if the secretary waives the right to participate in the plan; Rev. Rul. 73-340 superseded.

EMPLOYMENT TAXES

Rev. Rul. 80-348, page 6.
Reimbursed lost salary; labor union members. Amounts paid by an international labor union to reimburse local chapter delegates to its annual convention for lost salary are not "wages" under sections 3121, 3306, and 3401 of the Code; Rev. Rul. 78-209 modified and superseded.

EXCISE TAXES

Rev. Rul. 80-353, page 9.
Trucks used in servicing oil wells. Descriptions are provided of two types of truck chassis used in servicing oil wells that are subject to the tax imposed by section 4061(a)(1) of the Code and two types that are not subject to the tax; Rev. Rul. 66-61 superseded.

Rev. Rul. 80-354, page 11.
Gasoline; exemption; sale by parent to gasohol producer subsidiary. A subsidiary that 1) regularly buys gasoline from its parent, 2) mixes the gasoline with alcohol in its transport trucks to produce a 10 percent alcohol mixture, and 3) transports and unloads the mixture into its underground storage tanks at its service stations is a producer of gasohol for resale under section 48.4081-2(b) of the regulations. The sale of gasoline by the parent to the subsidiary qualifies for exemption from tax under section 4081(c) of the Code.

ADMINISTRATIVE

Rev. Proc. 80-57, page 55.
Inconsistent positions taken by the Service and Puerto Rico or Virgin Islands tax authorities. Procedures are provided to be used by the Service and taxpayers for resolving issues arising when a taxpayer is or would be subject to inconsistent tax treatment by the Service and the Puerto Rico or Virgin Islands tax authorities.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 38.—Investment in Certain Depreciable Property

26 CFR 1.38-1: Investment in certain depreciable property.

Whether concrete raceways and water diversion canals used in the raising of fish are property qualifying as "section 38 property" for purposes of the investment tax credit. See Rev. Rul. 80-341, below.

Section 48.—Definition; Special Rules

26 CFR 1.48-1: Definition of section 38 property.
(Also Section 38; 1.38-1.)

Investment credit; fish raising. The commercial raising of fish for food is a production activity within the meaning of section 48(a)(1)(B)(i) of the Code. Concrete raceways and concrete-lined water diversion canals that are designed and constructed to remain permanently in place and that are used as an integral part of the activity of raising fish qualify as section 38 property.

Rev. Rul. 80-341

ISSUE

Is the commercial raising of fish for food a production activity within the meaning of section 48(a)(1)(B)(i) of the Internal Revenue Code?

FACTS

Taxpayer is in the business of raising rainbow trout for sale to fish processing plants and other customers. Fertile eggs are purchased from a commercial fish breeder, hatched, and raised to market size, normally 10 to 12 inches in length. Taxpayer's facility includes a fish hatchery, which contains workspace and houses the necessary tanks and equipment for hatching eggs and growing the fish to a length of approximately 2 inches; outdoor raceway to which the fish are transferred and held until they reach market size; and a concrete-lined water diversion canal system that carries fresh water from a main spring water transmission ditch to the hatchery and raceways and then discharges the used water into a nearby river. The hatchery, which requires a constant supply of fresh water, is a one-story 30-by 90-foot concrete block structure. The raceways are rectangular, concrete-lined excavations varying in length from 70 to 100 feet and are approximately 3.5 feet deep. To control the volume of water entering the raceways, concrete head and tail gates are constructed at the ends. A vertical drop is necessary between sets of raceways for the water to achieve the required oxygen content.

In 1978, taxpayer constructed 12 new raceways and water diversion canals that supply the raceways. The taxpayer's new concrete raceways and concrete-lined canals are tangible depreciable property with a determinable useful life in excess of 3 years. Such property is depreciable property within the meaning of section 167 of the Code. Thus, the question presented is whether the raceways and canals are "section 38 property" for purposes of the investment tax credit.

LAW AND ANALYSIS

Section 48(a)(1) of the Code provides that the term "section 38 property" means (a) tangible personal property, or (b) other tangible property (not including a building and its structural components) but only if such property is used as an integral part of manufacturing, production, extraction, or certain other specified activities. Section 38 property includes only property with respect to which depreciation (or amortization in lieu of depreciation) is allowable and having a useful life of 3 years or more.

Section 1.48-1(d)(2) of the Income Tax Regulations provides that for the purpose of the credit allowed by section 38 of the Code the terms "manufacturing," "production," and "extraction" include the raising of livestock.

Section 1.48-1(l)(1) of the regulations provides, in part, that the term "livestock" includes cattle, hogs, sheep, goats, and mink and other furbearing animals.

Taxpayer's concrete raceways and water diversion canals are inherently permanent structures that are not tangible personal property. For such structures to qualify as section 38 property, they must, therefore, qualify as other tangible property used as an integral part of "production" or one of the other activities specified by section 48(a)(1)(B)(i) of the Code.

The commercial activity of raising fish in an area where they are artificially fed, protected, cared for, etc., as opposed to the activity of merely catching and harvesting fish, is generally considered to be a farming activity. See, for example, section 1.175-3 of the regulations, which provides that for purposes of section 175 of the Code, the term "farm" is used in its ordinary, accepted sense and includes fish farms. For purposes of the investment tax credit, the term "production" is defined by section 1.48-1(d)(2) to include certain farming activities such as "the cultivation of the soil" and "the raising of livestock." The activities specifically listed in the definition, while indicating the kinds of activities to be treated as production, are illustrative and not all-inclusive. Other activities may be considered production activities if the facts indicate that the business purpose, processing steps, and economics involved are similar to those involved in an activity listed in the definition. In the present case, because the purpose, processing steps, and economics involved in the raising of fish are very similar to those involved in the raising of livestock, taxpayer's business of raising rainbow trout for sale for food is considered to be a production activity within the meaning of section 1.48-1(d)(2).

Rev. Rul. 68-279, 1968-1 C.B. 18, holds that a lobster pound constructed by a taxpayer engaged in the wholesale lobster business is not "section 38 property" for purposes of the investment credit. The activities conducted in the lobster pound, such as retention of lobsters until they are marketable, periodic feeding, and daily testing of water for temperature and oxygen content, are necessary functions of a lobster wholesaler and are not "manufacturing," "production," or "extraction" as defined in section 1.48-1(d)(2) of the regulations.

HOLDING

The commercial raising of fish for food is a production activity within the meaning of section 48(a)(1)(B)(i) of the Code. Therefore, the concrete raceways and the concrete-lined water diversion canals that are designed and constructed to remain permanently in place and that are used as an integral part of the activity of raising fish are other tangible property that qualifies as "section 38 property" for purposes of the investment tax credit.

Section 61.—Gross Income Defined

26 CFR 1.61-1: Gross income.
(Also Sections 162, 3121, 3306, 3401; 1.162-2, 31.3121(a)-1, 31.3306(b)-1, 31.3401(a)-1.)

Reimbursed convention expenses and lost salary; labor union members. Amounts paid by an international labor union to reimburse delegates from local chapters for expenses of traveling away from home to attend the annual convention are not includible in gross income, and no deduction is allowable for the reimbursed expenses under section 162 of the Code, even though reimbursement is received in a later year. Amounts received by the delegates as reimbursement for lost salary are includible in gross income, but are not "wages" under sections 3121, 3306, and 3401. Rev. Rul. 78-209 modified and superseded.

Rev. Rul. 80-348

FACTS AND HOLDING

The Internal Revenue Service has reconsidered Rev. Rul. 78-209, 1978-1 C.B. 25, which holds that reimbursements received by elected representatives of union locals from their international union for expenses of traveling away from home incurred in attending the union's annual convention and for lost salary in connection therewith are includible in the delegates' gross incomes under section 61 of the Internal Revenue Code, but are not "wages" subject to withholding under sections 3121(a), 3306(b), and 3401(a).

The question has also been raised as to the application of section 162(a)(2) of the Code, particularly in circumstances where the local union representative incurred the travel expenses in one taxable year and received reimbursement from the international union in the following taxable year.

Ordinarily, travel expenses incurred while away from home in carrying on any trade or business are deductible under section 162(a)(2). However, taxpayers are not allowed deductions under section 162(a) for expenditures for which they have a right or expectation of reimbursement. *Burnett v. Commissioner*, 356 F.2d 755 (5th Cir. 1966); *Canelo v. Commissioner*, 53 T.C. 217, 225 (1969), *aff'd*, 447 F.2d 484 (9th Cir. 1971); Rev. Rul. 79-263, 1979-2 C.B. 82.

Travel expenditures incurred at the close of one taxable period, even though they would otherwise be allowable under section 162(a)(2) of the Code, may not be deducted because of the expectation of reimbursement. Also, the reimbursement that is received in the following taxable period would not be includible in income. See Rev. Rul. 79-263; see also Rev. Rul 79-142, 1979-1 C.B. 58, concerning exclusion from taxpayer's gross income of certain reimbursements.

Accordingly, the reimbursements in question are not includible in gross income, and no deductions are allowable for the reimbursed expenses under section 162 of the Code even if reimbursement does not occur until a later year. Reimbursements for lost salary are, however, includible in gross income in the year received, but are not "wages" for employment tax purposes.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 78-209 is modified to the extent it holds that the reimbursement of expenses of traveling away from home incurred by a union representative is includible in the representative's gross income and, as modified, superseded.

Section 162.—Trade or Business Expenses

26 CFR 1.162-2: Traveling expenses.

Whether reimbursed expenses by a union to delegates to its annual convention are deductible when reimbursement occurs in a later year. See Rev. Rul. 80-348, this page.

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401-1: Qualified pension, profit-sharing, and stock bonus plans.

Duplication of benefits; rehired participants. A defined benefit plan that does not contain any provisions to prevent duplication of benefits for rehired participants will not fail to qualify under section 401(a) of the Code merely because it provides benefits for some participants that duplicate the benefits already provided for those participants under the same plan; Rev. Rul. 62-139 modified and Rev. Ruls. 56-213, 70-126, and 72-351 revoked.

Rev. Rul. 80-349

The Service has reconsidered Rev. Ruls. 56-213, 1956-1 C.B. 194; 70-126, 1970-1 C.B. 95; 72-531, 1972-C.B. 221; and 62-139, 1962-2 C.B. 123. All of these revenue rulings deal with whether a pension plan will fail to satisfy the requirements of section 401(a) of the Internal Revenue Code merely because it provides benefits for some participants that duplicate the benefits already provided for those participants under the same plan or the plan of a prior employer.

Employer M maintains a defined benefit pension plan that provides for a normal retirement benefit equal to 50 percent of final average pay. The plan does not contain any provisions to prevent a duplication of benefits for rehired participants. Thus, it is possible for an individual who had previously been a participant, separated from service, and received payment for his or her entire nonforfeitable interest, to reenter the plan upon being rehired and receive the entire "50 percent of pay" normal retirement benefit without offset for the previous payments.

Rev. Rul. 56-213 dealt with a plan that permitted reinstatement of former participants and concluded that if the terms of the plan were uniformly applied and the full actuarial equivalent of the amount already vested in the participant was deducted from the benefit to be paid on account of the new participation, then the qualification of the plan would not be adversely affected.

Rev. Rul. 70-126 dealt with the issue under consideration and concluded that so long as the provisions did not discriminate within the meaning of section 401(a)(4) of the Code and did not result in a duplication of benefits, the providing of benefits for reinstated participants would not adversely affect the qualification of the plan under section 401(a). Although this ruling dealt with a situation where there was no duplication of benefits, the ruling stated that this characteristic was necessary to support the conclusion.

Rev. Rul. 62-139 dealt with the discrimination issue relative to allowing prior service credit to be used for eligibility and benefit purposes, and concluded, among other things, that prior service credit could not be used if the prior service had resulted in vested pension rights for the employee.

Rev. Rul. 72-531 also dealt with prior service credit and held that a plan that provides credit for service with the employee's immediate prior employer must contain a provision to preclude duplication of benefits if the plan is to be qualified under section 401(a).

There is no provision in the Code or in the Income Tax Regulations which specifically prohibits duplication of benefits. However, section 1.401-1(b)(1)(i) of the regulations defines a pension plan, within the meaning of section 401(a), as a plan established and maintained by an employer to provide definitely determinable benefits to employees after retirement.

Rev. Rul. 74-385, 1974-2 C.B. 130, provides that, in the case of a defined benefit plan, the definitely determinable benefit requirement of section 1.401-1(b)(1)(i) of the regulations is satisfied where the benefits for each participant can be computed in accordance with an express formula contained in the plan that is not subject to the discretion of the employer. The benefit formula contained in the plan described in this ruling satisfies the requirements of Rev. Rul. 74-385.

Accordingly, the pension plan of Employer M will not fail to qualify under section 401(a) of the Code merely because it provides benefits for some participants which duplicate the benefits already provided for those participants under the same plan.

This revenue ruling does not deal with whether duplication of benefits under a plan as described will violate the prohibition against discrimination as provided under section 401(a)(4) of the Code, or provide benefits in excess of the limits of section 415 of the Code.

Rev. Ruls. 56-213, 70-126, and 72-351 are revoked; and Rev. Rul. 62-139 is modified only to the extent that it required non-duplication of benefits.

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26 CFR 1.401-1: Qualified pension, profit-sharing, and stock bonus plans.

Voluntary employee contributions. An employee benefit plan will not fail to qualify under section 401(a) of the Code merely because it permits total voluntary employee contributions equal to 10 percent of the employee's compensation for all years since the employee became a plan participant; Rev. Ruls. 59-185 and 69-217 superseded.

Rev. Rul. 80-350

The purpose of this revenue ruling is to restate Rev. Rul. 59-185, 1959-1 C.B. 86, and Rev. Rul. 69-217, 1969-1 C.B. 115, under current law.

The issue in these two revenue rulings is whether an employee benefit plan will fail to qualify under section 401(a) of the Internal Revenue Code merely because it permits total voluntary employee contributions equal to 10 percent of the employee's aggregate compensation for all years since the employee became a participant under the plan.

A corporation established an employee benefit plan that in addition to the benefit derived from employer contributions, provided the additional retirement benefit that can be purchased with the participant's voluntary contributions and the earnings thereon. Voluntary contributions may be made in any year so long as the total of such contributions for all years does not exceed 10 percent of the aggregate compensation received for all years since the employee became a participant under the plan. Employee contributions and earnings thereon are nonforfeitable.

The tax advantages provided under a qualified employee plan were not intended by Congress to be extended to unlimited contributions by employees made primarily to escape tax on the increments thereon. However, where the purpose of a voluntary contribution feature in a plan is to encourage savings by participants, such feature is acceptable provided the contributions are kept within reasonable bounds. In this respect, employee contributions are deemed to be reasonable if they do not exceed 10 percent of the employee's aggregate compensation for all years since becoming a participant. Of course, the additional amounts voluntarily contributed by the employees must be used only for the purpose of providing benefits to the individual contributor in addition to the benefits provided by the employer's contributions.

Accordingly, the employee benefit plan in this case will not fail to qualify, under section 401(a) of the Code, merely because it permits total voluntary employee contributions equal to 10 percent of the employee's aggregate compensation for all years since the employee became a participant thereunder.

This revenue ruling does not provide guidance with respect to whether any voluntary employee contributions will result in a violation of section 415 of the Code.

Rev. Ruls. 59-185 and 69-217 are superseded because the positions stated therein are restated under current law in this revenue ruling.

Section 410.—Minimum Participation Standards

26 CFR 1.410(b)-1: Minimum coverage requirements.

Coverage; participation waived by low-paid employee. A pension plan established by an employer to cover its two employees—a highly compensated officer and a low-paid

secretary—does not meet the coverage requirements of section 410 (b) of the Code if the secretary waives the right to participate in the plan; Rev. Rul. 73-340 superseded.

Rev. Rul. 80-351

The purpose of this revenue ruling is to restate the position in Rev. Rul. 73-340, 1973-2 C.B. 134, in view of the enactment of the Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 1974-3 C.B. 1.

The issue in Rev. Rul. 73-340 is whether a pension plan meets the coverage requirements of section 401(a)(3) of the Internal Revenue Code (now section 410(b)) in a case where one of the two employees of a corporation, a low-paid secretary, waives eligibility under the plan thereby leaving only a highly paid officer as a plan participant.

A corporation established a pension plan which provided benefits for all employees who completed one year of service. At the time the plan was established the corporation had two employees, both of whom were eligible to participate in the plan. One was a highly compensated officer and the other was a low-paid secretary.

On the day after the plan was adopted, the secretary signed a statement waiving all rights to participate in the plan.

Section 410(b) of the Code provides "percentage" and "classification" tests for plan eligibility which a plan must satisfy in order to qualify under section 401(a). Generally, under these tests a plan will satisfy the eligibility requirements if it benefits either: (A) 70 percent or more of all employees, or 80 percent or more of all employees who are eligible to benefit under the plan if 70 percent or more of employees are eligible to benefit under the plan, or (B) such employees as qualify under a classification set up by the employer and found by the Secretary not to be discriminatory in favor of employees who are officers, shareholders, or highly compensated.

Although the plan in this case was designed to make all employees of the employer with one year of service eligible to benefit thereunder, the waiver executed by the secretary resulted in participation by only the officer. Under these circumstances, the percentage coverage requirements of section 410(b)(1)(A) of the Code were not satisfied. Furthermore, since the officer-employee was favored as against the corporation's only low-paid employee, the discrimination prohibited by the alternative coverage requirements of section 410(b)(1) was present. This discrimination was not eliminated by the low-paid employee's waiver of the right to receive benefits.

Accordingly, this pension plan does not meet the coverage requirements of section 410(b) of the Code.

Rev. Rul. 73-340 is superseded because the position stated therein is restated under current law in this revenue ruling.

Section 441.—Period for Computation of Taxable Income

26 CFR 1.441-1: Period for computation of taxable income.
(Also Section 442; 1.442-1.)

Accounting periods; nonresident alien's first taxable year. A nonresident alien individual engaged in a trade or business in the U.S. may, for the individual's first federal tax return, elect a fiscal year accounting period without obtaining the prior approval of the Commissioner.

Rev. Rul. 80-352

ISSUE

Can a nonresident alien individual, in the individual's first federal income tax return, adopt a fiscal year accounting period for federal income tax purposes without obtaining the prior approval of the Commissioner of Internal Revenue?

FACTS

A, a nonresident alien individual and citizen of country *Z*, is engaged in a trade or business within the United States. During the first year this trade or business was conducted in the United States *A* received income effectively connected with the conduct of such trade or business. *A* had always kept books and records that established a calendar year accounting period for the purpose of filing income tax returns with Country *Z*. However, from the beginning of *A*'s trade or business within the United States, *A* kept books and records of *A*'s business operations in the United States that adequately and clearly reflect income on the basis of a fiscal year beginning April 1 and ending March 31. Prior to the commencement of *A*'s trade or business in the United States, *A* had never been required by any provisions of the internal revenue laws or regulations to file any federal income tax return, statement, or other document with the Internal Revenue Service. *A*'s first federal income tax return was filed on the basis of a fiscal year ending March 31. *A* did not apply for permission to use a fiscal year accounting period.

LAW AND ANALYSIS

Section 441(a) of the Internal Revenue Code provides that taxable income shall be computed on the basis of the taxpayer's taxable year.

Section 441(b) of the Code provides that the term "taxable year" means (1) the taxpayer's annual accounting period, if it is a calendar year or a fiscal year, or (2) the calendar year, if section 441(g) applies.

Section 441(c) of the Code provides that the term "annual accounting period" means the annual period on the basis of which the taxpayer regularly computes income in keeping books.

Section 441(g) of the Code provides that, except as provided in Section 443, the taxpayer's taxable year shall be the calendar year if the taxpayer keeps no books, does not have an annual accounting period, or has an annual accounting period, but such period does not qualify as a fiscal year.

Section 442 of the Code provides that if a taxpayer changes the annual accounting period, the new accounting period shall become the taxpayer's taxable year only if the change is approved by the Secretary. For purposes of this subtitle, section 442 further provides, if a taxpayer to whom section 441(g) applies adopts an annual accounting period (as defined in section 441(c)) other than a calendar year, the taxpayer shall be treated as having changed the annual accounting period.

Section 7701(a) 14 of the Code provides that the term "taxpayer" means any person subject to any internal revenue tax.

Section 1.441-1(b)(3) of the Income Tax Regulations provides that a new taxpayer may adopt any taxable year that meets the requirements of section 441 of the Code without obtaining prior approval.

Section 1.441-1(g)(3) of the regulations provides that records that are sufficient to reflect income adequately and clearly on the basis of an annual accounting period will be regarded as keeping books.

Section 1.442-1(a)(1) of the regulations provides that a new taxpayer who adopts an annual accounting period as provided in section 441 of the Code need not secure the permission of the Commissioner under section 442 and this section.

Section 1.442-1(a)(2) of the regulations provides that if section 441(g) of the Code applies to a taxpayer, the adoption of a fiscal year will be treated as a change in the annual accounting period under section 442. Therefore, such fiscal year can become the taxpayer's taxable year only with the approval of the Commissioner.

Prior to the commencement of *A*'s trade or business in the United States, *A* had never been required by any provision of internal revenue laws or regulations to file a return or any equivalent document with the Service. Therefore, although *A* was in existence, *A* was not a United States taxpayer. When *A* began *A*'s trade or business in the United States, *A* was required to file a federal income tax return for the first time and was, therefore, a new taxpayer within the meaning of sections 1.441-1(b)(3) and 1.442-1(a)(2) of the regulations. Furthermore, at that time *A* maintained books and records that adequately and clearly reflected income on the basis of a fiscal year ending March 31 to comply with the requirement of section 1.441-(g)(3).

HOLDING

A, in *A*'s first federal income tax return, may adopt a fiscal year accounting period ending March 31 without the prior approval of the Commissioner.

Section 442.—Change of Annual Accounting Period

26 CFR 1.442-1: Change of annual accounting period.

Whether a nonresident alien individual engaged in a trade or business in the United States for the first time is a "new taxpayer" for federal income tax purposes. See Rev. Rul. 80-352, page 8.

Section 995.—Taxation of DISC Income to Shareholders

26 CFR 1.995-2: Deemed distributions in qualified years.

Whether a corporation may compute the estimated tax under section 6655(d)(3)(iv) of the Code by placing its taxable income on an annualized basis for the appropriate period of months without taking into account any part of a constructive distribution deemed to be received on the last day of its taxable year. See Rev. Rul. 80-343, page 12.

Section 3121.—Definitions [Federal Insurance Contributions Act]

26 CFR 31.3121(a)-1: Wages.

Whether reimbursement payments made by a union to its members are wages. See Rev. Rul. 80-348, page 6.

Section 3306.—Definitions [Federal Unemployment Tax Act]

26 CFR 31.3306(b)-1: Wages.

Whether reimbursement payments made by a union to its members are wages. See Rev. Rul. 80-348, page 6.

Section 3401.—Definitions [Collection of Income Tax at Source on Wages]

26 CFR 31.3401(a)-1: Wages.

Whether reimbursement payments made by a union to its members are wages. See Rev. Rul. 80-348, page 6.

Section 4061.—Imposition of Tax [Motor Vehicles]

26 CFR 48.4061(a)-1: Imposition of tax; exclusion for light-duty trucks, etc.
(Also Section 4063.)

Trucks used in servicing oil wells. Descriptions are provided of two types of truck chassis used in servicing oil wells that are subject to the tax imposed by section 4061(a)(1) of the Code and two types that are not subject to the tax; Rev. Rul. 66-61 superseded.

Rev. Rul. 80-353

ISSUE

Are sales of certain truck chassis used in servicing oil wells subject to manufacturers excise tax under section 4061(a)(1) of the Internal Revenue Code?

FACTS

The truck chassis have specially designed subframes with oil field machinery mounted thereon. They have heavy duty, high tensile steel frames that have been reinforced by the addition of fishplating and cross members positioned to support the heavier machinery components, standard running gear, and special drive trains. The chassis are used on and off the highway, are capable of traveling at 52 miles per hour, and are of the following types:

(1) Three or four-axled truck chassis on which are mounted engines, pumps, and other equipment to pump various materials, such as chemicals, sand, or sand and chemical mixtures, into oil and gas wells. The modification of the chassis by the addition of the fishplating, cross members, and subframes results in a framework with an asymmetric configuration designed to accommodate the equipment and the chassis. The chassis, as modified, are substantially different structurally from chassis that would ordinarily be used for hauling some other load.

(2) A three-axled truck chassis on which three tanks or compartments are mounted that are designed for and used in transporting cement and water, mixing the cement at the job site, and pumping it into wells.

(3) A three-axled truck chassis on which a diesel engine, a transmission, pumps, a tank, and air, mixing, lubrication, and electrical systems are mounted that are used for mixing cement with fluids and pumping the

mixture into wells. This equipment has no storage capacity and therefore cannot be used for transporting cement or fluids. The modification of the chassis by the addition of the fishplating, cross members, and subframes results in a symmetrical grid frame on the chassis. As modified, the chassis is not substantially different structurally from a chassis that would ordinarily be used for hauling some other load.

(4) A three or four-axled truck chassis on which an acid storage tank and a pump with an engine or a power take-off are mounted for use in pumping acid into a well. It does not transport acid but is supplied by a nurse tank. The cooling system is mounted behind the cab on the machinery for use with both the chassis engine and equipment engine. The modification of the chassis by the addition of the fishplating, cross members, and subframes results in an asymmetrical configuration designed to accommodate the equipment. The chassis, as modified, are substantially structurally different from chassis that would ordinarily be used for hauling some other load.

LAW AND ANALYSIS

Section 4061 of the Internal Revenue Code imposes a manufacturers excise tax on certain truck chassis and trucktractors. Section 4063(a)(5) exempts from that tax articles designed (1) to be mounted on truck chassis and (2) to be used to process or prepare concrete.

Sections 48.4061(a)-1(a)(2) and (e)(2)(i) of the Manufacturers and Retailers Excise Tax Regulations provide that a truck chassis which is sold as part of a completed vehicle is taxable uder section 4061(a)(1) only if the vehicle is a highway vehicle.

Section 48.4061(a)-1(d)(1) of the regulations defines the term "highway vehicle" as meaning any self-propelled vehicle designed to perform a function of transporting a load over public highways.

Section 48.4061(a)-1(d)(2)(i) of the regulations provides that a vehicle is not a highway vehicle if it (A) consists of a chassis to which there has been permanently mounted machinery or equipment to perform a construction, manufacturing, processing, farming, mining, drilling, timbering, or operation similar to any of the foregoing, if the operation of the machinery or equipment is unrelated to transportation on or off the public highways; (B) the chassis has been specially designed to serve only as a mobile carriage and mount for such machinery or equipment; and (C) by reason of such special design, such chassis could not, without substantial structural modification, be used as a component of a vehicle designed to haul a load other than that particular machinery or equipment.

Section 48.4061(a)-1(a)(3)(ii) of the regulations provides that amounts charged for machinery or equipment installed on a taxable chassis are not part of the taxable sale price of the chassis if (A) the machinery or equipment does not contribute to the highway transportation function of the vehicle and (B) the reasonableness of the charge for the machinery or equipment is supportable by adequate records.

Rev. Rul. 66-61, 1966-1 C.B. 250, held under prior regulations that truck chassis designed to be equipped with high pressure pumping equipment for use at oil well sites for cementing, fracturing, acidizing, etc., are subject to manufacturers excise tax. The chassis resemble conventional truck chassis but have features that distinguish them from such chassis including a reinforced frame with specially located cross members to accommodate the pumping equipment, an oversized diesel truck engine for operating pump equipment, a heavy-duty power transmission or torque converter with a specially designed hydraulic power take-off system, a cooling system that cools engine oil and water and also the hydraulic system of the transmission or converter, and a fireproof exhaust system.

Rev. Rul. 79-423, 1979-2 C.B. 386, states that the focus of the three part test of section 48.4061(a)-1(d)(2)(i) of the regulations is the character of the vehicle chassis and that the test applies to a chassis as modified for use as a component of the completed vehicle. The ruling also concludes that a chassis meets the part C requirement of the regulation if it has been specially designed to hold particular machinery or equipment and if it is substantially structurally different from a chassis that would ordinarily be used for hauling a load other than that particular machinery or equipment or similar machinery or equipment requiring such a specially designed chassis.

The types 1, 3, and 4 chassis have machinery mounted on them to perform a construction, drilling, or similar operation, and the operation of the machinery is unrelated to transportation. Therefore, these chassis satisfy the part A requirement of section 48.4061(a)-1(d)(2)(i) of the regulations. The type 2 chassis, however, does not satisfy this requirement. The machinery mounted on this chassis is used to transport cement and water to the job site, and, therefore, its operation is not unrelated to transportation.

The types 1, 3, and 4 chassis also satisfy the part B requirement of section 48.4061(a)-1(d)(2)(i) of the regulations. Because the structural additions are designed to adapt the chassis to the weight distribution and operating characteristics of the particular machinery, the chassis are specially designed to serve only as a mobile carriage and mount for that machinery.

The types 1 and 4 chassis also satisfy the part C requirement of section 48.4061(a)-1(d)(2)(i) of the regulations. As modified, they are substantially structurally different from a chassis that would ordinarily be used for hauling some other load.

The type 3 chassis does not satisfy the part C requirement. As modified, it is not substantially structurally different from a chassis that would ordinarily be used for hauling some other load.

The subframes mounted on the four types of chassis are part of the chassis. This is because they are mounted on the chassis to help support machinery or equipment on the chassis.

HOLDING

The types 2 and 3 chassis are highway vehicles and their sale by the manufacturer is subject to the manufacturers excise tax imposed by section 4061(a)(1) of the Code. However, the types 1 and 4 chassis are not highway vehicles and their sale by the manufacturer is not subject to the tax. Under the provisions of section 48.4061(a)-1(a)(3)(ii) of the regulations, the machinery and equipment installed on the type 3 chassis are not taxable under section 4061(a)(1) if the reasonableness of the charge allocated to the machinery and equipment is supportable by adequate records. The tanks or compartments on the type 2 chassis are exempt from tax under section 4063(a)(5).

EFFECT ON OTHER REVENUE RULING

Rev. Rul. 66-61 is superseded.

Section 4063.—Exemptions

Applicability of exemption under section 4063(a)(5) to tanks or compartments on truck chassis used in servicing oil wells. See Rev. Rul. 80-353, page 9.

Section 4081.—Imposition of Tax [Manufacturers Excise Taxes]

26 CFR 48.4081-2: Gasoline mixed with alcohol.

Gasoline; exemption; sale by parent to gasohol producer subsidiary. A subsidiary that 1) regularly buys gasoline from its parent, 2) mixes the gasoline with alcohol in its transport trucks to produce a 10 percent alcohol mixture, and 3) transports and unloads the mixture into its underground storage tanks at its service stations is a producer of gasohol for resale under section 48.4081-2(b) of the regulations. The sale of gasoline by the parent to the subsidiary qualifies for exemption from tax under section 4081(c) of the Code.

Rev. Rul. 80-354

ISSUE

For purposes of the manufacturers excise tax exemption provided by section 4081(c)(1) of the Internal Revenue Code, is *S* a producer under the circumstances described below?

FACTS

P, the parent company of *S*, is the sole supplier of gasoline to *S*. *S* operates a chain of retail service stations. To make gasohol, *S* purchases gasoline from *P* and alcohol from an independent alcohol supplier. The alcohol *S* purchases is not made from petroleum, natural gas, or coal. The gasoline and alcohol are mixed when loaded into *S*'s transport trucks. The mixture is then transported to and unloaded into its underground storage tanks at *S*'s service stations. The mixture contains 10 percent alcohol.

LAW AND ANALYSIS

Section 4081(a) of the Code imposes on gasoline sold by the producer or importer a tax of 4 cents a gallon. Section 4081(c) provides that no tax shall be imposed by section 4081(a) on the sale of gasoline (A) in a mixture with alcohol, if at least 10 percent of the mixture is alcohol, or (B) for use in producing a mixture at least 10 percent of which is alcohol.

Section 48.4081-2(a) of the Manufacturers and Retailers Excise Tax Regulations provides that under section 4081(c) of the Code the tax imposed by section 4081 on the sale of gasoline does not apply to the sale of qualifying gasohol or to the sale of gasoline for the purpose of producing gasohol if the requirements of this section are met. Qualifying gasohol is referred to in this section as gasohol. Gasohol is a blend of gasoline and alcohol (whether domestic or imported alcohol) in a mixture at least 10 percent of which is alcohol made from any product other than petroleum, natural gas, or coal.

Section 48.4081-2(b) of the regulations provides that under section 4081(c) of the Code sales of gasoline for the purpose of producing gasohol are not exempt unless the sale is in bulk quantities for delivery into a bulk storage tank of a producer who meets the requirements of this section. For purposes of section 4081(c) the term "producer" means any person who in the ordinary course of its trade or business regularly buys gasoline and alcohol in bulk quantities for blending for use in its trade or business or for resale. Thus, the mere purchase of gasoline for blending into gasohol does not qualify a person as a producer. A person is not a producer for purposes of section 4082 (which defines a producer for purposes of the tax imposed on gasoline by section 4081) merely because such a person is a producer of gasohol for purposes of section 4081(c). Thus, the provisions of section 4083 (relating to certain exempt sales to producers) do not necessarily apply.

S regularly buys gasoline and alcohol in bulk quantities for blending, storage in the bulk tanks at its service stations, and for resale. Although the regulations require only that a mixture of gasoline and alcohol yield a product that is at least 10 percent alcohol and the alcohol may not be from certain sources, neither the Code nor the regulations indicate that a special process is required in the production of gasohol. The mixing of the gasoline and alcohol on the transport trucks constitutes the blending of gasohol.

HOLDING

S meets the requirements of section 48.4081-2(b) of the regulations and is a producer of gasohol for resale. The sale of gasoline by *P* to *S* qualifies for the exemption from manufacturers excise tax provided by section 4081(c) of the Code.

Section 6013.—Joint Returns of Income Tax by Husband and Wife

26 CFR 1.6013-2: Joint return after filing separate return.

Whether the addition to the tax for underpayment of estimated tax is based on the tax shown on the joint return filed after the due date or on the separate returns filed by the due date. See Rev. Rul. 80-355, below.

Section 6654.—Failure by Individual to Pay Estimated Income Tax

26 CFR 1.6654-1: Addition to the tax in the case of an individual.
(Also Section 6013; 1.6013-2.)

Penalty; estimated tax underpayment; joint return following separate returns. The tax shown on a

joint return filed after due date, to replace separate returns filed before the due date, is the basis for computing the addition to tax for underpayment of estimated tax.

Rev. Rul. 80-355

ISSUE

Is the addition to the tax for underpayment of estimated tax based on the tax shown on the separate returns of the taxpayers or the tax shown on a joint return filed after the due date prescribed by law for the filing of the return?

FACTS

The taxpayers filed separate income tax returns for a taxable year by the due date, although they were eligible to file a joint return. Both were assessed the addition to the tax for underpayment of estimated tax since both taxpayers' estimated tax payments throughout the taxable year were less than 80 percent of the tax shown on each separate return. After the due date they filed a joint return, which resulted in less tax shown on the return than the total tax that had been shown on the two individual returns. Their estimated tax payments throughout the taxable year were more than 80 percent of the tax shown on the joint return.

LAW AND ANALYSIS

Section 6654(a) of the Internal Revenue Code provides that in the case of underpayments of estimated tax by an individual there shall be added to the tax an amount determined at an annual rate established under section 6621 upon the amount of the underpayment for the period of the underpayment.

Section 6654(b) of the Code provides that the underpayment shall be the difference between the amount paid on or before the last date prescribed for such payment and the amount that would be required to be paid if the estimated tax were equal to 80 percent of the tax shown on the return for the taxable year.

Section 6013(b) of the Code provides that if an individual has filed a separate return for a taxable year for which a joint return could have been made and the time prescribed by law for filing the return for such taxable year has expired, a joint return may be filed before expiration of the statute of limitations. The joint return shall be the return of the spouses for such taxable year. It also provides that for purposes of assessment and collection, where both spouses have filed separate returns, the joint return is deemed filed on the date the later separate return was filed (but not earlier than the last date prescribed by law for filing the return of either spouse).

The intent in allowing taxpayers to change their elections and file joint returns at any time within the period of the statute of limitations was to enable married taxpayers to minimize their tax liability. See S. Rep. No. 781, 82nd Cong., 1st Sess. 48 (1951), 1951-2 C.B. 458, 492.

Thus, in the case of a joint return following separate returns, any addition to the tax is based upon the joint return. Compare the case of amended returns where for purposes of determining the underpayment of estimated tax under section 6654(b) of the Code, the return for the taxable year is the original return of the taxpayer rather than any amended return filed after the due date and extensions thereof.

HOLDING

The addition to the tax for underpayment of estimated tax is based on the tax shown on the joint return of the taxpayers filed after the due date prescribed by law for the filing of the return when the joint return replaces the previously filed separate returns of the taxpayers.

Section 6655.—Failure by Corporation to Pay Estimated Income Tax

26 CFR 1.6655-2: Exceptions to imposition of the addition to the tax in the case of corporations.
(Also Section 995; 1.995-2.)

Estimated tax; corporation; year-end dividend from DISC. **A corporation using the same accounting period and method as its wholly owned DISC may compute estimated tax under section 6655(d)(3)(A)(iv) of the Code without taking into account the constructive dividend deemed to be received from the DISC on the last day of the corporation's taxable year.**

Rev. Rul. 80-343

ISSUE

May a corporation compute the estimated tax under section 6655(d)(3)(A)(iv) of the Internal Revenue Code by placing its taxable income on an annualized basis for the appropriate period of months without taking into account any part of a constructive distribution deemed to be received on the last day of its taxable year?

FACTS

X, a corporation, owns all the stock of *Y*, a Domestic International Sales Corporation (DISC). *X* and *Y* keep their books and file their tax returns using the accrual method of accounting and a fiscal year ending on October 31. Pursuant to section 995(b)(1) of the Code, *X* includes in its income an amount deemed received from *Y* on the last day of its taxable year. Prior to October 31 it is not possible to determine the amount of the deemed distribution.

LAW AND ANALYSIS

Section 995(b)(1) of the Code provides that a shareholder of a DISC shall be treated as having received a distribution taxable as a dividend with respect to its stock in an amount that is equal to its pro rata share of the sum of certain enumerated items, or if smaller, the earnings and profits of the DISC. Section 1.995-1(b)(2) and 1.995-2(a) of the Income Tax Regulations specify that such distribution shall be deemed to be received on the last day of the taxable year of the DISC in which the income was derived.

Section 6655(a) of the Code provides for an addition to the tax in the case of any underpayment of estimated tax by a corporation. Section 6655(d)(3)(A)(iv) provides that such addition shall not be imposed if the total amount of all payments of estimated tax made on or before the last date prescribed for the payment of such installment equals or exceeds the amount that would have been required to be paid on or before such date if the estimated tax were an amount equal to 80 percent of the tax for the taxable year computed by placing on an annualized basis the taxable income for the first 9 months or for the first 11 months of the taxable year in the case of the installment required to be paid in the 12th month of the taxable year.

X is not deemed to have received the distribution from *Y* until the last day of *Y*'s taxable year, October 31. That is also the last day of *X*'s taxable year and *X* does not receive income from *Y* until that date. Under section 6655(d)(3)(A)(iv) of the Code, taxable income for the 12th month is not included in the taxable income to be annualized.

HOLDING

X may compute the estimated tax under section 6655(d)(3)(A)(iv) of the Code without taking into account any part of the section 995(b)(1) distribution from *Y*.

Part II. Treaties and Tax Legislation

Subpart B.—Legislation and Related Committee Reports

Public Law 96-364
96th Congress, H.R. 3904 [1]
September 26, 1980

An act to amend the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1] and the Internal Revenue Code of 1954 to improve retirement income security under private multiemployer pension plans by strengthening the funding requirements for those plans, to authorize plan preservation measures for financially troubled multiemployer pension plans, and to revise the manner in which the pension plan termination insurance provisions apply to multiemployer plans, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE

This Act may be cited as the "Multiemployer Pension Plan Amendments Act of 1980".

* * * * *

SEC. 3. FINDINGS AND DECLARATION OF POLICY

(a) The Congress finds that—

(1) multiemployer pension plans have a substantial impact on interstate commerce and are affected with a national public interest;

(2) multiemployer pension plans have accounted for a substantial portion of the increase in private pension plan coverage over the past three decades;

(3) the continued well-being and security of millions of employees, retirees, and their dependents are directly affected by multiemployer pension plans; and

(4)(A) withdrawals of contributing employers from a multiemployer pension plan frequently result in substantially increased funding obligations for employers who continue to contribute to the plan, adversely affecting the plan, its participants and beneficiaries, and labor-management relations, and

(B) in a declining industry, the incidence of employer withdrawals is higher and the adverse effects described in subparagraph (A) are exacerbated.

(b) The Congress further finds that—

(1) it is desirable to modify the current multiemployer plan termination insurance provisions in order to increase the likelihood of protecting plan participants against benefit losses; and

(2) it is desirable to replace the termination insurance program for multiemployer pension plans with an insolvency-based benefit protection program that will enhance the financial soundness of such plans, place primary emphasis on plan continuation, and contain program costs within reasonable limits.

(c) It is hereby declared to be the policy of this Act—

(1) to foster and facilitate interstate commerce,

(2) to alleviate certain problems which tend to discourage the maintenance and growth of multiemployer pension plans,

(3) to provide reasonable protection for the interests of participants and beneficiaries of financially distressed multiemployer pension plans, and

(4) to provide a financially self-sufficient program for the guarantee of employee benefits under multiemployer plans.

* * * * *

TITLE II—AMENDMENTS TO THE INTERNAL REVENUE CODE OF 1954

SEC. 201. AMENDMENT OF THE INTERNAL REVENUE CODE OF 1954

Except as otherwise expressly provided, whenever in this title an amendment is expressed in terms of an amendment to a section or other provision, the reference is to a section or other provision of the Internal Revenue Code of 1954.

SEC. 202. MULTIEMPLOYER PLANS IN REORGANIZATION

(a) GENERAL RULE.—Part I of subchapter D of chapter 1 (relating to pension, profit sharing, stock bonus plans, etc.) is amended by inserting at the end thereof the following new subpart:

"Subpart C—Special Rules for Multiemployer Plans

"Sec. 418. Reorganization status.

"Sec. 418A. Notice of reorganization and funding requirements.

"Sec. 418B. Minimum contribution requirement.

"Sec. 418C. Overburden credit against minimum contribution requirement.

"Sec. 418D. Adjustments in accrued benefits.

"Sec. 418E. Insolvent plans.

"SEC. 418. REORGANIZATION STATUS

"(a) GENERAL RULE.—A multiemployer plan is in reorganization for a plan year if the plan's reorganization index for that year is greater than zero.

"(b) REORGANIZATION INDEX.—For purposes of this subpart—

"(1) IN GENERAL.—A plan's reorganization index for any plan year is the excess of—

"(A) the vested benefits charge for such year, over

"(B) the net charge to the funding standard account for such year.

"(2) NET CHARGE TO FUNDING STANDARD ACCOUNT.—The net charge to the funding standard account for any plan year is the excess (if any) of—

"(A) the charges to the funding standard account for such year under section 412(b)(2), over

"(B) the credits to the funding standard account under section 412(b)(3)(B).

"(3) VESTED BENEFITS CHARGE.—The vested benefits charge for any plan year is the amount which would be necessary to amortize the plan's unfunded vested benefits as of the end of the base plan year in equal annual installments—

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[1] This publication of the law and House Report No. 96-869 Part II, page 27, are restricted to excerpts involving tax matters. House Report No. 96-869 Part I, and Conference Report No. 96-1343 are not published.

"(A) over 10 years, to the extent such benefits are attributable to persons in pay status, and

"(B) over 25 years, to the extent such benefits are attributable to other participants.

"(4) DETERMINATION OF VESTED BENEFITS CHARGE.—

"(A) IN GENERAL.—The vested benefits charge for a plan year shall be based on an actuarial valuation of the plan as at the end of the base plan year, adjusted to reflect—

"(i) any—

"(I) decrease of 5 percent or more in the value of plan assets, or increase of 5 percent or more in the number of persons in pay status, during the period beginning on the first day of the plan year following the base plan year and ending on the adjustment date, or

"(II) at the election of the plan sponsor, actuarial valuation of the plan as of the adjustment date or any later date not later than the last day of the plan year for which the determination is being made,

"(ii) any change in benefits under the plan which is not otherwise taken into account under this subparagraph and which is pursuant to any amendment—

"(I) adopted before the end of the plan year for which the determination is being made, and

"(II) effective after the end of the base plan year and on or before the end of the plan year referred to in subclause (I), and

"(iii) any other event (including an event described in subparagraph (B)(i)(I) which, as determined in accordance with regulations prescribed by the Secretary, would substantially increase the plan's vested benefit charge.

"(B) CERTAIN CHANGES IN BENEFIT LEVELS.—

"(i) IN GENERAL.—In determining the vested benefits charge for a plan year following a plan year in which the plan was not in reorganization, any change in benefits which—

"(I) results from the changing of a group of participants from one benefit level to another benefit level under a schedule of plan benefits as a result of changes in a collective bargaining agreement, or

"(II) results from any other change in a collective bargaining agreement,

shall not be taken into account except to the extent provided in regulations prescribed by the Secretary.

"(ii) PLAN IN REORGANIZATION.—Except as otherwise determined by the Secretary, in determining the vested benefits charge for any plan year following any plan year in which the plan was in reorganization, any change in benefits—

"(I) described in clause (i)(I), or

"(II) described in clause (i)(II) as determined under regulations prescribed by the Secretary,

shall, for purposes of subparagraph (A)(ii), be treated as a change in benefits pursuant to an amendment to a plan.

"(5) BASE PLAN YEAR.—

"(A) IN GENERAL.—The base plan year for any plan year is—

"(i) if there is a relevant collective bargaining agreement, the last plan year ending at least 6 months before the relevant effective date, or

"(ii) if there is no relevant collective bargaining agreement, the last plan year ending at least 12 months before the beginning of the plan year.

"(B) RELEVANT COLLECTIVE BARGAINING AGREEMENT.—A relevant collective bargaining agreement is a collective bargaining agreement—

"(i) which is in effect for at least 6 months during the plan year, and

"(ii) which has not been in effect for more than 36 months as of the end of the plan year.

"(C) RELEVANT EFFECTIVE DATE.—The relevant effective date is the earliest of the effective dates for the relevant collective bargaining agreements.

"(D) ADJUSTMENT DATE. — The adjustment date is the date which is—

"(i) 90 days before the relevant effective date, or

"(ii) if there is no relevant effective date, 90 days before the beginning of the plan year.

"(6) PERSON IN PAY STATUS.—The term 'person in pay status' means—

"(A) a participant or beneficiary on the last day of the base plan year who, at any time during such year, was paid an early, late, normal, or disability retirement benefit (or a death benefit related to a retirement benefit), and

"(B) to the extent provided in regulations prescribed by the Secretary, any other person who is entitled to such a benefit under the plan.

"(7) OTHER DEFINITIONS AND SPECIAL RULES.—

"(A) UNFUNDED VESTED BENEFITS.—The term 'unfunded vested benefits' means, in connection with a plan, an amount (determined in accordance with regulations prescribed by the Secretary) equal to—

"(i) the value of vested benefits under the plan, less

"(ii) the value of the assets of the plan.

"(B) VESTED BENEFITS.—The term 'vested benefits' means any nonforfeitable benefit (within the meaning of section 4001(a)(8) of the Employee Retirement Income Security Act of 1974).

"(C) ALLOCATION OF ASSETS.—In determining the plan's unfunded vested benefits, plan assets shall first be allocated to the vested benefits attributable to persons in pay status.

"(D) TREATMENT OF CERTAIN BENEFIT REDUCTIONS.—The vested benefits charge shall be determined without regard to reductions in accrued benefits under section 418D which are first effective in the plan year.

"(E) WITHDRAWAL LIABILITY.—For purposes of this part, any outstanding claim for withdrawal liability shall not be considered a plan asset, except as otherwise provided in regulations prescribed by the Secretary.

"(c) PROHIBITION OF NONANNUITY PAYMENTS.—Except as provided in regulations prescribed by the Pension Benefit Guaranty Corporation, while a plan is in reorganization a benefit with respect to a participant (other than a death benefit) which is attributable to employer contributions and which has a value of more than $1,750 may not be paid in a form other than an annuity which (by itself or in combination with social security, railroad retirement, or workers' compensation benefits) provides substantially level payments over the life of the participant.

"(d) Terminated Plans. — Any multiemployer plan which terminates under section 4041A(a)(2) of the Employee Retirement Income Security Act of 1974 shall not be considered in reorganization after the last day of the plan year in which the plan is treated as having terminated.

"Sec. 418A. Notice of Reorganization and Funding Requirements

"(a) Notice Requirement.—

"(1) In general.—If—

"(A) a multiemployer plan is in reorganization for a plan year, and

"(B) section 418B would require an increase in contributions for such plan year,

the plan sponsor shall notify the persons described in paragraph (2) that the plan is in reorganization and that, if contributions to the plan are not increased, accrued benefits under the plan may be reduced or an excise tax may be imposed (or both such reduction and imposition may occur).

"(2) Persons to whom notice is to be given.—The persons described in this paragraph are—

"(A) each employer who has an obligation to contribute under the plan (within the meaning of section 4212(a) of the Employee Retirement Income Security Act of 1974), and

"(B) each employee organization which, for purposes of collective bargaining, represents plan participants employed by such an employer.

"(3) Overburden credit not taken into account.—The determination under paragraph (1)(B) shall be made without regard to the overburden credit provided by section 418C.

"(b) Additional Requirements.—The Pension Benefit Guaranty Corporation may prescribe additional or alternative requirements for assuring, in the case of a plan with respect to which notice is required by subsection (a)(1), that the person described in subsection (a)(2)—

"(1) receive appropriate notice that the plan is in reorganization,

"(2) are adequately informed of the implications of reorganization status, and

"(3) have reasonable access to information relevant to the plan's reorganization status.

"Sec. 418B. Minimum Contribution Requirement

"(a) Accumulated Funding Deficiency in Reorganization.—

"(1) In general.—For any plan year in which a multiemployer plan is in reorganization—

"(A) the plan shall continue to maintain its funding standard account, and

"(B) the plan's accumulated funding deficiency under section 412(a) for such plan year shall be equal to the excess (if any) of—

"(i) the sum of the minimum contribution requirement for such plan year (taking into account any overburden credit under section 418C(a)) plus the plan's accumulated funding deficiency for the preceding plan year (determined under this section if the plan was in reorganization during such plan year or under section 412(a) if the plan was not in reorganization), over

"(ii) amounts considered contributed by employers to or under the plan for the plan year (increased by any amount waived under subsection (f) for the plan year).

"(2) Treatment of withdrawal liability payments.—For purposes of paragraph (1), withdrawal liability payments (whether or not received) which are due with respect to withdrawals before the end of the base plan year shall be considered amounts contributed by the employer to or under the plan if, as of the adjustment date, it was reasonable for the plan sponsor to anticipate that such payments would be made during the plan year.

"(b) Minimum Contribution Requirement.—

"(1) In general.—Except as otherwise provided in this section, for purposes of this subpart the minimum contribution requirement for a plan year in which a plan is in reorganization is an amount equal to the excess of—

"(A) the sum of—

"(i) the plan's vested benefits charge for the plan year; and

"(ii) the increase in normal cost for the plan year determined under the entry age normal funding method which is attributable to plan amendments adopted while the plan was in reorganization, over

"(B) the amount of the overburden credit (if any) determined under section 418C for the plan year.

"(2) Adjustment for reductions in contribution base units.—If the plan's current contribution base for the plan year is less than the plan's valuation contribution base for the plan year, the minimum contribution requirement for such plan year shall be equal to the product of the amount determined under paragraph (1) (after any adjustment required by this subpart other than this paragraph) multiplied by a fraction—

"(A) the numerator of which is the plan's current contribution base for the plan year, and

"(B) the denominator of which is the plan's valuation contribution base for the plan year.

"(3) Special rule where cash-flow amount exceeds vested benefits charge.—

"(A) In general.—If the vested benefits charge for a plan year of a plan in reorganization is less than the plan's cash-flow amount for the plan year, the plan's minimum contribution requirement for the plan year is the amount determined under paragraph (1) determined before the application of paragraph (2)) after substituting the term 'cash-flow amount' for the term 'vested benefits charge' in paragraph (1)(A).

"(B) Cash-flow amount.—For purposes of subparagraph (A), a plan's cash-flow amount for a plan year is an amount equal to—

"(i) the amount of the benefits payable under the plan for the base plan year, plus the amount of the plan's administrative expenses for the base plan year, reduced by

"(ii) the value of the available plan assets for the base plan year determined under regulations prescribed by the Secretary,

adjusted in a manner consistent with section 418(b)(4).

"(c) Current Contribution Base; Valuation Contribution Base.—

"(1) Current contribution base.—For purposes of this subpart, a plan's current contribution base for a plan year is the number of contribution base units with respect to which contributions are required to be made under the plan for that plan year, determined in accordance with regulations prescribed by the Secretary.

"(2) Valuation contribution base.—

"(A) In general.—Except as provided in subparagraph (B), for purposes of this subpart a plan's valuation contribution base is the number of contribution base units for which contributions were received for the base plan year—

"(i) adjusted to reflect declines in the contribution base which have occurred (or could reasonably be anticipated) as of the adjustment date for the plan year referred to in paragraph (1),

"(ii) adjusted upward (in accordance with regulations prescribed by the Secretary) for any contribution base reduction in the base plan year caused by a strike or lockout or by unusual events, such as fire, earthquake, or severe weather conditions, and

"(iii) adjusted (in accordance with regulations prescribed by the Secretary) for reductions in the contribution base resulting from transfers of liabilities.

"(B) Insolvent plans.—For any plan year—

"(i) in which the plan is insolvent (within the meaning of section 418E(b)(1)), and

"(ii) beginning with the first plan year beginning after the expiration of all relevant collective bargaining agreements which were in effect in the plan year in which the plan became insolvent,

the plan's valuation contribution base is the greater of the number of contribution base units for which contributions were received for the first or second plan year preceding the first plan year in which the plan is insolvent, adjusted as provided in clause (ii) or (iii) of subparagraph (A).

"(3) Contribution base unit.—For purposes of this subpart, the term 'contribution base unit' means a unit with respect to which an employer has an obligation to contribute under a multiemployer plan (as defined in regulations prescribed by the Secretary).

"(d) Limitation on Required Increases in Rate of Employer Contributions.—

"(1) In general.—Under regulations prescribed by the Secretary, the minimum contribution requirement applicable to any plan for any plan year which is determined under subsection (b) (without regard to subsection (b)(2)) shall not exceed an amount which is equal to the sum of—

"(A) the greater of—

"(i) the funding standard requirement for such plan year, or

"(ii) 107 percent of—

"(I) if the plan was not in reorganization in the preceding plan year, the funding standard requirement for such preceding plan year, or

"(II) if the plan was in reorganization in the preceding plan year, the sum of the amount determined under this subparagraph for the preceding plan year and the amount (if any) determined under subparagraph (B) for the preceding plan year, plus

"(B) if for the plan year a change in benefits is first required to be considered in computing the charges under section 412(b)(2)(A) or (B), the sum of—

"(i) the increase in normal cost for a plan year determined under the entry age normal funding method due to increases in benefits described in section 418(b)(4)(A)(ii) (determined without regard to section 418(b)(4)(B)(ii)), and

"(ii) the amount necessary to amortize in equal annual installments the increase in the value of vested benefits under the plan due to increases in benefits described in clause (i) over—

"(I) 10 years, to the extent such increase in value is attributable to persons in pay status, or

"(II) 25 years, to the extent such increase in value is attributable to other participants.

"(2) Funding standard requirement.—For purposes of paragraph (1), the funding standard requirement for any plan year is an amount equal to the net charge to the funding standard account for such plan year (as defined in section 418(b)(2)).

"(3) Special rule for certain plans.—

"(A) In general.—In the case of a plan described in section 4216(b) of the Employee Retirement Income Security Act of 1974, if a plan amendment which increases benefits is adopted after January 1, 1980—

"(i) paragraph (1) shall apply only if the plan is a plan described in subparagraph (B), and

"(ii) the amount under paragraph (1) shall be determined without regard to subparagraph (1)(B).

"(B) Eligible plans.—A plan is described in this subparagraph if—

"(i) the rate of employer contributions under the plan for the first plan year beginning on or after the date on which an amendment increasing benefits is adopted, multiplied by the valuation contribution base for that plan year, equals or exceeds the sum of—

"(I) the amount that would be necessary to amortize fully, in equal annual installments, by July 1, 1986, the unfunded vested benefits attributable to plan provisions in effect on July 1, 1977 (determined as of the last day of the base plan year); and

"(II) the amount that would be necessary to amortize fully, in equal annual installments, over the period described in subparagraph (C), beginning with the first day of the first plan year beginning on or after the date on which the amendment is adopted, the unfunded vested benefits (determined as of the last day of the base plan year) attributable to each plan amendment after July 1, 1977; and "(ii) the rate of employer contributions for each subsequent plan year is not less than the lesser of—

"(I) the rate which when multiplied by the valuation contribution base for that subsequent plan year produces the annual amount that would be necessary to complete the amortization schedule described in clause (i), or

"(II) the rate for the plan year immediately preceding such subsequent plan year, plus 5 percent of such rate.

"(C) Period.—The period determined under this subparagraph is the lesser of—

"(i) 12 years, or

"(ii) a period equal in length to the average of the remaining expected lives of all persons receiving benefits under the plan.

"(4) Exception in case of certain benefit increases.—Paragraph (1) shall not apply with respect to a plan, other than a plan described in paragraph (3), for the period of consecutive plan years in each of which the plan is in reorganization, beginning with a plan year in which occurs the earlier of the date of the adoption or the effective date of any amendment of the plan which increases benefits with respect to service performed before the plan year in which the adoption of the amendment occurred.

"(e) Certain Retroactive Plan Amendments.—In determining the minimum contribution requirement with respect to a plan for a plan year under subsection (b), the vested benefits charge may be adjusted to reflect a plan amendment reducing benefits under section 412(c)(8).

"(f) Waiver of Accumulated Funding Deficiency.—

"(1) In general.—The Secretary may waive any accumulated funding deficiency under this section in accordance with the provisions of section 412(d)(1).

"(2) Treatment of waiver.—Any waiver under paragraph (1) shall not be treated as a waiver funding deficiency (within the meaning of section 412(d)(3)).

"(g) Actuarial Assumptions Must Be Reasonable.—For purposes of making any determination under this subpart, the requirements of section 412(c)(3) shall apply.

"Sec. 418C. Overburden Credit Against Minimum Contribution Requirement

"(a) General Rule.—For purposes of determining the contribution under section 418B (before the application of section 418B(b)(2) or (d)), the plan sponsor of a plan which is overburdened for the plan year shall apply an overburden credit against the plan's minimum contribution requirement for the plan year (determined without regard to section 418B(b)(2) or (d) and without regard to this section).

"(b) Definition of Overburdened Plan.—A plan is overburdened for a plan year if—

"(1) the average number of pay status participants under the plan in the base plan year exceeds the average of the number of active participants in the base plan year and the 2 plan years preceding the base plan year, and

"(2) the rate of employer contributions under the plan equals or exceeds the greater of—

"(A) such rate for the preceding plan year, or

"(B) such rate for the plan year preceding the first year in which the plan is in reorganization.

"(c) Amount of Overburden Credit.—The amount of the overburden credit for a plan year is the product of—

"(1) one-half of the average guaranteed benefit paid for the base plan year, and

"(2) the overburden factor for the plan year.

The amount of the overburden credit for a plan year shall not exceed the amount of the minimum contribution requirement for such year (determined without regard to this section).

"(d) Overburden Factor.—For purposes of this section, the overburden factor of a plan for the plan year is an amount equal to—

"(1) the average number of pay status participants for the base plan year, reduced by

"(2) the average of the number of active participants for the base plan year and for each of the 2 plan years preceding the base plan year.

"(e) Definitions.—For purposes of this section—

"(1) Pay status participant.—The term 'pay status participant' means, with respect to a plan, a participant receiving retirement benefits under the plan.

"(2) Number of active participants.—The number of active participants for a plan year shall be the sum of—

"(A) the number of active employees who are participants in the plan and on whose behalf contributions are required to be made during the plan year;

"(B) the number of active employees who are not participants in the plan but who are in an employment unit covered by a collective bargaining agreement which requires the employees' employer to contribute to the plan unless service in such employment unit was never covered under the plan or a predecessor thereof, and

"(C) the total number of active employees attributed to employers who made payments to the plan for the plan year of withdrawal liability pursuant to part 1 of subtitle E of title IV of the Employee Retirement Income Security Act of 1974, determined by dividing—

"(i) the total amount of such payments, by

"(ii) the amount equal to the total contributions received by the plan during the plan year divided by the average number of active employees who were participants in the plan during the plan year.

The Secretary shall by regulations provide alternative methods of determining active participants where (by reason of irregular employment, contributions on a unit basis, or otherwise) this paragraph does not yield a representative basis for determining the credit.

"(3) Average number.—The term 'average number' means, with respect to pay status participants for a plan year, a number equal to one-half the sum of—

"(A) the number with respect to

the plan as of the beginning of the plan year, and

"(B) the number with respect to the plan as of the end of the plan year.

"(4) Average guaranteed benefit.—The average guaranteed benefit paid is 12 times the average monthly pension payment guaranteed under section 4022A(c)(1) of the Employee Retirement Income Security Act of 1974 determined under the provisions of the plan in effect at the beginning of the first plan year in which the plan is in reorganization and without regard to section 4022A(c)(2).

"(5) First year in reorganization.—The first year in which the plan is in reorganization is the first of a period of 1 or more consecutive plan years in which the plan has been in reorganization not taking into account any plan years the plan was in reorganization prior to any period of 3 or more consecutive plan years in which the plan was not in reorganization.

"(f) No Overburden Credit in Case of Certain Reductions in Contributions.—

"(1) In general.—Notwithstanding any other provision of this section, a plan is not eligible for an overburden credit for a plan year if the Secretary finds that the plan's current contribution base for any plan year was reduced, without a corresponding reduction in the plan's unfunded vested benefits attributable to pay status participants, as a result of a change in an agreement providing for employer contributions under the plan.

"(2) Treatment of certain withdrawals.—For purposes of paragraph (1), a complete or partial withdrawal of an employer (within the meaning of part 1 of subtitle E of title IV of the Employee Retirement Income Security Act of 1974) does not impair a plan's eligibility for an overburden credit, unless the Secretary finds that a contribution base reduction described in paragraph (1) resulted from a transfer of liabilities to another plan in connection with the withdrawal.

"(g) Mergers.—Notwithstanding any other provision of this section, if 2 or more multiemployer plans merge, the amount of the overburden credit which may be applied under this section with respect to the plan resulting from the merger for any of the 3 plan years ending after the effective date of the merger shall not exceed the sum of the used overburden credit for each of the merging plans for its last plan year ending before the effective date of the merger. For purposes of the preceding sentence, the used overburden credit is that portion of the credit which does not exceed the excess of the minimum contribution requirement determined without regard to any overburden credit under this section over the employer contributions required under the plan.

"Sec. 418D Adjustments in Accrued Benefits.

"(a) Adjustments in Accrued Benefits.—

"(1) In general.—Notwithstanding section 411, a multiemployer plan in reorganization may be amended, in accordance with this section, to reduce or eliminate accrued benefits attributable to employer contributions which, under section 4022A(b) of the Employee Retirement Income Security Act of 1974, are not eligible for the Pension Benefit Guaranty Corporation's guarantee. The preceding sentence shall only apply to accrued benefits under plan amendments (or plans) adopted after March 26, 1980, or under collective bargaining agreement entered into after March 26, 1980.

"(2) Adjustment of vested benefits charge.—In determining the minimum contribution requirement with respect to a plan for a plan year under section 418B(b), the vested benefits charge may be adjusted to reflect a plan amendment reducing benefits under this section or section 412(c)(8), but only if the amendment is adopted and effective no later than 2½ months after the end of the plan year, or within such extended period as the Secretary may prescribe by regulations under section 412(c)(10).

"(b) Limitation on Reduction.—

"(1) In general.—Accrued benefits may not be reduced under this section unless—

"(A) notice has been given, at least 6 months before the first day of the plan year in which the amendment reducing benefits is adopted, to—

"(i) plan participants and beneficiaries,

"(ii) each employer who has an obligation to contribute (within the meaning of section 4212(a) of the Employee Retirement Income Security Act of 1974) under the plan, and

"(iii) each employee organization which, for purposes of collective bargaining, represents plan participants employed by such an employer,

that the plan is in reorganization and that, if contributions under the plan are not increased, accrued benefits under the plan will be reduced or an excise tax will be imposed on employers;

"(B) in accordance with regulations prescribed by the Secretary—

"(i) any category of accrued benefits is not reduced with respect to inactive participants to a greater extent proportionally that such category of accrued benefits is reduced with respect to active participants,

"(ii) benefits attributable to employer contributions other than accrued benefits and the rate of future benefit accruals are reduced at least to an extent equal to the reduction in accrued benefits of inactive participants, and

"(iii) in any case in which the accrued benefit of a participant or beneficiary is reduced by changing the benefit form or the requirements which the participant or beneficiary must satisfy to be entitled to the benefit, such reduction is not applicable to—

"(I) any participant or beneficiary in pay status on the effective date of the amendment, or the beneficiary of such a participant, or

"(II) any participant who has attained normal retirement age, or who is within 5 years of attaining normal retirement age, on the effective date of the amendment, or the beneficiary of any such participant; and

"(C) the rate of employer contributions for the plan year in which the amendment becomes effective and for all succeeding plan years in which the plan is in reorganization equals or exceeds the greater of—

"(i) the rate of employer contributions, calculated without regard to the amendment, for the plan year in which the amendment becomes effective, or "(ii) the rate of employer contributions for the plan year preceding the plan year in which the amendment becomes effective.

"(2) Information required to be included in notice.—The plan sponsors shall include in any notice required to be sent to plan participants and beneficiaries under paragraph (1) information as to the rights and remedies of plan participants and beneficiaries as well as how to contact the Department of Labor for further information and assistance where appropriate.

"(c) No Recoupment.—A plan may not recoup a benefit payment which is in excess of the amount payable under the plan because of an amendment retroactively reducing accrued benefits under this section.

"(d) Benefit Increases Under Multiemployer Plan in Reorganization.—

"(1) Restoration of previously reduced benefits.—

"(A) In general.—A plan which has been amended to reduce accrued benefits under this section may be amended to increase or restore accrued benefits, or the rate of future benefit accruals, only if the plan is amended to restore levels of previously reduced accrued benefits of inactive participants and of participants who are within 5 years of attaining normal retirement age to at least the same extent as any such increase in accrued benefits or in the rate of future benefit accruals.

"(B) Benefit increases and benefit restorations.—For purposes of this subsection, in the case of a plan which has been amended under this section to reduce accrued benefits—

"(i) an increase in a benefit, or in the rate of future benefit accruals, shall be considered a benefit increase to the extent that the benefit, or the accrual rate, is thereby increased above the highest benefit level, or accrual rate, which was in effect under the terms of the plan before the effective date of the amendment reducing accrued benefits, and

"(ii) an increase in a benefit, or in the rate of future benefit accruals, shall be considered a benefit restoration to the extent that the benefit, or the accrual rate, is not thereby increased above the highest benefit level, or accrual rate, which was in effect under the terms of the plan immediately before the effective date of the amendment reducing accrued benefits.

"(2) Uniformity in benefit restoration.—If a plan is amended to partially restore previously reduced accrued benefit levels, or the rate of future benefit accruals, the benefits of inactive participants shall be restored in at least the same proportions as other accrued benefits which are restored.

"(3) No benefit increases in year of benefit reduction.—No benefit increase under a plan may take effect in a plan year in which an amendment reducing accrued benefits under the plan, in accordance with this section, is adopted or first becomes effective.

"(4) Retroactive payments.—A plan is not required to make retroactive benefit payments with respect to that portion of an accrued benefit which was reduced and subsequently restored under this section.

"(e) Inactive Participant.—For purposes of this section, the term 'inactive participant' means a person not in covered service under the plan who is in pay status under the plan or who has a nonforfeitable benefit under the plan.

"(f) Regulations.—The Secretary may prescribe rules under which, notwithstanding any other provision of this section, accrued benefit reductions or benefit increases for different participant groups may be varied equitably to reflect variations in contribution rates and other relevant factors reflecting differences in negotiated levels of financial support for plan benefit obligations.

"Sec. 418E. Insolvent Plans.

"(a) Suspension of Certain Benefit Payments. — Notwithstanding section 411, in any case in which benefit payments under an insolvent multiemployer plan exceed the resource benefit level, any such payments of benefits which are not basic benefits shall be suspended, in accordance with this section, to the extent necessary to reduce the sum of such payments and the payments of such basic benefits to the greater of the resource benefit level or the level of basic benefits, unless an alternative procedure is prescribed by the Pension Benefit Guaranty Corporation under section 4022A(g)(5) of the Employee Retirement Income Security Act of 1974.

"(b) Definitions.—For purposes of this section, for a plan year—

"(1) Insolvency. — A multiemployer plan is insolvent if the plan's available resources are not sufficient to pay benefits under the plan when due for the plan year, or if the plan is determined to be insolvent under subsection (d).

"(2) Resource benefit level.—The term 'resource benefit level' means the level of monthly benefits determined under subsections (c)(1) and (3) and (d)(3) to be the highest level which can be paid out of the plan's available resources.

"(3) Available resources.—The term 'available resources' means the plan's cash, marketable assets, contributions, withdrawal liability payments, and earnings, less reasonable administrative expenses and amounts owed for such plan year to the Pension Benefit Guaranty Corporation under section 4261(b)(2) of the Employee Retirement Income Security Act of 1974.

"(4) Insolvency year.—The term 'insolvency year' means a plan year in which a plan is insolvent.

"(c) Benefit Payments Under Insolvent Plans.—

"(1) Determination of resource benefit level.—The plan sponsor of a plan in reorganization shall determine in writing the plan's resource benefit level for each insolvency year, based on the plan sponsor's reasonable projection of the plan's available resources and the benefits payable under the plan.

"(2) Uniformity of the benefit suspension.—The suspension of benefit payments under this section shall, in accordance with regulations prescribed by the Secretary, apply in substantially uniform proportions to the benefits of all persons in pay status (within the meaning of section 418(b)(6)) under the plan, except that the Secretary may prescribe rules under which benefit suspensions for different participant groups may be varied equitably to reflect variations in contribution rates and other relevant factors including differences in negotiated levels of financial support for plan benefit obligations.

"(3) RESOURCE BENEFIT LEVEL BELOW LEVEL OF BASIC BENEFITS.—Notwithstanding paragraph (2), if a plan sponsor determines in writing a resource benefit level for a plan year which is below the level of basic benefits, the payment of all benefits other than basic benefits shall be suspended for that plan year.

"(4) EXCESS RESOURCES.—

"(A) IN GENERAL.—If, by the end of an insolvency year, the plan sponsor determines in writing that the plan's available resources in that insolvency year could have supported benefit payments above the resource benefit level for that insolvency year, the plan sponsor shall distribute the excess resources to the participants and beneficiaries who received benefit payments from the plan in that insolvency year, in accordance with regulations prescribed by the Secretary.

"(B) EXCESS RESOURCES.—For purposes of this paragraph, the term 'excess resources' means available resources above the amount necessary to support the resource benefit level, but no greater than the amount necessary to pay benefits for the plan year at the benefit levels under the plan.

"(5) UNPAID BENEFITS.—If, by the end of an insolvency year, any benefit has not been paid at the resource benefit level, amounts up to the resource level which were unpaid shall be distributed to the participants and beneficiaries, in accordance with regulations prescribed by the Secretary, to the extent possible taking into account the plan's total available resources in that insolvency year.

"(6) RETROACTIVE PAYMENTS.—Except as provided in paragraph (4) or (5), a plan is not required to make retroactive benefit payments with respect to that portion of a benefit which was suspended under this section.

"(d) PLAN SPONSOR DETERMINATION.—

"(1) TRIENNIAL TEST.—As of the end of the first plan year in which a plan is in reorganization, and at least every 3 plan years thereafter (unless the plan is no longer in reorganization), the plan sponsor shall compare the value of plan assets (determined in accordance with section 418B(b)(3)(B)(ii)) for that plan year with the total amount of benefit payments made under the plan for that plan year. Unless the plan sponsor determines that the value of plan assets exceeds 3 times the total amount of benefit payments, the plan sponsor shall determine whether the plan will be insolvent in any of the next 3 plan years.

"(2) DETERMINATION OF INSOLVENCY.—If, at any time, the plan sponsor of a plan in reorganization reasonably determines, taking into account the plan's recent and anticipated financial experience, that the plan's available resources are not sufficient to pay benefits under the plan when due for the next plan year, the plan sponsor shall make such determination available to interested parties.

"(3) DETERMINATION OF RESOURCE BENEFIT LEVEL.—The plan sponsor of a plan in reorganization shall determine in writing for each insolvency year the resource benefit level and the level of basic benefits no later than 3 months before the insolvency year.

"(e) NOTICE REQUIREMENTS.—

"(1) IMPENDING INSOLVENCY.—If the plan sponsor of a plan in reorganization determines under subsection (d)(1) or (2) that the plan may become insolvent (within the meaning of subsection (b)(1)), the plan sponsor shall—

"(A) notify the Secretary, the Pension Benefit Guaranty Corporation, the parties described in section 418A(a)(2), and the plan participants and beneficiaries of that determination, and

"(B) inform the parties described in section 418A(a)(2) and the plan participants and beneficiaries that if insolvency occurs certain benefit payments will be suspended, but that basic benefits will continue to be paid.

"(2) RESOURCE BENEFIT LEVEL.—No later than 2 months before the first day of each insolvency year, the plan sponsor of a plan in reorganization shall notify the Secretary, the Pension Benefit Guaranty Corporation, the parties described in section 418A(a)(2), and the plan participants and beneficiaries of the resource benefit level determined in writing for that insolvency year.

"(4) POTENTIAL NEED FOR FINANCIAL ASSISTANCE.—In any case in which the plan sponsor anticipates that the resource benefit level for an insolvency year may not exceed the level of basic benefits, the plan sponsor shall notify the Pension Benefit Guaranty Corporation.

"(4) REGULATIONS. — Notice required by this subsection shall be given in accordance with regulations prescribed by the Pension Benefit Guaranty Corporation, except that notice to the Secretary shall be given in accordance with regulations prescribed by the Secretary.

"(5) CORPORATION MAY PRESCRIBE TIME.—The Pension Benefit Guaranty Corporation may prescribe a time other than the time prescribed by this section for the making of a determination or the filing of a notice under this section.

"(f) FINANCIAL ASSISTANCE.—

"(1) PERMISSIVE APPLICATION.—If the plan sponsor of an insolvent plan for which the resource benefit level is above the level of basic benefits anticipates that, for any month in an insolvency year, the plan will not have funds sufficient to pay basic benefits, the plan sponsor may apply for financial assistance from the Pension Benefit Guaranty Corporation under section 4261 of the Employee Retirement Income Security Act of 1974.

"(2) MANDATORY APPLICATION.—A plan sponsor who has determined a resource benefit level for an insolvency year which is below the level of basic benefits shall apply for financial assistance from the Pension Benefit Guaranty Corporation under section 4261 of the Employee Retirement Income Security Act of 1974.

"(g) FINANCIAL ASSISTANCE.—Any amount of any financial assistance from the Pension Benefit Guaranty Corporation to any plan, and any repayment of such amount, shall be taken into account under this subpart in such manner as determined by the Secretary.".

(b) Clerical Amendment.—The table of subparts for part I of subchapter D of chapter 1 is amended by adding at the end thereof the following new subpart:

"Subpart C. Special rules for multiemployer plans.".

Sec. 203. Minimum Funding Requirements

Section 412 (relating to minimum funding standards) is amended—

(1) in subsection (b), by striking out "(40 plan years in the case of a multiemployer plan)" and "(20 plan years in the case of a multiemployer plan)" each place they appear;

(2) by adding at the end of subsection (b) the following new paragraphs:

"(6) Certain amortization charges and credits.—In the case of a plan which, immediately before the date of the enactment of the Multiemployer Pension Plan Amendments Act of 1980, was a multiemployer plan (within the meaning of section 414(f) as in effect immediately before such date)—

"(A) any amount described in paragraph (2)(B)(ii), (2)(B)(iii), or (3)(B)(i) of this subsection which arose in a plan year beginning before such date shall be amortized in equal annual installments (until fully amortized) over 40 plan years, beginning with the plan year in which the amount arose;

"(B) any amount described in paragraph (2)(B)(iv) or (3)(B)(ii) of this subsection which arose in a plan year beginning before such date shall be amortized in equal annual installments (until fully amortized) over 20 plan years, beginning with the plan year in which the amount arose;

"(C) any change in past service liability which arises during the period of 3 plan years beginning on or after such date, and results from a plan amendment adopted before such date, shall be amortized in equal annual installments (until fully amortized) over 40 plan years, beginning with the plan year in which the change arises; and

"(D) any change in past service liability which arises during the period of 2 plan years beginning on or after such date, and results from the changing of a group of participants from one benefit level to another benefit level under a schedule of plan benefits which—

"(i) was adopted before such date, and

"(ii) was effective for any plan participant before the beginning of the first plan year beginning on or after such date,

shall be amortized in equal annual installments (until fully amortized) over 40 plan years, beginning with the plan year in which the change arises.

"(7) Special rules for multiemployer plans.—For purposes of this section—

"(A) Withdrawal liability. — Any amount received by a multiemployer plan in payment of all or part of an employer's withdrawal liability under part 1 of subtitle E of title IV of the Employee Retirement Income Security Act of 1974 shall be considered an amount contributed by the employer to or under the plan. The Secretary may prescribe by regulation additional charges and credits to a multiemployer plan's funding standard account to the extent necessary to prevent withdrawal liability payments from being unduly reflected as advance funding for plan liabilities.

"(B) Adjustments when a multiemployer plan leaves reorganization.—If a multiemployer plan is not in reorganization in the plan year but was in reorganization in the immediately preceding plan year, any balance in the funding standard account at the close of such immediately preceding plan year—

"(i) shall be eliminated by an offsetting credit or charge (as the case may be), but

"(ii) shall be taken into account in subsequent plan years by being amortized in equal annual installments (until fully amortized) over 30 plan years.

The preceding sentence shall not apply to the extent of any accumulated funding deficiency under section 418B(a) as of the end of the last plan year that the plan was in reorganization.

"(C) Plan payments to supplemental program or withdrawal liability payment fund.—Any amount paid by a plan during a plan year to the Pension Benefit Guaranty Corporation pursuant to section 4222 of such Act or to a fund exempt under section 501(c)(22) pursuant to section 4223 of such Act shall reduce the amount of contributions considered received by the plan for the plan year.

"(D) Interim withdrawal liability payments.—Any amount paid by an employer pending a final determination of the employer's withdrawal liability under part 1 of subtitle E of title IV of such Act and subsequently refunded to the employer by the plan shall be charged to the funding standard account in accordance with regulations prescribed by the Secretary.

"(E) For purposes of the full funding limitation under subsection (c)(7), unless otherwise provided by the plan, the accrued liability under a multiemployer plan shall not include benefits which are not nonforfeitable under the plan after the termination of the plan (taking into consideration section 411(d)(3))."; and

(3) by adding at the end thereof the following new subsection:

"(j) Certain Terminated Multiemployer Plans.—This section applies with respect to a terminated multiemployer plan to which section 4021 of the Employee Retirement Income Security Act of 1974 applies, until the last day of the plan year in which the plan terminates, within the meaning of section 4041A(a)(2) of that Act.

"(k) Financial Assistance.—Any amount of any financial assistance from the Pension Benefit Guaranty Corporation to any plan, and any repayment of such amount, shall be taken into account under this section in such manner as determined by the Secretary.".

Sec. 204. Excise Taxes

Section 4971 (relating to taxes on failure to meet minimum funding standard) is amended—

(1) by striking out "last sentence" in subsection (c) and inserting in lieu thereof "last two sentences"; and

(2) by adding at the end of subsection (d) the following new sentence: "In the case of a multiemployer plan

which is in reorganization under section 418, the same notice and opportunity shall be provided to the Pension Benefit Guaranty Corporation.".

Sec. 205. Deductibility of Employer Liability Payments

Subsection (g) of section 404 (relating to certain employer liability payments considered as contributions) is amended to read as follows:

"(g) Certain Employer Liability Payments Considered as Contributions.—

"(1) In general.—For purposes of this section, any amount paid by an employer under section 4062, 4063, or 4064, or part 1 of subtitle E of title IV of the Employee Retirement Income Security Act of 1974 shall be treated as a contribution to which this section applies by such employer to or under a stock bonus, pension, profit-sharing, or annuity plan.

"(2) Controlled group deductions.—In the case of a payment described in paragraph (1) made by an entity which is liable because it is a member of a commonly controlled group of corporations, trades, or businesses, within the meaning of subsection (b) or (c) of section 414, the fact that the entity did not directly employ participants of the plan with respect to which the liability payment was made shall not affect the deductibility of a payment which otherwise satisfies the conditions of section 162 (relating to trade or business expenses) or section 212 (relating to expenses for the production of income).

"(3) Coordination with subsection (a).—Any payment described in paragraph (1) shall (subject to the last sentence of subsection (a)(1)(A)) be deductible under this section when paid.".

Sec. 206. Minimum Vesting Requirements

Section 411 (relating to minimum vesting standards) is amended—

(1) by adding at the end of subsection (a)(3) the following new subparagraphs:

"(E) Cessation of contributions under a multiemployer plan.—A right to an accrued benefit derived from employer contributions under a multiemployer plan shall not be treated as forfeitable solely because the plan provides that benefits accrued as a result of service with the participant's employer before the employer had an obligation to contribute under the plan may not be payable if the employer ceases contributions to the multiemployer plan.

"(F) Reduction and suspension of benefits by a multiemployer plan.—A participant's right to an accrued benefit derived from employer contributions under a multiemployer plan shall not be treated as forfeitable solely because—

"(i) the plan is amended to reduce benefits under section 418D or under section 4281 of the Employee Retirement Income Security Act of 1974, or

"(ii) benefit payments under the plan may be suspended under section 418E or under section 4281 of the Employee Retirement Income Security Act of 1974.";

(2) in subsection (a)(4)(E), by striking out "and";

(3) in subsection (a)(4)(F), by striking out the period and inserting in lieu thereof "; and";

(4) by adding at the end of subsection (a)(4) the following new subparagraph:

"(G) in the case of a multiemployer plan, years of service—

"(i) with an employer after—

"(I) a complete withdrawal of that employer from the plan (within the meaning of section 4203 of the Employee Retirement Income Security Act of 1974), or

"(II) to the extent permitted in regulations prescribed by the Secretary, a partial withdrawal described in section 4205(b)(2)(A)(i) of such Act in conjunction with the decertification of the collective bargaining representative, and

"(ii) with any employer under the plan after the termination date of the plan under section 4048 of such Act."; and

(5) in subsection (d)(6), by striking out "section 412(c)(8)" and inserting in lieu thereof "section 412(c)(8), or section 4281 of the Employee Retirement Income Security Act of 1974".

Sec. 207. Definition of Multiemployer Plan

(a) Section 414 (relating to definitions and special rules) is amended by striking out subsection (f) and inserting in lieu thereof the following:

"(f) Multiemployer Plan.—

"(1) Definition.—For purposes of this part, the term 'multiemployer plan' means a plan—

"(A) to which more than one employer is required to contribute,

"(B) which is maintained pursuant to one or more collective bargaining agreements between one or more employee organizations and more than one employer, and

"(C) which satisfies such other requirements as the Secretary of Labor may prescribe by regulation.

"(2) Cases of common control.—For purposes of this subsection, all trades or businesses (whether or not incorporated) which are under common control within the meaning of subsection (c) are considered a single employer.

"(3) Continuation of status after termination.—Notwithstanding paragraph (1), a plan is a multiemployer plan on and after its termination date under title IV of the Employee Retirement Income Security Act of 1974 if the plan was a multiemployer plan under this subsection for the plan year preceding its termination date.

"(4) Transitional rule.—For any plan year which began before the date of the enactment of the Multiemployer Pension Plan Amendments Act of 1980, the term 'multiemployer plan' means a plan described in this subsection as in effect immediately before that date.

"(5) Special election.—Within one year after the date of the enactment of the Multiemployer Pension Plan Amendments Act of 1980, a multiemployer plan may irrevocably elect, pursuant to procedures established by the Pension Benefit Guaranty Corporation and subject to the provisions of section 4403(b) and (c) of the Employee Retirement Income Security Act of 1974, that the plan shall not be treated as a multiemployer plan for any purpose under such Act or this title, if for each of the last 3 plan years ending prior to the effective date of the Multiemployer Pension Plan Amendments Act of 1980—

"(A) the plan was not a multiemployer plan because the plan was not a plan described in section 3(37)(A)(iii) of the Employee Retirement Income Security Act of 1974 and section 414(f)(1)(C) (as such provisions were in effect on the day before the date of the enactment of the Multiemployer Pension Plan Amendments Act of 1980); and

"(B) the plan had been identified as a plan that was not a multiemployer plan in substantially all its filings with the Pension Benefit Guaranty Corporation, the Secretary of Labor and the Secretary.".

SEC. 208. RELATED TECHNICAL AMENDMENTS

(a) Sections 401(a)(12) and 414(l) are each amended by striking out the last sentence and inserting in lieu thereof the following: "The preceding sentence does not apply to any multiemployer plan with respect to any transaction to the extent that participants either before or after the transaction are covered under a multiemployer plan to which title IV of the Employee Retirement Income Security Act of 1974 applies."

(b) Subsection (d) of section 4975 is amended—

(1) by striking out "or" at the end of paragraph (12);

(2) by striking out the period at the end of paragraph (13) and inserting in lieu thereof a semicolon; and

(3) by inserting after paragraph (13) the following new paragraphs:

"(14) any transaction required or permitted under part 1 of subtitle E of title IV or section 4223 of the Employee Retirement Income Security Act of 1974, but this paragraph shall not apply with respect to the application of subsection (c)(1)(E) or (F); or

"(15) a merger of multiemployer plans, or the transfer of assets or liabilities between multiemployer plans, determined by the Pension Benefit Guaranty Corporation to meet the requirements of section 4231 of such Act, but this paragraph shall not apply with respect to the application of subsection (c)(1)(E) or (F).".

(c) Section 412(a) is amended by adding at the end thereof the following new sentence: "In any plan year in which a multiemployer plan is in reorganization, the accumulated funding deficiency of the plan shall be determined under section 418B.".

(d) Section 413(b)(6) is amended by adding at the end thereof the following new sentence: "For purposes of this subsection and the last sentence of section 4971(a), an employer's withdrawal liability under part 1 of subtitle E of title IV of the Employee Retirement Income Security Act of 1974 shall not be treated as a liability for contributions under the plan.'.

(e) Section 401(a)(2), as amended by section 411(b) of this Act, is amended by inserting ", or the return of any withdrawal liability payment determined to be an overpayment within 6 months of such determination" after "501(a)".

SEC. 209. WITHDRAWAL LIABILITY PAYMENT FUNDS

(a) Subsection (c) of section 501 (relating to list of exempt organizations) is amended by adding at the end thereof the following new paragraph:

"(22) A trust created or organized in the United States and established in writing by the plan sponsors of multiemployer plans if—

"(A) the purpose of such trust is exclusively—

"(i) to pay any amount described in section 4223(c) or (h) of the Employee Retirement Income Security Act of 1974, and

"(ii) to pay reasonable and necessary administrative expenses in connection with the establishment and operation of the trust and the processing of claims against the trust,

"(B) no part of the assets of the trust may be used for, or diverted to, any purpose other than—

"(i) the purposes described in subparagraph (A), or

"(ii) the investment in securities, obligations, or time or demand deposits described in clause (ii) of paragraph (21)(B),

"(C) such trust meets the requirements of paragraphs (2), (3), and (4) of section 4223(b), 4223(h), or, if applicable, section 4223(c) of the Employee Retirement Income Security Act of 1974, and

"(D) the trust instrument provides that, on dissolution of the trust, assets of the trust may not be paid other than to plans which have participated in the plan or, in the case of a trust established under section 4223(h) of such Act, to plans with respect to which employers have participated in the fund.".

(b) Subsection (e) of section 4975 (relating to tax on prohibited transactions) is amended by adding at the end thereof the following new paragraph:

"(9) SECTION MADE APPLICABLE TO WITHDRAWAL LIABILITY PAYMENT FUNDS.—For purposes of this section—

"(A) IN GENERAL. — The term 'plan' includes a trust described in section 501(c)(22).

"(B) DISQUALIFIED PERSON. — In the case of any trust to which this section applies by reason of subparagraph (A), the term 'disqualified person' includes any person who is a disqualified person with respect to any plan to which such trust is permitted to make payments under section 4223 of the Employee Retirement Income Security Act of 1974.".

(c)(1) Part VI of subchapter B of chapter 1 (relating to itemized deductions for individuals and corporations) is amended by adding at the end thereof the following new section:

"SEC. 194. CONTRIBUTIONS TO EMPLOYER LIABILITY TRUSTS

"(a) ALLOWANCE OF DEDUCTION. —There shall be allowed as a deduction for the taxable year an amount equal to the amount—

"(1) which is contributed by an employer to a trust described in section 501(c)(22) (relating to withdrawal liability payment fund) which meets the requirements of section 4223(h) of the Employee Retirement Income Security Act of 1974, and

"(2) which is properly allocable to such taxable year.

"(b) ALLOCATION TO TAXABLE YEAR.—In the case of a contribution described in subsection (a) which relates to any specified period of time which includes more than one taxable year, the amount properly allocable to any taxable year in such period shall be determined by prorating such amounts to such taxable years under regulations prescribed by the Secretary.

"(c) Disallowance of Deduction.—No deduction shall be allowed under subsection (a) with respect to any contribution described in subsection (a) which does not relate to any specified period of time.".

(2) The table of sections for such part VI is amended by adding at the end thereof the following new item:

"Sec. 194. Contributions to employer liability trusts.".

Sec. 210. Effective Date

(a) Except as otherwise provided in this section, the amendments made by this title shall take effect on the date of the enactment of this Act.

(b) Subpart C of part I of subchapter D of chapter 1 of such Code (as added by this Act) shall take effect, with respect to each plan, on the first day of the first plan year beginning on or after the earlier of—

(1) the date on which the last collective-bargaining agreement providing for employer contributions under the plan, which was in effect on the date of the enactment of this Act, expires, without regard to extensions agreed to after such date of enactment, or

(2) 3 years after the date of the enactment of this Act.

(c) The amendments made by section 209 shall apply to taxable years ending after the date of the enactment of this Act.

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TITLE IV—MISCELLANEOUS PROVISIONS

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Sec. 405. Action Taken Before Regulations Are Prescribed

(a) Except as otherwise provided in the amendments made by this Act and in subsection (b), if the way in which any such amendment will apply to a particular circumstance is to be set forth in regulations, any reasonable action during the period before such regulations take effect shall be treated as complying with such regulations for such period.

(b) Subsection (a) shall not apply to any action which violates any instruction issued, or temporary rule prescribed, by the agency having jurisdiction but only if such instruction or rule was published, or furnished to the party taking the action, before such action was taken.

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Sec. 407. Church Plans

* * * * *

(b) Section 414(e) of the Internal Revenue Code of 1954 (defining church plan) is amended to read as follows:

"(e) Church Plan.—

"(1) In general.—For purposes of this part, the term 'church plan' means a plan established and maintained (to the extent required in paragraph (2)(B)) for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under section 501.

"(2) Certain plans excluded.—The term 'church plan' does not include a plan—

"(A) which is established and maintained primarily for the benefit of employees (or their beneficiaries) of such church or convention or association of churches who are employed in connection with one or more unrelated trades or businesses (within the meaning of section 513); or

"(B) if less than substantially all of the individuals included in the plan are individuals described in paragraph (1) or (3)(B) (or their beneficiaries).

"(3) Definitions and other provisions.—For purposes of this subsection—

"(A) Treatment as church plan.—A plan established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches includes a plan maintained by an organization, whether a civil law corporation or otherwise, the principal purpose or function of which is the administration or funding of a plan or program for the provision of retirement benefits or welfare benefits, or both, for the employees of a church or a convention or association of churches, if such organization is controlled by or associated with a church or a convention or association of churches.

"(B) Employee defined. — The term employee of a church or a convention or association of churches shall include—

"(i) a duly ordained, commissioned, or licensed minister of a church in the exercise of his ministry, regardless of the source of his compensation;

"(ii) an employee of an organization, whether a civil law corporation or otherwise, which is exempt from tax under section 501 and which is controlled by or associated with a church or a convention or association of churches; and

"(iii) an individual described in subparagraph (E).

"(C) Church treated as employer.—A church or a convention or association of churches which is exempt from tax under section 501 shall be deemed the employer of any individal included as an employee under subparagraph (B).

"(D) Association with church.—An organization, whether a civil law corporation or otherwise, is associated with a church or a convention or association of churches if it shares common religious bonds and convictions with that church or convention or association of churches.

"(E) Special rule in case of separation from plan.—If an employee who is included in a church plan separates from the service of a church or a convention or association of churches or an organization described in clause (ii) of paragraph (3)(B), the church plan shall not fail to meet the requirements of this subsection merely because the plan—

"(i) retains the employee's accrued benefit or account for the payment of benefits to the employee or his beneficiaries pursuant to the terms of the plan; or

"(ii) receives contributions on the employee's behalf after the employee's separation from such service, but only for a period of 5 years after such separation, unless the employee is disabled (within the meaning of the disability provisions of the church plan or, if there are no such provisions in the church plan, within the meaning of section 72(m)(7)) at the time of such separation from service.

"(4) Correction of failure to meet church plan requirements.—

"(A) In general.—If a plan established and maintained for its employees (or their beneficiaries) by a church or by a convention or association of churches which is exempt from tax under section 501 fails to meet one or more of the requirements of this subsection and corrects its failure to meet such requirements within the correction period, the plan shall be deemed to meet the requirements of this subsection for the year in which the correction was made and for all prior years.

"(B) Failure to correct.—If a correction is not made within the correction period, the plan shall be deemed not to meet the requirements of this subsection beginning with the date on which the earliest failure to meet one or more of such requirements occurred.

"(C) Correction period defined.—The term 'correction period' means—

"(i) the period ending 270 days after the date of mailing by the Secretary of a notice of default with respect to the plan's failure to meet one or more of the requirements of this subsection;

"(ii) any period set by a court of competent jurisdiction after a final determination that the plan fails to meet such requirements, or, if the court does not specify such period, any reasonable period determined by the Secretary on the basis of all the facts and circumstances, but in any event not less than 270 days after the determination has become final; or

"(iii) any additional period which the Secretary determines is reasonable or necessary for the correction of the default,

whichever has the latest ending date.".

(c) The amendments made by this section shall be effective as of January 1, 1974.

Sec. 408. Deductibility of Payments to Plan by a Corporation Operating Public Transportation System Acquired by a State

(a) For purposes of subsection (g) of section 404 of the Internal Revenue Code of 1954 (relating to certain employer liability payments considered as contributions), as amended by section 205 of this Act, any payment made to a plan covering employees of a corporation operating a public transportation system shall be treated as a payment described in paragraph (1) of such subsection if—

(1) such payment is made to fund accrued benefits under the plan in conjunction with an acquisition by a State (or agency or instrumentality thereof) of the stock or assets of such corporation, and

(2) such acquisition is pursuant to a State public transportation law enacted after June 30, 1979, and before January 1, 1980.

(b) The provisions of this section shall apply to payments made after June 29, 1980.

* * * * *

Sec. 410. Refund of Mistaken Contributions

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(b) Paragraph (2) of section 401(a) of the Internal Revenue Code of 1954 (relating to exclusive benefit of employees and beneficiaries) is amended by inserting before the semicolon at the end thereof the following: "(but this paragraph shall not be construed, in the case of a multiemployer plan, to prohibit the return of a contribution within 6 months after the plan administrator determines that the contribution was made by a mistake of fact or law (other than a mistake relating to whether the plan is described in section 401(a) or the trust which is part of such plan is exempt from taxation under section 501(a)).".

(c) The amendment made by this section shall take effect on January 1, 1975, except that in the case of contributions received by a collectively bargained plan maintained by more than one employer before the date of enactment of this Act, any determination by the plan administrator that any such contribution was made by mistake of fact or law before such date shall be deemed to have been made on such date of enactment.

* * * * *

Sec. 414. Treatment of Certain Retirement Benefits

(a) General Rule.—Paragraph (15) of section 3304(a) of the Internal Revenue Code of 1954 (relating to requirements for approval of State laws) is amended by striking out the semicolon at the end thereof and inserting in lieu thereof the following:

"except that—

"(A) the requirements of this paragraph shall apply to any pension, retirement or retired pay, annuity, or other similar periodic payment only if—

"(i) such pension, retirement or retired pay, annuity, or similar payment is under a plan maintained (or contributed to) by a base period employer or chargeable employer (as determined under applicable law), and

"(ii) in the case of such a payment not made under the Social Security Act or the Railroad Retirement Act of 1974 (or the corresponding provisions of prior law), services performed for such employer by the individual after the beginning of the base period (or remuneration for such services) affect eligibility for, or increase the amount of, such pension, retirement or retired pay, annuity, or similar payment, and

"(B) the State law may provide for limitations on the amount of any such reduction to take into account contributions made by the individual for the pension, retirement or retired pay, annuity, or other similar periodic payment;".

(b) Effective Date.—The amendment made by subsection (a) shall apply to certifications of States for 1981 and subsequent years.

* * * * *

Sec. 416. Cessation of Extended Benefits When Paid Under an Interstate Claim in a State Where Extended Benefit Period is Not in Effect

(a) General Rule.—Section 202

of the Federal-State Extended Unemployment Compensation Act of 1970 [Pub. L. 91-373, 1970-2 C.B. 348, 355] is amended by adding at the end thereof the following new subsection.

"Cessation of Extended Benefits When Paid Under an Interstate Claim in a State Where Extended Benefit Period Is Not in Effect

"(c) (1) Except as provided in paragraph (2), payment of extended compensation shall not be made to any individual for any week if—

"(A) extended compensation would (but for this subsection) have been payable for such week pursuant to an interstate claim filed in any State under the interstate benefit payment plan, and

"(B) an extended benefit period is not in effect for such week in such State.

"(2) Paragraph (1) shall not apply with respect to the first 2 weeks for which extended compensation is payable (determined without regard to this subsection) pursuant to an interstate claim filed under the interstate benefit payment plan to the individual from the extended compensation account established for the benefit year.

"(3) Section 3304(a)(9)(A) of the Internal Revenue Code of 1954 shall not apply to any denial of compensation required under this subsection."

(b) Effective Date.—

(1) In general.—The amendment made by subsection (a) shall apply to weeks of unemployment beginning after October 1, 1980; except that such amendment shall not be a requirement of any State law under section 3304 (a)(11) of the Internal Revenue Code of 1954 for any week which begins before June 1, 1981.

(2) Special rule for certain states.—In the case of any State the legislature of which does not meet in a regular session which begins during calendar year 1981 and before April 1, 1981, paragraph (1) shall be applied by substituting "June 1, 1982" for "June 1, 1981".

Approved September 26, 1980.

House of Representatives Report No. 96-869 Part II 2d Session

[Bracketed numerals indicate official report page numbers]

Multiemployer Pension Plan Amendments Act of 1980

April 23, 1980

Mr. Ullman, from the Committee on Ways and Means, submitted the following report together with supplemental and minority views to accompany H.R. 3904 which on May 3, 1979, was referred jointly to the Committee on Education and Labor and the Committee on Ways and Means.[1]

[Including cost estimate of the Congressional Budget Office]

The Committee on Ways and Means, to whom was referred the bill (H.R. 3904) to amend the Employee Retirement Income Security Act of 1974 [Pub. L. 93-406, 1974-3 C.B. 1] and the Internal Revenue Code of 1954, as amended, for the purpose of improving retirement income security under private multiemployer pension plans by strengthening the funding requirements for those plans, authorizing plan preservation measures for financially troubled multiemployer pension plans, and revising the manner in which the pension plan termination insurance provisions apply to multiemployer plans, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

The amendment to the text of the bill is a complete substitute therefor and appears in boldface roman type in the reported bill.

The title of the bill is amended to reflect the amendment to the text of the bill.

[2] I. OVERVIEW

Background

The Employee Retirement Income Security Act of 1974 (ERISA) established a program of insurance for employee benefits under most tax-qualified, private, domestic, defined benefit pension plans.[1] The program is administered by the Pension Benefit Guaranty Corporation (PBGC), a corporation within the Department of Labor. The Board of Directors of the PBGC consists of the Secretary of Labor (Chairman), the Secretary of the Treasury, and the Secretary of Commerce.

The PBGC maintains a trust fund and a revolving fund for insurance of benefits under terminated multiemployer defined benefit pension plans (multiemployer plans), as well as a trust fund and a revolving fund for insurance of benefits under all other terminated defined benefit pension plans (referred to as "single-employer plans"). The PBGC presently is not "on budget" and the United States is not liable for debts of the PBGC.

The insurance program (referred to as "termination insurance") is funded by (1) premiums paid by plans, (2) assets of plans that have terminated with insufficient funds to provide insured benefits, (3) payments by employers who maintained plans which terminated with insufficient funds to provide insured benefits, and (4) earnings on investments. The funds maintained for multiemployer plans are the sole source of guaranteed benefits under terminated multiemployer plans. Similarly, the funds maintained for single-employer plans are the sole source of guaranteed benefits under single-employer plans.

Under present law, the guarantee by the PBGC of benefits under a multiemployer plan is within the discretion of the PBGC until April 30, 1980. Beginning on May 1, 1980, the guarantee of these benefits becomes mandatory.

Consideration by Education and Labor Committee

The bill (H.R. 3904), as approved by the House Committee on Education and Labor, provides a new definition for the term "multiemployer plan," imposes liability for unfunded benefits upon employers who withdraw from a multiemployer plan and allows a deduction for payments of the liability, permits multiemployer plans in financial distress to reduce certain benefits for workers, retirees and beneficiaries, imposes funding requirements for multiemployer plans, provides new rules for mergers and transfers of assets or liabilities involving multiemployer plans, authorizes the PBGC to provide financial assistance [3] to insolvent multiemployer plans, and provides new enforcement powers for the PBGC and others. In addition, the bill increases premiums payable to the PBGC by multiemployer plans, makes insurance of basic benefits under multiemployer plans by the PBGC mandatory, but modifies the level of plan benefits guaranteed by the PBGC, modifies the rules relating to employer liability to the PBGC and the plan in the event of the insolvency or termination of a multiemployer plan, and changes the insurable event to plan insolvency. The amendments made by the bill are generally effective upon enactment.

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[1] Public Law 96-364, page 14.

[1] See ERISA sec. 4021. A defined benefit pension plan provides a specified level of benefits for participants (e.g., the Federal Civil Service Retirement plan). A church pension plan is generally exempt from the insurance program unless the plan has elected to be subject to ERISA standards. Also, plans of certain professional service employers are excluded from the program.

Ways and Means Committee Amendment

The Ways and Means Committee considered H.R. 3904 as approved by the Education and Labor Committee. The Ways and Means Committee further amended the bill, with an amendment in the nature of a substitute for the bill as amended by the Education and Labor Committee.

The Ways and Means Committee amendment provides additional safeguards for employee benefits and provides additional protection for employers against escalating increases in the cost of maintaining a multiemployer plan. The Committee amendment also provides rules (1) to ease the computation and collection of liability with respect to a withdrawing employer, and (2) to provide relief from the retroactive application of withdrawal liability in limited circumstances. Additionally, the Committee amendment provides for Congressional review of premiums for certain new guarantees provided by the bill and clarifies the effect of the bill with respect to premiums for single-employer plans. Further, the Committee amendment includes the receipts and disbursements of the PBGC in the budget of the United States (i.e., places the PBGC "on budget"). The amendment also makes numerous technical changes in the bill.

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[10] III. GENERAL REASONS FOR THE BILL

During the period following the enactment of ERISA, the PBGC has learned that a significant number of multiemployer plans which would automatically be covered by termination insurance on May 1, 1980, are experiencing financial difficulty.

The termination insurance program was established by ERISA because of concern that the Act could not otherwise secure employee pension benefits against loss due to premature plan termination. The program was designed, in part, on the basis of an Administration study[1] which considered the effects of the termination of single-employer and multiemployer pension plans during a period preceding the enactment of ERISA. Because of substantial uncertainty as to the need for the insurance in the case of multiemployer plans and the effects of insuring such plans, the insurance of benefits under multiemployer plans was generally left to the discretion of the PBGC until January 1, 1978. The date for nondiscretionary insurance of benefits under multiemployer plans was subsequently delayed until May 1, 1980, because of concerns that the program, if nondiscretionary, might encourage the premature termination of multiemployer plans.

Under ERISA, an employer who has paid all required contributions to a multiemployer plan can withdraw from the plan and, if the plan does not terminate within 5 years after the withdrawal, the employer will have no further responsibility for any part of the unfunded liabilities of the plan. Where this occurs, employers who continue to maintain the plan "inherit" the liability which would have been satisfied by the withdrawing employer. The committee believes that, in this regard, present law provides an undesirable incentive for employers to withdraw from plans and an unfair burden on the employers who continue to maintain the plans.

Before ERISA, multiemployer plans in financial distress sometimes delayed funding, reduced benefits, or imposed further restrictions on eligibility for benefits. The ERISA standards designed to require systematic plan funding, and to protect employee benefits, have accordingly reduced the ability of multiemployer plans to deal with financial distress. The PBGC has indicated that the combined effect of the availability of guaranteed benefits, limited employer liability on termination, and ERISA restrictions on the ability of a plan to reduce its liabilities has made termination attractive for multiemployer plans covering workers in declining industries. According to the PBGC, in a significant number of cases, plan termination will be less expensive for employers maintaining a particular multiemployer plan than continuation of the plan. H.R. 3904 deals with these problems of multiemployer [11] plans by (1) increasing the funding requirements for multiemployer plans in most cases, (2) requiring further, accelerated funding of plans in financial distress, subject to restrictions designed to avoid undue financial strain on employers maintaining seriously overburdened plans, (3) relaxing the vesting rules of ERISA to permit benefit reductions in limited circumstances, (4) modifying the level of benefits guaranteed so that in most cases, contiuation of a plan will be more beneficial to employees than plan termination, (5) requiring continued funding of terminated plans, and (6) making plan insolvency the only insurable event. The bill also provides for increased termination insurance premiums, additional reporting requirements, and enforcement authority.

[12] IV. EXPLANATION OF PROVISIONS

A. Findings and Declaration of Policy (Sec. 3 of the Bill)

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[1] Department of the Treasury and Department of Labor, ***Study of Pension Plan Terminations, 1972—Interim Report,*** February 1973.

The statement of policy included in ERISA does not specifically provide that ERISA is for the purpose of encouraging the growth and maintenance of multiemployer plans.

The policy of the bill, as declared therein, is to make specified changes in the pension rules applicable to multiemployer plans (1) to protect the interests of participants and beneficiaries in financially distressed multiemployer plans, and (2) to encourage the growth and maintenance of multiemployer plans.

B. Definition of Multiemployer Plan (Secs. 108(d), 207, and 302 of the Bill and Sec. 414(f) of the Code, and Secs. 3(37) and 4403 of ERISA)

Present law

Under present law, a plan is a multiemployer plan for a year if (1) more than one employer is required to contribute to the plan, (2) the plan is maintained pursuant to a collective bargaining agreement between employee representatives and more than one employer, (3) the amount of contributions made under the plan for the year by each employer is less than 50 percent of the aggregate employer contributions for that year (unless a special rule is satisfied), (4) benefits under the plan are payable to each participant without regard to the cessation of contributions by the employer of the participant except to the extent the benefits accrued because of service with the employer before the employer was required to contribute to the plan, and (5) the plan satisfies other requirements imposed by Labor Department regulations.[1]

All corporations, which are members of a controlled group of corporations, are treated as a single employer in determining the status of a plan as a multiemployer plan for purposes of the tax law.

Reasons for change

The Ways and Means Committee believes that the definition of a multiemployer plan under ERISA which is limited to a plan in which (1) no employer contributes more than 50 percent of the total employer contributions for the year and (2) employers share liability for participants' benefits accrued for service while the employer maintained the plan creates two major problems. First, not all plans that share the basic characteristics of multiemployer plans (i.e., plans to which more than one employer is required to contribute and which are maintained pursuant to a collective bargaining agreement) are considered multiemployer plans under the definition pres-[13]ently in ERISA. Second, a plan could move in and out of multiemployer plan status from year to year. The Committee has determined to remove the limitations from the definition of multiemployer plan so that generally plans which share the basic characteristics of multiemployer plans are treated consistently under the law.

Explanation of provisions

Under the bill, the test relating to proportionate employer contributions (the 50-percent test) is deleted, and the test relating to continuity of benefits in the event of a cessation of employer contributions is preserved in the minimum vesting standard of ERISA. The bill provides that all trades and businesses (whether or not incorporated) under common control are considered a single employer for purposes of testing the status of a plan as a multiemployer plan. In addition, the bill provides that a plan continues to be a multiemployer plan after its termination if it was a multiemployer plan for the plan year ending before its termination date.

A plan which is a single-employer plan under present law (even though more than one employer maintains the plan) and which has paid PBGC premiums for the three plan years preceding the date of enactment as a single-employer plan is permitted to irrevocably elect to be considered a single-employer plan where the plan would otherwise be a multiemployer plan under the bill.

Effective date

The provision will apply upon enactment, except that the present law definition will continue for plan years beginning before enactment.

[14] C. Employer Withdrawal Liability, Mergers, Etc. (Secs. 104 and 108 of the Bill, Secs. 411, 412, 418-418F and 4917 of the Code, and Secs. 4201-4206, 4221-4224, 4241-4246, 4261, 4281, 4301 and 4303 of ERISA)

Present law

Employer liability

Under present law, if an employer maintained or contributed to a multiemployer plan (or a single-employer plan to which more than one employer contributes) during the 5-year period preceding the termination of the plan, and if the plan terminates with insufficient assets to provide benefits at the level guaranteed by the PBGC, the employer is liable to the PBGC for a share of the insufficiency. The insufficiency is generally allocated to employers on the basis of each employer's proportionate share of the total contributions required under the plan during the 5-year period. The liability of any particular employer, however, is limited to 30 percent of that employer's net worth (before taking the liability to the PBGC into account.[1] In addition, if a "substantial employer" withdraws from a plan to which more than one employer contributes, the employer is required to pay to the PBGC (or to post a bond for payment of) an amount equal to the employer's share of the insufficiency which would arise if the plan were to terminate. The payment is returned to the employer (or the bond is cancelled) if the plan does not terminate within 5 years after the withdrawal. Under present law, an employer is a substantial employer for a plan year if the employer's contributions during (1) each of the two preceding plan years, or (2) both the second and third preceding plan years were at least equal to 10 percent of the total contributions paid to the plan for each of such years.[2]

In the case of a single-employer plan to which only one employer contributes, liability for an insufficiency is allocated in full to that employer, subject to the "30 percent of net worth" limit. The substantial employer rules do not apply in such a case.[3]

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[1] See DOL Regs. § 2510. 3-37.

[1] See ERISA secs. 4062 and 4064.

[2] See ERISA secs. 4001(a)(2) and 4063.

[3] See ERISA sec. 4062.

Mergers, transfers, etc.

Under the Code and under the nontax provisions of ERISA, a plan is not permitted to merge or consolidate with, or transfer its assets or liabilities to, another plan unless certain conditions are met. The applicable conditions require that the benefits which each participant in the plan would receive if the plan were to terminate immediately after the merger, etc., will not be less than the benefits the participant would receive under the merged plan if that plan terminated immediately before the merger, etc.

[15] In the case of a single-employer plan to which only one employer contributes, liability for an insufficiency is allocated in full to that employer, subject to the "30 percent of net worth" limit. The substantial employer rules do not apply in such a case.

Reasons for change

The Ways and Means Committee believes that the current rules governing an employer's liability upon withdrawal from a multiemployer plan fail to adequately protect plan participants, the employers who remain in the plan and the PBGC premium payers. The present-law rules have the effect of increasing the liabilities of employers who remain with a plan until it terminates and rewarding those employers who leave the plan early. When an employer withdraws from a multiemployer plan, the remaining employers must assume the burden for funding benefit liabilities left by the withdrawing employer. In addition, a withdrawal may reduce the plan's contribution base and necessitate an increase in the rate of contributions to the plan.

The Committee finds it necessary to adopt statutory withdrawal rules to protect a multiemployer plan from the adverse financial impact of employer withdrawal. The Committee believes that a rule which requires an employer who withdraws from a multiemployer plan to continue funding a share of the plan's unfunded benefit obligations removes the present incentive for employer withdrawals and provides protection to remaining employers where withdrawals nevertheless occur. The Committee, however, intends that these rules not deter new employers from entering a multiemployer plan.

The Committee believes that, because in the construction industry and in certain segments of the entertainment industry, the withdrawal of an employer from a plan may not eliminate jobs from a plan's contribution base unless the employer continues working in the area, liability for employers in these industries should be narrowly limited.

Under present law, the PBGC is authorized to determine the extent to which the statutory rules governing mergers and transfers of assets and liabilities apply to multiemployer plans. The Committee believes that these statutory rules are not readily adaptable to multiemployer plans. Accordingly, appropriate rules are needed to protect participants in multiemployer plans when a merger or transfer of assets occurs. In addition, the rules should prevent transfers that would create unnecessary liability for the PBGC. The Committee believes that the rules contained in the bill protect plan participants and PBGC premium payers.

The Committee understands that the purpose of plan reorganization is to require a plan facing financial difficulties to take corrective action to stabilize or improve its financial condition. Generally, reorganization would (1) prevent plans in financial distress from funding new past service liabilities over unreasonably long periods of time, and (2) require plans with severe financial difficulties to raise contributions.

However, with respect to plans in declining industries, the contribution requirements could result in inappropriately high and escalating pension costs. The Committee therefore believes that the funding standard for plans in reorganization should be adjusted in certain circumstances for overburdened plans. To encourage the continuation [16] of plans, the Committee believes that PBGC funds should be available to make up the difference between the guaranteed level of benefits and the level supportable by the plan. The Committee believes that through the mechanism of reorganization, PBGC involvement and assistance will be deferred until absolutely necessary, which will result in significant premium savings. In addition, administrative responsibility would largely remain with the plan, thereby simplifying administration of the guarantee program.

Explanation of provisions

1. Employer withdrawal liability

Under the bill, an employer who withdraws from a multiemployer plan generally is liable to the plan for the portion of the plan's unfunded benefit obligations (if any) assigned to the employer. The bill provides four alternative methods, any of which a plan could uniformly use to determine this liability. In addition, a plan could devise its own method of computation subject to the approval of the PBGC.

a. Definition of withdrawal

(1) Complete withdrawal

The bill treats an employer as withdrawing from a multiemployer plan when the employer (1) permanently ceases to have an obligation to contribute under the plan, or (2) permanently ceases all covered operations under the plan. A withdrawal does not occur, however, where an employer ceases to exist merely by reason of a change in form or structure, as long as the employer is replaced by a successor employer and there is no interruption in the successor employer's contributions to the plan or obligation to contribute under the plan. For example, if P Corporation owns 100 percent of the stock of S Corporation, a subsidiary that has an obligation to contribute to a multiemployer plan on behalf of its employees, the controlled group consisting of P and S would be considered an employer with an obligation to contribute to the plan. If P sells all of its interest in S to an unrelated party, the controlled group consisting of P and S would cease to exist. However, if S continues to have an obligation to contribute to the plan, no withdrawal would be considered to have taken place merely because of the change in ownership of S.

In addition, a withdrawal does not take place merely because an employer suspends making plan contributions during a labor dispute which involves its employees.

Generally if a withdrawal occurs, the date of the withdrawal is considered to be the last day of the plan year in which the employer permanently ceased to have an obligation to contribute under the plan (other than for delinquent contributions or withdrawal liability) or permanently ceased all covered operations under the plan. Under certain circumstances the date of the withdrawal of an employer who has an obligation to contribute under a plan for work performed in the building and construction industry or in certain segments of the entertainment industry is the date on which the employer's obligation to contribute under the plan ceases.

[17] With respect to an employer who has completely withdrawn from a multiemployer plan and who subsequently resumes covered operations under the plan or renews an obligation to contribute to the plan, the PBGC is to prescribe regulations regarding the reduction or waiver of the employer's withdrawal liability to the extent consistent with the policy of protecting remaining employers, beneficiaries, and other participants. In addition, the PBGC is to prescribe regulations or a procedure under which a plan can provide rules for the reduction or waiver of withdrawal liability with respect to such an employer in appropriate circumstances.

(2) *Partial withdrawal*

Under the bill, an employer becomes subject to withdrawal liability in some cases in the event of a partial withdrawal, that is, where the employer neither completely ceases to have an obligation to contribute under the plan nor permanently ceases all covered operations under the plan. Under the bill, a partial withdrawal arises because of the occurrence of any of several specified events which could significantly decrease the employer's obligations for contributions under the plan. Under the bill, a partial withdrawal occurs—

(1) if the number of contribution base units (e.g., hours worked) with respect to which the employer is required to contribute for each of three consecutive plan years does not exceed 40 percent of the number of contribution base units with respect to which the employer was obligated to contribute under the plan for any one of the five plan years preceding the three-year period (a 60-percent decline in contribution base units);

(2) if, because the employer ceased substantially all of its covered operations at one or more facilities, the number of contribution base units with respect to which the employer is required to contribute under the plan for the plan year does not exceed 75 percent of the number of contribution base units with respect to which the employer was required to contribute under the plan for any one of the preceding five plan years; or

(3) if any employer who is required to contribute to a plan under two or more collective bargaining agreements ceases to have an obligation to contribute under at least one but not all of the agreements.

The liability which an employer incurs in the case of a partial withdrawal is to be a *pro rata* portion of the liability which the employer would incur in the event of a complete withdrawal on the same date. In addition, the bill provides that there is to be no obligation for withdrawal liability in the case of a partial withdrawal of an employer who made less than two percent of the average annual contributions to the plan in the five-year period immediately preceding the withdrawal, except where the plan specifically provides for liability in such a case.

Whenever an event giving rise to a partial withdrawal occurs, the date of the partial withdrawal is generally the last day of the plan year in which the event takes place. However, if a partial withdrawal takes place under the 3-year/40-percent rule described above, for purposes of calculating the amount of an employer's liability, the first plan [18] year of the 3-year period is considered the year in which the employer partially withdrew.

The bill provides that a plan may be amended to eliminate partial withdrawal liability, in whole or in part, to the extent permitted by PBGC regulations. Also, PBGC regulations may prescribe a procedure by which a plan may, by amendment, adopt rules providing for alternative events which will trigger partial withdrawal liability.

For purposes of the partial withdrawal rules, unless a plan provides another definition of "facility", the term means an economic unit, generally at a single physical location, where business is conducted or industrial operations are performed.

The bill provides for abatement of all or part of an employer's partial withdrawal liability in the event of (1) a two-year 90 percent restoration of contributions, (2) a one-year complete restoration of contributions, (3) a two-year reversal of the reduction of contributions which triggered the liability, or (4) a ten percent contribution increase. In addition, the PBGC is authorized to prescribe regulations providing for the reduction or elimination of partial withdrawal liability under conditions where the PBGC determines that such an abatement is consistent with the policy of protecting remaining employers. Also, under a PGBC regulatory procedure, a plan may adopt rules for abatement of partial withdrawal liability under any other conditions, subject to PBGC approval to be based on a determination that the rules are consistent with the policy of protecting remaining employers.

A two-year 90 percent restoration of contributions occurs where, for any two consecutive plan years after the partial withdrawal, the number of contribution base units applied to determine the employer's required plan contributions is at least 90 percent of the number of contribution base units to determine the employer's required contributions for any one of the five plan years (1) immediately preceding the three consecutive plan years used to test for a partial withdrawal in the case of a partial withdrawal caused by a 60 percent decline in contribution base units, or (2) immediately preceding the year of the partial withdrawal in the case of a partial withdrawal caused by a facility closing or the cessation of contribution obligations under a collective bargaining agreement (the five-year base period). An abatement under this rule completely eliminates the employer's partial withdrawal liability for plan years following the two consecutive plan years in which the 90-percent restoration of contributions takes place.

A one-year complete restoration of contributions occurs where the number of contribution base units used to determine the employer's required contributions for a plan year equals or exceeds the number of such units for the year in the five-year base period for which such units were the highest. Where such a restoration takes place, the employer may, in lieu of continuing to pay partial withdrawal liability, post a bond to the plan for an amount determined by the plan sponsor not exceeding 50 percent of the otherwise required annual partial withdrawal liability payment. If the plan sponsor determines that the employer has no further partial withdrawal liability, the liability is completely eliminated and the bond is cancelled. If the plan sponsor determines that the employer continues to have partial withdrawal liability, [19] (1) the plan may realize on the bond, (2) the employer remains liable for the amount of the year's liability not covered by the bond, and (3) no abatement takes place.

A two-year reversal of the reduction in contributions which triggered the liability occurs where for any two consecutive plan years after the partial withdrawal (1) the number of contribution base units applied to determine the employer's required plan contributions exceeds (a) 40 percent of the number of such units for the year in the five-year base period for which such units were the highest, in the case of a partial withdrawal caused by a 60 percent decline in contribution base units, or (b) 75 percent of the number of such units for the year in the base period for which such units were the highest, in the case of a partial withdrawal caused by a facility closing or the cessation of contributions under a collective bargaining agreement, and (2) the total number of contribution base units applied to determine required plan contributions for all employers is not less than 90 percent of the total number of such units for the year of the partial withdrawal. An abatement under this rule completely eliminates the employer's partial withdrawal liability for plan years following the two consecutive years in which the reversal of the reduction in contributions takes place.

A ten percent contribution increase occurs where, for a plan year following the partial withdrawal, the number of contribution base units applied to determine the employer's required plan contributions exceeds the number of such units for the year of the partial withdrawal by at least 10 percent. In the case of an abatement under this rule, the employer's partial withdrawal liability payment for the year of the abatement is reduced *pro rata* under PBGC regulations. A plan may use a percentage other than 10 percent in applying this rule, except for a percentage prohibited by PBGC regulations.

(3) Construction etc., industry exception

In the case of certain plans under which an employer has an obligation to contribute for work performed in the building and construction industry, a withdrawal is considered to take place only if an employer ceases to have an obligation to contribute under the plan, and (1) continues to perform work in the jurisdiction of the collective bargaining agreement, of the type for which contributions were previously required, or (2) resumes work in the jurisdiction within five years after the date the employer's obligation to contribute under the plan ceased without renewing such obligation if, when the employer resumes work, (i) other employers have an obligation to contribute under the plan, and (ii) the plan would have permitted the employer to contribute.

An employer contributing to a plan is subject to these special rules only if substantially all of the employees for whom the employer has an obligation to contribute perform work in the building and construction industry, and (1) the plan covers primarily employees in the building and construction industry, or (2) the plan is amended to provide that the rules apply to employers with an obligation to contribute for work performed in the building and constuction industry.

The partial withdrawal rules apply to an employer subject to the special building and construction industry rules only where the em-[20]ployer so substantially reduces its involvement with a plan that the employer's continuing obligation to make contributions is for only a token portion of its work of the type for which contributions to the plan are required in the craft and area jurisdiction of the particular collective bargaining agreement. The partial withdrawal rules apply to an employer subject to the special entertainment industry rules only to the extent provided in PBGC regulations.

(4) De minimis rules

(*a*) *General de minimis rule.*—In any case where the withdrawal liability of an employer (computed before any *pro rata* reduction in the case of a partial withdrawal) the greater of (a) $25,000, or (b) 0.75 percent of the plan's unfunded benefit obligations determined as of the close of the plan year immediately preceding the withdrawal, the bill does not impose any withdrawal liability on the employer. A plan may provide, however, for a lower *de minimis* amount or for no *de minimis* amount.

The *de minimis rule* under the bill does not apply in the case of a mass withdrawal from a plan. Thus, the rule does not apply to an employer who withdraws from a plan in a plan year in which substantially all employers withdraw, or to an employer who withdraws under an agreement or arrangement under which substantially all employers withdraw from the plan in one or more plan years. Where substantially all employers withdraw from a plan within a period of three plan years, it is presumed that such an agreement or arrangement exists unless the contrary is shown by a preponderance of the evidence.

(*b*) *Two-percent de minimis rule.*—Under the bill, an employer will not incur withdrawal liability in the case of a partial withdrawal if the average annual contributions during the five plan years preceding the year of withdrawal were less than two percent of the total average annual contributions of all employers contributing to the plan. However, the bill permits a plan to provide that this two percent exception to partial withdrawal liability will not apply.

(5) *Exception for new employers*

The bill provides a rule under which an employer first entering a plan would not be subject to withdrawal liability, either in the case of a complete withdrawal or of a partial withdrawal, if certain conditions are met. The applicable conditions are as follows:

a. the employer was first obligated to make plan contributions after the date of enactment of the bill;

b. the employer was not required to make plan contributions for more than the lesser of (1) six consecutive plan years preceding the date of withdrawal or (2) the number of years required for vesting under the plan;

c. for each plan year for which contributions by the employer were required, the employer's contributions were less than 2 percent of all employer contributions to the plan for the plan year;

d. the plan does not primarily cover employees in the building and construction industry; and

e. the employer did not previously have the benefit of this exception with respect to the plan.

[21] In addition, the exception applies only if (1) the plan provides for its application; (2) the plan provides that benefits of participants accrued on the basis of service for the employer before the employer was required to contribute to the plan may not be payable if the employer ceases contributions to the plan and (3) the ratio of plan assets to benefit payments during the plan year preceding the first plan year for which the employer was required to make plan contributions was at least 8 to 1. Of course, the rule requiring that a plan provide for cancellation of benefits where the employer ceases contributions to the plan would not require any reduction of benefits to participants or beneficiaries whose benefits are in pay-status at the time of the cessation and who are not working in employment covered by the plan.

b. Computation of withdrawal liability

(1) *Presumptive method*

The bill, in its presumptive method for computing withdrawal liability, draws a distinction between employers who contributed to a plan for a plan year ending before February 28, 1979, and employers who did not contribute to the plan for such a year. As to employers who contributed to a plan for such a year, the computation of withdrawal liability is based on (1) the unfunded benefit obligations[4] of the plan attributable to those years, as well as on (2) changes in the unfunded benefit obligations of the plan for plan years ending on or after February 28, 1979, in which the employer was required to contribute to the plan. In the case of an employer who was not required to contribute to the plan for a plan year ending before February 28, 1979, the employer's withdrawal liability is computed solely with reference to changes in the unfunded benefit obligations under the plan for plan years ending on or after February 28, 1979, in which the employer was required to contribute to the plan. Under the bill, the presumptive method generally applies unless a plan adopts one of the alternative methods.

In particular, withdrawal liability under the presumptive method is divided into two parts, as follows:

(1) liability with respect to changes in unfunded benefit obligations for plan years ending on or after February 28, 1979, in which the employer was obligated to contribute under the plan; and

(2) liability with respect to unfunded benefit obligations for plan years ending before February 28, 1979.

In the case of an employer who was not required to contribute to a plan until a plan year ending on or after February 28, 1979, the second component of withdrawal liability does not apply.

The portion of an employer's withdrawal liability attributable to plan years ending after February 28, 1979, is computed in four steps, as follows:

(1) The first step is to determine what is known as the "change in a plan's unfunded benefit obligations" for each plan year [22] ending on or after February 28, 1979. Under the bill, this amount is calculated for each plan year as the difference between (a) the unfunded benefit obligations as of the end of the plan year which precedes the plan year, and (b) the sum of (i) the unfunded benefit obligations on the last day of the last plan year ending before February 28, 1979, reduced by five percent for each succeeding plan year which precedes the plan year, and (ii) the sum of the changes in unfunded benefit obligations for each plan year ending on or after February 28, 1979, and preceding the plan year (computed with each such change reduced by five percent for each succeeding plan year preceding the plan year).

(2) The second step is to determine what is known as "the unamortized amount of the change in a plan's unfunded benefit obligations with respect to a plan year". This amount is determined by reducing the change in a plan's unfunded benefit obligations for a plan year (determined under step (1)) by five percent for each succeeding plan year.

(3) The third step is to calculate the employer's "proportional share" of the unamortized amount of the change in the plan's unfunded benefit obligations for each plan year involved. This is accomplished by multiplying the unamortized amount of the change for each plan year, determined as of the end of the plan year in which the employer withdraws from the plan, by a fraction. The numerator of the fraction is the sum of contributions which the employer was required to make to the plan for the year of the change and for the preceding four plan years. The denominator of the fraction is the sum of contributions which all employers made to the plan for the year of the change and for the preceding four plan years.

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[4] Generally, the term "unfunded benefit obligations" is intended to mean the plan's unfunded liability for benefits for which participants have met service requirements (including early retirement subsidies, Social Security supplements, and vested accrued benefits).

(4) The final step is to add up the employer's proportional share of the unamortized amount of the change in the plan's unfunded benefit obligations for each of the plan years. This total is the employer's proportional share of the unamortized amount of the change in the plan's unfunded benefit obligations for all plan years ending on or after February 28, 1979.

The portion of an employer's withdrawal liability with respect to plan years ending before February 28, 1979, is determined by multiplying (1) the amount of the unfunded benefit obligations under the plan at the close of the last plan year ending before February 28, 1979 (reduced by five percent for each succeeding plan year) by (2) a fraction. The numerator of the fraction is the sum of contributions which the employer was required to make to the plan for the last five plan years ending before February 28, 1979. The denominator of the fraction is the sum, for the same five plan years, of plan contributions made by all employers who (a) had an obligation to contribute under the plan for the first plan year ending on or after February 28, 1979, and (b) had not withdrawn from the plan before February 28, 1979.

Under the bill, except as otherwise provided by PBGC regulations, the plan's unfunded benefit obligations will be increased by (1) the present value of uncollectible withdrawal liability if the plan sponsor [23] determines the withdrawal liability to be uncollectible, and (2) an amount equal to an employer's potential withdrawal liability if the plan sponsor determines that the employer is not liable for the withdrawal liability because of the bill's *de minimis* rule.

(2) First alternative method

The first alternative method also draws a distinction between employers who contributed to a plan for plan years ending before February 28, 1979, and employers who did not contribute to the plan for such years. As in the case of the presumptive method, only employers who contributed for years ending before February 28, 1979, are to have their withdrawal liability computed with reference to unfunded benefit obligations under the plan attributable to such years. Other employers are to have their withdrawal liability computed solely with reference to the plan's unfunded benefit obligations attributable to plan years ending on or after February 28, 1979. However, unlike the presumptive method, under the first alternative method, an employer's withdrawal liability is to be based on the aggregate change in unfunded benefit obligations with respect to all plan years ending on or after February 28, 1979, rather than on the changes in unfunded benefit obligations for each separate plan year for which the employer was required to contribute to the plan.

In particular, the first component of withdrawal liability under the first alternative method is to be obtained by multiplying (1) the plan's unfunded benefit obligations as of the end of the last plan year ending before February 28, 1979, reduced as if that amount were being amortized thereafter in level annual installments over 15 years, by (2) a fraction. The numerator of the fraction is the sum of the plan contributions required of the employer for the last plan year ending before February 28, 1979, and for the preceding four plan years. The denominator of the fraction is the sum of the contributions made by included employers for that period of five plan years. An employer is included if (1) the employer was required to contribute to the plan for the first plan year ending on or after February 28, 1979, and (2) the employer had not withdrawn from the plan before that date.

The second component of withdrawal liability under the first alternative method is to be obtained by computing the excess of the plan's unfunded benefit obligations (as of the last day of the plan year in which the employer withdraws) over the sum of (1) the value on such date of all outstanding claims for withdrawal liability (with respect to employers withdrawing before the plan year) which can reasonably be expected to be collected and (2) the portion of the plan's unfunded benefit obligations as of the last day of the last plan year ending before February 28, 1979 (as reduced by 15-year amortization) which is allocable to remaining included employers and multiplying such excess by a fraction. The numerator of the fraction is the total amount required to be contributed by the employer for the last plan year ending before withdrawal and for the four preceding four plan years. The denominator of the fraction is the total amount contributed by all employers for those five plan years, increased by employer contributions for earlier periods that are collected during the [24] five plan years, and reduced by the contributions made by any employer who withdrew from the plan during any of the five plan years. An employer is included in this case if the employer was required to contribute to the plan for the first plan year ending on or after February 28, 1979, as well as for the plan year of the withdrawal.

(3) Second alternative method

The second alternative method for computing withdrawal liability draws no distinction between employers who were required to contribute to a plan for plan years ending before February 28, 1979, and employers who were required to contribute only for plan years ending on or after February 28, 1979. Accordingly, employers in both categories are to have their withdrawal liability computed with reference to all of a plan's unfunded benefit obligations.

Under this method, withdrawal liability is to be determined by multiplying (1) the plan's unfunded benefit obligations as of the end of the plan year of the withdrawal, reduced by the value as of such date of outstanding claims for withdrawal liability (with respect to employers withdrawing before the plan year) which can reasonably be expected to be collected by (2) a fraction. The numerator of the fraction is the amount which the employer was required to contribute to the plan for the five plan years preceding the plan year of the withdrawal. The denominator of the fraction is the total amount contributed by all employers for those five plan years, increased by employer contributions for earlier periods that are collected during the five plan years, and reduced by the contributions made by any employer who withdrew from the plan during any of the five plan years.

(4) Third alternative method

The third alternative method takes a substantially different approach to computing withdrawal liability. Rather than determining the liability based upon the employer's share of plan contributions during a five-year period, the method is intended to compute the portion of the plan's unfunded benefit obligations which are attributable to service of plan participants with the employer. This is generally to be done by attributing portions of the unfunded benefit obligations to each employer in accordance with specified rules. In addition, the plan's unfunded benefit obligations which are not attributable to any present employer is also to be computed. A portion of those "unattributable obligations" is then to be allocated to the employer. An employer's withdrawal liability is then to be determined as the sum of (1) the portion of the plan's unfunded benefits obligations which are attributable to plan participants' service with the employer, and (2) the portion of "unattributable obligations" which is allocated to the employer. All determinations are to be made as of the end of the plan year of the withdrawal.

The portion of an employer's withdrawal liability arising from plan unfunded benefit obligations attributable to plan participants' service with the employer is computed in four steps, as follows:

(1) The first step is to determine the actuarial present value of benefit entitlements under the plan which are attributable to [25] participants' service with the employer (attributable entitlements).

(2) The second step is to determine the value of plan assets allocated to benefit entitlements attributable to service with the employers with an obligation to contribute under the plan in the plan year of the withdrawal (obligated employers). This is accomplished by multiplying (a) the value of plan assets as of the end of the year of the withdrawal, by (b) a fraction. The numerator of the fraction is the actuarial present value of benefit entitlements attributable to service with obligated employers. The denominator of the fraction is the actuarial present value of all benefit entitlements for the year of the withdrawal.

(3) The third step is to determine the share of the value of the assets (determined under step (2)) which is allocated to the withdrawn employer. This is done by multiplying the value of such assets by one of three alternative fractions. The fraction used by a particular plan is to be designated by plan amendment. Under the first alternative fraction, (1) the numerator is the actuarial present value of benefit entitlements attributable to service with the employer, and (2) the denominator is the actuarial present value of benefit entitlements attributable to service with all employers required to contribute in the plan year of the withdrawal. Under the second alternative fraction, (1) the numerator is the actuarial present value of all plan contributions by the employer for the plan year of the withdrawal and all preceding plan years, and (2) the denominator is the actuarial present value of all plan contributions, for the plan year of the withdrawal and all preceding plan years, by employers required to contribute in the plan year of the withdrawal. Under the third alternative fraction, (1) the numerator is the difference between (a) the amount determined as the numerator of the second alternative fraction, and (b) the actuarial present value of plan benefit payments, for the plan year of the withdrawal and preceding plan years, attributable to service with the employer; and (2) the denominator is the difference between (a) the amount determined as the denominator of the second alternative fraction, and (b) the actuarial present value of plan benefit payments, for the plan year of the withdrawal and all preceding plan years, attributable to service with employers required to contribute in the plan year of the withdrawal.

(4) The final step is to subtract (1) the employer's share of the plan assets (determined under step (3)) from (2) the employer's attributable entitlements (determined under step (1)).

The portion of unattributable obligations which is allocated to the employer is determined in two steps, as follows:

(1) The first step is to calculate the unattributable obligations. This is accomplished by subtracting from the difference between two amounts the value of outstanding claims for withdrawal liability (with respect to employers withdrawing before the plan year of the withdrawal) which can reasonably be expected to be collected. The first amount is equal to (a) the actuarial present value of all plan benefit entitlements at the end of the year of the [26] withdrawal, less (b) the actuarial present value of plan benefit entitlements on that date attributable to participants' service with employers required to contribute to the plan for the year of the withdrawal. The second amount is equal to (a) the value of plan assets at the end of the year of the withdrawal, less (b) the value of plan assets computed at such date under step (2) of the calculation of the portion of the plan's unfunded benefit obligations which are attributable to plan participants' service with the employer.

(2) The second step is to allocate the amount determined under step (1) under any allocation method used under the presumptive method or any of the other alternative methods. The plan must provide for the specific method of allocation to be utilized.

The PBGC is authorized by the bill to prescribe regulations setting forth other methods a plan may adopt to allocate assets in determining withdrawal liability for (1) unfunded benefit obligations attributable to service with the employer, and (2) unattributable obligations.

(5) Other methods

The bill authorizes the PBGC to prescribe by regulations a procedure by which a plan may adopt other methods for determining withdrawal liability. The PBGC, before approving any such method, is to be required to determine that the method would not significantly increase the risk of loss to plan participants, beneficiaries, or the PBGC. In addition, the PBGC is to be authorized to prescribe standard approaches for alternative methods for which approval would either not be necessary or would be necessary only under a modified procedure. Any such alternative method is to be required to allocate to employers all of the plan's unfunded benefit obligations.

In determining an employer's withdrawal liability under the presumptive method or any of the alternative methods, if the method specifies the use of a five plan year period in the numerator or denominator of a fraction, the plan could provide instead for the use of a period of more than five, but not more than 10, plan years, unless PBGC regulations provide otherwise.

(6) Other rules.

Under the bill, in the event of a transfer of liabilities from the plan from which a withdrawal takes place to another plan in connection with a withdrawal, withdrawal liability is to be reduced by an amount equal to the actuarial present value, determined at the end of the last plan year ending on or before the date of the withdrawal, of the transferred unfunded benefit obligations.

In the case of a withdrawal by an employer following a merger of multiemployer plans, withdrawal liability is to be computed under the applicable method in accordance with PBGC regulations. However, in the case of a withdrawal in the first plan year beginning after the merger, withdrawal liability is determined as if the plans had remained separate.

Under the bill, a plan may be amended to adopt rules, consistent with the interests of plan participants, beneficiaries and contributing employers, which provide for reduction or waiver of withdrawal liability to the extent the employer's obligation to contribute under [27] the plan or make withdrawal liability payments is assumed by another employer.

In the case of certain plans established prior to January 1, 1954, as a result of an agreement between employee representatives and the Government of the United States during a period of government operation, under seizure powers, of a major part of the productive facilities of an industry (Code sec. 404(c)), the presumptive method for determining withdrawal liability is the second alternative method for computing such liability. In addition, (1) the general *de minimis* rule, and (2) the exception for new employers, do not apply to such a plan unless the plan is amended to provide for their application.

c. Payment of withdrawal liability

(1) In general

An employer who withdraws from a multiemployer plan is to be required to pay its withdrawal liability to the plan in accordance with a payment schedule to be determined by the plan sponsor under standards set forth in the bill.[5] As soon as practicable after a withdrawal, the plan sponsor is to be required to notify the employer of (1) the amount of withdrawal liability, and (2) the payment schedule. In addition, the plan sponsor is to be required to demand that the employer make payment of withdrawal liability in accordance with the payment schedule.

In calculating the payment schedule, the plan is to compute the annual payment under a formula set forth in the bill. The employer is generally to be required to make this payment to the plan for the lesser of (1) the number of years it would take to amortize its withdrawal liability (determined under the assumptions used for the most recent actuarial valuation for the plan) or (2) 30 years. The amount of each annual payment under the formula is to be determined as the product of two amounts. The first amount is the average number of contribution base units (*e.g.*, hours worked, tons of coal mined) for the three consecutive plan years, during the period of 10 plan years ending with the plan year in which withdrawal occurs, in which the number of units was the highest. The second amount is the highest contribution rate (*e.g.*, cents per hour) which the employer had an obligation to contribute under the plan during the period of 10 plan years ending with the year of withdrawal.

However, with respect to these two amounts a plan could provide that for the first plan year ending on or after February 28, 1979, the number "5" is substituted for the number "10" and is increased by one for each succeeding plan year until it becomes 10.

For example, assume that an employer's withdrawal liability is $1 million and that the plan's valuation rate of interest is 6 percent. Assume that in the 3 years for which the contribution base units were the highest during the 10 most recent plan years during which the employer was obligated to contribute to the plan, the number of such units were 80,000 hours, 85,000 hours and 90,000 hours respectively, and that during the last ten plan years the highest contribution [28] rate applicable to the employer under the plan was 75 cents an hour. The product of 85,000 hours (the average of 80,000, 85,000, and 90,000) and 75 cents an hour is $63,750. This would result in the amortization of the liability over approximately 49 years. Because the 49-year schedule is longer than 30 years, the employer would be liable to the plan for 30 annual payments of $63,750.

In the event that a multiemployer plan terminates upon (1) withdrawal of all employers in the plan or (2) withdrawal of substantially all employers in the plan pursuant to an agreement or arrangement to withdraw (a "mass withdrawal"), the annual amount of withdrawal liability payable by each employer is to be computed without regard to the 30-year limit, and total unfunded benefit obligations of the plan are allocated to all employers under PGBC regulations. Thus in the above example, if all employers were to withdraw, the liability of the employer would be $63,750 a year for approximately 49 years, unless the amount or payment period were to differ because of PBGC regulations which allocate unfunded benefit obligations.

In the case of a "partial withdrawal," withdrawal liability payments are to be made in the same fashion as in the instance of a complete withdrawal, but the amount payable would be only a *pro rata* portion of the payment required in the case of a complete withdrawal.

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[5] The plan sponsor of a multiemployer plan is generally a Joint Board of Trustees which administers the plan.

(2) Time for payment

Payment of withdrawal liability is to begin no later than 60 days after the date on which a demand for payment is made by the plan sponsor. Under the bill, payments are generally to be made in four equal quarterly installments unless a particular plan provides for payment at other intervals. In any case where payment is not made when due, the bill requires interest to accrue with respect to the unpaid amount based on the prevailing market rate.

An employer is to be permitted to prepay its withdrawal liability obligations plus accrued interest, if any, in whole or in part without penalty.

In the event of default by an employer in payment of its withdrawal liability, the plan sponsor is to be permitted to require immediate payment of the balance of the employer's withdrawal liability plus any accrued interest thereon. Default is generally considered to occur where an employer fails to make any payment with respect to withdrawal liability when due, and further fails to make payment within 60 days after receiving written notice from the plan sponsor that payment of withdrawal liability is due but unpaid. In addition, the plan is to be permitted to adopt rules which would provide for other instances of default where it is indicated that there is a reasonable likelihood that an employer will be unable to pay its withdrawal liability.

A multiemployer plan may adopt rules consistent with the bill which set forth other terms and conditions for the satisfaction of an employer's withdrawal liability.

In the case of a multiemployer plan which terminates, each employer's obligation to make withdrawal liability payments for the future is to cease at the plan year in which the plan's assets, exclusive of outstanding withdrawal liability claims, are sufficient to meet all of its obligations. This determination of sufficiency is to be made by the PBGC.

[29] *(3) Notice requirements and furnishing of information*

Withdrawal liability is to be collectible upon notice and demand to the withdrawn employer by the plan sponsor. In order for the plan sponsor to be in a position to accurately determine liability, the bill requires the employer to furnish information to the plan sponsor. After an employer withdraws from a plan, the plan sponsor is to request in writing that the employer furnish such information as the plan sponsor reasonably considers necessary for it to fulfill its duties in computing and collecting withdrawal liability. The bill requires an employer to furnish the requested information within 30 days after such a written request from the plan sponsor.

The actual demand for payment of liability in accordance with the payment schedule is to be made by the plan sponsor. The bill requires that before the plan sponsor demands payment the plan must afford the employer a reasonable opportunity (1) to identify errors in the determination of withdrawal liability, (2) to identify errors in the payment schedule, and (3) to furnish to the plan sponsor any additional pertinent information. The plan sponsor also is required, if requested, to make relevant plan records reasonably available to the employer for review and duplication.

After the plan sponsor demands payment of withdrawal liability, an employer is permitted to request the plan sponsor to review any item relating to the calculation of the liability and the payment schedule. Any such request for review is to be made within 90 days after the employer receives the initial notice and demand for payment of the liability. In response to such a request by an employer, the plan sponsor is required to conduct a reasonable review of any matter questioned and to notify the employer of (1) its decision, (2) the grounds for its decision, and (3) the reason for any modification in the employer's withdrawal liability or of the payments schedule.

(4) Determination of actuarial assumptions, etc.

The PBGC is authorized to prescribe regulations setting forth actuarial assumptions which a plan may use in calculating withdrawal liability. However, a plan may provide instead that its own assumptions will be used to determine withdrawal liability rather than those developed by the PBGC.

In determining the unfunded benefit obligations under a plan, the plan's actuary and the plan administrator are permitted to rely on data available or on data secured by certain sampling techniques in situations where complete and definitive data is absent, provided such data can reasonably be expected to be representative of the status of the entire plan. In addition, a complete valuation of the plan is not required by the bill to be made more often than once every three years for the purpose of computing unfunded benefit obligations under the withdrawal liability provisions and reasonable estimates would be permitted in the interim years. However, the bill continues the authority of the Internal Revenue Service to require more frequent valuations in appropriate cases.

Under the bill, the plan sponsor may initially determine withdrawal liability on the basis of the latest available determination of contributions made to the plan by employers and the latest available actuarial valuation or, if later, the latest actuarial estimate.

[30] *(5) Plan rules and amendments*

There are several situations where plans, in the application of their own rules, either initially or by amendment, are permitted a wide degree of latitude in allocating and calculating withdrawal liability. In order to protect an employer from certain retroactive changes in a plan's rules, the bill prohibits the retroactive application of a plan rule or amendment relating to withdrawal liability from applying to a withdrawal occurring before its date of adoption, unless the employer consents to its earlier application.

The bill also requires that plan rules and amendments operate and be applied uniformly with respect to all employers except to the extent that lack of uniformity would be required to take into account employers' credit ratings.

Under the bill, when a plan rule or amendment affects withdrawal liability, the plan sponsor is required to give notice of the adoption of the rule or amendment to all employers required to contribute to the plan and to all employee organizations representing employees covered by the plan.

(6) Notice to the PBGC

Under regulations the PBGC is permitted to require a plan sponsor to notify the PBGC in any case where the withdrawal from a plan of an employer has resulted, or will result, in a significant reduction in total contributions to the plan.

(7) Relationship to other rules

Actions taken under the bill pursuant to the withdrawal liability rules are not to be considered prohibited self-dealing transactions for purposes of the nontax provision of ERISA.

In addition payments of withdrawal liability are not to be considered employer contributions for purposes of calculating withdrawal liability.

(8) Approval of amendments

If an amendment to a multiemployer plan authorized under the withdrawal liability provisions is adopted more than 36 months after the effective date of the bill, the amendment will be effective only if (1) the PBGC approves the amendment, or (2) within 90 days after it receives notice of the amendment from the plan sponsor, the PBGC fails to disapprove the amendment. However, certain amendments regarding methods for computing withdrawal liability could be adopted only in accordance with the section of the bill authorizing the amendments. The PBGC is to disapprove of a plan amendment only where it determines that the amendment creates an unreasonable risk of loss to plan participants, beneficiaries, or the PBGC.

(9) Determinations presumed correct

Under the bill, a determination of withdrawal liability by a plan would be presumed correct unless the party seeking to contest the determination shows by a preponderance of the evidence that the determination is unreasonable or clearly erroneous.

The determination by a plan as to the amount of its unfunded benefit obligations for a plan year is to be presumed correct, unless a party [31] seeking to contest the determination shows by a preponderance of the evidence that (1) the actuarial assumptions and methods used in the determination were unreasonable in the aggregate, or (2) a significant error was made by the plan's actuary in applying actuarial assumptions or methods.

(10) Supplemental fund for reimbursement for uncollectible withdrawal liability

Under the bill, the PBGC is required to establish a supplemental program by May 1, 1982, to reimburse multiemployer plans for withdrawal liability payments which are uncollectible because of bankruptcy or similar proceedings involving the employer. Under the program, the PBGC could also provide for reimbursement of a plan for withdrawal liability which is uncollectible for any other appropriate reason. A plan could elect coverage under the supplemental program and, if it did so, would be charged a premium for such coverage. The cost of the program (including appropriate administrative and legal costs) could be paid only out of premiums collected under the program. The PBGC could carry out the program in whole or in part under an arrangement with private insurers.

(11) Definition of obligation to contribute

For purposes of the withdrawal liability rules, an employer has an obligation to contribute if its obligation arises under one or more collective bargaining (or related) agreements or as a result of a duty under applicable labor-management relations law. An obligation to pay withdrawal liability or delinquent contributions is not considered an obligation to contribute.

2. Merger or transfer of plan assets or liabilities

a. Mergers and transfers to multiemployer plans

Under the bill, unless otherwise provided in PBGC regulations, a plan sponsor is not to be permitted to allow a multiemployer plan to merge (or consolidate) with one or more other multiemployer plans or to engage in a transfer of assets or liabilities to or from another multiemployer plan unless certain conditions are met. The applicable conditions are that:

(1) The accrued benefit of any participant or beneficiary will not be lower after the merger or transfer than it was before the merger or transfer;

(2) the benefits of participants and beneficiaries are not reasonably expected to be reduced under the reorganization or insolvency provisions of the bill during the five-year period following the year in which the merger or transfer is effective;

(3) it is not reasonably expected that the risk of loss to the PBGC with respect to any of the affected plans will increase significantly;

(4) an actuarial valuation of assets and liabilities of each of the affected plans for the plan year preceding the merger or transfer has been performed and the valuation is based on data not more than two years old; and

(5) the merger or transfer is agreed to by the plan sponsors of all the affected plans.

[32] Under the bill, action taken under the merger, etc. provisions does not constitute a prohibited self-dealing transaction under the nontax provisions of ERISA.

The plan sponsor of a multiemployer plan which is affected by a proposed merger is to be permitted to request an advisory opinion from the PBGC that the proposed merger complies with the requirements of the bill.

b. Transfers between a multiemployer plan and a single-employer plan

The bill provides that, in the case of a transfer of assets or liabilities from a multiemployer plan to a single-employer plan, the accrued benefit of any participant could not be lower immediately after the transfer than it was immediately before the transfer. In addition, in the case of a transfer of liabilities from a single-employer plan to a multiemployer plan or a merger of a single-employer plan into a multiemployer plan, no accrued benefit could be lower immediately after the transfer or merger than it was immediately before the transfer or merger.

As a general rule, the bill requires that, where a multiemployer plan transfers liabilities to a single-employer plan, the multiemployer plan is to be liable to the PBGC in the event of the termination of the single-employer plan within 60 months after the transfer. Under the bill, the amount of the liability is to be the lesser of (1) the excess of the insufficiency of plan assets of the terminated single-employer plan over 30 percent of the net worth of the employer maintaining the single-employer plan, or (2) the actuarial present value of the unfunded benefits transferred to the single-employer plan and guaranteed by the PBGC (such present value to be determined at the time of the transfer). This liability is to apply to a multiemployer plan unless the PBGC determines that the interests of the participants and the PBGC are otherwise adequately protected or the PBGC fails to make a determination. The PBGC is to make such determination within 120 days after receipt of a complete application from the plan sponsor of the multiemployer plan that such a determination be made. If the PBGC fails to make the determination within the prescribed period, the multiemployer plan is not to have contingent liability. A multiemployer plan is not to be liable under the bill because of the transfer of liabilities to a single-employer plan where (1) the liabilities had previously accrued under a single-employer plan that merged with the multiemployer plan, (2) the present value of the liabilities is not greater than the present value of liabilities for benefits which accrued before the single-employer plan merged with the multiemployer plan, and (3) the value of the assets which would have been in the single-employer plan if the employer had maintained and funded it as a separate plan under which no benefits accrued after the merger. This exception to the liability provision is sometimes referred to as the "in and out rule" because it is designed to protect multiemployer plans which merge with but later spin off single-employer plans.

In any case where a multiemployer plan is liable under the bill because of a merger or transfer, the PBGC is authorized to make arrangements for satisfaction of the liability.

[33] Where benefits are transferred to a single-employer plan under the merger or transfer rules, the benefits are thereafter to be governed by the termination insurance rules applicable to single-employer plans.

As a general rule, a multiemployer plan is not to be permitted to transfer assets to a single-employer plan unless the plan sponsor of the single-employer plan agrees to the transfer. In the case of a transfer under the "in and out" rule, however, the plan sponsor need not so consent if advance agreement is obtained from the employer who, after the transfer, will be obligated to contribute to the single-employer plan.

c. Partition

Partition could occur under the bill when, pursuant to court order obtained by the PBGC, a portion of the assets and liabilities of a multiemployer plan is segregated and held as a separate fund. Under the bill, a plan sponsor is permitted to request the PBGC to petition a Federal District Court for an order of partition upon a showing of certain facts. The plan sponsor would have to show that (1) a bankruptcy or similar proceeding with respect to an employer has resulted or will result in a subtantial reduction in the aggregate amount of contributions to the plan, and (2) it has determinel that the participants and beneficiaries' vested benefits which would be partitioned are directly attributable to service with the employer involved in the bankruptcy or similar proceeding.

If the PBGC determines that a multiemployer plan is likely to become insolvent as a result of a reduction of contributions because an employer is involved in a bankruptcy or similar proceeding, the PBGC may petition the Federal District Court for partition, if the PBGC determines that partition will significantly decrease the risk that insolvency of the multiemployer plan will occur. In such a case, the PBGC is required to notify the plan sponsor and the plan participants and beneficiaries whose benefits would be partitioned. The PBGC, in its petition, is to be permitted to propose a transfer of only vested benefits directly attributable to service with the employer involved in the bankruptcy or similar proceeding and an equitable share of the plan's assets.

The portion of the multiemployer plan which is partitioned is treated under the bill as a terminated multiemployer plan under which only the employer involved in the bankruptcy or similar proceeding would have withdrawal liability.

d. Assets transferable

Under the bill, multiemployer plans are required to provide rules regarding the transfer of assets to another plan. The rules could not restrict unreasonably the transfer of plan assets in connection with a transfer of plan liabilities and are to operate and be applied uniformly with respect to all transfers, except that reasonable variations are to be permitted to take into account the potential financial impact of a particular transfer on a multiemployer plan.

e. Other rules

Under the bill, the PBGC is required to prescribe regulations exempting *de minimis* transfers of assets from the merger, etc. rules. In addition, the merger, etc. rules do not apply to transfers of assets [34] pursuant to written reciprocity agreements except to the extent provided in PBGC regulations.

3. Reorganization and minimum contribution requirement

a. In general

Under the bill, certain financially troubled multiemployer plans are to be considered in a status of "reorganization." Once a plan enters a status of reorganization (1) benefits under the plan, including benefits currently being paid to retirees or their beneficiaries, could be reduced, (2) certain modifications to the otherwise applicable funding requirements of ERISA are to apply, and (3) certain prohibitions against increases in benefits are to apply if reductions are made.

b. Reorganization status

Under the bill, if the financial condition of a multiemployer plan becomes sufficiently poor under standards set forth in the bill, the plan is to be considered in reorganization and become subject to certain special rules regarding funding and adjustments in accrued benefits.

A multiemployer plan is to be in reorganization for a year if the plan's reorganization index is greater than zero. The reorganization index is the excess of the "benefit entitlements charge" of the plan over the net charge to the plan's funding standard account (see I. Minimum Funding Requirements) for the year without taking into account (1) credits for actual contributions to the plan for the year, (2) credits with respect to any waived funding deficiency for the year, and (3) credits with respect to any switchback liability for the year.[6] "Benefit entitlements charge" is defined as the amount necessary to amortize, in equal annual installments, the unfunded benefit obligations of the plan, determined as of the close of the plan year, (1) over 10 years in the case of obligations attributable to persons whose benefits are in pay status, and (2) over 25 years in the case of unfunded benefit obligations for other participants.

Under the bill, the determination of unfunded benefit obligations for purposes of calculating the benefit entitlements charge is based on a valuation of the plan performed as of the last day of the "base plan year", with certain adjustments. The "base plan year" for any plan year is the last plan year ending at least six months before the earliest of the effective dates of the "relevant collective bargaining agreements". A relevant collective bargaining agreement is a collective bargaining agreement (1) which is in effect for more than six months during the plan year for which the charge is determined and (2) which has not been in effect for more than three years as of the end of the plan year.[7] In any case where there is no relevant collective bargaining agreement, the base plan year is the plan year ending at least one year before the beginning of the plan year in which the determination of unfunded benefit obligations is made. Of course, the Secretary of the Treasury is to have the authority to require that the benefit entitlements charge and the charges and credits to the funding standard account are computed on a consistent basis.

[35] *c. Prohibition of certain payments*

Under the bill, while a plan is in reorganization, the present value of a participant's vested benefits derived from employer contributions is not to be permitted to be distributed in a form other than substantially level pension payments for life if the present value distribution would exceed $1,750. This prohibition is not to apply (1) in the case of a death benefit distribution, or (2) if the PBGC approves the payment of benefits in accordance with the plan in a greater amount after determining that the payment is in the interest of the plan's participants and beneficiaries and does not unreasonably add to the PBGC's risk of loss with respect to the plan.

d. Termination of reorganization status

A terminated multiemployer plan is not considered to be in reorganization after the date on which the last employer maintaining the plan withdraws from the plan. For this purpose, the determination of whether a withdrawal takes place is to be made in accordance with the definition of withdrawal contained in the bill's withdrawal liability provisions (see C. Employer Withdrawal Liability, Mergers, Etc., *Explanation of provisions, 1. Employer withdrawal liability, a. Definition of withdrawal, (1) Complete withdrawal*) and partial withdrawals are not to be taken into account.

e. Notice of reorganization

Under the bill when a multiemployer plan is in reorganization and would require an increase in contributions (before taking into account the credit for overburdened plans and accrued benefit reductions permitted under the reorganization provisions), the plan sponsor is required to notify interested parties of the reorganization status in the plan's summary annual report. The persons to be notified are (1) plan participants and beneficiaries, (2) employers required to contribute to the plan, and (3) employee organizations representing plan participants with respect to the plan. In addition to stating that the plan is in reorganization status, the notice must state that if contributions to the plan are not increased, then accrued benefits under the plan may be reduced or an excise tax may be imposed on employers if they fail to increase plan contributions.

In addition, the PBGC is to be authorized to issue regulations prescribing additional or alternative requirements for assuring adequate notice to, and access to relevant information, by interested parties.

f. Minimum contribution requirement

(1) In general

Under the bill, a plan in reorganization or a plan under which plan assets are not more than a specified multiple of benefit payments is to continue to maintain its funding standard account, but such a plan is also to be required to meet special minimum funding requirements. These requirements are to be met for a plan year if the sum of the "minimum contribution requirement" plus any accumulated funding deficiency for the preceding plan year did not exceed the amounts contributed by employers to the plan year, including amounts contributed to meet withdrawal liability obligations. If these requirements are not met, the accumulated funding deficiency for that plan year is to be the excess of the sum of the "minimum contribution re-[36]quirement" and the accumulated funding deficiency for the preceding plan year over the plan contributions, and employers are to be subject to the current excise taxes on accumulated funding deficiencies (or subject to the current conditions for having such deficiencies waived by the Internal Revenue Service).

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[6] In the case of a multiemployer plan using the "shortfall" method in computing actuarial costs, shortfall gains and losses in that plan year are to be taken into account in computing the net charge for the plan year.

[7] The six-month period may be, for example, the first six months or last six months of a particular agreement.

The bill defines the minimum contribution requirement as the sum of (1) the plan's benefit entitlements charge,[8] and (2) in certain cases where the plan has been amended to increase benefits while the plan is in reorganization, the excess, if any, of the normal cost attributable to such plan amendment reduced by 15 percent of the normal cost computed without regard to the amendment. The minimum contribution requirement is reduced proportionately where the plan's current contribution base (*e.g.*, hours of service) for which employer contributions are required for the plan year is less than the plan's valuation contribution base. A plan's "valuation contribution base" is generally equal to the plan's contribution base for the plan year for which the actuarial valuation used to determine unfunded benefit obligations under the plan was made, with certain adjustments for upward or downward trends. Special rules apply for determining a plan's valuation contribution base for a plan year in which the plan is insolvent.

In the case of a plan in reorganization, if the plan's benefit entitlements charge is less than the plan's "cash flow amount" for a plan year, the minimum contribution requirement is determined by substituting the "cash flow amount" for the benefit entitlements charge. For this purpose, "cash flow amount" is the aggregate amount of benefits payable under the plan increased by the plan's administrative expenses for the plan year and decreased by the value of available plan assets, as determined under regulations prescribed by the Secretary of the Treasury. Also, in determining a plan's minimum contribution requirement for a plan year, the benefit entitlements charge may be adjusted to reflect a subsequent plan amendment which reduces benefits under the reorganization or plan termination provisions of the bill or under the funding standard. This adjustment would only take place, however, if the amendment is adopted and effective no later than 2½ months after the close of the plan year, or within an extended period for making the amendment as prescribed in regulations issued by the Secretary of the Treasury.

In addition, during the period that a plan is required to meet the "minimum contribution requirement," a credit or charge balance may build up in the plan's funding standard account which is being maintained. The bill provides that if a plan is not required to meet the "minimum contribution requirement" for a plan year but was required to meet such requirement for the preceding plan year, any balance in the funding standard account is to be eliminated by an offsetting credit or charge (as appropriate) which is to be amortized over the following 30 years.

[37] Under the bill, a multiemployer plan is considered not to have a reorganization deficiency for a plan year if the rate of employer contributions under the plan equals or exceeds (1) the net charges to the funding standard account plus (2) seven percent of such amount for each year for which the minimum contribution requirement has applied to the plan. This seven percent limitation does not apply if a plan amendment is adopted while the plan is in reorganization and the amendment increases benefits with respect to service performed before the date the amendment is adopted.

(2) *Credit for overburdened plans*

Where a plan is considered to be financially overburdened for a plan year (determined under standards set forth in the bill), the plan is required to apply an "overburden credit" against its minimum contribution requirement for the plan year. Accordingly, the overburden credit would reduce the additional funding needed to satisfy the minimum contribution requirement.

A plan is considered overburdened for a plan year under the bill if (1) the average number of participants in pay status in the year exceeds the average of the average number of active participants in that year and in the preceding two plan years, and (2) the rate of employer contributions to the plan is at least equal to the greater of the rate of contributions for the preceding plan year or the rate of contributions for the year before the first plan year in which the plan was in reorganization (or in which the plan assets were not more than a specified multiple of benefit payments). For purposes of this rule, "pay status participant" means a retired employee receiving pension payments as an annuity, and "active participant" means (1) any plan participant who has not failed to accrue a benefit for the year because of insufficient active employment, (2) any active employee who is not a plan participant but who is in an employment unit covered by a collective bargaining agreement requiring the employee's employer to contribute to the plan, and (3) any active employee considered an employee of the employer under a special formula in the bill which treats certain employees as the employer's employees on the basis of the employer's withdrawal liability contributions to the plan. Also, for purposes of applying the overburden credit rules, in determining the first plan year in which a plan is in reorganization, years in which the plan was previously in reorganization are disregarded if followed by three consecutive plan years in which the plan is not in reorganization.

The amount of overburden credit for a plan year is to be the product of two amounts. The first amount is one-half of the "average guaranteed benefit paid" in the base plan year and the second amount is the "overburden factor" for the plan year. The "average guaranteed benefit paid" is 12 times the average monthly pension payments guaranteed under the bills, computed by dividing (1) the total guaranteed annuity pension payments under the plan by (2) the number of pay status participants in the plan for the plan year. The "overburden factor" for a plan for a plan year is the excess of (1) the average number of pay status participants for the base plan year over (2) the average of the average number of active participants in the plan in that plan year and the two preceding plan years.

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[8] Where the benefit entitlements charge is less than 115 percent of the amount of benefits payable during a plan year, reduced by the plan's investment income for the year, and plan reserves are very low, such amount is substituted for the benefit entitlements charge.

[38] Under the bill, the Secretary of the Treasury could deny a plan an overburden credit for a plan year upon a finding that (1) the plan's current contribution base was reduced without a correlative reduction in the plan's unfunded benefit obligations attributable to pay status participants, and (2) such reduction resulted from a change in an agreement providing for employer contributions to the plan. Accordingly, a plan that has excluded active employees is not to be eligible for the overburden credit. However, an employer withdrawal from a plan is not to prevent the plan from being eligible for the overburden credit, unless the Secretary of the Treasury finds that in connection with the withdrawal a contribution base reduction resulted from a transfer of plan liabilities to another plan.

Under the bill, in the case of the merger of plans involving one or more multiemployer plans which are in reorganization, there is to be a limit on the amount of overburden credit which could be applied to the minimum contribution requirement of the merged plan. The maximum credit for any of the first three plan years ending after the merger could not exceed the sum of the overburden credits applied by each of the plans to avoid a reorganization deficiency for the last plan year ending before the merger. Of course, the rules relating to mergers also apply in computing the overburden credit in the case of a consolidation of plans.

g. *Adjustments in accrued benefits*

With very limited exceptions, under present law, plan amendments are not permitted to reduce benefits already accrued by an employee. However, in the case of a multiemployer plan in reorganization, the bill permits plan amendments to reduce accrued benefits attributable to employer contributions under specified circumstances. The accrued benefits which are subject to reduction are those which have been in effect under the plan for less than 60 months and are not eligible for guarantee by the PBGC.

The conditions which must be met in order for a plan's accrued benefits to be reduced are as follows:

a. A notice must be given, at least six months in advance of the first day of the plan year in which the amendment reducing accrued benefits is adopted, to plan participants and beneficiaries, to each employer with an obligation to contribute to the plan, and to each affected employee organization. The notice must state that the plan is in reorganization and that if contributions to the plan are required to be increased and the increase is not made, accrued benefits under the plan are required to be reduced or the failure to increase employer contributions to the plan may result in an excise tax for failure to meet the minimum funding standard.

b. Under regulations to be issued by the Secretary of the Treasury—

(i) accrued benefits of inactive participants are not to be reduced to a greater extent proportionally than accrued benefits for active participants are reduced;

(ii) benefits attributable to employer contributions other than accrued benefits (such as death benefits or health benefits) and the rate of future benefit accruals are to be decreased [39] at least as much as accrued benefits of active participants are decreased; and

(iii) if the reduction in accrued benefits takes the form of a change in the mode of benefit or the requirements for benefit entitlements, the reduction may not affect benefits in pay status on the effective date of the amendment or benefits of any participant who has reached, or is within five years of reaching, normal retirement age on the effective date of the amendment.

c. The rate of employer contributions for the plan year in which the amendment becomes effective and for all future years while the plan is in reorganization must at least equal the greater of (i) the rate of employer contributions (without regard to the amendment) for the plan year in which the amendment becomes effective, or (ii) the rate of employer contributions for the preceding plan year.

Where accrued benefits are decreased by a plan amendment, a plan is not to be permitted to recapture a benefit payment which has already been made under the plan's accrued benefit provisions determined before the amendment is adopted.

Once a plan has been amended to decrease accrued benefits, a future plan amendment is not to be permitted to increase (1) accrued benefits, or (2) the rate of future benefit accrual, only if the plan is first amended to restore previously eliminated accrued benefits of inactive participants and participants within five years of normal retirement age at least to the extent of the amount or rate by which the plan amendment increases benefit accruals. Moreover, where a plan is amended so that it partially restores previously accrued benefit levels or the previous rate of accrual, the benefits of inactive participants must be restored in at least the same proportion as accrued benefits are restored overall.

Under the bill, no increase in benefits under a plan is to be permitted to take effect in a plan year in which an amendment reducing accrued benefits is adopted or first becomes effective.

Where a benefit is reduced and later restored, a plan is not required to make retroactive benefit payments to participants who received payment under the reduced accrued benefit levels.

For purpose of applying the benefit reduction rules, an inactive participant is an individual whose benefits are in pay status under the plan or an individual not currently in service under the plan but who nevertheless has a vested plan benefit.

The Secretary of the Treasury is authorized to prescribe regulations permitting benefit reductions or increases for different groups of participants on an equitable basis to reflect variations in contribution rates and other relevant factors reflecting differences in bargained-for levels of financial support for plan benefit obligations.

h. *Insolvent plans*

Under the bill, if a multiemployer plan is insolvent for a plan year, the plan is to be required to suspend the payment of benefits, other than basic benefits, which exceed the "resource benefit level." The suspension rule does not apply, however, if the PBGC prescribes a procedure for the guarantee of supplemental benefits (retirement ben-[40]efits exceeding basic benefits) to the extent supplemental benefits are guaranteed by the PBGC. A multiemployer plan is considered insolvent for a plan year if (1) it is in reorganization, (2) it has been amended to reduce benefits to the level of basic benefits, and (3) it does not have available resources sufficient to pay benefits under the plan when due for the plan year. The term "resource benefit level" means the highest level of monthly benefits which the plan could pay out of its available resources.

For each year for which a multiemployer plan is insolvent, the plan sponsor is to be required to determine and certify the resource benefit level of the plan, based on its reasonable projection of available resources and benefits payable. Where the suspension of benefits above the resource benefit level takes place, benefits are to be suspended in substantially uniform proportions with respect to all persons whose benefits are in pay status under the plan. The proportionate suspension is to be done in a manner consistent with regulations prescribed by the Secretary of the Treasury. In addition, the Secretary of the Treasury is to be authorized to prescribe rules under which the benefits of different participant groups could be suspended in disproportionate fashion if varied equitably to reflect variations in contribution rates and other relevant factors reflecting differences in bargained-for levels of financial support for plan benefit obligations.

A plan sponsor is not to be permitted to determine and certify a resource benefit level which is below the level of basic benefits for a plan year, except in a case where payment of all benefits other than basic benefits was suspended for the plan year.

If, by the end of a plan year for which a plan is insolvent, the plan sponsor determines that benefits can be paid above the resource benefit level, the plan sponsor is required to direct the distribution of such additional benefits in accordance with regulations prescribed by the Secretary of the Treasury. Where by the end of the year, benefits up to the resource benefit level have not been paid, the amount necessary to bring benefits up to that level are required to be distributed in accordance with regulations prescribed by the Secretary of the Treasury, to the extent possible, considering the plan's available resources.

Every three years during the period when a plan is in reorganization, beginning with the end of the first such plan year, the plan sponsor is required to compare the value of plan assets with the total amount of benefit payments for the year. Except where plan assets exceed three times the total amount of benefit payments, the plan sponsor is to be required to make a determination regarding whether the plan will be insolvent during any of the next three plan years. In addition, if at any time the plan sponsor determines, on the basis of experience, that available resources are not sufficient to pay benefits when due for the forthcoming plan year, the sponsor is required to certify that the plan will be insolvent for that year. Such certification is required no later than three months before the commencement of the plan year.

For each year for which a plan is insolvent, the plan sponsor is required to determine and certify the resource benefit level and the level of basic benefits no later than three months before the commencement of the plan year. In addition, if the plan sponsor determines that [41] the plan may be insolvent any time in the next three plan years, the sponsor is to be required to so notify (1) the Secretary of the Treasury, (2) the PBGC, (3) plan participants and beneficiaries, (4) each employer required to contribute to the plan, and (5) each affected employee organization. In addition, the above parties other than the Secretary of the Treasury and the PBGC are to be informed that, in the event of insolvency, payments in excess of basic benefits are to be suspended (unless guaranteed as supplemental benefits). No later than two months before the first day of a year for which a plan is insolvent, the plan sponsor is required to notify each of the above parties of the plan's resource benefit level.

Where the plan sponsor believes that the resource benefit level for a plan year for which a plan is insolvent may not exceed the level of basic benefits, the plan sponsor is to so notify PBGC no later than six months before the first day of the plan year.

Where a plan sponsor determines and certifies a resource benefit level below the level of basic benefits, the sponsor is to apply for PBGC financial assistance. Where the plan sponsor determines a resource benefit level above the level of basic benefits but anticipates that for any month during a year for which the plan is insolvent the plan will not have sufficient assets to pay basic benefits, the plan sponsor is to be permitted to apply to the PBGC for financial assistance.

4. *Financial assistance*

Under the bill, if the PBGC receives an application for financial assistance from a plan and verifies that the plan will be insolvent and unable to pay basic benefits when due, the PBGC is to provide financial assistance to the plan in an amount sufficient to permit the plan to pay its basic benefits. Such financial assistance is to be provided under such conditions as the PBGC determines to be equitable and appropriate to prevent unreasonable loss to the PBGC with respect to the plan. Where a plan receives financial assistance from the PBGC, it is to repay the PBGC for such assistance on reasonable terms which are consistent with regulations to be issued by the PBGC.

While the PBGC is determining the amount of assistance necessary to permit a plan to pay basic benefits, the PBGC is to be permitted to provide interim financial assistance in an amount appropriate to avoid undue hardship to plan participants and beneficiaries.

5. *Benefits under certain terminated plans*

Under the bill, where a plan terminates by a mass withdrawal of employers the plan sponsor is required to amend the plan (1) to reduce benefits, and (2) to suspend certain benefit payments. The reduction in benefits is to be to a level at which plan assets will be sufficient to discharge the plan's obligations when due, but not to a level of benefits below the level eligible for guarantee. In making the determination of this level, the present value of vested benefits under the plan and the value of plan assets are to be determined and certified as of the end of the plan year in which the plan terminates, and as of the end of every plan thereafter. For this purpose, (1) plan assets include the value of outstanding claims for withdrawal liability that are not uncollectible, and (2) for the year in which the plan terminates and for the following two plan years plan assets also include certain additional assets [42] attributable to employer withdrawal liability, as prescribed in regulations issued by the PBGC in order to avoid premature benefit reductions.

Any plan amendment reducing benefits as to (1) limit the reduction to the extent necessary to permit the payment of vested benefits, (2) eliminate or reduce only those accrued benefits which are not guaranteed by the PBGC, (3) except to the extent permitted by the PBGC, make reductions only in accordance with the reorganization rules and only to the extent permitted under such rules, and (4) become effective no later than six months after the plan year in which it was determined that the present value of vested benefits exceeds plan assets. The Committee expects that a reduction of benefits for a participant or beneficiary to a greater extent than is permitted under the bill will be considered a violation of the minimum standards of ERISA (*e.g.*, the vesting and fiduciary standards) and that fiduciaries will act prudently in discharging their duties to retirees and other participants and beneficiaries.

The benefit payments which are to be suspended where a plan terminates are all nonbasic benefits that cannot be provided out of plan resources.

6. *Enforcement*

a. *Civil actions*

Under the bill, certain parties could bring a civil action for appropriate legal relief, equitable relief, or both. These parties are (1) a plan fiduciary, an employer, a plan participant, or a plan beneficiary, any of whom are adversely affected by an act or omission of any party under the provisions of the bill with respect to multiemployer plans, as well as (2) an employee organization which represents an affected plan participant. However, no such action could be brought against the Secretary of the Treasury or the Commissioner of Internal Revenue.

In any case where a civil action is brought to compel an employer to pay withdrawal liability, the court may award (1) the unpaid liability plus interest as well as (2) liquidated damages payable to the plan. In general, the district courts of the United States have exclusive jurisdiction for civil actions under the bill without regard to the amount in controversy. In the case of an action brought by a plan fiduciary to collect withdrawal liability, State courts of competent authority are also to have jurisdiction.

The proper venues in Federal district court for bringing an action under the bill are to be (1) the district where the plan is administered, (2) the district where a defendant resides, or (3) the district where a defendant does business. Service of process is to be permitted in any district where a defendant (1) resides, (2) does business, or (3) may be found. In addition, a copy of the complaint in any action brought under the bill is to be served on the PBGC by certified mail. The PBGC may intervene in any action brought under the bill.

In the case of an action under the bill, the court is permitted to award to the prevailing party all or a portion of costs and expenses in connection with the action, including reasonable attorney's fees.

The period of limitations for the commencement of an action under the bill is to expire six years after the date on which the cause of action arose.

[43] *b. Penalty for failure to provide notice*

If any person fails without reasonable cause to provide any notice required under the termination insurance program for multiemployer plans or under implementing regulations the bill provides that the person is to be liable to the PBGC in an amount up to $100 for each day that the failure continues. The PBGC is authorized to bring a civil action against the person failing to give notice. The action could be brought in the United States District Court for the District of Columbia or in any United States district court within the jurisdiction where (1) the plan assets are located, (2) the plan is administered, or (3) a defendant resides or does business. Service of process for such an action may take place in any district where a defendant (1) resides, (2) does business, or (3) may be found.

General effective date

The provisions of the bill generally apply on the date of enactment. One exception is that the withdrawal liability rules take effect as of February 27, 1979. For purposes of determining whether an employer has withdrawn from a multiemployer plan, the definition of multiemployer plan in effect at the time of the withdrawal is to be applied. Another exception is that the reorganization provisions take effect on the first day of the first plan year beginning after the earlier of (1) the expiration date of the last collective bargaining agreement in effect on the date of enactment of the bill or (2) 3 years after the date of enactment of the bill.

Also, the bill provides that where an employer has withdrawn from a multiemployer plan before the date of enactment of the bill, and a bond or escrow has been provided by the employer under present law, the PBGC is to pay the bond or escrow to the plan if, because of the withdrawal of all employers from the plan, the plan terminates before February 27, 1984. In any case in which the plan is not terminated before February 27, 1984, the liability of the employer is abated and any payment held in escrow is to be refunded without interest to the employer or the employer's bond is to be cancelled.

[44] *Ways and Means Committee Amendment*

1. Definition of withdrawal—two-percent de minimis rule

Under the bill, an employer who is obligated to make less than two percent of the total contributions to a plan is generally not charged with withdrawal liability for a partial withdrawal from the plan. The Committee determined that it is inappropriate automatically to relieve employers of partial withdrawal liability where a plan has substantial unfunded benefit obligations.

The Committee amendment revises the two-percent *de minimis* rule for partial withdrawals. Under the amendment, the rule automatically applies only in the case of a plan with unfunded benefit obligations, determined as of the close of the plan year of a partial withdrawal, not exceeding $1.25 million. In the case of a plan with unfunded benefit obligations of more than $1.25 million, the two-percent *de minimis* rule applies only if the plan provides for its application.

2. Computation of withdrawal liability—West Coast longshore labor

Under the bill, withdrawal liability is imposed on employers who maintain multiemployer pension plans. Also under the bill, withdrawal liability, absent a plan provision to the contrary, is generally computed under a rule which draws a distinction between unfunded benefit obligations created in plan years ending before February 28, 1979, and unfunded benefit obligations incurred in plan years ending on or after February 28, 1979.

The Committee has concluded that in the case of multiemployer plans covering West Coast longshore labor the PBGC should be authorized to define the term "employer". In addition the Committee has concluded that the presumptive method for computing withdrawal liability under the bill is inappropriate for a plan covering West Coast longshore labor and that withdrawal liability under such a plan should be computed under a method which draws no distinction with respect to whether unfunded benefit obligations are incurred in plan years ending before February 28, 1979, or in plan years ending on or after February 28, 1979.

The Committee amendment provides special rules for a West Coast longshore labor plan. Under the amendment (1) a West Coast longshore labor plan is to be required to use the second alternative method of computing withdrawal liability, and (2) the term "employer" with respect to such a plan will be defined under regulations prescribed by the PBGC. The amendment defines a West Coast longshore labor plan as a plan which covers longshore labor in all major ports with the western coastal area of the United States between Canada and Mexico.

[45] *3. Payment of withdrawal liability*

a. Determination by reference to prior average contributions

Under the bill, the annual amount of the withdrawal liability payments of an employer is based on the product of the average contribution base units and the employer's rate of contribution to the plan, determined with reference to a prior period.

The Ways and Means Committee recognizes that for purposes of computing the amount of an employer's annual withdrawal liability payments, a plan, at this time, may not have ready access to the records necessary to compute such payment based on the average number of contribution-base units during a prior period. For this reason, the Committee has decided for a transition period to permit plans to base the computation on the average required employer contributions during the prior period.

Under the amendment, a plan could provide that for any plan year ending before 1986, the amount of an employer's annual withdrawal liability payment would, be the average of the required employer contributions under the plan for the period of three consecutive plan years for which such contributions were the highest during the period of ten consecutive plan years ending with the plan year in which the withdrawal occurs. This method could not be used by a plan for determining withdrawal liability payments in any case in which the plan terminates because of mass withdrawal. If a plan provides the computation method permitted by the Committee amendment and then the plan is amended to provide for use of the original method provided under the bill, the plan must use the original method thereafter.

b. Charge to employer for calculating withdrawal liability

Under the bill, because an employer who withdraws from a multiemployer plan may incur withdrawal liability, employers may be expected to request plan sponsors periodically to calculate potential withdrawal liabilities. The Committee has concluded that the expense of such calculations should not necessarily be borne by the plans.

Under the amendment, if any employer requests the plan sponsor to make an estimate of the employer's potential liability upon withdrawal from the plan, the plan sponsor may require the employer to pay the reasonable cost of providing the estimate. This specific authorization to adopt a plan provision under which a reasonable charge may be imposed for providing estimates of withdrawal liability is not intended by the Committee to limit the right of a plan to adopt other provisions for other reasonable charges authorized by the bill.

c. Withdrawal liability payment fund

Under the bill, a fund would be established to pay uncollectible employer withdrawal liability. The fund would be established and administered by the PBGC.

The Committee has concluded that a privately established fund for payment of withdrawal liability should be available as an alternative to a fund administered by the PBGC. In addition, the Committee has concluded that premiums for the PBGC maintained fund should be subject to Congressional review. The Committee believes that the [46] PBGC should not be permitted to set unrealistically low premiums because such conduct could attract additional plan participation in the voluntary program in reliance on low premium levels.

Accordingly, the Committee amendment permits plan sponsors of multiemployer plans to establish and participate in private funds for the purpose of paying withdrawal liabilities under certain circumstances. Any such fund which meets the applicable requirements is to be a tax-exempt organization. The fund could be required to maintain agreements for collection of premiums and payment of withdrawal liability with respect to a substantial portion of the participants in the multiemployer plan eligible to participate in the fund. The fund is to be administered by a board of trustees on which there is equal representation of employers and employees.

Under the Committee amendment, the fund would receive contributions from participating plans. Contributions by a plan to the fund during a plan year are to reduce the amount considered contributed to the plan for the year for purposes of the minimum funding standard and the minimum contribution requirement. The Committee expects that, in considering whether to approve a waiver of the funding requirements for a plan under section 412(d) of the Code for a plan year during which the plan has made a contribution to a withdrawal liability payment fund, the amount and nature of the payment will be taken into account.

The eligibility of a plan to participate in a fund is to be determined by the rules of the fund. Where an employer has withdrawn from a participating multiemployer plan and has incurred withdrawal liability, the fund would pay to the plan on behalf of the employer an amount not exceeding the portion of the employer's withdrawal liability which is not attributable to plan participants' service with an employer who was obligated to contribute to the plan on or after February 28, 1980 (unattributable liability). The fund could also pay withdrawal liability-type amounts which are not due from an employer solely because of (1) the special two-percent *de minimis* rule for partial withdrawal, (2) the general *de minimis* rule, or (3) the 30-year cap on withdrawal liability payments. In addition, the fund could pay withdrawal liability payments to the extent that they are uncollectible. The extent to which these types of amounts would be paid by the fund is generally to be determined under the rules of the fund. These payments are to be treated in the same manner as payments of withdrawal liability to the plan.

To the extent the fund pays unattributable withdrawal liability incurred by an employer, the employer is to be relieved of the liability.

Where a fund has paid uncollectible withdrawal liability to a plan, the fund is to be subrogated to the rights of the plan against the employer. If a withdrawal liability payment fund is terminated, any assets of the fund at termination are to revert to the participating plans and are not to revert to employers. Under the Committee amendment, the fund is not to lend its assets to participating plans or to the PBGC and the fund is not to borrow from participating plans or the PBGC.

The Committee amendment authorizes the PBGC to prescribe regulations with respect to withdrawal liability payment funds. The [47] Committee expects that such regulations will assure that the funds do not have the effect of undermining the purposes of the withdrawal liability rules. For example, the Committee expects the PBGC regulations will assure that payments by a fund with respect to unattributable liability are not in excess of appropriate levels. Of course, PBGC rules with respect to the withdrawal liability payment fund and with respect to the PBGC-administered fund are not to be designed or administered for the purpose of providing either of the arrangements a competitive advantage over the other.

The fund is to be maintained for the exclusive purpose of paying the specified withdrawal liability and withdrawal liability-type payments to plans as well as paying reasonable administrative expenses in connection with its operation.

Payments are not to be permitted from a withdrawal liability payment fund to a plan in the event of a withdrawal or partial withdrawal where the employees in the bargaining unit that has withdrawn from the plan continue, after the withdrawal, to be represented in negotiations with the employer by the labor organization representing the employees immediately before the withdrawal.

The amendment also provides for Congressional review of premiums for coverage under the PBGC maintained fund. Under the amendment, no revision of the premium schedule for this coverage could be adopted by the PBGC unless the revised schedule has been submitted to the Congress. The PBGC could adopt the revised schedule unless, within 60 days after the submission, the Congress disapproves of the revised schedule by a concurrent resolution which has been referred to the Committee on Ways and Means and the Committee on Education and Labor of the House, and to the Committee on Finance and the Committee on Labor and Human Resources of the Senate. The Committee expects that if the Congress disapproves of a revised premium schedule recommended by the PBGC, the PBGC will make appropriate adjustments to payments from the fund.

4. Notice of reorganization—content of notice to encompass beneficiary rights and remedies

Under the bill, a multiemployer plan in reorganization must notify interested parties of potential benefit reductions. Under the Committee amendment, the notices are to inform plan participants and beneficiaries of their rights and remedies and of the manner in which they may contact the Department of Labor for certain information. The Committee expects that the Department of Labor will refer inquiries from participants and beneficiaries to the Internal Revenue Service or to the PBGC in appropriate cases.

5. Minimum contribution requirement —seven-percent limitation on annual increase in contribution rate

Under the bill, a plan in reorganization is subject to a minimum contribution requirement which may require contributions greater than would be required under the minimum funding standard of ERISA, generally not to exceed the net charges to the funding standard account plus 7 percent of such amount for each year the minimum contribution requirements have applied to the plan. The Committee has determined that the minimum contribution requirement should not be [48] permitted to increase the rate of plan contributions above those required for the prior year by more than a reasonable amount.

Under the amendment, the minimum contribution requirement applicable to a plan for a particular plan year could not exceed an amount which would require a rate of employer contributions in excess of the rate which would be required to meet the greater of (1) the net charges under the plan's funding standard account as if it were not in reorganization (without regard to any credit balance in the funding standard account) or (2) 107 percent of the amount required for the preceding year. This limitation does not apply with respect to a plan if, while the plan is in reorganization, a plan amendment is adopted which increases benefits with respect to service performed before the date the amendment is adopted.

6. Adjustments in accrued benefits—prohibition against reducing benefits scheduled on or before March 26, 1980

Under the bill, a multiemployer plan in reorganization may reduce certain accrued benefits. The Committee has determined that retroactive application of the accrued benefit reduction provision to a date before the day following the date the Committee considered the provision is not appropriate.

The Committee's amendment limits the reduction in accrued benefits which could be made by a plan in reorganization. Under the amendment, only a net increase in accrued benefits due to plan amendments (or plans) adopted after March 26, 1980, or under collective bargaining agreements entered into after March 26, 1980, could be reduced. The Committee intends that benefit increases which occur after March 26, 1980, but which were bargained for before that date, would be protected from reduction under the reorganization rules. However, the Committee does not intend to protect increases in benefits which are provided for under a plan before March 26, 1980, as part of a schedule of benefits which could be bargained for, but which are bargained for after March 26, 1980 (so called "bargaining-up").

7. Enforcement — liquidated damages with respect to delinquent contributions

Under the bill, in the case of an action to collect withdrawal liability, a court may award a plan liquidated damages. The Committee has concluded that in certain situations, reasonable attorney's fees, court costs, and liquidated damages should be awarded to a plaintiff in an action to collect delinquent plan contributions.

The Committees amendment provides that in the case of a civil action by any person to collect delinquent multiemployer plan contributions, regardless of otherwise applicable law, the court before which the action is brought may award the plaintiff (1) reasonable attorney's fees, (2) court costs, and (3) liquidated damages not to exceed 20 percent of the amount of delinquent contributions as determined by the court. However, these items are to be awarded to a plaintiff only to the extent that the multiemployer plan in question provided for such an award. The bill preempts any State or other law which would prevent the award of reasonable attorney's fees, court costs or liquidated damages or which would limit liquidated damages to an amount below the 20 percent level. However, the bill does not [49] preclude the award of liquidated damages in excess of the 20 percent level where an award of such a higher level of liquidated damages is permitted under applicable State or other law. The Committee amendment does not change any other type of remedy permitted under State or Federal law with respect to delinquent multiemployer plan contributions.

a. Certain withdrawals completed before July 31, 1979

Under the bill, the withdrawal liability rules are generally effective on February 27, 1979. The Committee has concluded, however, that the rules should not apply to certain partial or complete withdrawals completed before July 31, 1979.

The Committee's amendment creates an exception to the general effective date for withdrawal liability. Under the amendment, if (1) on March 23, 1979, an employer publicly announced (for example, by a press release or other appropriate means) a decision to cease covered operations at a number of facilities, (2) before May 3, 1979, such decision was communicated to the labor organizations which represented employees at the facilities, and (3) before July 31, 1979, the employer ceased all covered operations at any of the facilities, then the employer's withdrawal liability, if any, attributable to such facilities, could not exceed the amount determined under a special formula. The Committee intends that notice given at the national or local level of a labor organization is adequate notice to the labor organization for purposes of the amendment.

The special formula generally would limit withdrawal liability to the excess of an amount deemed to be the employer's liability to the plan less an amount deemed to be an accumulation of the employer's contributions to the plan. In addition, for a partial withdrawal, the employer, in the event of any future withdrawal, is to have its withdrawal liability computed as if it had paid its full liability for the partial withdrawal rather than only the amount determined under the special formula.

b. Certain partial withdrawals announced before December 13, 1979

Under the bill, in the case of a partial withdrawal, the withdrawal liability rules are generally effective on February 27, 1979. The Committee has concluded that the rules should not apply to certain withdrawals announced before December 13, 1979.

The Committee's amendment creates an exception to the general effective date for partial withdrawal liability. Under the amendment, if an employer (1) publicly announced the total cessation of covered operations at a facility before December 13, 1979, and such cessation occurs within 12 months after the announcement; (2) had not been obligated to make contributions to the multiemployer plan on behalf of the employees at such facility for more than eight years; and (3) after the cessation, does not commence operations which would be covered by the plan within the same State for one year, then the employer's partial withdrawal liability attributable to such facility could not exceed the amount determined under a special formula. The special formula generally would limit partial withdrawal liability to the excess of the present value of vested benefits under the plan considered [50] to be attributable to the withdrawing employer (determined on the basis of actual employee data for the period preceding the date of the partial withdrawal and on the basis of actuarial estimates thereafter) less an amount deemed to be an accumulation of employers' contributions to the plan.

8. Related technical changes

a. Notice provisions in connection with collection of withdrawal liability

Under the bill, an employer is permitted a 90-day period to request a review of a plan sponsor's determination of the employer's withdrawal liability and schedule payments. The Committee amendment makes it clear that the 90-day period begins to run the day after the employer receives notice from the plan sponsor of the amount of its withdrawal liability and of the payment schedule.

b. Determination of reorganization status

The bill provides a test to determine whether a plan is in reorganization. Under the test, as a general rule, a plan will be in reorganization for a plan year unless the net charges to the funding standard account under the plan for the year are sufficient to amortize the plan's unfunded benefit obligations in equal annual installments over 10 years in the case of obligations attributable to persons in pay status and over 25 years in the case of other obligations.

The Committee amendment clarifies the precise tests to be applied under the bill in determining whether a plan is in reorganization for a year.

c. Partial withdrawal liability

Under the bill, an employer will generally be liable to a multiemployer plan for withdrawal liability in the event of what is known as a "partial withdrawal." A partial withdrawal occurs where the employer does not completely withdraw from the plan but where an event occurs indicating a meaningful reduction in the base for computing the employer's contributions to the plan. Under the bill, the amount of withdrawal liability in the case of a partial withdrawal is a pro rata portion of the amount of liability which would be applicable if the withdrawal were a complete withdrawal.

The Committee amendment clarifies the three events which trigger a partial withdrawal and the rules for computing the liability for a partial withdrawal.

Under the amendment, as under the bill, the three events which will trigger a partial withdrawal from a multiemployer plan are (1) a 60-percent decline in contribution base units; (2) a facility closing resulting in a 25-percent decline in contribution base units; and (3) a cessation of an employer's obligation to contribute to a plan under one but not all of the collective bargaining agreements obligating the employer to contribute to the plan.

(1) 60-percent decline.—

Under the amendment, a 60-percent decline in contribution base units is considered to take place in a plan year if during the plan year and during the preceding two plan years (the "3-year testing period") the number of contribution base units (*e.g.*, hours worked) [51] with respect to which the employer was required to make plan contributions did not exceed 40 percent of the number of such contribution base units during the plan year (in a five-year base period) during which contribution base units were the highest. For example, assume a determination is to be made as to whether a partial withdrawal takes place under this rule for the plan year which is the calendar year 1987. Assume that the employer's contribution base units for 1985, 1986 and 1987 are 35,000 hours, 36,000 hours, and 37,000 hours respectively, and that the employer's contribution base units for 1980, 1981, 1982, 1983 and 1984 are 100,000 hours, 98,000 hours, 95,000 hours, 91,000 hours, and 85,000 hours, respectively.

Contribution base units are the highest in 1980 when such units are 100,000 hours. Accordingly, to determine if a partial withdrawal occurs in 1987, it must be determined whether the number of contribution base units in each of 1985, 1986 and 1987 does not exceed 40 percent of the number of contribution base units in 1980. Because contribution base units in 1980 are 100,000 hours, a withdrawal does not occur unless contribution base units do not exceed 40,000 hours in each of 1985, 1986 and 1987. In this case, contribution base units are less than 40,000 hours in each year during the three-year testing period. Accordingly, a partial withdrawal in this case would be considered to take place as of the close of 1987.

(2) 25-percent decline.—

Under the amendment, a facility closing resulting in a 25-percent decline in contributions is considered to take place where (1) the facilities closed by an employer during the plan year and during the five preceding plan years accounted in the aggregate for at least 25 percent of that employer's contribution base units under the plan and (2) the employer's contribution base units for the plan year are 75 percent or less of the employer's contribution base units in the plan year during the five plan years preceding the plan year during which contribution base units were the highest. For purposes of this rule, a facility closing means the cessation of substantially all of the employer's covered operations at a facility.

In determining whether facility closing in the plan year and in the five preceding plan years resulted in a 25-percent reduction in contribution base units a formula is applied. Under the formula, a percentage is determined for each particular facility closing during the six-year period. If the sum of the percentages equals or exceeds 25 percent, a 25-percent decline in contribution base units is considered to have occurred. The percentage for each separate facility closing is determined by dividing (1) the number of contribution base units for the facility for the year during the six-year period encompassing the year of the closing and the preceding five years in which the number of such units were the highest (the "high six years") by (2) the number of contribution base units for all facilities with covered operations under the plan for the high six years.

(3) *Cessation of an employer's obligation.*—

A cessation of an employer's obligation to contribute to a plan under one but not all the collective bargaining agreements obligating the employer to contribute to the plan will not be considered to take [52] place in any case where there is a mere substitution of an agreement with one collective bargaining agent for an agreement with another collective bargaining agent under the same plan.

Once it has been determined that a partial withdrawal has occurred, the amount of withdrawal liability is determined by multiplying the amount of withdrawal liability which would have applied in the case of a complete withdrawal on the same date (or, in the case of a partial withdrawal in the nature of a 60-percent decline in contributions, on the last day of the first plan year in the three-year testing period) by (1) one minus (2) a fraction. The numerator of the fraction is the employer's contribution base units for the plan year following the plan year of the partial withdrawal. The denominator of the fraction is the average of the employer's contribution base units for the five plan years immediately preceding the plan year of the partial withdrawal. However, in the case of a partial withdrawal because of a 60-percent decline in contributions, the denominator of the fraction is the average of the employer's contribution base units for the five plan years immediately preceding the three-year testing period.

Under the amendment, if withdrawal liability is determined on account of a partial withdrawal, the amount of the liability is applied as a credit against withdrawal liability for any future withdrawal from the plan, whether partial or complete. In addition, the future withdrawal will not relieve the employer from continuing to make its payments for withdrawal liability with respect to the earlier partial withdrawal. The PBGC is authorized to prescribe regulations necessary to make appropriate adjustments in the credit for future events so that withdrawal liability in the event of a future withdrawal properly reflects the employer's proper share of the plan's unfunded benefits obligations.

For purposes of computing an employer's annual withdrawal liability payment, a partial withdrawal in the nature of a 60-percent decline in contributions is deemed to occur on the last day of the first plan year in the three-year testing period.

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[64] I. Minimum Funding Requirements (Secs. 203 and 304 of the Bill, Sec. 412 of the Code and Secs. 301 and 302 of ERISA)

Present law

In general

Under the Code and the nontax provisions of ERISA,[1] multiemployer pension plans are required to meet a minimum funding standard on an annual basis. As an administrative aid in the application of this standard, ERISA requires that each plan must establish and maintain a special account called a "funding standard account" to which specified charges and credits (including credits for contributions to the plan) must be made for each plan year. If, as of the close of a plan year, the account does not have a balance of charges, the plan is treated as satisfying the minimum funding standard for that year. Thus, as a general rule, the minimum contribution for a year is determined as the amount by which charges to the account would exceed credits to the account if no contribution were made to the plan.

For example, in the case of a plan the plan year of which is the calendar year, if, as of the close of 1980, charges to the plan's funding standard account would exceed credits to the account by $200,000 if no contribution were made to the plan for 1980, a minimum contribution for the year of that amount would generally be required for the plan to meet the minimum funding standard for 1980.

If, as of the close of any plan year, charges to the funding standard account exceed credits to the account, the excess is called an "accumulated funding deficiency." The deficiency is subject to a five-percent nondeductible excise tax and, if not corrected within a specified correction period, is also subject to a 100-percent nondeductible excise tax. The tax is payable by the employers responsible for contributing to the plan for the year.

Actuarial cost methods

In computing the amounts which are required to be contributed to a defined benefit pension plan for a plan year in order to meet the minimum funding standard for the year, the plan utilizes what is known as an "actuarial cost method." [2] Generally, an actuarial cost method breaks up the cost of the benefits into annual charges consisting of two elements with respect to benefits that are effective for the plan year. These elements are called (1) normal cost, and (2) past service cost. Normal cost generally represents the cost of future benefits under the plan for current employees and, under some funding methods, for separated employees, which will be funded by future con-[65]tributions to the plan (1) in level dollar amounts, (2) as a uniform percentage of payroll, (3) as a uniform amount per unit of service (*e.g.*, 50 cents per hour), or (4) on the basis of the actuarial present values of benefits accruing under the plan in particular plan years. Past service liability represents the cost of future benefits under the plan (1) on the date the plan is first effective, or (2) on the date a plan amendment increasing plan benefits is first effective, which will not be funded by future plan contributions to meet normal cost.

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[1] See sec. 412 of the Code and part 3, Title I of ERISA.

[2] See Temp. Treas. Regs. §§ 11.412(c)(1)-1 and 11.412(c)(1)-2, and Prop. Treas. Regs. §§ 1.412(c)(2)-1 and 1.412(c)(3)-1.

Normal cost and past service cost are key elements in computations under the minimum funding standard. While these costs may differ substantially, depending upon the actuarial cost method used to value a plan's assets and liabilities, they must be determined under an actuarial cost method permitted by ERISA. ERISA enumerates six acceptable actuarial cost methods and provides that additional methods may be permitted under Treasury regulations. Normal cost and past service costs under a plan are computed on the basis of an actuarial valuation of the assets and liabilities of a plan. Generally, an actuarial valuation is required at least once during each period of 3 plan years. More frequent valuations may be required by the Internal Revenue Service.

Charges to funding standard account

Normal cost

Each plan year, the plan's funding standard account must be charged with the normal cost assigned to that year under the plan's actuarial cost method. This will generally mean that the employers maintaining the plan will have to contribute to the plan an amount at least equal to the normal cost to create a credit in the funding standard account to balance off the charge for normal cost.

For example, if the normal cost for a plan for the plan year ending December 31, 1980, is $150,000, the funding standard account is charged for that amount. Assuming there are no credits to the account to offset that charge, an employer contribution to the plan of $150,000 would be required for 1980 in order to avoid an accumulated funding deficiency for that year.

Past service liability

There are three separate charges to the funding standard account which may arise as the result of past service liabilities. The first applies only to a plan in existence on January 1, 1974; the second applies only to a plan which came into existence after January 1, 1974; and the third applies to a plan under which past service liability has increased due to a plan amendment made after January 1, 1974.

In the case of a plan in existence on January 1, 1974, the funding standard account is charged with a portion of the past service liability under the plan determined as of the first day of the plan year beginning in the first year the funding standard applied to the plan (generally 1976). The amount of the liability with which the account is charged in the case of a multiemployer plan is based on amortization of past service liabilities over a period of 40 years. The liability must be amortized (in much the same manner as a mortgage) in equal annual installments over the 40-year amortization period.

[66] For example, assume that a plan in existence on January 1, 1974, uses the calendar year as its plan year and has a past service liability of $500,000 determined as of January 1, 1976. The plan's actuary uses an interest rate of six percent in determining plan costs. The 40-year schedule requires that $31,350 be charged against the funding standard account each year to amortize this liability. Thus, for each year in the 40-year period commencing with 1976, the plan's funding standard account is charged with the amount of $31,350. This will require the employers maintaining the plan to make a contribution to the plan of that amount for each year in the 40-year period to generate a credit to the account to offset the charge, unless it is offset by some other credit to the account or the plan becomes fully funded.

In the case of a plan not in existence on January 1, 1974, the plan is generally required to determine past service liability as of the first day of its first plan year beginning after September 2, 1974. This liability must be amortized by a multiemployer plan in equal annual installments over 40 years (30 years, in the case of a single-employer plan) in the same manner as past service liability is amortized for a plan in existence on January 1, 1974. Each year during the 40-year period, the funding standard is charged with the amount of past service liability amortized in that year unless the plan becomes fully funded.

In any case where a net increase in benefits under a plan takes place as a result of plan amendments in a year, the unfunded past service liability attributable to the net increase is determined and amortized over a period of 40 years in the case of a multiemployer plan (30 years for a single-employer plan). Each year during the 40-year period, the funding standard account is charged with the amount of the amortization for that year, and the employers are required to make sufficient contributions to offset the charge unless it is offset by another credit or the plan becomes fully funded.

Experience losses

In determining plan funding under an actuarial cost method, the plan's actuary generally makes certain assumptions regarding rates of interest, mortality, disability, salary increases, etc. If on the basis of these assumptions the contributions made to the plan result in unfunded liabilities less than that anticipated by the actuary, the excess of the expected unfunded liabilities over the actual unfunded liabilities is called an "experience gain."

On the other hand, if the expected unfunded liabilities fall short of the actual unfunded liabilities, the shortfall is considered an "experience loss." The minimum funding standard requires that an experience loss be amortized in equal installments over a period of 20 years (15 years for a single-employer plan) and that the funding standard account be charged with each year's amortization unless the plan becomes fully funded. (Some funding methods do not separately determine experience gains or losses.)

Changes in actuarial assumptions

If the actuarial assumptions used for funding a plan are revised and under the new assumptions the accrued liability of the plan is less than the accrued liability computed under the old assumptions, the decrease [67] in accrued liability is considered a "gain from changes in actuarial assumptions." "Accrued liability" refers to the actuarial present value of projected pension benefits under the plan which will not be funded by future contributions to meet normal cost. On the other hand, if, after the change in assumptions, accrued liability exceeds accrued liability computed under the old assumptions, the excess is considered a "loss from changes in actuarial assumptions." The amount of the loss from changes in actuarial assumptions must be amortized in equal annual installments over a period of 30 years, and the amount of each year's amortization must be charged to the funding standard account unless the plan becomes fully funded.

Waived funding deficiency

If 10 percent or more of the employers contributing to a multiemployer plan are unable to make contributions which will satisfy the minimum funding standard for a plan year without substantial business hardship, the Internal Revenue Service is permitted to waive all or a portion of the contribution requirements of the minimum funding standard for the plan year if it is determined that requiring the contributions would be adverse to the interests of plan participants in the aggregate. However, the Service is not permitted to grant such a waiver for a plan for more than five plan years in any period of 15 consecutive plan years. The amount of the contribution not required as a result of the waiver is called a "waived funding deficiency."

Under the funding standard, the amount of a waived funding deficiency must be amortized in equal annual installments over a period of 15 years commencing with the year first following the year for which the waiver is granted, and the funding standard account must be charged each year with the amount amortized for that year unless the plan becomes fully funded.

Switchback liability

ERISA provides that certain plans may elect to use an alternative minimum funding standard account for any year in lieu of the funding standard account, and prescribes specified annual charges and credits to the alternative account. If it would take a smaller contribution to balance charges and credits in the alternative account than it would take to balance the funding standard account for a plan year, no accumulated funding deficiency is considered to exist for the year if a contribution satisfying the requirements of the alternative account is made. During years for which contributions are made under the alternative account, an excess of charges over credits may build up in the funding standard account. If the plan later switches back from the alternative account to the funding standard account, this excess of charges over credits must be amortized over a period of five plan years. This amount is known as a "switchback liability."

Credits to funding standard account

Employer contributions

Each plan year, the funding standard account is credited with the amount considered contributed to a plan by employers maintaining the plan for the year. This amount includes contributions made during [68] the year as well as contributions made on account of the year up to two and one-half months after the close of the year. (The Internal Revenue Service can extend the period for an additional six months.)[3]

Past service liability

If plan amendments in a year result in a net decrease in past service liability, the amount of the decrease must be amortized in equal annual installments over a period of 40 years, and each year's amortization during the 40-year period (30 years for a single-employer plan) must be credited to the funding standard account unless the plan becomes fully funded. These credits will help offset charges to the account and will decrease otherwise required contributions to the plan.

Experience gains

If a net experience gain is determined in a plan year, the gain must be amortized in equal annual installments over a period of 20 years (15 years for a single employer plan), and the amount amortized each year must be credited to the funding standard account unless the plan becomes fully funded. These credits also offset charges to the account and thus decrease contribution requirements.

Changes in actuarial assumptions

If a change in actuarial assumptions results in a gain because of a decrease in plan accrued liability under the new assumptions, the gain must be amortized in equal annual installments over a period of 30 years. The amount amortized each year must be credited to the funding standard account unless the plan becomes fully funded and the credit will reduce plan contributions otherwise required for the year.

Switchback liability

When a plan switches back from the alternative minimum funding standard account to the funding standard account, the funding standard account is credited with the excess of charges over credits which have built up in that account. If this were not done, the entire excess would have to be offset by a contribution (or other credit) to the account in the year of the switchback to prevent an accumulated funding deficiency.

Extension of amortization periods

The Internal Revenue Service is permitted to extend for up to 10 years the period for amortizing any unfunded past service liability under a multiemployer plan.[4] If such an extension is granted, the period over which the funding standard account is charged with amortization of the liability is similarly extended. Before granting such an extension, the Service must determine that (1) the extension will carry out the purposes of ERISA, (2) the extension will provide adequate protection to plan participants and beneficiaries, and (3) the failure to grant the extension will (a) result in a substantial risk of plan termination or in substantial reduction of pension benefits or [69] compensation, and (b) be adverse to the interest of plan participants in the aggregate.

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[3] See Temp. Treas. Regs. § 11.412(c)-12.

[4] Under Reorganization Plan No. 4 of 1978, referral to the Secretary of Labor may be required.

Reasons for change

The Ways and Means Committee believes that existing minimum funding requirements may not provide adequate safeguards to insure that multiemployer plans will be able to meet their pension obligations. However, the Committee is also concerned that when applied to an overburdened multiemployer plan, the present funding requirements may result in an undue financial burden on employers.

Explanation of provisions

1. In general

The bill modifies the periods over which past service liabilities and experience gains and losses under multiemployer plans would be required to be amortized for the purpose of making charges and credits to the funding standard account. In general, the new amortization periods follow those required of single-employer plans for funding purposes. However, certain transitional rules are provided under which the present law amortization periods continue to apply to multiemployer plans in certain circumstances.

In addition, the Secretary of the Treasury is to be authorized to prescribe regulations requiring additional charges and credits to the funding standard account to prevent withdrawal liability payments from being unduly reflected as advance funding of plan liabilities.

The bill also makes conforming amendments to the funding rules to take account of changes made in other parts of the bill.

2. Modification of charges to funding standard account

a. Past service liability

Under the bill, certain amounts of unfunded past service liability are to be amortized in equal annual installments over 30 years for purposes of determining charges to the funding standard account. These changes are (1) unfunded past service liability determined as of the first day of the first plan year of a plan not in existence on enactment, and (2) any net increase in unfunded past service liability arising from plan amendments adopted during a plan year.

b. Experience losses

Under the bill, a net experience loss is to be amortized in equal annual installments over 15 years for purposes of determining charges to the funding standard account.

3. Modification of credits to funding standard account

a. Past service liability

Under the bill, any decrease in unfunded past service liability arising from plan amendments adopted during a plan year is to be amortized in equal annual installments over 30 years for purposes of determining credits to the funding standard account.

b. Experience gains

Under the bill, a net experience gain is to be amortized in equal annual installments over 15 years for purposes of determining credits to the funding standard account.

[70] *c. Withdrawal liability*

Under the bill, any withdrawal liability payment to a plan for a plan year is to be treated as an amount contributed to the plan for the year. Accordingly, it will generate a credit to the funding standard account.

4. Prior amortizable amounts and transitional rules

Under the bill, any amortizable amounts described above that arose in a plan year beginning before the date the bill was enacted are to continue to be amortized over their respective previously established amortization periods. The bill also provides transitional rules under which the amortization periods of present law apply to certain future changes in past service liability.

5. Application of minimum funding standards to terminated multiemployer plan

Under the bill, the minimum funding standard applies with respect to a terminated multiemployer plan until the date on which the last remaining employer withdraws from the plan.

Effective date

These provisions of the bill apply on the date of enactment.

[71] J. Excise Taxes (Sec. 204 of the Bill and Sec. 4971 of the Code)

Present law

Under present law, an employer who maintains a plan to which the ERISA minimum funding standard applies is subject to a two-tier annual nondeductible excise tax on any accumulated funding deficiency under the plan. The initial tax is 5 percent of the deficiency. If the deficiency is not corrected within a correction period, an additional excise tax equal to 100 percent of the deficiency is imposed.

Before issuing a notice of deficiency under this provision, the Internal Revenue Service is required to notify the Secretary of Labor and afford to the Secretary of Labor an opportunity to (1) require the responsible employer to eliminate the deficiency and (2) to comment on the imposition of the tax.

Reason for change

Under the bill, a required contribution to a multiemployer plan may, under certain circumstances (*e.g.*, reorganization) differ from the amount required to satisfy the minimum funding standard of ERISA.

Explanation of provisions

The bill conforms the penalty excise tax provisions relating to the ERISA funding standard to the plan reorganization provisions of the bill by changing the accumulated funding deficiency of a plan in reorganization (the amount to which the excise tax applies) to the reorganization deficiency computed under the bill. The bill also provides that in the case of a multiemployer plan in reorganization, the notice issued by the Internal Revenue Service to the Secretary of Labor with respect to a notice of deficiency for a tax on an accumulated funding deficiency, and the opportunity to comment on the imposition of the tax, are to be provided to the PBGC.

Effective date

These provisions of the bill apply on the date of enactment.

Revenue effect

It is estimated that this provision will result in a negligible net decrease in budget receipts.

[72] K. Deductibility of Employer Liability Payments (Sec. 205 of the Bill and Sec. 404 of the Code)

Present law

Under present law, an employer is allowed a deduction for a contribution to a qualified pension plan for its employees. The deduction is allowed (within limits) in the taxable year for which the contribution is made.[1] Payments of employer liability under the termination insurance program are treated as employer contributions.[2]

Reason for change

The Ways and Means Committee has determined that the payment of withdrawal liability by an employer should be treated as a contribution to the plan by the employer without regard to the usual limitation on employer deductions for contributions to a tax qualified plan.

Explanation of provision

The bill generally allows a deduction for amounts paid by a taxpayer under the employer withdrawal liability provisions of the termination insurance program without regard to the usual limitations on employer deductions for contributions to a tax qualified plan.

Under the bill, for employer tax deduction purposes, withdrawal liability payments are treated as employer contributions to the plan. Thus, the deduction of total plan contributions, including withdrawal liability payments, is subject to the full funding limitation. In addition, withdrawal liability payments are deductible only if paid for a taxable year which ends with or within a taxable year of the plan for which the plan is qualified. Of course, an employer's total contribution to the plan, including withdrawal liability payments, must be ordinary and necessary business expenses of the employer to be deductible. Special rules are provided which allow a deduction for employer liability payments to a taxpayer whose liability for the payments arises out of the liability of an employer who is a member of the same controlled group of companies that includes the taxpayer.

Effective date

This provision of the bill is effective upon enactment.

Revenue effect

It is estimated that this provision will decrease budget receipts by a negligible amount per year.

[73] L. Minimum Vesting Requirements (Secs. 206 and 303 of the Bill, Sec. 411 of the Code, and Sec. 203 of ERISA)

Present law

Under present law, benefits under a plan which are vested may be forfeited only (1) in the case of death, (2) where benefits are suspended upon reemployment, (3) in the case of certain retroactive plan amendments which reduce benefits, or (4) in the case of certain withdrawals of mandatory employee contributions. Also, under present law, with certain very limited exceptions, all of a participant's years of service with an employer must be taken into account for vesting purposes.

Reason for change

The changes made under the reorganization provisions and the provisions relating to the definition of multiemployer plan require conforming changes in the ERISA rules relating to vesting.

Explanation of provisions

In general

The bill provides for additional circumstances under which vested benefits under a multiemployer plan, which are nonforfeitable under present law, could be forfeited. The bill provides that certain of a participant's years of service with an employer, currently taken into account for vesting purposes, could be disregarded in the case of a multiemployer plan. (Also, see C., Employer Withdrawal Liability Mergers, Etc. 3. *Reorganization and minimum contribution requirement, g. Adjustments in accrued benefits.*) In addition, the bill conforms the vesting provisions of ERISA to changes made in other parts of the bill.

Cessation of contributions under a multiemployer plan

Under the bill, a multiemployer plan does not fail to meet the vesting requirements of ERISA merely because the plan provides for the forfeiture of accrued benefits attributable to service with a participant's employer before the employer was required to contribute to the plan in the event that the employer ceases making contributions to the plan.

Reduction and suspension of benefits

Under the bill, a multiemployer plan does not fail to meet the vesting requirements of ERISA merely because (1) it is amended to reduce accrued benefits, but not below the level of benefits eligible for the PBGC guarantee, in the event of plan reorganization or plan determination, or (2) benefits payments under the plan, other than basic benefits, are suspended in the event of plan reorganization or plan termination.

[74] *Authority to disregard service after withdrawal or plan termination*

Under the bill, if an employer withdraws from a multiemployer plan, a participant's years of service with the employer completed after the withdrawal would not have to be taken into account in determining the participant's vested percentage in his accrued benefits under the plan. This rule applies to partial withdrawals only to the extent permitted in regulations prescribed by the Secretary of the Treasury.

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[1] See Code sec. 404(a)(1)(A) and Prop. Treas. Reg. § 1.404(a)-14.

[2] See Code sec. 404(g).

Also, under the bill, if a multiemployer plan terminates for purposes of termination insurance, an employee's years of service completed after the date of termination do not have to be taken into account in determining a participant's vested percentage in his accrued benefits under the plan.

Effective date

This provision of the bill applies on the date of enactment.

Revenue effect

It is estimated that this provision will have no effect on budget receipts.

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[76] M. Action Taken Before Regulations are Prescribed
(Sec. 405 of the Bill)

Present law

No provision.

Reason for change

The bill requires that many regulations be prescribed in the effectuation of its rules. The Ways and Means Committee has concluded that the parties affected by the bill should be permitted, pending the issuance of regulations, to act under the bill's provisions in the absence of regulations provided any action so taken is reasonable.

Explanation of provision

Where the manner in which a provision of the bill is to apply is to be set forth in regulations, any reasonable action taken before the regulations are issued is to be treated as complying with the regulations for the period preceding their issuance. However, this rule does not apply if the action is in violation of an instruction or temporary rule which is issued before the action is taken.

Effective date

This provision of the bill is effective upon enactment.

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Part III. Administrative, Procedural, and Miscellaneous

26 CFR 601.201: Rulings and determination letters.

Rev. Proc. 80-57

SECTION 1. PURPOSE

The purpose of this revenue procedure is to prescribe the procedures to be used by the Internal Revenue Service and taxpayers for resolving issues arising when a taxpayer is or would be subject to inconsistent tax treatment by the Service and the Puerto Rico or Virgin Islands tax authorities. Such issues generally involve: (1) allocations of income, deductions, credits, or allowances between related persons; (2) determination of residency; and (3) determinations of the source of income and related expenses. This revenue procedure does not provide procedures to be used by possession tax authorities.

SEC. 2. BACKGROUND

.01 The Service has in accordance with the Agreements on Coordination of Tax Administration ("Agreements") with the Department of the Treasury of Puerto Rico (Internal Revenue News Release IR-2123, April 25, 1979, Announcement 79-84, 1979-23 I.R.B. 19) and the Department of Finance of the United States Virgin Islands (Internal Revenue News Release IR-1926, December 30, 1977, Announcement 78-21, 1978-7 I.R.B. 42) (hereinafter "the possession tax agencies") established cooperative programs to resolve tax disputes arising from inconsistent positions taken by the Service and the possession tax agencies.

.02 The Agreements provide that when by reason of inconsistent positions taken by the Service and the possession tax agency a taxpayer is or would be subject to inconsistent tax treatment by the two jurisdictions, the Director of International Operations and the designated possession tax official shall endeavor to resolve by mutual agreement any difficulties arising from the application of the tax laws of the United States and the possession. In particular, but not by way of limitation, the Director of International Operations and the designated possession tax official may consult together to endeavor to agree: (a) to the same allocation of income, deductions, credits, or allowance between related persons; (b) to the same determination of residency of a particular taxpayer; or (c) to the same determination of the source of particular items of income.

.03 The Agreements provide that the Director of International Operations will be the representative of the Service to handle exchanges of tax returns and tax return information with the possessions, as well as to develop and coordinate cooperative programs designed to improve the administration and enforcement of both federal and possession tax laws.

.04 Requests for assistance under these mutual agreement procedures should be addressed to the Director of International Operations, Internal Revenue Service, 1325 K Street, N.W., Washington, D.C. 20225.

SEC. 3. PROCEDURES TO BE FOLLOWED

.01 A taxpayer, or a taxpayer with a related person in a possession, that is subject to double taxation because of inconsistent tax treatment by the Service and the possession tax agency may request assistance in accordance with this revenue procedure.

.02 In addition to the tax assistance request, the taxpayer should file a claim for credit or refund of any overpayment of federal tax that was paid on the income in question, provided the period of limitations prescribed under section 6511 of the Internal Revenue Code, with respect to the claim for credit or refund, has not expired. The taxpayer, or a related person in a possession, should also take whatever steps are necessary under the possession tax code to prevent the expiration of the period of limitations with respect to a claim for credit or refund of the possession tax.

.03 When, in conjunction with a request for assistance under this revenue procedure, a taxpayer seeks relief in the form of a credit or refund of either possession or United States tax, the allowance of such relief is subject to the applicable tax and procedural rules of the possession and the United States.

.04 Federal income tax claims are to be made as appropriate, on: Form 1040X, Amended U.S. Individual Income Tax Return; Form 1120X, Amended U.S. Corporation Income Tax Return; or Form 1041, U.S. Fiduciary Income Tax Return. The taxpayer should indicate on the appropriate form that a request for assistance under the possession mutual agreement procedure has been filed pursuant to this revenue procedure and should attach a copy of such request to that form. The claim should be computed on the assumption that the taxpayer does not qualify for relief through mutual agreement procedures for the year or years in question.

.05 With respect to the computation of the foreign tax credit, either Form 1116, Computation of Foreign Tax Credit, Individual, Fiduciary, or Nonresident Alien Individual, which also covers credits for foreign tax on income received from foreign partnerships and other business organizations, or Form 1118, Computation of Foreign Tax Credit-Corporations, shall be attached to the Form 1040X, Form 1120X, or Form 1041, as appropriate.

.06 If any possession tax issues subject to consideration under the possession mutual agreement procedures are expected to reoccur in the future and if the period for filing Form 1040X, Form 1120X, or Form 1041 is about to expire, the taxpayer should, before the expiration of the period of limitations for the taxable year involved, file a protective claim on Form 1040X, Form 1120X, or Form 1041 and transmit a copy to the Director of International Operations. The claim should describe the expected possession tax agency action and state that the taxpayer plans to file a request for assistance under the possession mutual agreement procedure. If the taxpayer later decides not to file the request, the Director of International Operations should be promptly notified by the taxpayer.

.07 The taxpayer should file a written request for assistance with the

Director of International Operations, Internal Revenue Service, 1325 K Street N. W., Washington, D.C. 20225, as soon as the issues are sufficiently developed to indicate that the taxpayer is or would be subject to inconsistent tax treatment by the Service and the possession tax agency. This will: (1) insure consideration while the facts are more easily obtainable; (2) insure adequate time for the representatives of the two jurisdictions to consult and attempt to arrive at an agreement prior to the imposition of any procedural barriers under federal or possession law; and (3) avoid unnecessary delay in the final determination of tax liability.

.08 The Director of International Operations will not accept any taxpayer's request for consideration of a case that is pending in court without the consent of the Chief Counsel of the Service. If the case is pending in the United States Tax Court, the Chief Counsel may in appropriate cases request the court to delay trial pending mutual agreement action. If the case is pending in any other court, the Chief Counsel will consult with the Department of Justice. Final decision on delaying trial rests with the court. Suspension of litigation pending any possession mutual agreement consideration will not relieve the United States taxpayer from any obligation to act with respect to that litigation.

.09 A request for assistance under this revenue procedure shall be signed by the taxpayer or a person having authority to sign the taxpayer's federal income tax returns; shall contain a statement that assistance is requested under the possession mutual agreement procedure; and shall include the following information:

1 the taxpayer's name, address, and employer identification number (individuals not engaged in a trade or business should use their Social Security number) and where applicable the name, address and employer identification number (or for individuals not engaged in a trade or business a Social Security number) of a related person in the United States possession;

2 the taxable year or years in question and the Service Center where the taxpayer's federal income tax return was filed, or if no return was filed, a statement to that effect;

3 when income tax is involved, the type of income at issue (such as salary, dividends, or interest), a description of the transaction, activities, or other circumstances pertinent to the issue and the respective positions taken by the possession tax agency and the taxpayer on the issue raised;

4 the amount of the particular item involved in the issue raised and the amount of the possession tax assessed or proposed for assessment;

5 when applicable, a decription of the control and business relationships between the United States taxpayer and a related person in the possession;

6 when applicable, a statement of the status of the tax liability of the taxpayer and a related person in the possession for the year or years in question, as well as a statement as to whether the taxpayer or related person is entitled to any possession tax incentive or subsidy program benefits for the year or years in question;

7 a copy of any correspondence received from the possession tax agency and also copies of any briefs, protests and other relevant material submitted to the possession tax agency;

8 a copy of possession tax returns for the year or years in question;

9 a statement whether the federal tax return of the United States taxpayer, and where applicable the tax return of a related person in the possession, for the year or years in question were examined, or are in the process of being examined;

10 a statement as to whether a foreign tax credit was claimed in the taxpayer's federal tax return for the taxable year or years in question and, if a credit was claimed, whether it was claimed for all or part of the possession tax paid or accrued with respect to the particular item that is the subject of the request for assistance under a possession mutual agreement procedure;

11 on a separate and single document, a statement that the United States taxpayer consents to the disclosure to the designated possession tax official of any or all of the items of information set forth or enclosed in the request for assistance under this revenue procedure; this statement shall be dated and signed by a person having authority to sign the United States taxpayer's federal tax returns; and

12 other pertinent material the taxpayer may wish to supply.

Sec. 4. Notification to Taxpayer

.01 The taxpayer will be notified whether the facts submitted provide a basis for assistance under the possession mutual agreement procedure.

.02 The Director of International Operations will not assist the taxpayer if:

1 under the facts and circumstances the taxpayer is not entitled to such assistance (for example, the facts do not indicate that inconsistent positions have been taken by the Service and the possession tax agency).

2 the taxpayer indicates unwillingness to accept an agreement under the possession mutual agreement procedure except under conditions that are clearly unreasonable or unfairly prejudicial to the interests of the United States; or

3 the taxpayer does not furnish, upon request, sufficient information to determine the applicability of the possession mutual agreement procedure or otherwise fails to act as required by this revenue procedure.

.03 If the Director of International Operations accepts a request for assistance, the continuing cooperation of the taxpayer is essential. The taxpayer shall supply any additional information needed to resolve the case and keep the Director of International Operations informed as to proceedings in the possession and any other pertinent developments. The taxpayer may also be requested to execute a consent extending the period of limitations on assessment of tax for the taxable year or years in question.

.04 The Director of International Operations will notify a taxpayer requesting assistance under this revenue procedure of any agreement or partial agreement that the Service and the possession tax agency reach with respect to the taxpayer's request. If such agreement or partial agreement is not acceptable to the taxpayer, the taxpayer may pursue all rights to administrative and judicial review otherwise available under the law of the possession and the United States.

.05 When appropriate, in cases covered by this revenue procedure, the taxpayer will be requested to enter into a closing agreement in accordance with sections 6.07 and 6.17 of Rev. Proc. 68-16, 1968-1 C.B. 770.

.06 Rev. Proc. 65-17, 1965-1 C.B. 833, and Amendment I of Rev. Proc. 65-17, 1966-2 C.B. 1211, as amplified by Rev. Proc. 65-31, 1965-2 C.B. 1024, provide that a United States taxpayer must file a request for the treatment provided by Rev. Proc. 65-17 in writing with the appropriate district director before closing action is taken on issues arising under section 482 of the Code that forecloses availability of Rev. Proc. 65-17. Accordingly, if a United States taxpayer desires assistance under this revenue procedure and the benefits provided by Rev. Proc. 65-17, the request filed under this revenue procedure should state that the taxpayer desires the benefits of Rev. Proc. 65-17 before entering into any closing agreement or before any other closing action (as defined in section 4.03 of Rev. Proc. 65-31) is taken.

SEC. 5. EFFECTIVE DATE

This revenue procedure is effective immediately.

Part IV. Items of General Interest

Imputed Interest Rates—Public Hearing

Announcement 80-164 [1]

SUMMARY: This document provides notice of a public hearing and an extension of time for submitting comments on proposed regulations relating to the interest rate used to impute interest on loans between related entities and on deferred paymetns in the case of certain sales of property.

DATE: The public hearing will be held on January 8, 1981, beginning at 10:00 a.m. Outlines of oral comments must be delivered or mailed by December 24, 1980. The extended deadline for submission of written comments is December 24, 1980.

ADDRESS: The public hearing will be held in the I.R.S. Auditorium, Seventh Floor, 7400 Corridor, Internal Revenue Building, 1111 Constitution Avenue, N.W., Washington, D.C. The outlines and comments should be submitted to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-221-78), Washington, D.C. 20224.

FOR FURTHER INFORMATION CONTACT: Charles Hayden of the Legislation and Regulations Division, Office of Chief Counsel, Internal Revenue Service, 1111 Constitution Avenue, N.W., Washington, D.C. 20224, 202-566-3935, not a toll-free call.

SUPPLEMENTARY INFORMATION: The subject of the public hearing is proposed regulations under sections 482 and 483 of the Internal Revenue Code of 1954. By a notice of proposed rulemaking, the proposed regulations appeared in the Federal Register for Friday, August 29, 1980 (45 FR 57739). By the same notice of proposed rulemaking, comments and requests for a public hearing with respect to the proposed rules were to be delivered or mailed to the Commissioner of Internal Revenue, Attn: CC:LR:T (LR-221-78), Washington, D.C. 20224, by October 28, 1980. The date by which written comments must be delivered or mailed is hereby extended to December 24 ,1980.

The rules of § 601.601(a)(3) of the "Statement of Procedural Rules" (26 CFR Part 601) shall apply with respect to the public hearing. Persons who have submitted or who submit written comments within the time prescribed in the notice of proposed rulemaking and this extension notice and also desire to present oral comments at the hearing on the proposed regulations should submit an outline of oral comments to be presented at the hearing and the time they wish to devote to each subject by December 24, 1980.

Each speaker will be limited to 10 minutes for an oral presentation exclusive of time consumed by questions from the panel for the Government and answers to these questions.

Because of controlled access restrictions, attendees cannot be admitted beyond the lobby of the Internal Revenue Building until 9:45 a.m.

An agenda showing the scheduling of the speakers will be made after outlines are received from the speakers. Copies of the agenda will be available free of charge at the hearing.

This document does not meet the criteria for significant regulations set forth in paragraph 8 of the Treasury Directive on improving government regulations appearing in the Federal Register for Wednesday, November 8, 1978.

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[1] Filed by the Office of the Federal Register on December 4, 1980, and published in the issue of the Federal Register for December 8, 1980, 45 F.R. 80837.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individual has been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
H. Jim Uchida	Oakland, CA	Certified Public Accountant	Indefinite effective November 5, 1980

Announcement of the Suspension, Termination, or Consent to Voluntary Suspension or Termination of Enrollment to Perform Actuarial Services Under the Employee Retirement Income Security Act of 1974

Under 20 Code of Federal Regulations, Part 901, an enrolled actuary, in order to avoid the initiation or conclusion of a suspension or termination proceeding, may offer his/her consent to suspension of enrollment. The Executive Director, Joint Board for the Enrollment of Actuaries, may suspend enrollment in accordance with the consent offered. An enrolled actuary whose enrollment is suspended is prohibited from performing actuarial services under the Employee Retirement Income Security Act of 1974 (ERISA) during the period of suspension.

To enable employees of the Internal Revenue Service and others to identify enrolled actuaries under suspension, the Executive Director will announce in the Internal Revenue Bulletin the names and addresses of enrolled actuaries who have been suspended. This announcement will appear in the weekly Bulletin at the earliest practicable date following suspension and will continue to appear in the weekly Bulletin for at least three successive weeks for each enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

Mr. Charles L. Cormack, Birmingham, Alabama, has been placed under consent suspension from enrollment to perform actuarial services under ERISA. An announcement of his reinstatement will be placed in the Bulletin at the end of the period of suspension.

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 1.671-4, 1.6012-3, 301.6109-1 amended.	Modification of reporting requirements for certain grantor trusts.	Oct. 24, 1980	Dec. 23, 1980
26 CFR 301.7701-2 amended.	Tax classification of limited partnerships.	Oct. 27, 1980	Dec. 26, 1980
26 CFR 1.46-4(d), 1.48-1, 1.48-2, amended; 1.48-11 added.	Investment credit for qualified rehabilitated buildings.	Oct. 28, 1980	Dec. 29, 1980
26 CFR 150.4995-3, 150.4997-1, 150.6402-1 amended; published as temporary regulations in T.D. 7732, 1980-48 I.R.B. 19.	Tax deposits and refunds based on net income limitation.	Nov. 5, 1980	Jan. 5, 1981
26 CFR 150.4989-1(c)(1), 150.4989-1(c)(2), 150.4989-1(c)(3), 150.4989-1(c)(7), revised.	Base prices of tier 2 and tier 3 oil.	Nov. 14, 1980	Jan. 13, 1981
26 CFR 1.164-2(d) amended; 1.901-4 added.	Payments to foreign countries for oil and gas that are not considered taxes.	Nov. 17, 1980	Jan. 16, 1981
26 CFR 1.907-0 through 1.907(f)-1, added; 1.78-1(a), 1.901-1(a), 1.904-2(a), 1.904-3(e), 1.904-4(a), 1.904-5(a), 1.960-1(g), 1.1248-1(d)(1)(i), amended.	Limitation on foreign tax credit for foreign oil and gas taxes.	Nov. 17, 1980	Jan. 16, 1981
26 CFR 301.7701-2 amended.	Classification of limited liability companies.	Nov. 17, 1980	Jan. 16, 1981
26 CFR 1.960-1 through 1.960-3, 1.960-7, revised.	Foreign tax credit for domestic corporate shareholders of certain third-tier corporations.	Nov. 19, 1980	Jan. 19, 1981
26 CFR 1.162-20, 1.6001-1(c), 1.6033-2, 53.4945-2, amended.	Treatment of expenditures for attempts to influence legislation.	Nov. 25, 1980	Jan. 26, 1981

Finding List of Current Action on Previously Published Rulings[1]

Bulletins 1980-27 through 1980-50

*** Denotes entry since last publication.**

Delegations Orders:

4 (Rev. 10)
Superseded by
4 (Rev. 11), 1980-33, I.R.B. **19**

11 (Rev. 11)
Superseded by
11 (Rev. 12), 1980-33 I.R.B. **20**

96 (Rev. 3)
Superseded by
96 (Rev. 4), 1980-29 I.R.B. **25**

112 (Rev. 5)
Superseded by
112 (Rev. 6), 1980-29 I.R.B. **26**

114 (Rev. 1)
Superseded by
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[1] See footnote at end of list.

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27, dated July 7, 1980.

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______	1930–1	7.30
______	1930–2	9.50
______	*1931–1*	*3.60*
______	1931–2	13.00
______	*1932–1*	*2.80*
______	1932–2	8.65
______	*1933–1*	*3.35*
______	*1933–2*	*3.45*
______	*1934–1*	*3.70*
______	1934–2	14.00
______	1935–1	6.90
______	*1935–2*	*14.00*
______	*1936–1*	*3.55*
______	*1936–2*	*14.00*
______	*1937–1*	*13.00*
______	1937–2	7.70
______	*1938–1*	*16.00*
______	*1938–2*	*13.00*
______	1939–1–1	8.25
______	1939–1–2	10.90
______	1939–2	9.40
______	1940–1	5.55
______	1940–2	14.00
______	1941–1	*6.95*
______	*1941–2*	*$3.55*
______	1942–1	7.25
______	*1942–2*	*5.55*
______	*1943(*)*	*9.55*
______	*1944(*)*	*7.85*
______	1945(*)	9.40
______	*1946–1*	*2.55*
______	1946–2	5.20
______	*1947–1*	*1.80*
______	1947–2	3.40
______	*1948–1*	*3.15*
______	1948–2	7.50
______	*1949–1*	*6.90*
______	*1949–2*	*2.80*
______	1950–1	6.35
______	*1950–2*	*4.70*
______	*1951–1*	*12.00*
______	*1951–2*	*5.05*
______	*1952–1*	*2.55*
______	1952–2	7.05
______	*1953–1*	*4.25*
______	1953–2	12.00
______	1954–1	12.00
______	1954–2	12.00
______	1955–1	10.25
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______	1956–1	15.00
______	1956–2	18.00
______	1957–1	16.00
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______	1963–2	10.75
______	1964–1–1	10.00
______	1964–1–2	11.00
______	1964–2	9.80
______	1965–1	10.70
______	1965–2	12.25
______	1966–1	14.00
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______	1972–2	13.70
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______	1978–1	11.75
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The Introduction on page 3 describes the purpose and content of this publication. The weekly Internal Revenue Bulletin is sold on a yearly subscription basis by the Superintendent of Documents. Current subscribers are notified by the Superintendent of Documents when their subscriptions must be renewed.

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December 29, 1980
Bulletin No. 1980-52

nternal Revenue
bulletin

ighlights
f this Issue

ese synopses are intended only as aids to e reader in identifying the subject matter vered. They may not be relied upon as thoritative interpretations.

NCOME TAX

ev. Rul. 80-356, page 7.

ndustrial development bonds; exempt small isue; moving acquired buildings. Bond proceeds hat are to be used to pay for moving buildings hat a corporation is purchasing from an unreated corporation to the purchaser's property ualify as amounts used for the acquisition of roperty of a character subject to the allowance or depreciation within the meaning of section 03(b)(6)(A) of the Code; Rev. Rul. 79-135 disinguished.

Rev. Rul. 80-357, page 7.

Disaster losses; year of deduction. Disaster areas n which losses during 1980 qualify for special ax treatment under section 165(h) of the Code re listed.

Rev. Rul. 80-358, page 10.

Liquidations; subsidiary; basis of assets. A personal holding company "purchased," within the meaning of section 334(b)(3) of the Code, all of he stock of a corporation having a wholly owned subsidiary on September 30, 1975, liquidated he parent on December 31, 1976, and liquidated he subsidiary on January 3, 1977. The personal holding company "purchased" the stock of the subsidiary on the date of liquidation of the parent. The "purchase" of the stock of the subsidiary did not occur within the 12-month period specified in section 334(b)(2)(B), and the basis in the subsidiary's assets to the personal holding company is determined under section 334(b)(1).

Rev. Rul. 80-361, page 13.

Interest on uncollectible loan; accrual method. An accrual method taxpayer must include in gross income for the taxable year in which a loan payable to the taxpayer becomes uncollectible the interest that accrues on the loan for the part of that year prior to the time the loan becomes uncollectible. If the accrued interest subsequently becomes uncollectible, the taxpayer may be entitled to a bad debt deduction under section 166 of the Code.

Rev. Rul. 80-362, page 14.

Income source; royalties for U.S. patent rights; paid by foreign corporation. An individual who is a citizen and resident of a foreign country with which the U.S. has no income tax convention licensed the U.S. rights on a patent to a Netherlands corporation that relicensed the rights to a U.S. corporation for use in the U.S. The patent royalties paid to the individual are subject to U.S. tax, and the Netherlands corporation is required to withhold the tax from the royalties.

Rev. Rul. 80-364, page 15.

Legal fees; awarded with back pay and interest. Legal fees, interest, and back pay awarded by a court in connection with a claim against an individual's employer are includible in gross income. Likewise, back pay paid to union members out of a court-approved settlement between a union and a company involving a breach of a collective bargaining agreement is includible in the members'

(Continued on page 4)

Finding Lists begin on page 54.
Announcement Relating to Decisions of the Tax Court on page 6.
Announcement of Voluntary Suspensions on page 51.
Announcement of Notice of Proposed Rulemaking on page 52.

Department of the Treasury
Internal Revenue Service

Statement of Principles of Internal Revenue Tax Administration

The function of the Internal Revenue Service is to administer the Internal Revenue Code. Tax policy for raising revenue is determined by Congress.

With this in mind, it is the duty of the Service to carry out that policy by correctly applying the laws enacted by Congress; to determine the reasonable meaning of various Code provisions in light of the Congressional purpose in enacting them; and to perform this work in a fair and impartial manner, with neither a government nor a taxpayer point of view.

At the heart of administration is interpretation of the Code. It is the responsibility of each person in the Service, charged with the duty of interpreting the law, to try to find the true meaning of the statutory provision and not to adopt a strained construction in the belief that he is "protecting the revenue." The revenue is properly protected only when we ascertain and apply the true meaning of the statute.

The Service also has the responsibility of applying and administering the law in a reasonable, practical manner. Issues should only be raised by examining officers when they have merit, never arbitrarily or for trading purposes. At the same time, the examining officer should never hesitate to raise a meritorious issue. It is also important that care be exercised not to raise an issue or to ask a court to adopt a position inconsistent with an established Service position.

Administration should be both reasonable and vigorous. It should be conducted with as little delay as possible and with great courtesy and considerateness. It should never try to overreach, and should be reasonable within the bounds of law and sound administration. It should, however, be vigorous in requiring compliance with law and it should be relentless in its attack on unreal tax devices and fraud.

Introduction

The Internal Revenue Bulletin is the authoritative instrument of the Commissioner of Internal Revenue for announcing official rulings and procedures of the Internal Revenue Service and for publishing Treasury Decisions, Executive Orders, Tax Conventions, legislation, court decisions, and other items of general interest. It is published weekly and may be obtained from the Superintendent of Documents on a subscription basis. Bulletin contents of a permanent nature are consolidated semiannually into Cumulative Bulletins, which are sold on a single-copy basis.

It is the policy of the Service to publish in the Bulletin all substantive rulings necessary to promote a uniform application of the tax laws, including all rulings that supersede, revoke, modify, or amend any of those previously published in the Bulletin. All published rulings apply retroactively unless otherwise indicated. Procedures relating solely to matters of internal management are not published; however, statements of internal practices and procedures that affect the rights and duties of taxpayers are published.

Revenue rulings represent the conclusions of the Service on the application of the law to the pivotal facts stated in the revenue ruling. In those based on positions taken in rulings to taxpayers or technical advice to Service field offices, identifying details and information of a confidential nature are deleted to prevent unwarranted invasions of privacy and to comply with statutory requirements.

Rulings and procedures reported in the Bulletin do not have the force and effect of Treasury Department Regulations, but they may be used as precedents. Unpublished rulings will not be relied on, used, or cited as precedents by Service personnel in the disposition of other cases. In applying published rulings and procedures, the effect of subsequent legislation, regulations, court decisions, rulings, and procedures must be considered, and Service personnel and others concerned are cautioned against reaching the same conclusions in other cases unless the facts and circumstances are substantially the same.

The Bulletin is divided into four parts as follows:

Part I.—1954 Code.

This part includes rulings and decisions based on provisions of the Internal Revenue Code of 1954.

Part II.—Treaties and Tax Legislation.

This part is divided into two subparts as follows: Subpart A, Tax Conventions, and Subpart B, Legislation and Related Committee Reports.

Part III.—Administrative, Procedural, and Miscellaneous.

To the extent practicable, pertinent cross references to these subjects are contained in the other Parts and Subparts.

Part IV.—Items of General Interest.

With the exception of the disbarment and suspension list included in this part, none of these announcements is consolidated in the Cumulative Bulletins.

The first Bulletin for each month includes an index for the matters published during the preceding month. These monthly indexes are cumulated on a quarterly and semiannual basis, and are published in the first Bulletin of the succeeding quarterly and semi-annual period, respectively.

The Bulletin Index-Digest System, a research and reference service supplementing the Bulletin, may be obtained from the Superintendent of Documents on a subscription basis. It consists of four Services: Service No. 1, Income Tax; Service No. 2, Estate and Gift Taxes; Service No. 3, Employment Taxes; Service No. 4, Excise Taxes. Each Service consists of a basic volume and a cumulative supplement that provide (1) finding lists of items published in the Bulletin, (2) digests of revenue rulings, revenue procedures, and other published items, and (3) topical indexes of Public Laws, Treasury Decisions, and Tax Conventions.

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Highlights of this Issue—Continued

(Continued from page 1)

INCOME TAX—Cont'd

gross income. The portion of the total settlement that is used by the union to pay legal fees incurred in enforcing the agreement is not includible in the members' gross income and is not deductible by them as a business expense.

Rev. Rul. 80-366, page 18.
Estimated tax; beneficiary of farming trust. Income to a beneficiary who receives more than two-thirds of the beneficiary's yearly gross income from a trust that is engaged solely in the business of farming is considered to be gross income from farming for estimated tax purposes; Rev. Rul. 63-26 modified.

Rev. Rul. 80-367, page 19.
Obsolete rulings. Certain post-1952 rulings dealing with engineering and corporate matters, including reorganizations, are declared obsolete.

Rev. Proc. 80-58, page 46.
CLADR; addition; deletion. Asset guideline classes 13.0, Offshore Drilling, and 15.0, Construction, are created to include those assets formerly included in asset guideline classes 15.1, Contract Construction Other than Marine, and 15.2, Marine Contract Construction, which included assets used in offshore oil and gas drilling. Asset guideline classes 15.1 and 15.2 are deleted. Rev. Proc. 77-10 modified.

Rev. Proc. 80-59, page 47.
Returns; filing; Presidential appointee with interest in blind trust. Conditions are set forth under which a Presidential appointee who has an interest in a blind trust that qualifies under section 202(f)(4)(B) of the Ethics in Government Act of 1978 will be granted permission to have the appointee's income tax return filed by the trustee of the blind trust and to state the procedure the trustee must follow in filing the appointee's income tax return; Rev. Proc. 79-43 modified and superseded.

Pub. L. 96-449, page 20.
The Hostage Relief Act of 1980 provides for certain exclusions from gross income, exemptions from income taxes, and other benefits for individuals held captive in Iran and other similarly situated individuals.

Pub. L. 96-471, page 25.
The Installment Sales Revision Act of 1980 revises the rules relating to certain installment sales.

Announcement 80-158, page 49.
Form 6478, Credit for Alcohol Used as Fuel, has been developed to compute the credit for alcohol used as a fuel after September 30, 1980, and is now available at Service offices.

EMPLOYEE PLANS

Rev. Rul. 80-359, page 11.
Discrimination; deferred compensation included in benefit base. An employer adopted a voluntary deferred-payment plan that allows electing employees to defer 5 percent of their compensation earned in any year. The employer also adopted a pension plan that takes into account all compensation for computing benefits, including amounts deferred under the first plan. The inclusion of the deferred amounts in computing benefits may result in discrimination prohibited under section 401(a)(4) of the Code if the proportion of compensation deferred by rank-and-file employees participating in the second plan is less than that of highly paid employees participating in the plan. Rev. Ruls. 69-145 and 71-225 superseded.

Rev. Rul. 80-360, page 12.
Eligibility; plan provisions. Examples illustrate whether plan provisions that describe the date of eligibility for plan participation meet the eligibility requirements of section 410(a)(4) of the Code.

EXEMPT ORGANIZATIONS

Announcement 80-160, page 49.
A listing is given of organizations now classified as private foundations.

Announcement 80-163, page 50.
Letters should be sent to key District Directors to obtain recognition of exemption for trusts organized to accumulate funds to provide withdrawal liability payments to multiemployer pension plans.

ESTATE TAX

Rev. Rul. 80-363, page 15.
Domicile; employee of international organization. An employee of an international organization who

(Continued on page 5)

Highlights of this Issue—Continued

(Continued from page 4)

ESTATE TAX—Cont'd

entered the U.S. on a G-4 visa and intended to remain in the U.S. indefinitely, which intent persisted until death, was a resident of the U.S.; Rev. Rul. 74-364 revoked.

GIFT TAX

Announcement 80-161, page 50.
Form 709-A, United States Short Form Gift Tax Return, will be available for filing in 1981 for gifts made in 1980.

EMPLOYMENT TAXES

Rev. Rul. 80-364, page 15.
Wages; legal fees and interest; awarded with back pay. The portion of a court-approved back-pay settlement between a union and a company that is used to pay legal fees incurred in enforcing a collective bargaining agreement on behalf of union members is not wages to the members. Likewise, the portion of back-pay award that is specified for legal fees and interest in connection with a claim against an individual's employer is also excludable from wages. However, the full amount of a similar award that does not specify that a part of the award is for legal fees is wages, even if the individual uses a portion of the award to pay attorney's fees.

Rev. Rul. 80-365, page 17.
Babysitters. Individuals engaged to perform sitting services for the clients of a babysitting agency that receives a fixed percentage of the fee collected by the sitters are not employees of the agency with respect to remuneration received after 1974. The general rule for determining employee status set forth in Rev. Rul. 56-502 only applies to sitting services if the agency pays the sitters directly. Rev. Rul. 74-414 revoked; Rev. Rul. 56-502 modified.

Rev. Proc. 80-60, page 47.
FUTA; credit reduction. The credit against unemployment tax for amounts paid into the unemployment funds maintained by various states, the District of Columbia, Puerto Rico, and the Virgin Islands is reduced for wages paid by employers during 1980 for services performed in those jurisdictions.

Page 16.
Railroad retirement; rate determination; quarterly. The Railroad Retirement Board has determined that the rate of tax imposed by section 3221(c) of the Code shall be fourteen and one-half cents per hour for the quarter beginning January 1, 1981.

EXCISE TAXES

Announcement 80-165, page 50.
The separate statement of the amount of windfall profit tax deductible to producers, operators, or partnerships referred to in Announcement 80-150 will not be required. This information will be required on Form 6248 and be due March 31, 1981.

ADMINISTRATIVE

Del. Order 51 (Rev. 5), page 46.
Proofs of claim in insolvency proceedings. Authority to sign proofs of claim and other documents may be redelegated to Special Procedures Officers, Advisors, and Advisor/Reviewers no lower than grade 12; Del. Order 51 (Rev. 4) superseded.

Page 48.
Social Security contribution and benefit base. The Secretary of Health and Human Services has announced that the contribution and benefit base for remuneration paid in and self-employment income earned in taxable years beginning in 1981 is $29,700.

Announcement 80-162, page 50.
Extension Forms 2350, 2688, and 4868 have been revised to reflect provisions of Pub. L. 96-167 that amended section 6075(b) of the Code to provide that any extension of time granted a taxpayer for filing a calendar year income tax return also extends the time granted for filing a gift tax return that is due by April 15. The revised forms will be available after January 1, 1981.

Announcement Relating to Decisions of the Tax Court

It is the policy of the Internal Revenue Service to announce in the Internal Revenue Bulletin at the earliest practicable date the determination of the Commissioner to acquiesce or not acquiesce in a decision of the Tax Court which disallows a deficiency in tax determined by the Commissioner to be due.

Notice that the Commissioner has acquiesced or nonacquiesced in a decision of the Tax Court relates only to the issue or issues decided adversely to the Government.

Actions of acquiescences in adverse decisions shall be relied on by Revenue officers and others concerned as conclusions of the Service only to the application of the law to the facts in the particular case. Caution should be exercised in extending the application of the decision to a similar case unless the facts and circumstances are substantially the same, and consideration should be given to the effect of new legislation, regulations, and rulings as well as subsequent court decisions and actions thereon.

Acquiescence in a decision means acceptance by the Service of the conclusion reached, and does not necessarily mean acceptance and approval of any or all of the reasons assigned by the court for its conclusions.

No announcements are made in the Bulletin with respect to memorandum opinions of the Tax Court.

The announcements published in the weekly Internal Revenue Bulletins are consolidated semiannually and annually. The semiannual consolidation appears in the first Bulletin for July and in the Cumulative Bulletin for the first half of the year and the annual consolidation appears in the first Bulletin for the following January and in the Cumulative Bulletin for the last half of the year.

The Commissioner ACQUIESCES in the following decisions:

Taxpayer	Docket No.	Report	
		Volume	Page
Larry Lange Ford, Inc.[1]	4830-77	73	676
Professional Standards Review Organization of Queens County, Inc.[2]	9952-77X	74	240
Red Carpet Car Wash, Inc.[1]	4829-77	73	676
University of Massachusetts Medical School Group Practice[3]	2710-79X	74	—
Westbrook, Yvonne (now Yvonne Westbrook Maciel)[4]	618-79	74	—

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[1] Acquiescence in the issue relating to whether taxpayer was the owner of a partnership interest for the purpose of deducting a share of the loss incurred by the partnership. Acquiescence in result in the issue relating to whether a controlled group of corporations are bound to equally allocate the $25,000 surtax exception as a result of the failure of the group to file an election provided under 1.1561-3A(2) of the regulations. Acquiescence "in result" means acceptance of the decision of the Court but disagreement with some or all the reasons assigned for the decision.

[2] Acquiescence relating to whether an organization that reviews the appropriateness and quality of service provided under Medicare and Medicaid is operated exclusively for charitable purposes.

[3] Acquiescence relating to whether an organization created by a state statute to serve as a component of the University of Massachusetts Medical School and its teaching hospital is organized and operated exclusively for charitable, educational, and scientific purposes.

[4] Acquiescence relating to whether installment payments made to petitioner by her former husband are taxable to her as alimony.

Part I. Rulings and Decisions Under the Internal Revenue Code of 1954

Section 61.—Gross Income Defined

26 CFR 1.61-1: Gross income.

Whether a creditor-taxpayer may suspend the accrual of interest income on a loan that becomes uncollectible during the taxable year. See Rev. Rul. 80-361, page 13.

26 CFR 1.61-1: Gross income.

Whether court awarded payments of interest, attorney's fees and back pay are includible in gross income. See Rev. Rul. 80-364, page 15.

26 CFR 1.61-7: Interest.

Whether interest to be paid on obligations of a city will be exempt from tax. See Rev. Rul. 80-356, below.

Section 103.—Interest on Certain Governmental Obligations

26 CFR 1.103-10: Exemption for certain small issues of industrial development bonds.
(Also Sections 61, 263; 1.61-7, 1.263(a)-2.)

Industrial development bonds; exempt small issue; moving acquired buildings. Bond proceeds that are to be used to pay for moving buildings that a corporation is purchasing from an unrelated corporation to the purchaser's property qualify as amounts used for the acquisition of property of a character subject to the allowance for depreciation within the meaning of section 103(b)(6)(A) of the Code; Rev. Rul. 79-135 distinguished.

Rev. Rul. 80-356

ISSUE

Will bond proceeds to be expended for the cost of moving buildings qualify as amounts used for the acquisition of property of a character subject to the allowance for depreciation within the meaning of secton 103(b)(6)(A) of the Internal Revenue Code?

FACTS AND LAW

City *M* proposes to issue industrial development bonds in the amount of $1,000,000 and loan the proceeds to corporation *X* for use in acquiring and moving several buildings. *X* will purchase the buildings from an unrelated corporation for $600,000. The cost of moving the buildings to *X*'s property will be $400,000. The bonds will not be arbitrage bonds within the meaning of section 103(c)(2) of the Code.

Section 103(a)(1) of the Code provides that interest on obligations of a political subdivision of a state is excludable from gross income. Section 103(b)(1) provides that, with certain exceptions, industrial development bonds will not be treated as obligations described in section 103(a)(1). Section 103(b)(6)(A) provides that an exempt small issue of $1,000,000 or less will not be treated as an industrial development bond if substantially all (90 percent or more) of the bond proceeds are to be used for the acquisition of land or property of a character subject to the allowance for depreciation.

Section 263 of the Code provides that no deduction shall be allowed for any amount paid out for new buildings or for permanent improvement or betterments made to increase the value of any property. Section 1.263(a)-2 of the Income Tax Regulations lists as an example of a capital expenditure the cost of acquiring buildings having a useful life substantially beyond the taxable year.

The application of section 263 of the Code is illustrated in Rev. Rul. 72-113, 1972-1 C.B. 99, which holds that the costs of transporting horses purchased for breeding purposes to a taxpayer's farm are capital expenditures within the meaning of section 263(a) of the Code and are includible in the basis of the horses acquired.

HOLDING

The cost of moving the buildings to *X*'s property will be a capital expenditure that must be added to the basis of the buildings since it is part of the cost of the acquisition of such buildings. Therefore, the bond proceeds used to move the buildings will qualify as amounts used to acquire property of a character subject to the allowance for depreciation. Because substantially all (90 percent or more) of the bond proceeds will be used to acquire depreciable property, the bonds will qualify for the exception provisions of section 103(b)(6)(A) of the Code and the interest on the bonds will be excludable from the gross incomes of the bondholders under the provisions of section 103(a)(1).

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 79-135, 1979-1 C.B. 78, which holds, in part, that amounts incurred for moving existing equipment to a new location will not qualify as expenditures for property subject to the allowance for depreciation, is distinguishable because the facts of Rev. Rul. 79-135 do not involve moving costs attributable to the acquisition of property.

Section 162.—Trade or Business Expenses

26 CFR 1.162-1: Business expenses.

Whether court awarded payments for attorney's fees to a union on behalf of its members are deductible by the members as a business expense. See Rev. Rul. 80-364, page 15.

Section 165.—Losses

26 CFR 1.165-11: Election in respect of losses attributable to a disaster.

Disaster losses; year of deduction. Disaster areas in which losses during 1980 qualify for special tax treatment under section 165(h) of the Code are listed.

Rev. Rul. 80-357

LAW AND ANALYSIS—HOLDING

Under section 165(h) of the Internal Revenue Code, a taxpayer who suffers a disaster loss may elect to take a deduction for that loss on the federal income tax return for the taxable year immediately preceding the taxable year in which the disaster occurred, provided the loss is one that occurred in an area determined by the President of the United States to warrant assistance by the Federal Government under the Disaster Relief Act of 1974, Pub. L. 93-288, 1974-2 C.B. 414.

The election to deduct for the preceding year must be made on or before the later of (1) the original due date of the taxpayer's income tax return for the year in which the disaster occurred, or (2) the due date of the preceding year's return (taking into account extensions of time for filing granted to the taxpayer). Section 1.165-11 of the Income Tax Regulations sets forth the procedures for making an election with respect to such losses.

The provisions of section 165(h) of the Code will apply only to losses that are otherwise deductible under section 165(a). An individual taxpayer may deduct losses if they are incurred in a trade or business, if they are incurred in a transaction entered into for profit, or if they are casualty losses under section 165(c)(3).

The President has determined that areas in the states and possession listed below have been adversely affected by disasters of sufficient severity occurring during 1980 to warrant disaster assistance by the Federal Government under the Disaster Relief Act of 1974.

Disaster Areas in 1980	Type of Disaster	Date Disaster Declared or Occurred
Alabama Counties of Lee, Mobile	Severe storms, tornadoes, and flooding	April 12, 1980
Arizona Counties of Gila, Maricopa, Mohave, Yavapai; Fort Apache and San Carlos Apache Indian Reservations	Severe storms and flooding	February 13, 1980
Arkansas Counties of Crittenden, Faulkner, Johnson, Lonoke, Pulaski	Severe storms and tornadoes	April 7, 1980
California		
Contra Costa County Reclamation Districts 799, 800, 2024, 2025 (Holland Tract), 2026 (Webb Tract), 2036, 2059, 2065, and Bethel Island Municipal Improvement District		
Sacramento County Reclamation Districts 341, 563, 756, 1601, 2111, and Brannan—Andrus Levee Maintenance District		
San Joaquin County Reclamation Districts 2, 38, 524, 544, 548, 684, 2021, 2023, 2027, 2028, 2029, 2030, 2033, 2037, 2039, 2040, 2041, 2042, 2044, and 2072	Torrential rains, high tides, and strong winds	January 13, 1980
Counties of Los Angeles, Orange, Riverside, San Bernardino, San Diego, Santa Barbara, Santa Cruz, Ventura	Severe storms, mudslides, and flooding	January 8, 1980
Upper and Lower Jones Tract in San Joaquin Delta of San Joaquin County	Flooding	September 26, 1980
Counties of Los Angeles, Orange, San Bernardino, Riverside [1]	Major fires and high winds	November 15, 1980
Florida Counties of Broward, Dade, Monroe, Palm Beach [2]	Arrival of large numbers of undocumented aliens	April 13, 1980
Hawaii County of Maui	Severe storms, high surf, and flooding	January 7-16, 1980
Idaho Counties of Benewah, Bonner, Boundary, Clearwater, Kootenai, Latah, Nez Perce, Shoshone	Volcanic eruption of Mount St. Helens	May 18, 1980
Louisiana		
Parishes of Assumption, Iberville, Jefferson, Lafourche, Orleans, St. Bernard, St. Charles, St. Bernard, St. Charles, St. Martin, St. Mary, St. Tammany, Terrebonne, Washington	Severe storms and flooding	March 26-31, 1980
Parishes of Acadia, Calcasieu, Jefferson Davis, Lafayette, Pointe Coupee, Vermilion	Severe storms and flooding	May 15, 1980

Disaster Areas in 1980	Type of Disaster	Date Disaster Declared or Occurred
Maine		
Counties of Cumberland, Hancock, Knox, Lincoln, Sagadahoc, Waldo, Washington, York	Toxic paralytic shellfish poisoning	July 30, 1980
Michigan		
Counties of Kalamazoo, Van Buren	Severe storms and tornadoes	May 13, 1980
Counties of Allegan, Berrien, Calhoun, Cass, Jackson, Ottawa, St. Joseph, Van Buren, Washtenaw, Wayne	Severe thunderstorms and high winds	July 15-20, 1980
Mississippi		
Counties of Adams, Forrest, George, Harrison, Jackson, Marion, Pike, Walthall	Severe storms, flooding, mudslides, tornadoes and high winds	March 28, 1980
Missouri		
County of Pettis	Severe storms and tornadoes	May 12, 1980
Nebraska		
Counties of Hall, Hamilton, Merrick	Severe storms and tornadoes	June 3, 1980
New Jersey	Water shortage	October 19, 1980
New York		
Love Canal area of Niagara County [2]	Adverse impact of chemical wastes in the Love Canal waste landfill in the City of Niagara Falls	May 5, 1980
Northern Mariana Islands		
Island of Saipan [1]	Typhoon Dinah	November 23, 1980
Ohio		
Counties of Belmont, Columbiana, Guernsey, Jefferson, Monroe, Muskingum, Noble	Severe storms and flooding	August 11, 1980
Pennsylvania		
Counties of Allegheny, Armstrong, Indiana, Westmoreland	Severe storms and tornadoes	June 3, 1980
Counties of Armstrong, Butler, Clarion	Severe storms and flooding	August 14, 1980
Texas		
Aransas, Brooks, Cameron, Duval, Hidalgo, Jim Hogg, Jim Wells, Kenedy, Kleberg, Nueces, San Patricio, Willacy; Robert Mueller Airport in Travis County for repair and restoration of fixed hanger facilities	Hurricane Allen	August 10, 1980
Precinct One of Nolan County	Tropical Storm Danielle, intermittent rains, and flooding	September 5, 1980
Washington		
Entire area of the State of Washington	Volcanic eruption of Mount St. Helens	May 18, 1980
West Virginia		
Counties of Fayette, Hancock, Harrison, Jackson, Kanawha, Marion, Marshall, Monongalia, Nicholas, Ohio, Preston, Putnam, Raleigh, Taylor, Webster	Severe storms and flooding	August 4, 1980
Wisconsin		
Counties of Chippewa, Dunn, Eau Claire, Pierce	Severe storms and flooding	July 15, 1980

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[1] Not previously published in the Internal Revenue Bulletin.

[2] No determination has been made by the Internal Revenue Service that losses suffered by taxpayers in the listed area will, in fact, qualify as casualty losses deductible under section 165 of the Code.

Section 166.—Bad Debts

26 CFR 1.166-1: Bad debts.

Whether a creditor-taxpayer may suspend the accrual of interest income on a loan that becomes uncollectible during the taxable year. See Rev. Rul. 80-361, page 13.

Section 167.—Depreciation

26 CFR 1.167(a)-11: Depreciation based on class lives and asset depreciation ranges for property placed in service after December 31, 1970.

New asset guideline classes 13.0, Offshore Drilling, and 15.0, Construction. Deletion of asset guideline classes 15.1, Contract Construction Other than Marine and 15.2, Marine Contract Construction. See Rev. Proc. 80-58, page 46.

Section 263.—Capital Expenditures

26 CFR 1.263(a)-2: Examples of capital expenditures.

Whether the cost of moving a building is a capital expenditure. See Rev. Rul. 80-356, page 7.

Section 334.—Basis of Property Received in Liquidations

26 CFR 1.334-1: Basis of property received in liquidations.

Liquidations; subsidiary; basis of assets. A personal holding company "purchased," within the meaning of section 334(b)(3) of the Code, all of the stock of a corporation having a wholly owned subsidiary on September 30, 1975, liquidated the parent on December 31, 1976, and liquidated the subsidiary on January 3, 1977. The personal holding company "purchased" the stock of the subsidiary on the date of liquidation of the parent. The "purchase" of the stock of the subsidiary did not occur within the 12-month period specified in section 334(b)(2)(B), and the basis in the subsidiary's assets to the personal holding company is determined under section 334(b)(1).

Rev. Rul. 80-358

ISSUE

Is the parent's (*P*) basis in a subsidiary's (*T*) assets received in a complete liquidation within the meaning of section 332(b) of the Internal Revenue Code determined with reference to section 334(b)(1) or section 334(b)(2)?

FACTS

S is a corporation engaged in a service business. For many years *S* has owned all of the stock of *T*, a corporation engaged in the same business as *S*. On September 30, 1975, *P*, a holding company, purchased, within the meaning of section 334(b)(3) of the Code, all of the outstanding stock of *S* for cash from an unrelated seller, with *T* remaining a wholly owned subsidiary of *S*. On December 31, 1976, *P*, pursuant to a plan of liquidation, completely liquidated *S* within the meaning of sections 332(b) and 334(b)(2), thus directly acquiring all of the stock of *T*. The basis of the stock of *T* in the hands of *P* was determined under section 334(b)(2). On January 3, 1977, *P*, pursuant to a plan of liquidation adopted on that date, liquidated *T*, within the meaning of section 332(b), and received *T*'s assets.

LAW AND ANALYSIS

The basis of assets received by a corporation upon the liquidation of another corporation within the meaning of section 332(b) of the Code is generally a carryover basis under section 334(b)(1). However, an exception to this general rule is contained in section 334(b)(2), which provides that the basis of assets so received in complete liquidation will be determined with reference to the adjusted basis of the parent corporation in the stock of the liquidated subsidiary, provided the requirements of section 334(b)(2) are met. One of these requirements, contained in section 334(b)(2)(B), is that stock of the distributing corporation possessing at least 80 percent of the total combined voting power of all classes of stock entitled to vote, and at least 80 percent of the total number of shares of all other classes of stock (except nonvoting stock which is limited and preferred as to dividends), must have been acquired by the distributee by purchase during a specific 12-month period. For this purpose, the term "purchase" is defined in section 334(b)(3), which provides:

> (3) Purchase defined.—For purposes of paragraph (2)(B), the term "purchase" means any acquisition of stock, but only if—
>
> (A) the basis of the stock in the hands of the distributee is not determined (i) in whole or in part by reference to the adjusted basis of such stock in the hands of the person from whom acquired, or (ii) under section 1014(a) (relating to property acquired from a decedent),
>
> (B) the stock is not acquired in an exchange to which section 351 applies; and
>
> (C) the stock is not acquired from a person the ownership of whose stock would, under section 318(a) be attributed to the person acquiring such stock.
>
> Notwithstanding subparagraph (C) of this paragraph, for purposes of paragraph (2)(B), the term "purchase" also means an acquisition of stock from a corporation when ownership of such stock would be attributed under section 318(a) to the person acquiring such stock, if the stock of such corporation by reason of which such ownership would be attributed was acquired by purchase (within the meaning of the preceding sentence).

Section 318(a) of the Code provides that for the purposes of those provisions of Subchapter C of the Code to which the rules in this section are expressly made applicable, if 50 percent or more in value of the stock in a corporation is owned, directly or indirectly, by or for any person, that person shall be considered as owning the stock owned, directly or indirectly, by or for such corporation, in that proportion which the value of the stock which such person so owns bears to the value of all the stock in such corporation.

In the present case, immediately prior to *P*'s liquidation of *S* and acquisition of the stock of *T*, *P* owned all the stock of *S*. *P* therefore acquired the stock of *T* from a corporation (*S*) whose ownership of the *T* stock was attributable to *P* under section 318(a) of the Code. Moreover, *P* had acquired the stock of *S* by purchase, within the meaning of section 334(b)(3), from an unrelated seller. *P*'s acquisition of the stock of *T* therefore qualified as a purchase within the meaning of the second sentence of section 334(b)(3). The issue of whether *P*'s basis in the *T* stock is determined under section 334(b)(1) or section 334(b)(2) thus depends upon whether *P*'s purchase of the requisite 80 percent of the *T* stock occurred during the 12-month period specified in section 334(b)(2)(B).

Section 334(b)(2)(B)(ii) of the Code specifies that if any of the stock of the distributing corporation (*T*) was acquired in an acquisition which is a purchase within the meaning of the second sentence of section 334(b)(3), then the 12-month period within which the 80 percent ownership of the stock of the distributing corporation (*T*) must be acquired by the distributee (*P*) begins on the date on which the distributee is first considered under section 318(a) as owning stock owned by the corporation (*S*) from which such acquisition was made.

P was first considered under section 318(a) of the Code as owning stock of *T* on September 30, 1975, the date upon which *P* acquired the stock of *S*. However, *P*'s "purchase" (within the meaning of section 334(b)(3)) of the stock of *T* did not occur until December 31, 1976, the date upon which the liquidation of *S* occurred. Therefore, *P*'s "purchase" of the requisite amount of the stock of *T* did not occur within the 12-month period specified by section 334(b)(2)(B).

HOLDING

P's basis in *T*'s assets received by *P* in complete liquidation of *T* is determined under section 334(b)(1) of the Code.

Section 401.—Qualified Pension, Profit-Sharing, and Stock Bonus Plans

26 CFR 1.401-4: Discrimination as to contributions or benefits.

Discrimination; deferred compensation included in benefit base. An employer adopted a voluntary deferred-payment plan that allows electing employees to defer 5 percent of their compensation earned in any year. The employer also adopted a pension plan that takes into account all compensation for computing benefits, including amounts deferred under the first plan. The inclusion of the deferred amounts in computing benefits may result in discrimination prohibited under section 401(a)(4) of the Code only if the proportion of compensation deferred by rank-and-file employees participating in the second plan is less than that of highly paid employees participating in the plan. Rev. Ruls. 69-145 and 71-225 superseded.

Rev. Rul. 80-359

The purpose of this revenue ruling is to restate the positions in Rev. Rul. 69-145, 1969-1 C.B. 126, and Rev. Rul. 71-225, 1971-1 C.B. 124, under current law.

The issue in the revenue rulings is whether a pension plan that determines benefits under the circumstances described below may fail to satisfy section 401(a)(4) of the Internal Revenue Code.

An employer adopted a nonqualified, deferred-payment arrangement for its employees. Under the arrangement any employee of the employer may elect, before the beginning of any taxable year, to defer, until retirement, the receipt of 5 percent of the compensation earned in that year. The deferred amounts are allocated to the employee's account as nonforfeitable credits. The employer has not made any contributions to fund the deferred-payment arrangement.

In the same year, the employer also adopted a pension plan for its employees. The plan provides that all compensation will be considered as the base for purposes of computing benefits regardless of the deferment of payment of any part of such compensation.

Section 401(a)(4) of the Code provides that a plan will satisfy that section if the contributions or benefits under the plan do not discriminate in favor of employees who are officers, shareholders, or highly compensated. However, section 401(a)(5) provides that a plan will not be considered discriminatory merely because the contributions or benefits of or on behalf of the employees under the plan bear a uniform relationship to the total compensation or the basic or regular rate of compensation of such employees.

The amounts credited under an unfunded, deferred payment, under which the amounts will not be paid until retirement, are not considered compensation for the purposes of section 401(a)(5) of the Code. Therefore, such deferred amounts may not be used under a qualified plan to compute the employees' benefits if it results in discrimination prohibited under section 401(a)(4). However, these amounts may be used under a qualified plan if they do not result in prohibited discrimination.

In this case, if the proportion of compensation deferred under the unfunded arrangement by rank-and-file employees participating in the qualified plan equals or exceeds that deferred by employees participating in the qualified plan who are officers, shareholders, or highly compensated, the basis for computing benefits does not cause prohibited discrimination.

On the other hand, if in the plan under consideration only a few of the lower paid employees elected to participate under the unfunded deferred-payment arrangement, the use of the amounts credited under the unfunded arrangement benefits primarily the highly paid employees and, therefore, the plan in operation may result in discrimination prohibited under section 401(a)(4) of the Code.

Accordingly, the use of deferred amounts and current compensation as the basis for computing benefits will not automatically cause the plan to fail to satisfy section 401(a)(4) of the Code. However, the basis of benefits may, in operation, result in failure to satisfy section 401(a)(4).

This revenue ruling does not deal with whether the nonqualified deferred-payment arrangement may fail to satisfy the funding requirements of Part 3 of Title I of the Employee Retirement Income Security Act of 1974, Pub. L. 93-406, 1974-3 C.B. 1.

This revenue ruling does not consider whether the basis of benefits for the pension plan may result in a violation of the limits of section 415 of the Code.

Rev. Ruls. 69-145 and 71-225 are superseded because the positions stated therein are restated under current law in this revenue ruling.

Section 410.—Minimum Participation Standards

26 CFR 1.410(a)-4: Maximum age conditions and time of participation.

Eligibility; plan provisions. Examples illustrate whether plan provisions that describe the date of eligibility for plan participation meet the eligibility requirements of section 410(a)(4) of the Code.

Rev. Rul. 80-360

Advice has been requested whether the plans described below meet the requirements regarding commencefent of plan participation of section 410(a)(4) of the Internal Revenue Code and section 1.410(a)-4(b) of the Income Tax Regulations.

Plan 1. A plan provides that an employee is eligible to participate in the plan on the first day of the first plan year beginning after the employee's employment commencement date. The plan has no other requirements for participation.

Plan 2. A calendar year plan sets minimum service requirements regarding eligibility for plan participation as the completion of at least one hour of service (as defined in section 2530.200b-2(a) of the Department of Labor Regulations) in each of six calendar months after the employee's employment commencement date. An employee who has not separated from service may enter the plan on the first day of the first plan year beginning after completion of this service. The plan designates 12-consecutive-month periods beginning on the first anniversary of an employee's employment commencement date and succeeding anniversaries thereof as the eligibility computation period after the initial eligibility computation period.

Plan 3. A calendar year plan provides that an employee who has satisfied the minimum age and service requirements of section 410(a)(1)(A) of the Code is eligible to participate in the plan on the first day of the first plan year beginning after the date such requirements are met.

Plan 4. A calendar year defined benefit plan provides that an employee may enter the plan on the first semiannual entry date following attainment of age 25 and completion of one year of service.

Section 410(a)(1)(A) of the Code states that, in general, a qualified plan may not, as a condition of plan participation, require that an employee complete a period of service with the employer extending beyond the date on which the employee attains age 25 or completes one year of service, whichever is later. Section 410(a)(1)(B) sets forth special eligibility guidelines for 1) plans which provide 100 percent vesting after three years of service, and 2) plans maintained by certain specified employers.

Section 410(a)(3)(A) of the Code defines the term "year of service" as a 12-month period during which an employee has completed at least 1,000 hours of service.

Section 410(a)(4) of the Code provides that employees who have met the applicable minimum age and service requirements of section 410(a)(1) and who otherwise are eligible must be allowed to participate in the plan no later than the earlier of 1) the first day of the first plan year beginning after the date on which the employee satisfies these requirements, or 2) the date six months after these conditions are met, unless the employee separates from service prior to such date.

For purposes of section 410(a)(1) of the Code, a "break in service" is defined in section 411(a)(6)(A) as a calendar year, plan year, or other 12-consecutive-month period designated by the plan (and not prohibited under regulations prescribed by the Secretary of Labor) during which the participant has not completed more than 500 hours of service.

Section 1.410(a)-4(b) of the regulations provides that if the separated employee returns to service after the time described in section 410(a)(4) of the Code, without incurring a one-year break in service, the employee must commence participation immediately upon the return. Example (3) of section 1.410(a)-4(b) of the regulations describes a situation wherein an employee who separates from service with a vested benefit and then incurs a break in service must be allowed to participate in the plan as of the date of reemployment so long as the employee completes a year of service after his or her return. A plan similarly must accommodate the reentry of certain employees who have satisfied the applicable minimum age and service requirements but who separate from service prior to one of the participation dates referred to in this section (whichever date is applicable). If such an employee later returns after one of these dates, without incurring a one-year break in service, the employee must be allowed to participate in the plan as of his or her return to service.

Section 2530.202-2(a) of the Department of Labor Regulations states that, for purposes of section 410(a)(1)(A)(ii) of the Code, the initial eligibility computation period that a plan must use is the 12-consecutive-month period beginning on the employee's employment commencement date. An employee's employment commencement date is the first day for which the employee is entitled to be credited with an hour of service (as described in section 2530.200b-2(a)(1) of the Department of Labor Regulations) for an employer maintaining the plan.

Section 2530.202-2(b) of the Department of Labor Regulations defines eligibility computation periods after the initial eligibility computation period. According to this section, a plan may, in general, choose one of two methods in measuring years of service for purposes of eligibility to participate after the initial eligibility computation period. The plan may designate the 12-consecutive month periods beginning on the first anniversary of an employee's employment commencement date and succeeding anniversaries thereof as the eligibility computation period after the initial eligibility computation period. Alternatively, a plan may, subject to certain restrictions, designate plan years beginning with the plan year which includes the first anniversary of an employee's employment commencement date as the eligibility computation period after the initial eligibility computation period.

These criteria are applied to the plans described above as follows:

Plan 1. For plans meeting the requirements of section 410(a)(1)(A) of the Code, section 410(a)(4) permits a maximum waiting period of six months after completion of one year of service for employees who are age 25 or over. This plan ensures that an employee always will be able to participate in the plan within a 12-month period after his or her date of employment.

Accordingly, this plan will not fail to satisfy the requirements of section 410(a)(4) (provided the plan also accommodates the immediate reentry exceptions set forth in section 1.410(a)-4(b) of the regulations, as described above.)

Plan 2. These plan provisions will not always permit an employee to participate within the period mandated by section 410(a)(4) of the Code, as illustrated by the following example.

A comences employment on January 2, 1978. On May 29, 1978, *A* separates from service after having completed over 1,000 hours of service. *A* returns to full-time work for this employer on July 2, 1979. *A* completes six months of employment that July and is thus allowed to participate in the plan as of January 1, 1980.

In the above example, the latest date by which *A* should have been allowed to participate is July 2, 1979, six months after *A* completed one year of service (as defined in section 410(a)(3)(A) of the Code.) The break-in-service provisions of section 410(a)(5) do not allow *A*'s hours of service completed in 1978 to be disregarded, for purposes of eligibility to participate, because *A* did not incur a break in service in either the initial eligibility computation period (January 2, 1978 to January 1, 1979) or in *A*'s subsequent eligibility computation period (January 2, 1979 to Janunary 1, 1980.)

Accordingly, this plan will not satisfy the requirements of section 410(a)(4) of the Code.

Plan 3. The plan's single annual entry date violates the requirements of section 410(a)(4) of the Code because operation of the provision will not ensure that an employee always will be eligible to participate within six months of attaining age 25 and completing one year of service. An employee, for instance, who had attained age 25 and completed one year of service on January 2 would be prevented from participating in the plan until the following January 1.

Accordingly, this plan fails to satisfy the requirements of section 410(a)(4) of the Code.

Plan 4. Two semi-annual entry dates are not sufficient to allow the plan to comply with the requirements of section 1.410(a)-4(b) of the regulations, as is evidenced by the following example.

B, after working ten years, separates from service in 1979 with a vested benefit. On March 3, 1984, *B* returns to employment that is covered by the plan and is allowed to resume plan participation on July 1 of that year.

In the above example, the employee's prior service may not be disregarded because *B* had a vested benefit upon separation from service. Thus, the plan may not postpone *B*'s participation until July 1 but, rather, must allow *B*, to participate as of his or her return on March 3, 1984 (subject to *B*'s completion of a year of service after returning to work for this employer.)

Accordingly, this plan will not meet the requirements of section 410(a)(4) of the Code unless it also provides for the reentry of vested employees who return after a break in service (and who complete a year of service after returning) and of certain employees who separate from service and later return to work without incurring a one-year break in service.

Section 451.—General Rule for Taxable Year of Inclusion

26 CFR 1.451-1: General rule for taxable year of inclusion.
(Also Sections 61, 166; 1.61-1, 1.166-1.)

Interest on uncollectible loan; accrual method. An accrual method taxpayer must include in gross income for the taxable year in which a loan payable to the taxpayer becomes uncollectible the interest that accrues on the loan for the part of that year prior to the time the loan becomes uncollectible. If the accrued interest subsequently becomes uncollectible, the taxpayer may be entitled to a bad debt deduction under section 166 of the Code.

Rev. Rul. 80-361

ISSUE

When may a creditor-taxpayer suspend the accrual of interest income on a loan that becomes uncollectible during the taxable year?

FACTS

M, a domestic corporation, is a calendar year taxpayer that uses the accrual method of accounting. *M* made a secured loan to *A* in 1975. During 1975 and through the major part of 1976, *A*'s financial condition was such that the interest on the loan obligation to *M* was collectible. During the latter part of 1976, however, due to sudden and severe financial reverses, *A* became insolvent, and, as a consequence, the debt became uncollectible. Shortly thereafter, *A* defaulted on the loan. The security was sufficient to satisfy only the principal amount of the indebtedness.

APPLICABLE LAW AND ANALYSIS

Section 1.451-1(a) of the Income Tax Regulations provides that under an accrual method of accounting, income is includible in gross income when all events have occurred that fix the right to receive such income and the amount thereof can be determined with reasonable accuracy.

Rev. Rul. 72-100, 1972-1 C.B. 122, as clarified by Rev. Rul. 74-607, 1974-2 C.B. 149, states that the right to receive interest income becomes fixed ratably over the period of the loan so long as all events have accrued to fix the right to receive income and the amount thereof can be fixed with reasonable accuracy.

A fixed right to a determinable amount does not require accrual, however, if the income item is uncollectible when the right to receive the item arises. *Jones Lumber Co. v. Commissioner,* 404 F.2d 764 (6th Cir. 1968).

When an income item is properly accrued and subsequently becomes uncollectible, a taxpayer's remedy is by way of deduction rather than through elimination of the accrual. Moreover, this rule is applicable even when the item is accrued and becomes uncollectible during the same taxable year. *Spring City Foundry Co. v. Commissioner,* 292 U.S. 182 (1934), Ct.D. 829, XIII-1 C.B. 28 (1934). Also *Atlantic Coast Line Railroad Co. v. Commissioner,* 31 B.T.A. 730, 751 (1934), *acq.,* XIV-2 C.B. (1935).

HOLDINGS

The interest, the right to which became fixed during that part of 1976 prior to *A*'s insolvency, accrued as such right arose and therefore must be included in the gross income of *M* for that year. To the extent that the accrued interest subsequently became uncollectible because of *A*'s insolvency, *M* is entitled to treat the accrued interest as a bad debt pursuant to section 166 of the Code, provided the requirements of that section are satisfied.

The interest, the right to which became fixed during that part of 1976 after A's insolvency, did not properly accrue, since the interest was uncollectible at the time such right arose, Therefore, such interest need not be included in the gross income of *M* for 1976.

Section 861.—Income From Sources Within the United States

26 CFR 1.861-5: Rentals and royalties. (Also Sections 871, 1441; 1.871-7, 1.1441-1.)

Income source; royalties for U.S. patent rights; paid by foreign corporation. An individual who is a citizen and resident of a foreign country with which the U.S. has no income tax convention licensed the U.S. rights on a patent to a U.S. corporation for use in the U.S. The patent royalties paid to the individual are subject to U.S. tax, and the Netherlands corporation is required to withhold the tax from the royalties.

Rev. Rul. 80-362

ISSUE

Are royalties paid for the use of a patent in the United States, under the circumstances described below, subject to United States tax?

FACTS

A, a citizen and resident of a country other than the United States or the Netherlands, licenses the United States rights on a patent to *X*, a Netherlands corporation. *X* is a bona fide corporation unrelated to *A*. *X* agrees to pay *A* a fixed royalty each year in return for the patent license. *X* relicenses the patent to *Y*, a United States corporation, for use in the United States. *Y* agrees to pay *X* royalties based on the number of units produced by *Y* each year under the patent. *X*'s fixed royalty to *A* is not contingent upon the receipt of royalties from *Y*. *A*'s royalty income is not effectively connected with the conduct of a trade or business within the United States within the meaning of section 871(b) of the Internal Revenue Code.

Article IX(1) of the United States-Netherlands Income Tax Convention, T.D. 5778, 1950-1 C.B. 92, as amended by the United States-Netherlands Supplementary Income Tax Convention, 1967-2 C.B. 472, provides that royalties paid to a resident or corporation of the Netherlands shall be exempt from tax by the United States. There is no income tax convention between *A*'s country of residence and the United States.

LAW AND ANALYSIS

Section 861(a)(4) of the Code provides that royalties for the privilege of using a patent in the United States are treated as income from sources within the United States.

Section 871(a)(1)(A) of the Code imposes a tax of 30 percent of the amount received from sources within the United States by a nonresident alien individual as interest, dividends, rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, and other fixed or determinable annual or periodical gains, profits, and income.

Section 1.871-7(b) of the Income Tax Regulations provides that royalties, including royalties for the use of a patent, constitute fixed or determinable annual or periodical income to which the 30-percent tax rate imposed by section 871(a)(1)(A) applies.

Section 1441(a) of the Code provides that all persons, in whatever capacity acting, having the control, receipt, custody, disposal or payment of any of the items of income specified in section 1441(b) (to the extent that any of such items constitute gross income from sources within the United States), of any nonresident individual shall deduct and withhold from such items a tax equal to 30 percent thereof.

Section 1.1441-2(a) of the regulations provides that royalties are included in the items of income enumerated under section 1441(b) of the Code.

In the present factual situation, the royalties from *Y* to *X* are exempt from United States tax under Article IX(1) of the Convention. However, the royalties from *X* to *A* are not exempt from taxation by the United States because there is no income tax convention between *A*'s country of residence and the United States providing for such an exemption. Since the royalties from *X* to *A* are paid in consideration for the privilege of using a patent in the United States, they are treated as income from sources within the United States under section 861(a)(4) of the Code and are subjec to United States income taxation under section 871(a)(1)(A).

HOLDING

Royalties paid by *X* to *A* are subject to United States tax at the 30-percent rate pursuant to section 871(a)(1)(A) of the Code. *X*, under section 1441(a), is required to withhold from the royalties paid to *A* a tax equal to 30 percent of such royalties.

Section 871.—Tax On Nonresident Alien Individuals

26 CFR 1.871-7: Taxation of nonresident alien individuals not engaged in U.S. business.

Whether royalties paid by a Netherlands corporation that relicenses a patent for use n the United States to the licensor of the patent, an individual who is a citizen and resident of a country other than the United States or the Netherlands, are subject to the 30 percent tax imposed by section 871(a)(1)(A) of the Code. See Rev. Rul. 80-362, page 14.

Section 1441.—Withholding Of Tax On Nonresident Aliens

26 CFR 1.1441-1: Requirement for withholding of tax on nonresident aliens, foreign partnerships, and foreign corporations.

Whether a Netherlands corporation that relicenses a patent for use in the United States and pays royalties to the licensor of the patent, an individual who is a citizen and resident of a country other than the United States or the Netherlands, is required under section 1441(a) of the Code to withhold from the royalties a tax equal to 30 percent of such royalties. See Rev. Rul. 80-362, page 14.

Section 2001.—Imposition and Rate of Tax

26 CFR 20.2001-1: Rate of tax.

Domicile; employee of international organization. An employee of an international organization who entered the U.S. on a G-4 visa and intended to remain in the U.S. indefinitely, which intent persisted until death, was a resident of the U.S.; Rev. Rul. 74-364 revoked.

Rev. Rul. 80-363

ISSUE

For purposes of the federal estate tax imposed by Section 2001 of the Internal Revenue Code, was a person who entered the United States as a non-immigrant alien on a "G-4" visa a resident of the United States when that person intended to remain in the United States indefinitely at the date of death?

FACTS

The decedent, *D*, a citizen of a foreign country, was an employee of an international organization until death. In 1965, *D* entered and remained in the United States with a "G-4" visa. A "G-4" visa is a non-immigrant visa granted to employees of international organizations. After arrival, *D* formed the intent to remain in the United States indefinitely and the intent persisted until death in 1978.

LAW AND ANALYSIS

Section 2001(a) of the Code imposes a tax on the transfer of the taxable estate of every decedent who is a citizen or resident of the United States.

Section 2101(a) of the Code sets out a table of graduated rates of tax to be applied to the taxable estate of a decedent who was a nonresident not a citizen of the United States at the time of death. The taxable estate of a decedent who was a citizen or resident of the United States is subject to the tax in accordance with the table set out in section 2001.

Section 20.0-1(b)(1) of the regulations provides that a resident decedent is one who, at the time of death, was domiciled in the United States. A person acquires a domicile in a place by living there, for even a brief period of time, with no definite present intention of later moving. Residence without the requisite intention to remain indefinitely will not suffice to constitute domicile.

The Supreme Court of the United States, in *Elkins v. Moreno,* 435 U.S. 647 (1978), held that, under federal law, a nonimmigrant alien holding a "G-4" visa has the legal capacity to establish domicile within the United States. The Court concluded that when federal law, such as the statute that governs the granting of "G-4" visas, did not impose restrictions on intent or duration of stay, Congress intended that, while permanent immigration would normally occur through immigrant channels, nonrestricted nonimmigrant alients could adopt the United States as their domicile under certain circumstances.

The question of domicile depends on whether the decedent had formed the intent to remain in the United States indefinitely. In the present situation, *D* was a resident decedent since, at the time of death, domicile had been established in the United States. *D* had formed the intent and did, in fact, reside in the United States with no definite, present intention of leaving. This is true notwithstanding that *D* had entered and remained in the United States with a "G-4" visa.

HOLDING

At the date of death, *D* was a resident of the United States. Therefore, the transfer of *D*'s taxable estate is subject to the federal estate tax imposed by section 2001 of the Code.

EFFECT ON OTHER REVENUE RULINGS

In Rev. Rul. 74-364, 1974-2 C.B. 321, the Service concluded that a French citizen, who was the holder of a "G-4" visa that was valid at date of death, was under a legal disability and could not form the necessary intent to remain indefinitely in the United States. Rev. Rul. 74-364 is hereby revoked.

Pursuant to the authority contained in Section 7805(b) of the Code, this revenue ruling will not be applied with respect to decedents dying prior to December 29, 1980, the date of publication of this revenue ruling in the Internal Revenue Bulletin.

Section 3121.—Definitions [Federal Insurance Contributions Act]

26 CFR 31.3121(a)-1: Wages.
(Also Sections 61, 162, 3306, 3401; 1.61-1, 1.162-1, 31.3306(b)-1, 31.3401(a)-1.)

Legal fees and interest awarded with back pay. Examples illustrate the income tax and employment tax consequences of interest and attorneys' fees being awarded by a court in connection with claims for back pay.

Rev. Rul. 80-364

ISSUE

Whether interest and an attorney's fee awarded by a court in connection with a claim for back pay are wages for federal employment tax purposes.

FACTS

Situation 1. After termination of employment by a company, an individual filed a complaint against the company for back pay owed to the individual. The court awarded the individual 8*x* dollars as back pay, and also awarded interest of $1x$ dollars and an attorney's fee of $1x$ dollars.

Situation 2. An individual sued the individual's employer for $15x$ dollars for back pay. Pursuant to a court order the employer made a payment to the employee of $10x$ dollars. The court order did not indicate that a portion of the award was attorney's fees or interest. The employee paid $1x$ dollars for an attorney's fee which was paid out of the award.

Situation 3. Due to a breach of a collective bargaining agreement a union filed claims on behalf of its members against a company. Subsequently, the union and the company entered into a settlement agreement, later approved by a federal district court, that provided that the company would pay the union $40x$ dollars in full settlement of all claims. The union paid $6x$ dollars of the settlement for atorney's fees and returned $34x$ dollars to the employees for back pay owed to them. The back pay was distributed among the employees in proportion to their claims.

LAW AND ANALYSIS

Section 61(a) of the Internal Revenue Code provides that gross income means all income from whatever source derived, including compensation for services.

Section 3121(a) of the Code relating to the Federal Insurance Contributions Act and section 3306(b) relating to the Federal Unemployment Tax Act provide that the term "wages" means all remuneration for employment. Section 3401(a), relating to income tax withholding, contains a similar definition.

Rev. Rul. 72-268, 1972-1 C.B. 313, holds that payments by employers for previously unpaid minimum wages and overtime compensation under the Fair Labor Standards Act of 1938 are wages for federal employment tax purposes. However, payments of liquidated damages to employees under the Act are not remuneration for employment and are not wages.

HOLDINGS

In *Situation 1,* while the full amount of the award is income to the employee and must be included in the employee's gross income, only the back pay award of $8x$ dollars is wages for federal employment tax purposes. The payments for interest and the attorney's fee are not wages, because they are not remuneration for employment.

In *Situation 2,* the full amount of the award is income to the employee and it is also wages for federal employment tax purposes, notwithstanding that a portion of it was spent on attorney's fees.

In *Situation 3,* the amount of the settlement paid by the union for attorney's fees is not remuneration to the individual employees and, therefore, is not wages for purposes of the federal employment taxes. The attorney's fees portion of the settlement is a reimbursement for expenses incurred by the union to enforce the collective bargaining agreement. The amount allocated to attorney's fees is not includible in the gross income of the individual employees and the individual employees may not deduct the attorney's fees as a business expense. Compare Rev. Rul. 58-301, 1958-1 C.B. 23.

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26 CFR 31.3121(d)-1: Who are employees.

Whether babysitters engaged by a sitter agency are employees. See Rev. Rul. 80-365, page 17.

Section 3221.—Rate of Tax [Railroad Retirement Tax Act]

RAILROAD RETIREMENT BOARD

Determination of Quarterly Rate of Excise Tax for Railroad Retirement Supplemental Annuity Program

In accordance with directions in Section 3221(c) of the Railroad Retirement Tax Act (26 U.S.C. 3221(c)), the Railroad Retirement Board has determined that the excise tax imposed by such Section 3221(c) on every employer, with respect to having individuals in his employ, for each work-hour for which compensation is paid by such employer for services rendered to him during the quarter beginning January 1, 1981, shall be at the rate of fourteen and one-half cents.

In accordance with directions in Section 15(a) of the Railroad Retirement Act of 1974, the Railroad Retirement Board has determined that for the quarter beginning January 1, 1981, 20.7 percent of the taxes collected under Sections 3211(b) and 3221(c) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Account and 79.3 percent of the taxes collected under such Sections 3211(b) and 3221(c) plus one hundred percent of the taxes collected under Section 3221(d) of the Railroad Retirement Tax Act shall be credited to the Railroad Retirement Supplemental Account.

By Authority of the Board.
Dated: November 4, 1980.

R. R. Butler,
Secretary of the Board.

(Filed by the Office of the Federal Register on November 10, 1980, 8:45 a.m., and published in the issue of the Federal Register for November 12, 1980, 45 F.R. 74798.)

Section 3302.—Credits Against Tax

26 CFR 31.3302(c)-1: Limit on total credits.

Reductions in credit applicable to employers for whom services are performed in 1980 in various states, the District of Columbia, Puerto Rico, and the Virgin Islands. See Rev. Proc. 80-60, page 47.

Section 3306.—Definitions [Federal Unemployment Tax Act]

26 CFR 31.3306(b)-1: Wages.

Whether a court awarded payment of interest and attorney's fee along with a payment of back pay, is wages for federal employment tax purposes. See. Rev. Rul. 80-364, page 15.

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26 CFR 31.3306(i)-1: Who are employees.

Whether babysitters engaged by a sitter agency are employees. See Rev. Rul. 80-365, page 17.

Section 3401.—Definitions [Collection of Income Tax at Source on Wages]

26 CFR 31.3401(a)-1: Wages.

Whether a court awarded payment of interest and attorney's fee along with a payment of back pay, is wages for federal employment tax purposes. See Rev. Rul. 80-364, page 15.

26 CFR 31.3401(c)-1: Employee.

Whether babysitters engaged by a sitter agency are employees. See Rev. Rul. 80-365, below.

Section 3506.—Individuals Providing Companion Sitting Placement Services [Employment Taxes]

26 CFR 31.3506-1: Companion sitting placement services.
(Also Sections 3121, 3306, 3401; 31.3121(d)-1, 31.3306(i)-1, 31.3401(c)-1.)

Babysitters. Individuals engaged to perform sitting services for the clients of a babysitting agency that receives a fixed percentage of the fee collected by the sitters are not employees of the agency with respect to remuneration received after 1974. The general rule for determining employee status set forth in Rev. Rul. 56-502 only applies to sitting services if the agency pays the sitters directly. Rev. Rul. 74-414 revoked; Rev. Rul. 56-502 modified.

Rev. Rul. 80-365

ISSUE

Are individuals engaged by a babysitting agency to perform sitting services for the clients of the babysitting agency employees of the agency under sections 3121(d), 3306(i) and 3401(c) of the Internal Revenue Code?

FACTS

As a result of section 10 of Pub. L. No. 95-171, 1978-1 C.B. 457, 458, which added section 3506 to the Code, the Internal Revenue Service has given further consideration to Rev. Rul. 56-502, 1956-2 C.B. 688 and Rev. Rul. 74-414, 1974-2 C.B. 334.

Rev. Rul. 56-502 holds that individuals engaged by an agency that is not licensed or registered under state or municipal law as an employment agency to perform domestic service for its clients are employees of the agency for federal employment tax purposes. In that revenue ruling, the agency holds itself out as being engaged in the business of furnishing domestic help and determines the individuals' remuneration. The clients pay the agency for the individual's services, and the agency deducts a stipulated commission from the amount and turns the balance over to the individuals.

Rev. Rul. 56-502 sets forth a general rule to be applied in situations concerning the federal employment tax status of individuals engaged by a company to perform domestic services for its clients. The individuals are considered to be employees of such agency for federal employment tax purposes where the facts show that (1) the agency is engaged in the business of furnishing such services and so holds itself out to the general public, (2) the agency furnishes the employment of the individuals and fixes their remuneration, (3) the parents, homeowners, or others for whom the services are performed look to the agency for duly qualified and trained individuals, (4) the services are necessary to the conduct of the agency's business and promote or advance its business interests, and (5) the total business income of the agency is derived through a percentage of the remuneration received by the individuals for the performance of their services. Rev. Rul. 56-502 states that the above rule is considered applicable whether the agency pays the individuals directly or the individuals are paid directly by the agency's clients.

However, Rev. Rul. 56-502 holds that the foregoing general rule does not apply in those instances where the agency furnishing the services is licensed or registered under state or municipal law as an employment agency that has the function of furnishing applicants for employment to prospective employers and is subject to the applicable laws and regulations respecting the charging of fees, the maintenance of its employment register, etc.

Rev. Rul. 74-414 holds that individuals performing babysitting services for customers of a babysitting agency licensed as an employment agency in accordance with city and state requirements are employees of the agency for federal employment tax purposes, since the agency has retained the primary right to direct and control them. That agency furnishes instructions regarding conduct, requires semimonthly reports, prohibits the individuals from engaging assistants or substitutes or securing work with a client other than through the agency, and determines the fee to be charged. The babysitters collect the total fee for the services from the clients and pay a fixed percentage to the agency.

In addition to its holding, Rev. Rul. 74-414 clarifies Rev. Rul. 56-202 to provide that a state or municipal licensing requirement is not exclusively determinative of the existence of an employer-employee relationship, if, in fact, the agency has the right to control and direct the individual under the common law rules. The clarification is effective with respect to the remuneration received by individuals engaged by a company to perform domestic services for its clients for calendar quarters beginning after August 26, 1974.

LAW AND ANALYSIS

Effective with respect to remuneration received after December 31, 1974, section 3506(a) of the Code provides that, for federal employment tax purposes, a person engaged in the trade or business of putting sitters in touch with individuals who wish to employ them shall not be treated as the employer of such sitters (and such sitters shall not be treated as employees of such person) if such person does not pay or receive the salary or wages of the sitters and such person is compensated by the sitters or the persons who employ them on a fee basis.

Section 3506(b) provides that the term "sitters" means individuals who furnish personal attendance, companionship, or household care services to children or to individuals who are elderly or disabled.

Section 31.3506-1(c) of the Employment Tax Regulations provides that sitters are not treated as employees by reason of section 3506 of the Code, shall be deemed to be self-employed for purposes of the tax on self-employment income imposed by section 1401.

HOLDING

The babysitters engaged by the agency in Rev. Rul. 74-414 to perform sitting services for its clients are not treated as employees of the agency for federal employment tax purposes with respect to remuneration received by them after December 31, 1974. However, they are self-employed for purposes of the tax on self-employment income imposed by section 1401 of the Code with respect to remuneration received after that date.

Since the agency in Rev. Rul. 56-502 receives the entire amount of the charges for the domestic services performed by the individuals, retains a percentage, and pays the difference to the individuals, individuals performing sitting services remain the employees of the agency under the facts of that revenue ruling and are not affected by the provisions of section 3506 of the Code.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 74-414 is revoked, effective with respect to remuneration received by the sitters after December 31, 1974.

Rev. Rul. 56-502 is modified to state that the general rule set forth in that ruling only applies to sitting services if the agency pays the sitters directly.

The clarification of Rev. Rul. 56-502, effective with respect to remuneration for calendar quarters beginning after August 26, 1974, remains in effect.

Section 6012.—Persons Required to Make Returns of Income

26 CFR 1.6012-1: Individuals required to make returns of income.

Conditions under which a Presidential appointee who has an interest in a blind trust that meets the requirements of section 202(f)(4)(B) of the ethics in Government Act of 1978, will be granted permission to have a trustee file the appointee's income tax return and to state the procedure that the trustee must follow in filing the appointee's income tax return. See Rev. Proc. 80-59, page 47.

Section 6073.—Time for Filing Declarations of Estimated Income Tax by Individuals

26 CFR 1.6073-1: Time and place for filing declarations of esimated income tax by individuals.

Estimated tax; beneficiary of farming trust. Income to a beneficiary who receives more than two-thirds of the beneficiary's yearly gross income from a trust that is engaged solely in the business of farming is considered to be gross income from farming for estimated tax purposes; Rev. Rul. 63-26 modified.

Rev. Rul. 80-366

ISSUE

Is income to a beneficiary from a trust that is engaged in the business of farming considered to be gross income from farming to the beneficiary for estimated tax purposes?

FACTS

A is the beneficiary of a trust described in section 651 of the Internal Revenue Code that is engaged solely in the business of farming. *A* does not participate in the operation or management of the farm. For 1978, more than two-thirds of *A*'s gross income was attributable to payments from the trust. *A* is a calendar year taxpayer.

LAW AND ANALYSIS

Section 652(a) of the Code provides that beneficiaries of trusts must include in income the amount required to be distributed to them whether or not distributed.

Section 652(b) of the Code provides that the amounts distributed to the beneficiary shall have the same character in the hands of the beneficiary as in the hands of the trust.

Section 6015(f)(1) of the Code and the regulations thereunder provide that if an individual referred to in section 6073(b) files a return for the taxable year for which the declaration is required on or before March 1 of the succeeding taxable year, and pays in full at the time of filing the amount computed on the return as payable, such return shall be considered a declaration of estimated tax.

Section 6073(b) of the Code concerns individuals whose estimated gross income from farming or fishing for the taxable year is at least two-thirds of their estimated gross income from all sources for the taxable year.

Section 1.6073-1(b) of the Income Tax Regulations provides that estimated gross income from farming is the estimated income from oyster farming, the cultivation of the soil, the raising or harvesting of any agricultural or horticultural commodities and the raising of livestock, bees, or poultry. The regulation also provides that the requisite gross income from farming must be derived from the operations of a stock, dairy, poultry, fruit, or truck farm, or plantation, ranch, nursery, range, orchard, or oyster bed. If an individual receives for the use of the land income in the form of a share of the crops produced thereon, such income is from farming.

The legilsative history of section 60(a) of the Internal Revenue Code of 1939, the predecessor of section 6073(b) of the 1954 Code, indicates that it was created in recognition of the difficulty of accurately estimating early in the tax year the amount of income derived from farm operations since unexpected crop failures and market prices may have a drastic bearing on the result of farming operations. See H. Rep. No. 78-401, 78th Cong., 1st Sess. 36 (1943) 1943 C.B. 1283, 1310. The income of a beneficiary of a trust described in section 651 that is engaged in farming is as variable and as difficult to estimate as that of a person actively involved in farming operations.

Under Section 652(b) of the Code, income from farming to a trust described in section 651 is considered income from farming to the trust's beneficiary.

Rev. Rul. 63-26, 1963-1 C.B. 295, concerns whether gains from the sale of livestock held for draft, breeding, or dairy purposes, and gains from the sale of farm land and depreciable farm equipment constitute gross income from farming for purposes of section 6073(b) of the Code. In resolving these questions the ruling appropriately referred to the definition contained in section 1.175-5(a)(2) of the Income Tax Regulations. However, since section 175 and section 6073(b) have different objectives, the definition of gross income from farming for purposes of section 175 will not, in all instances, apply for purposes of section 6073(b). Accordingly, Rev. Rul. 63-26 is modified to remove the implication that the same meaning is attributable to that term in interpreting both section 175 and section 6073(b).

HOLDING

Income to a beneficiary from a trust that is engaged in the business of farming is considered to be gross income from farming to the beneficiary for estimated tax purposes.

EFFECT ON OTHER REVENUE RULINGS

Rev. Rul. 63-26 is modified.

Section 7805.—Rules and Regulations

26 CFR 301.7805-1: Rules and regulations.

Obsolete rulings. Certain post-1952 rulings dealing with engineering and corporate matters, including reorganizations, are declared obsolete.

Rev. Rul. 80-367

Rev. Proc. 67-6, 1967-1 C.B. 576, anounced a program for the review of rulings published before 1953 with the immediate objective of identifying and publishing lists of those rulings that, although not specifically revoked or suspended, are not considered determinative with respect to future transactions.

Consistent with the objectives of that program, the Internal Revenue Service has undertaken a review of certain rulings that were published in the Internal Revenue Bulletin after 1952. The purpose of this revenue ruling is to publish a list of post 1952 rulings dealing with engineering and corporate matters, including reorganizations that, although not specifically revoked or suspended, are not considered determinative with respect to future transactions because (1) the applicable statutory provisions have been changed or repealed; (2) the ruling position is specifically covered by statute, regulations, or a subsequent published position; or (3) the facts set forth no longer exist or are not sufficient to permit application to the current statute.

Accordingly, the rulings listed below are declared obsolete.

Rev. Rul. No.	*C.B. Citation*
259	1953-2, 55
289	1953-2, 37
55-78	1955-1, 357
55-120	1955-1, 382
55-121	1955-1, 382
55-592	1955-2, 573
56-170	1956-1, 155
56-227	1956-1, 183
56-449	1956-2, 180
56-485	1956-2, 176
56-540	1956-2, 177
59-308	1959-2, 110
64-157	1964-1 (Part 1), 139
65-7	1965-1, 254
68-547	1968-2, 123
74-230	1974-1, 187

The purpose of this declaration of obsolescence is to make clear to all concerned that the above-listed rulings are not determinative with respect to future transactions. It is not the purpose of this revenue ruling to determine their applicability to past transactions.

Other rulings published after 1952 relating to reorganization, corporate and engineering matters will continue to be reviewed to ascertain those that are inapplicable to future transactions. Therefore, failure to include any particular ruling in the above list should not be construed as an indication that the ruling necessarily is determinative with respect to future transactions.

Subpart B.—Legislation and Related Committee Reports

Public Law 96-449
96th Congress, H.R. 7085[1]
October 14, 1980

An Act to provide certain benefits to individuals held hostage in Iran and to similarly situated individuals, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Hostage Relief Act of 1980".

* * * * *

TITLE II—TAX PROVISIONS

SEC. 201. COMPENSATION EXCLUDED FROM GROSS INCOME

For purposes of the Internal Revenue Code of 1954, the gross income of an individual who was at any time an American hostage does not include compensation from the United States received for any month during any part of which such individual was—

(1) in captive status, or

(2) hospitalized as a result of such individual's captive status.

SEC. 202. INCOME TAXES OF HOSTAGES WHERE DEATH RESULTS FROM CAPTIVE STATUS

(a) GENERAL RULE.—In the case of an individual who was at any time an American hostage and who dies as a result of injury or disease or physical or mental disability incurred or aggravated while such individual was in captive status—

(1) any tax imposed by subtitle A of the Internal Revenue Code of 1954 shall not apply with respect to—

(A) the taxable year in which falls the date of such individual's death, or

(B) any prior taxable year ending on or after the first day such individual was in captive status, and

(2) any tax imposed under such subtitle A for taxable years preceding those specified in paragraph (1) which is unpaid at the date of such individual's death (including interest, additions to the tax, and additional amounts)—

(A) shall not be assessed,

(B) if assessed, the assessment shall be abated, and

(C) if collected, shall be credited or refunded as an overpayment.

(b) DEATH MUST OCCUR WITHIN 2 YEARS OF CESSATION OF CAPTIVE STATUS.—This section shall not apply unless the death of the individual occurs within 2 years after such individual ceases to be in captive status.

SEC. 203. SPOUSE MAY FILE JOINT RETURN

(a) GENERAL RULE.—If an individual is an American hostage who is in captive status, such individual's spouse may elect to file a joint return under section 6013(a) of the Internal Revenue Code of 1954 for any taxable year—

(1) which begins on or before the day which is 2 years after the date on which the hostage period ends, and

(2) for which such spouse is otherwise entitled to file such a joint return.

(b) CERTAIN RULES MADE APPLICABLE.—For purposes of subsection (a), paragraphs (2) and (4) of section 6013(f) of such Code (relating to joint return where individual is in missing status) shall apply as if the election described in subsection (a) of this section were an election described in paragraph (1) of such section 6013(f).

SEC. 204. TIME FOR PERFORMING CERTAIN ACTS POSTPONED BY REASON OF CAPTIVE STATUS

(a) GENERAL RULE.—In the case of any individual who was at any time an American hostage, any period during which he was in captive status (and any period during which he was outside the United States and hospitalized as a result of captive status), and the next 180 days thereafter, shall be disregarded in determining, under the internal revenue laws, in respect of any tax liability (including any interest, penalty, additional amount, or addition to the tax) of such individual—

(1) whether any of the acts specified in paragraph (1) of section 7508 (a) of the Internal Revenue Code of 1954 was performed within the time prescribed therefor, and

(2) the amount of any credit or refund (including interest).

(b) APPLICATION TO SPOUSE.—The provisions of this section shall apply to the spouse of any individual entitled to the benefits of subsection (a). The preceding sentence shall not cause this section to apply to any spouse for any taxable year beginning more than 2 years after the date on which the hostage period ends.

(c) SECTION 7508(d) MADE APPLICABLE.—Subsection (d) of section 7508 of the Internal Revenue Code of 1954 shall apply to subsection (a) in the same manner as if the benefits of subsection (a) were provided by subsection (a) of such section 7508.

SEC. 205. DEFINITIONS AND SPECIAL RULES

(a) AMERICAN HOSTAGE.—For purposes of this title, the term "American hostage" means any individual who, while—

(1) in the civil service or the uniformed service of the United States, or

(2) a citizen or resident alien of the United States rendering personal service to the United States abroad similar to the service of a civil officer or employee of the United States (as determined by the Secretary of State),

is placed in a captive status during the hostage period.

(b) HOSTAGE PERIOD.—For purposes of this title, the term "hostage period" means the period beginning on November 4, 1979, and ending on whichever of the following dates is the earlier:

(1) the date the President specifies, by Executive order, as the date on which all citizens and resident aliens of the United States who were placed in a captive status due to the seizure

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[1] This publication of the law, House Report No. 96-1349, Part 2, page 21, and House Report No. 96-1349, Part 3, page 23, are restricted to excerpts involving tax matters. House Report No. 96-1349, Part 1, is not published.

of the United States Embassy in Iran have been returned to the United States or otherwise accounted for, or

(2) December 31, 1981.

(c) Captive Status.—For purposes of this title—

(1) In General.—The term "captive status" means a missing status arising because of a hostile action abroad—

(A) which is directed against the United States during the hostage period, and

(B) which is identified by the Secretary of State in the Federal Register.

(2) Missing status defined.—The term "missing status"—

(A) in the case of employees, has the meaning given it in section 5561 (5) of title 5, United States Code,

(B) in the case of members of the uniformed services, has the meaning given it in section 551(2) of title 37, United States Code, and

(C) in the case of other individuals, has a similar meaning as that provided under such sections, as determined by the Secretary of State.

For purposes of the preceding sentence, the term "employee" has the meaning given to such term by section 5561(2) of title 5, United States Code.

(d) Hospitalized as a Result of Captive Status.—

(1) In general.—For purposes of this title, an individual shall be treated as hospitalized as a result of captive status if such individual is hospitalized as a result of injury or disease or physical or mental disability incurred or aggravated while such individual was in captive status.

(2) 2-year limit.—Hospitalization shall be taken into account for purposes of paragraph (1) only if it is hospitalization—

(A) occurring on or before the day which is 2 years after the date on which the individual's captive status ends (or, if earlier, the date on which the hostage period ends), or

(B) which is part of a continuous period of hospitalization which began on or before the day determined under subparagraph (A).

(e) Civil Service Uniformed Services.—For purposes of this section, the terms "civil service" and "uniformed services" have the meanings given to such terms by section 2101 of title 5, United States Code.

(f) Application of Title to All Tehran Hostages.—In the case of any citizen or resident alien of the United States who is determined by the Secretary of State to have been held hostage in Tehran at any time during November 1979, for purposes of this title—

(1) such individual shall be treated as an American hostage whether or not such individual meets the requirements of paragraph (1) or (2) of subsection (a), and

(2) if such individual was not in the civil service or the uniformed services of the United States—

(A) Section 201 shall be applied by substituting "earned income (as defined in section 911(b) of the Internal Revenue Code of 1954) attributable to" for "compensation from the United States received for", and

(B) the amount excluded from gross income under section 201 for any month shall not exceed the monthly equivalent of the annual rate of basic pay payable for level V of the Executive Schedule.

(g) Application of Title to Individual Held Captive in Colombia.—For purposes of this title, Richard Starr of Edmonds, Washington, who, as a Peace Corps volunteer, was held captive in Colombia, shall be treated as an American hostage who was in captive status beginning on November 4, 1979, and ending on February 10, 1980.

(h) Special Rules.—

(1) Compensation.—For purposes of this title, the term "compensation" shall not include any amount received as an annuity or as retirement pay.

(2) Wage withholding — Any amount excluded from gross income under section 201 shall not be treated as wages for purposes of chapter 24 of the Internal Revenue Code of 1954.

Sec. 206. Study of Tax Treatment of Hostages

(a) Study.—The Chief of Staff of the Joint Committee on Taxation shall study all aspects of the tax treatment of citizens and resident aliens of the United States who are taken hostage or are otherwise placed in a missing status.

(b) Report.—The Chief of Staff of the Joint Committee on Taxation shall, before July 1, 1981, report the results of the study made pursuant to subsection (a) to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate.

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Approved October 14, 1980.

House Report No. 96-1349, Part 2 2d Session

[Bracketed numerals indicate official report page numbers]

HOSTAGE RELIEF ACT OF 1980

September 19, 1980

Mr. Fascell, from the Committee on Foreign Affairs, submitted the following report to accompany H.R. 7085[1] which on April 17, 1980, was referred jointly to the Committee on Foreign Affairs, the Committee on Post Office and Civil Service, and the Committee on Ways and Means

The Committee on Foreign Affairs, to whom was referred the bill (H.R. 7085) to amend title 5 of the United States Code and the Internal Revenue Code of 1954 to provide certain benefits to individuals held hostage in Iran and to similarly situated individuals, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

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Committee Action

[5] On April 17, 1980, Hon. Dante B. Fascall (for himself and Mr. Ullman, Mr. Zablocki, Mr. Broomfield, Mr. Buchanan, and Mr. Derwinski) introduced H.R. 7085, which was jointly referred to the Committee on Foreign Affairs, Committee on Post Office and Civil Service, and the Committee on Ways and Means. On April 22, 1980, the bill was referred to the Subcommittee on International Oper-

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[1] Public Law 96-449, page 20.

ations by Hon. Clement J. Zablocki, chairman of the Committee on Foreign Affairs.

[6] On July 24, 1980, the Subcommittee on International Operations held an open hearing on H.R. 7085 during which testimony was received from Hon. Ben H. Read, Under Secretary of State for Management; Maj. Gen. R. Dean Tice, Deputy Assistant Secretary of Defense for Military and Personnel Policy; and Louisa L. Kennedy, spokesperson for FLAG (Family Liaison Action Group), which is composed of families and relatives of the hostages being held in Iran.

The subcommittee held an open markup session on September 3 on the legislation and reported to the full committee, H.R. 7085, as amended. On September 10 the full committee met in open session to consider the bill and ordered it favorably reported, as amended, by voice vote, a quorum being present.

PURPOSE

The purpose of the legislation, as amended, is to provide certain relief benefits to U.S. hostages in Iran and their families, as well as to U.S. Government employees in future hostage situations. The benefits provided would apply to civilian and military employees of the U.S. Government and are based on those benefits available to U.S. military prisoners of war from the Vietnam era. The benefits include the following: (1) establishment of a special interest-bearing savings fund for deposit of hostages' salaries; (2) reimbursement for expenses of family members, spouses, dependents, or the hostages for medical and health care which are incurred because of the ordeal; (3) protection of civilian Government employees from civil suit while they are in a missing status; (4) educational benefits for the spouse and dependent children for the duration of the hostile action against the United States, except in certain circumstances where the benefits could be extended; (5) educational benefits, under special circumstances, for the hostages themselves; (6) educational benefits for the spouse and dependent children of a hostage should the hostage die while being held hostage; (7) exemption from taxes on compensation received while a military or civilian Government employee is a hostage or missing as a result of a hostile action abroad against the United States; (8) complete income tax exclusion for income received by an employee who dies as a result of a hostile action; and (9) clarification of authority to allow the spouse of a hostage to file a joint tax return and to defer payment of certain taxes for up to 180 days after the return of a hostage or missing military or civilian employee.

BACKGROUND AND COMMITTEE COMMENT

H.R. 7085 was introduced on April 17, 1980, the 166th day of captivity of American citizens in Iran. At this writing, the hostages have been held 321 days.

This legislation is intended as an expression of the Nation's recognition of the difficulties faced by those held hostage as a result of their Government service. While such legislation has been enacted in the past for those in the military service, the Congress has not had reason until today to expand such protection to civilians in Government service. The benefits contained in H.R. 7085, as amended, are based on those which were given to POW's as a result of the Vietnam [7] war. Some of those benefits are still in effect and thus give the military who are being held hostage some relief, but the civilian Government employees have no such relief for themselves or their families.

Despite intensive diplomatic efforts of our Government, U.S. Government personnel continue to be held in Iran in gross violation of international law. These hostages have been incarcerated cruelly and unjustly since November 4, 1979. In addition to the prisoners' intolerable situation, the families of these individuals have also undergone severe mental, and in some cases financial, strain due to this forced separation.

The Congress must act now to alleviate, to the extent possible, the burdens of the hostages and their families and to make certain that all necessary assistance is provided upon their return home. It must assure that any assistance these families require is readily available.

The executive branch has suggested that the benefits contained in the legislation be temporary to permit further study before permanent legislation is proposed.

The committee feels that the problems dealt with in H.R. 7085 have been sufficiently studied in the 10 months that our hostages have been held in Iran. The legislation has been written to apply to hostage situations, generally, as well as to the Iran problem specifically. The authorities are available to be used as needed, and can certainly be amended at a later date if the need arises. The important point now is to insure that protections are in place for individuals caught in any future hostage situation.

The recent attacks on the U.S. Ambassador in Lebanon and on the U.S. Embassy in El Salvador underline the increasingly hostile environment in which U.S. personnel serve and, therefore, the increased likelihood of additional hostage situations. Experience with the problems confronting American POW's in the past, coupled with the more recent hostage situations in Latin America and Iran, provide sufficient background upon which to formulate permanent legislation Permanent legislation would avoid unnecessary delays in future situations and enable the provision of benefits as they are needed by the hostage and hostage family rather than at a later date.

The benefits provided by H.R. 7085, as amended, such as access to the Soldiers' and Sailors' Civil Relief Act, which has been in effect for the military for over 40 years, are not extraordinary. The legislation has also been written to give the President sufficient discretion to adjust to the vagaries of any future case.

The committee feels that legislation is needed which will be effective not only after a hostage situation is over, but also during the period of captivity, since the hostages' families are affected from the beginning. The committee is therefore convinced that permanent legislation is the desirable course to follow.

SECTION-BY-SECTION ANALYSIS OF THE BILL AS AMENDED

SHORT TITLE

The short title of H.R. 7085 is the Hostage Relief Act of 1980.

[11] TITLE II—AMENDMENTS TO THE INTERNAL REVENUE OF 1954

Title II contains amendments to the Internal Revenue Code of 1954 which would provide certain tax benefits to hostages or persons missing as a result of hostile action against the United States. The committee did not consider this title of the legislation since it falls within the jurisdiction of the Committee on Ways and Means. However, a summary of the provisions is included here in order to provide a complete analysis of the bill.

Section 201—Exemption from Income Taxes

Section 201 of H.R. 7085 would add a new subsection (e) to section 112 of the Internal Revenue Code regarding certain combat pay of members of the Armed Forces.

New subsection (e)(1) would exempt from gross income all compensation received for active service as a Government employee during any month the employee was in a missing status as a result of a hostile action against the United States in a foreign area. It would also exempt from gross income compensation received for any month during any part of which such employee was hospitalized as a result of such hostile action, but within 2 years of the date of termination of the hostile action.

Subsection (e)(2)(A) defines "hostile action against the United States" as an action abroad which is directed against the United States that occurs on or after November 1, 1979, which the Secretary of State identifies for this purpose in a letter published in the Federal Register.

Subsection (e)(2)(B) defines "Federal employee" to include any person who is an employee, whether direct or indirect, of any agency or instrumentality of the United States. The term would include any person whose presence abroad is for the purpose of implementing a federally funded program as determined by the Secretary of State.

Section 202—Income Taxes on Government Employees on Death

Section 202 amends section 692 of the Internal Revenue Code of 1954 by adding a new subsection relating to foreign hostile actions.

New subsection 692 (c)(1) provides for exclusion from payment of federal income tax if a Government employee should die as a result of injuries sustained during a hostile action against the United States. Under subsection 692 (c)(1)(A), this exclusion would be effective only for income received during the year of death and during any prior year the Government employee first entered into a missing status as a result of such hostile action.

Subsection 692(c)(1)(B) stipulates that any unpaid tax (including interest, additions to the tax, and additional amounts) will not be assessed, that any assessment will be voided, and that any tax collected will be credited or refunded as an overpayment.

The subsection also provides that the date of death of the employee shall be determined under 5 U.S.C. 5565 (agency review), but that the provisions shall not apply for any taxable year beginning more than 2 years after the date of termination of the hostile action.

Subsection 692(c)(2) defines "active service", "employee", and "hostile action against the United States" for the purposes of the section.

[12] *Section 203—Joint Return Where Individual is in a Missing Status*

Section 203 amends section 6013(f)(1) of the Internal Revenue Code of 1954 to permit an individual otherwise entitled to file a joint return to file such a return if the individual's spouse is in a missing status as a result of a hostile action against the United States.

Section 204—Federal Tax Deferment

Section 204 would amend section 7508(a) of the Internal Revenue Code of 1954 to include within that section U.S. citizens or resident aliens who are in a missing status because of a hostile action against the United States or who are hospitalized outside the United States because of such hostile action. Specifically, section 7508 (a) relates to exemptions from time deadline for filing tax returns in meeting other time requirements relating to tax liability.

Section 205—Applicability to all Teheran Hostages

Section 205 would make the bill's amendments to the Internal Revenue Code of 1954 applicable to all citizens and resident aliens of the United States held hostage in Iran, as determined by the Secretary of State, at any time during November 1979, whether or not they are Federal employees. The exemptions would apply only to those who file an income tax return for the period in question.

Section 206—Effective Date

Section 206 provides that the title II tax provisions shall apply to taxable years ending on or after December 31, 1979.

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House Report No. 96-1349, Part 3
2d Session

[Bracketed numerals indicate official report page numbers]

HOSTAGE RELIEF ACT OF 1980

SEPTEMBER 19, 1980

Mr. ULLMAN, from the Committee on Ways and Means, submitted the following report to accompany H.R. 7085[1] which on April 17, 1980, was referred jointly to the Committee on Foreign Affairs, the Committee on Post Office and Civil Service, and the Committee on Ways and Means.

The Committee on Ways and Means, to whom was referred the bill (H.R. 7085) to amend title 5 of the United States Code and the Internal Revenue Code of 1954 to provide certain benefits to individuals held hostage in Iran and to similarly situated individuals, having considered the same, report favorably thereon with amendments and recommend that the bill as amended do pass.

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[1] Public Law 96-449, page 20.

The amendment to the text of the bill is shown in the reported bill, with the matter proposed to be stricken shown in linetype and the matter proposed to be inserted shown in italic type.

The title of the bill is amended to conform to the amendment to the text of the bill.

[2] I. SUMMARY

The tax provisions of the bill provide tax relief to the American hostages in Iran and other American hostages. Federal employees held hostage could exclude from income their Federal compensation. If death results from captivity, all income tax liability of that individual from the initial year of captivity to the year of death would be forgiven. The spouse of a hostage would be permitted to file a joint return. Various deadlines under the tax laws would be postponed during the period of captivity for 180 days thereafter. Finally, the staff of the Joint Committee on Taxation is directed to make a study of this area.

II. EXPLANATION OF THE BILL

Tax Treatment of Hostages

Present law

Gross income does not include certain combat pay of members of the Armed Forces. (The exclusion is limited to $500 monthly in the case of officers.) Also, if a member of the Armed Forces dies as a result of service in a combat zone, he is not subject to Federal income tax on any of his income beginning with the first year he served in the combat zone and ending with the year of his death. Comparable rules do not apply to civilian employees.

If a member of the Armed Forces serves in a combat zone or is hospitalized as a result of that service, he generally is excused from meeting a variety of deadlines under the Internal Revenue Code for the period of service or hospitalization and 180 days thereafter.

More limited relief is provided for other Federal employees. Generally, if such an individual is in a missing status, no return need be filed, and no tax need be paid, until three months and fifteen days following the cessation of his missing status. (Other deadlines, however, are not waived.) The Internal Revenue Service has announced that this provision will apply in the case of the American hostages in Iran.

Ordinarily, if married individuals elect to file a joint return rather than separate returns, the return must actually be signed by both spouses. The Internal Revenue Service has announced that it will accept joint returns signed by only one spouse if the other is being held in Iran.

Reasons for change

[The committee believes that it is important to extend tax relief to] the American hostages in Iran and their families beyond the limited relief which is permitted by current law. In many ways, the ordeal suffered by these hostages is comparable to that of members of Armed Forces in combat zones. The committee believes that, at least insofar as matters within its jurisdiction are involved, comparable treatment is warranted. The relief provided by the committee's bill would also extend to other Americans being held hostage.

[3] At the same time, the committee has made the provisions of the bill temporary, rather than permanent, to facilitate a further review by the committee of the issues presented. While no one disputes the need to provide relief to the American hostages in Iran, the committee believes that permanent legislation should be drawn to deal more clearly with a number of issues should similar incidents arise in the future. Accordingly, the committee bill requires the staff of the Joint Committee on Taxation to conduct a study and to report its findings to the tax-writing committees of the Congress.

Explanation of provisions

Exclusion for compensation

Under the bill, gross income of an individual who was at any time an American hostage would not include compensation from the Federal Government received for any month during any part of which the individual was in captive status or hospitalized as a result of captive status.

For purposes of the tax provisions of the bill, the term "American hostage" means any individual who is placed in a captive status during the "hostage period" while (1) in the civil service or the uniformed services of the United States, or (2) a citizen or resident alien of the United States rendering personal service to the United States abroad similar to the service of a civil officer or employee of the United States (as determined by the Secretary of State). The hostage period began on November 4, 1979. It will end on the earlier of two dates: the date the President specifies, by Executive order, as the date on which all citizens and resident aliens of the United States who are placed in a captive status due to the seizure of the United States Embassy in Iran have been returned to the United States or otherwise accounted for, or December 31, 1981. An individual is in captive status if he is in a missing status arising because of a hostile action abroad which is directed against the United States during the hostage period. An individual is in missing status if he is in that status under the appropriate provision of law (5 U.S.C. § 5561 (5) for civilian Federal employees; 37 U.S.C. § 551 (2) for uniformed Federal employees) or, in the case of other individuals, as determined by the State Department.

Because the hostages held in Iran were placed in a captive status during the hostage period, they could continue to exclude income under this provision so long as they remain in captive status even in the event that that status extended beyond December 31, 1981.

Death resulting from captive status

In the case of an individual who was at any time an American hostage and who dies as a result of injury or disease or physical or mental disability incurred or aggravated while that individual was in captive status, the bill provides that any income taxes imposed by the Code would not apply with respect to the taxable year in which the individual dies or any prior taxable year ending on or after the first day the individual was in captive status. Moreover, if there were any unpaid income tax liability of the individual from years prior to captivity, it would be forgiven. These provisions would not apply, however, unless death occurred within two years after the individual ceased to be in captive status.

[4] *Joint returns*

The bill provides that, during the period an American hostage is in captive status, the individual's spouse may elect to file a joint return for any taxable year which begins on or before the day which is 2 years after the date on which the hostage period ends, and for which that spouse is otherwise entitled to file a joint return.

Postponement of deadlines

In the case of any individual who was at any time an American hostage, any period during which he was in captive status (and any period during which he was outside the United States and hospitalized as a result of captive status), and the next 180 days thereafter, would be disregarded in determining in respect of any tax liability (including any interest, penalty, additional amount, or addition to the tax) of that individual, whether any of a variety of acts was performed within the time prescribed. These include the time for filing returns, paying tax, filing a refund claim, and filing suit in the Tax Court or other courts. Also, this time period is to be ignored in determining the amount of any credit or refund (including interest).

The relief afforded by this provision also will apply to the spouse of any individual entitled to its benefits. However, the relief to the spouse will not apply for any taxable year beginning more than 2 years after the date on which the hostage period ends.

Also, relief under this provision does not apply in certain limited situations, such as certain situations when collection is in jeopardy.

Special rules

The bill makes it clear that tax provisions apply to any citizen or resident alien of the United States who was held hostage in Tehran at any time during November 1979, whether or not the individual was in the civil or uniformed services of the United States or was performing similar services. If such an individual was not in the civil or uniformed services, he may exclude under section 201 of the bill his earned income while captive or hospitalized as a result of captivity, but not in excess of the monthly equivalent of the annual rate of basic pay for Level V of the Executive Schedule.

It is also provided that the tax portions of the bill will apply to Richard Starr, a Peace Corps volunteer, for the period from November 4, 1979, through February 10, 1980.

The bill provides that an individual is to be treated as hospitalized as a result of captive status if that individual is hospitalized as a result of injury or disease or physical or mental disability incurred or aggravated while that individual was in captive status. However, hospitalization would be taken into account for this purpose only if it occurs on or before the day which is 2 years after the date on which the individual's captive status ends (or, if earlier, the date on which the hostage period ends), or is part of a continuous period of hospitalization which began on or before the earlier of those dates. Thus, for example, if the hostage period ends on December 31, 1981, the hospitalization would have to begin prior to January 1, 1984.

It is also provided that "compensation" which may be excluded under section 201 of the bill does not include any amount received as an annuity or as retirement pay.

[5] *Study by Joint Committee staff*

The bill requires the Chief of Staff of the Joint Committee on Taxation to study all aspects of the tax treatment of citizens and resident aliens of the United States who are taken hostage or are otherwise placed in a missing status. The Chief of Staff is to report before July 1, 1981, the results of the study to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate.

Effective date

The tax provisions of the bill are effective for all years affected by the legislation.

Revenue effect

It is estimated that the tax provisions of the bill will decrease receipts by less than $1 million annually.

* * * * *

Public Law 96-471
96th Congress, H.R. 6883 [1]
October 19, 1980

An Act to amend the Internal Revenue Code of 1954 to revise the rules relating to certain installment sales.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE; AMENDMENT OF 1954 CODE

(a) SHORT TITLE.—This Act may be cited as the "Installment Sales Revision Act of 1980".

(b) AMENDMENT OF 1954 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1954.

SEC. 2. INSTALLMENT SALES RULES

(a) GENERAL RULE.—Subpart B of part II of subchapter E of chapter 1 is amended by striking out section 453 and inserting in lieu thereof the following new sections:

"SEC. 453. INSTALLMENT METHOD

"(a) GENERAL RULE.—Except as otherwise provided in this section, income from an installment sale shall be taken into account for purposes of this title under the installment method.

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[1] Senate Report No. 96-1000, page 30; House Report No. 96-1042 is not published.

"(b) Installment Sale Defined.—For purposes of this section—

"(1) In general.—The term 'installment sale' means a disposition of property where at least 1 payment is to be received after the close of the taxable year in which the disposition occurs.

"(2) Exceptions.—The term 'installment sale' does not include—

"(A) Dealer disposition of personal property.—A disposition of personal property on the installment plan by a person who regularly sells or otherwise disposes of personal property on the installment plan.

"(B) Inventories of personal property.—A disposition of personal property of a kind which is required to be included in the inventory of the taxpayer if on hand at the close of the taxable year.

"(c) Installment Method Defined.—For purposes of this section, the term 'installment method' means a method under which the income recognized for any taxable year from a disposition is that proportion of the payments received in that year which the gross profit (realized or to be realized when payment is completed) bears to the total contract price.

"(d) Election Out.—

"(1) In general.—Subsection (a) shall not apply to any disposition if the taxpayer elects to have subsection (a) not apply to such disposition.

"(2) Time and manner for making election.—Except as otherwise provided by regulations, an election under paragraph (1) with respect to a disposition may be made only on or before the due date prescribed by law (including extensions) for filing the taxpayer's return of the tax imposed by this chapter for the taxable year in which the disposition occurs. Such an election shall be made in the manner prescribed by regulations.

"(3) Election revocable only with consent.—An election under paragraph (1) with respect to any disposition may be revoked only with the consent of the Secretary.

"(e) Second Disposition by Related Persons.—

"(1) In general.—If—

"(A) any person disposes of property to a related person (hereinafter in this subsection referred to as the 'first disposition'), and

"(B) before the person making the first disposition receives all payments with respect to such disposition, the related person disposes of the property (hereinafter in this subsection referred to as the 'second disposition'),

then, for purposes of this section, the amount realized with respect to such second disposition shall be treated as received at the time of the second disposition by the person making the first disposition.

"(2) 2-year cutoff for property other than marketable securities.—

"(A) In general.—Except in the case of marketable securities, paragraph (1) shall apply only if the date of the second disposition is not more than 2 years after the date of the first disposition.

"(B) Substantial diminishing of risk of ownership.—The running of the 2-year period set forth in subparagraph (A) shall be suspended with respect to any property for any period during which the related person's risk of loss with respect to the property is substantially diminished by—

"(i) the holding of a put with respect to such property (or similar property),

"(ii) the holding by another person of a right to acquire the property, or

"(iii) a short sale or any other transaction.

"(3) Limitation on amount treated as received.—The amount treated for any taxable year as received by the person making the first disposition by reason of paragraph (1) shall not exceed the excess of—

"(A) the lesser of—

"(i) the total amount realized with respect to any second disposition of the property occurring before the close of the taxable year, or

"(ii) the total contract price for the first disposition, over

"(B) the sum of—

"(i) the aggregate amount of payments received with respect to the first disposition before the close of such year, plus

"(ii) the aggregate amount treated as received with respect to the first disposition for prior taxable years by reason of this subsection.

"(4) Fair market value where disposition is not sale or exchange.—For purposes of this subsection, if the second disposition is not a sale or exchange, an amount equal to the fair market value of the property disposed of shall be substituted for the amount realized.

"(5) Later payments treated as receipt of tax paid amounts.—If paragraph (1) applies for any taxable year, payments received in subsequent taxable years by the person making the first disposition shall not be treated as the receipt of payments with respect to the first disposition to the extent that the aggregate of such payments does not exceed the amount treated as received by reason of paragraph (1).

"(6) Exception for certain dispositions.—For purposes of this subsection—

"(A) Reacquisitions of stock by issuing corporation not treated as first dispositions.—Any sale or exchange of stock to the issuing corporation shall not be treated as a first disposition.

"(B) Involuntary conversions not treated as second dispositions.—A compulsory or involuntary conversion (within the meaning of section 1033) and any transfer thereafter shall not be treated as a second disposition if the first disposition occurred before the threat or imminence of the conversion.

"(C) Dispositions after death.—Any transfer after the earlier of—

"(i) the death of the person making the first disposition, or

"(ii) the death of the person acquiring the property in the first disposition, and any transfer thereafter shall not be treated as a second disposition.

"(7) Exception where tax avoidance not a principal purpose.—This subsection shall not apply to a second disposition (and any transfer thereafter) if it is established to the satisfaction of the Secretary that neither the first disposition nor the second disposition had as one of its principal purposes the avoidance of Federal income tax.

"(8) Extension of statute of limitations.—The period for assessing a deficiency with respect to a first disposition (to the extent such deficiency is attributable to the application of this subsection) shall not expire before the day which is 2 years after the date on which the person making the first disposition furnishes (in such manner as the Secretary may be regulations prescribe) a notice that there was a second disposition of the property to which this subsection may have applied. Such deficiency may be assessed notwithstanding the provisions of any law or rule of law which would otherwise prevent such assessment.

"(f) Definitions and Special Rules.—For purposes of this section—

"(1) Related person. — Except for purpose of subsections (g) and (h), the term 'related person' means a person whose stock would be attributed under section 318(a) (other than paragraph (4) thereof) to the person first disposing of the property.

"(2) Marketable securities.—The term 'marketable securities' means any security for which, as of the date of the disposition, there was a market on an established securities market or otherwise.

"(3) Payment.—Except as provided in paragraph (4), the term 'payment' does not include the receipt of evidences of indebtedness of the person acquiring the property (whether or not payment of such indebtedness is guaranteed by another person).

"(4) Purchaser evidences of indebtedness payable on demand or readily tradable.—Receipt of a bond or other evidence of indebtedness which—

"(A) is payable on demand, or

"(B) is issued by a corporation or a government or political subdivision thereof and is readily tradable.

shall be treated as receipt of payment.

"(5) Readily tradable defined.—For purposes of paragraph (4), the term 'readily tradable' means a bond or other evidence of indebtedness which is issued—

"(A) with interest coupons attached or in registered form (other than one in registered form which the taxpayer establishes will not be readily tradable in an established securities market), or

"(B) in any other form designed to render such bond or other evidence of indebtedness readily tradable in an established securities market.

"(6) Like-kind exchanges.—In the case of any exchange described in section 1031(b)—

"(A) the total contract price shall be reduced to take into account the amount of any property permitted to be received in such exchange without recognition of gain.

"(B) the gross profit from such exchages shall be reduced to take into account any amount not recognized by reason of section 1031(b), and

"(C) the term 'payment' shall not include any property permitted to be received in such exchange without recognition of gain.

Similar rules shall apply in the case of an exchange which is described in section 356(a) and is not treated as a dividend.

"(7) Depreciable property.—The term 'depreciable property' means property of a character which (in the hands of the transferee) is subject to the allowance for depreciation provided in section 167.

"(g) Sale of Depreciable Property to Spouse or 80-Percent Owned Entity.—

"1) In general.—In the case of an installment sale of depreciable property between related persons within the meaning of section 1239(b), subsection (a) shall not apply, and, for purposes of this title, all payments to be received shall be deemed received in the year of the disposition.

"(2) Exception where tax avoidance not a principal purpose.—Paragraph (1) shall not apply if it is established to the satisfaction of the Secretary that the disposition did not have as one of its principal purposes the avoidance of Federal income tax.

"(h) Use of Installment Method by Shareholders in Section 337 Liquidations.—

"(1) Receipt of obligations not treated as receipt of payment.—

"(A) In general.—If, in connection with a liquidation to which section 337 applies, in a transaction to which section 331 applies the shareholder receives (in exchange for the shareholder's stock) an installment obligation acquired in respect of a sale or exchange by the corporation during the 12-month period set forth in section 337(a), then, for purposes of this section, the receipt of payments under such obligation (but not the receipt of such obligation) by the shareholder shall be treated as the receipt of payment for the stock.

"(B) Obligations attributable to sale of inventory must result from bulk sale.—Subparagraph (A) shall not apply to an installment obligation is also described in section 337 (b)(2)(B).

"(C) Special rule where obligor and shareholder are related persons.—If the obligor of any installment obligation and the shareholder are related persons (within the meaning of section 1239(b)), to the extent such installment obligation is attributable to the disposition by the corporation of depreciable property—

"(i) subparagraph (A) shall not apply to such obligation, and

"(ii) for purposes of this title, all payments to be received by the shareholder shall be deemed received in the year the shareholder receives the obligation.

"(D) Coordination with subsection (e)(1)(A).—For purposes of subsection (e)(1)(A), disposition of property by the corporation shall be treated also as disposition of such property by the shareholder.

"(E) Sales by liquidating subsidiary.—For purposes of subparagraph (A), in any case to which section 337(c)(3) applies, an obligation acquired in respect of a sale or exchange by the selling corporation shall be treated as so acquired by the corporation distributing the obligation to the shareholder.

"(2) Distributions received in more than 1 taxable year of shareholder.—If—

"(A) paragraph (1) applies with respect to any installment obligation received by a shareholder from a corporation, and

"(B) by reason of the liquidation such shareholder receives property in more than 1 taxable year,

then, on completion of the liquidation, basis previously allocated to property so received shall be reallocated for all such taxable years so that the shareholder's basis in the stock of the corporation is properly allocated among all property received by such shareholder in such liquidation.

"(i) Regulations.—

"(1) In general.—The Secretary shall prescribe such regulations as may be necessary or appropriate to carry out the provisions of this section.

"(2) Selling price not readily ascertainable.—The regulations prescribed under paragraph (1) shall include regulation providing for ratable basis recovery in transactions where the gross profit or the total contract price (or both) cannot be readily ascertained.

"Sec. 453A. Installment Method for Dealers in Personal Property

"(a) General Rule.—

"(1) *In* general.—Under regulations prescribed by the Secretary, a person who regularly sells or otherwise disposes of personal property on the installment plan may return as income therefrom in any taxable year that proportion of the installment payments actually received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price.

"(2) Total contract price.—For purposes of paragraph (1), the total contract price of all sales of personal property on the installment plan includes the amount of carrying charges or interest which is determined with respect to such sales and is added on the books of account of the seller to the established cash selling price of such property. This paragraph shall not apply with respect to sales of personal property under a revolving credit type plan.

"(b) Carrying Charges Not Included in Total Contract Price.—If the carrying charges or interest with respect to sales of personal property, the income from which is returned under subsection (a)(1), is not included in the total contract price, payments received with respect to such sales shall be treated as applying first against such carrying charges or interest.

"Sec. 153B. Gain or Loss Disposition of Installment Obligations

"(a) General Rule.—If an installment obligation is satisfied at other than its face value or distributed, transmitted, sold, or otherwise disposed of, gain or loss shall result to the extent of the difference between the basis of the obligation and—

"(1) the amount realized, in the case of satisfaction at other than face value or a sale or exchange, or

"(2) the fair market value of the obligation at the time of distribution, transmission, or disposition otherwise than by sale or exchange.

any gain or loss so resulting shall be considered as resulting from the sale or exchange of the property in respect of which the installment obligation was received.

"b) Basis of Obligation.—The basis of an installment obligation shall be the excess of the face value of the obligation over an amount equal to the income which would be returnable were the obligation satisfied in full.

"(c) Special Rule for Transmission at Death.—Except as provided in section 691 (relating to recipients of income in respect of decedents), this section shall not apply to the transmission of installment obligations at death.

"(d) Effect of Distribution in Certain Liquidations.—

"(1) Liquidations to which section 332 applies.—If—

"(A) an installment obligation is distributed in a liquidation to which section 332 (relating to complete liquidations of subsidiaries) applies, and

"(B) the basis of such obligation in the hands of the distributee is determined under section 334(b)(1),

then no gain or loss with respect to the distribution of such obligation shall be recognized by the distributing corporation.

"(2) Liquidations to Which Section 337 Applies.—If—

"(A) an installment obligation is distributed by a corporation in the course of a liquidation, and

"(B) under section 337 (relating to gain or loss on sales or exchanges in connection with certain liquidations) no gain or the loss would have been recognized to the corporation if the corporation had sold or exchanged such installment obligation on the day of such distribution.

then no gain or loss shall be recognized to such corporation by reason of such distribution. The preceding sentence shall not apply to the extent that under paragraph (1) gain to the distributing corporation would be considered as gain to which section 341(f), 617(d)(1), 1245(a), 1250(a), 1251(c), 1252(a), or 1254(a) applies.

"(e) Life Insurance Companies.—

"(1) In general.—In the case of a disposition of an installment obligation by any person other than a life insurance company (as defined in section 801(a)) to such an insurance company or to a partnership of which such an insurance company is a partner, no provision of this subtitle providing for the nonrecognition of gain shall apply with respect to any gain resulting under subsection (a). If a corporation which is a life insurance company for the taxable year was (for the preceding taxable year) a corporation which was not a life insurance company, such corporation shall, for purposes of this subsection and subsection (a), be treated as having transferred to a life insurance company, on the last day of the preceding taxable year, all installment obligations which it held on such last day. A partnership of which a life insurance company becomes a partner shall, for purposes of this subsection and subsection (a), be treated as having transferred to a life insurance company, on the last day of the preceding taxable year of such partnership, all installment obligations which it holds at the time such insurance company becomes a partner.

"(2) Special rule where life insurance company elects to treat income as investment income.—Paragraph (1) shall not apply to any transfer or deemed transfer of an installment obligation if the life insurance company elects (at such time and in such manner as the Secretary may by regulations prescribe) to determine its life insurance company taxable income—

"(A) by returning the income on such installment obligation under the installment method prescribed in section 453, and

"(B) if such income would not otherwise be returnable as an item referred to in section 804(b) or as long-term capital gain, as if the income on such obligations were income specified in section 804(b).

"(f) Obligation Becomes Unenforceable.—For purposes of this section, if any installment obligation is canceled or otherwise becomes unenforceable—

"(1) the obligation shall be treated as if it were disposed of in a transaction other than a sale or exchange, and

"(2) if the obligor and obligee are related persons (within the meaning of section 453(f)(1)), the fair market value of the obligation shall be treated as not less than its face amount."

(b) Technical Amendments.—

(1) Section 311(a) and section 336 (as in effect on the day before the date of the enactment of the Crude Oil Windfall Profit Tax Act of 1980 [Pub. L. 96-223, 1980-3 C.B. 1]) are each amended by striking out "section 453(d)" and inserting in lieu thereof "section 453B".

(2) Paragraph (8) of section 381(c) is amended—

(A) by striking out "has elected, under section 453, to report on the installment basis" and inserting in lieu thereof "reports on the installment basis under section 453 or 453A", and

(B) by striking out "for purposes of section 453" and inserting in lieu thereof "for purposes of section 453 or 453A".

(3) Subsection (d) of section 481 is hereby repealed.

(4) Subsection (f) of section 644 is amended by striking out "elects to report income under section 453" and inserting in lieu thereof "reports income under section 453".

(5) Paragraph (4) of section 691(a) is amended—

(A) by striking out "received by a decedent on the sale of other disposition of property, the income from which was properly reportable by the decedent on the installment basis under section 453" and inserting in lieu thereof "reportable by the decedent on the installment method under section 453 or 453A", and

(B) by striking out "section 453(d)" each place it appears and inserting in lieu thereof "section 453B".

(6) Paragraph (2) of section 1255(b) is amended by striking out "453(d)(4)(B)" and inserting in lieu thereof "453B(d)(2)".

(c) Conforming Amendments.—

(1) Subsection (a) of section 336 (as amended by the Crude Oil Windfall Profit Tax Act of 1980 [*supra* at 76]) is amended by striking out "section 453(d)" and inserting in lieu thereof "section 453B".

(2) Paragraph (3) of section 337(f) is amended by striking out "section 453(d)(1)" and inserting in lieu thereof "section 453B(a)".

(3) Paragraph (2) of section 453(d) is amended by adding at the end thereof the following new sentence: "In the case of any installment obligation which would have met the requirements of subparagraphs (A) and (B) of the first sentence of this paragraph but for section 337(f), gain shall be recognized to such corporation by reason of such distribution only to the extent gain would have been recognized under section 337(f) is such corporation had sold or exchanged such installment obligation on the date of such distribution."

(4) Subparagraph (B) of section 403(b)(2) of the Crude Oil Windfall Profit Tax Act of 1980 is hereby repealed.

(d) Clerical Amendment.—The table of sections for such subpart B is amended by striking out the item relating to section 453 and inserting in lieu thereof the following:

"Sec 453. Installment method.

"Sec. 453A. Installment methods for dealers in personal property.

"Sec. 453B. Gain or loss on disposition of installment obligations.".

Sec. 3. Coordination With Section 691

Subsection (a) of section 691 (relating to income in respect of a decedent) is amended by adding at the end thereof the following new paragraph:

"(5) Other rules relating to installent obligations.—

"(A) In general.—In the case of an installment obligation reportable by the decedent on the installment method under section 453 or 453(A), for purposes of paragraph (2)—

"(i) the second sentence of paragraph (2) shall be applied by inserting '(other than the obligor)' after 'or a transfer to a person',

"(ii) any cancellation of such an obligation shall be treated as a transfer, and

"(iii) any cancellation of such an obligation occurring at the death of the decedent shall be treated as a transfer by the estate of the decedent (or, if held by a person other than the decedent before the death of the decedent, by such person).

"(B) Face amount treated as fair market value in certain cases.—In any case to which the first sentence of paragraph (2) applies by reason of subparagraph (A), if the decedent and the obligor were related persons (within the meaning of section 453(f)(1)), the fair market value of the installment obligation shall be treated as not less than its face amount.

"(C) Cancellation includes becoming unenforceable.—For purposes of subparagraph (A), an installment obligation which becomes unenforceable shall be treated as if it were canceled.".

Sec. 4. Amendment of Section 1038.

Section 1038 (relating to certain reacquisitions of real property) is amended by adding at the end thereof the following new subsection:

"(g) Acquisition by Estate, Etc., of Seller.—Under regulations prescribed by the Secretary, if an installment obligation is indebtedness to the seller which is described in subsection (a), and if such obligation is, in the hands of the taxpayer, an obligation with respect to which section 691(a)(4)(B) applies, then—

"(1) for purposes of subsection (a), acquisition of real property by the taxpayer shall be treated as reacquisition by the seller, and

"(2) the basis of the real property acquired by the taxpayer shall be increased by an amount equal to the deduction under section 691(c) which would (but for this subsection) have been allowable to the taxpayer with respect to the gain on the exchange of the obligation for the real property."

Sec. 5. Coordination With Section 1239.

Subsections (b) and (c) of section 1239 (defining related persons) are amended to read as follows:

"(b) Related Persons.—For purposes of subsection (a), the term 'related persons' means—

"(1) the taxpayer and the taxpayer's spouse,

"(2) the taxpayer and an 80-percent owned entity, or

"(3) two 80-percent owned entities.

"(c) 80-Percent Owned Entity Defined.—

"(1) General rule.—For purposes of this section, the term '80-percent owned entity' means—

"(A) a corporation 80 percent or more in value of the outstanding stock of which is owned (directly or indirectly) by or for the taxpayer, and

"(B) a partnership 80 percent or more of the capital interest or profits interest in which is owned (directly or indirectly) by or for the taxpayer.

"(2) Constructive ownership.—For purposes of subparagraph (A) and (B) of paragraph (1), the principles of section 318 shall apply, except that—

"(A) the members of an individual's family shall consist only of such individual and such individual's spouse, and

"(B) paragraphs (2)(C) and (3)(C) of section 318(a) shall be applied without regard to the 50-percent limitation contained therein.".

Sec. 6. Effective Dates.

(a) For Sections 2 and 5.—

(1) In general.—Except as otherwise provided in this subsection, the amendments made by section 2 and 5 shall apply to dispositions made after the date of the enactment of this Act in taxable years ending after such date.

(2) For section 453(e).—Section 453(e) of the Internal Revenue Code of 1954 (as amended by section 2) shall apply to first dispositions made after May 14, 1980.

(3) For section 453(h).—Paragraphs (1) and (2) of section 453(h) of such Code (as amended by section 2) shall apply in the case of distributions of installment obligations after March 31, 1980.

(4) For section 453A.—Section 453A of the Internal Revenue Code of 1954 (as amended by section 2) shall apply to taxable years ending after the date of enactment of this Act.

(5) For section 453B(f).—Section 453B(f) of the Internal Revenue Code of 1954 (as amended by section 2) shall apply to installment obligations becoming unenforceable after the date of the enactment of this Act.

(6) For section 2(c).—The amendments made by section 2(c) shall take effect as if included in the amendments made by section 403(b) of the Crude Oil Windfall Profit Tax Act of 1980.

(7) Special rule for application of former section 453 to certain dispositions.—In the case of any disposition made on or before the date of the enactment of this Act in any taxable year ending after such date, the provisions of section 453(b) of the Internal Revenue Code of 1954, as in effect before such date, shall be applied with respect to such disposition without regard to—

(A) paragraph (2) of such section 453(b), and

(B) any requirement that more than 1 payment be received.

(b) For Section 3.—The amendment made by section 3 shall apply in the case of decedents dying after the date of the enactment of this Act.

(c) For Section 4.—The amendment made by section 4 shall apply to acquisitions of real property by the taxpayer after the date of the enactment of this Act.

Approved October 19, 1980.

Senate Report No. 96-1000
2d Session

[Bracketed numerals indicate official report page numbers]

INSTALLMENT SALES REVISION ACT OF 1980

September 26 (legislative day, June 12), 1980.

Mr. Long, from the Committee on Finance, submitted the following report to accompany H.R. 6883.[1]

The Committee on Finance, to which was referred the bill (H.R. 6883) to amend the Internal Revenue Code of 1954 to revise the rules relates to certain installment sales, having considered the same, reports favorably thereon with an amendment and recommends that the bill as amended do pass.

The amendment is shown in the text of the bill in italic.

House bill.—H.R. 6883, as it passed the House, amends the rules for reporting gains under the installment method for sales of real property and casual sales of personal property. The bill would (1) make structural improvements to these provisions, (2) eliminate the 30-percent initial payment limitation, (3) eliminate the requirement that an eligible sale be for two or more payments, (4) eliminate the selling price requirement for nondealer sales of personal property, (5) provide that installment reporting automatically applies to a deferred payment sale unless the taxpayer elects otherwise, (6) prescribe special rules for sales to certain related parties, (7) provide that the receipt of like-kind property in connection with an installment sale will not accelerate recognition of gain, (8) provide nonrecognition treatment for distributions of installment obligations received in connection with a 12-month corporate liquidation, (9) permit installment method reporting for sales for a contingent selling price, (10) clarify the treatment of gift cancellations of an installment obligation, (11) clarify the treatment of an installment obligation which is cancelled at the death of the seller, and (12) permit an executor or beneficiary to succeed the decedent for purposes of qualifying for nonrecognition treatment if real property sold by the decedent is reacquired in cancellation of an installment obligation.

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[1] Public Law 96-471, page 25.

[2] *Committee amendment.* — The committee amended the bill to (1) clarify and coordinate the provisions relating to sales of depreciable property between closely related parties, (2) clarify that a third party guarantee (including a standby letter of credit) securing a deferred payment sale will not constitute payment to the seller, (3) eliminate any potential for double taxation when a dealer changes from an accrual method of accounting for sales to the installment method of reporting, (4) provide that existing special disposition rules for transfers of installment obligations to a life insurance company will not apply if the company reports any remaining gain as taxable investment income when it receives payments on the obligation, and (5) make the repeal of the 30-percent initial payment and two or more payment requirements effective for transactions occurring in taxable years ending after the date of enactment rather than for transactions occurring after that date.

[3] I. SUMMARY

The bill (H.R. 6883) amends the rules for reporting gain under the installment method for sales of real property and casual sales of personal property, the rules for electing the installment method by an accrual basis taxpayer, and the special disposition rules for obligations transferred to a life insurance company.

The bill makes the following changes:

(1) Structural improvements. — Under present law, a single provision (Code sec. 453) prescribes rules for installment method reporting for dealers in personal property, for sales of real property and nondealer personal property, and special disposition rules. Under the bill, the basic rules for nondealer transactions will be contained in one Code section (sec. 453), the rules for dealer transactions will be contained in another section (sec. 453A), and generally applicable installment obligation disposition rules will be contained in a third section (sec. 453B).

(2) Initial payment limitation. — The bill eliminates the requirement that no more than 30 percent of the selling price be received in the taxable year of sale to qualify for installment sale reporting for gains from sales of realty and nondealer personal property.

(3) Two-payment rule. — The bill eliminates the requirement that a deferred payment sale be for two or more payments. Thus, a sale will be eligible for installment reporting even if the purchase price is to be paid in a single lump sum amount in a year subsequent to the taxable year in which the sale is made.

(4) Selling price requirements. — The bill eliminates the requirement that the selling price for casual sales of personal property must exceed $1,000 to qualify for installment sale reporting.

(5) Election. — The bill eliminates the present law requirement that the installment method must be elected for reporting gains from sales of realty and nondealer personal property. Instead, the provision will automatically apply to a qualified sale unless the taxpayer elects not to have the provision apply with respect to a deferred payment sale.

(6) Related party sales. — The bill prescribes special rules for situations involving installment sales to certain related parties who also dispose of the property and for situations involving installment sales of depreciable property between a taxpayer and his spouse or certain 80-percent owned corporations or partnerships.

Sales other than sales of depreciable property between certain closely-related parties.—Under the bill, the amount realized upon a resale by the related party installment purchaser will trigger recognition of gain by the initial seller, based on his gross profit ratio, only to the extent the amount realized from the second disposition exceeds actual payments made under the installment sale. Thus, acceleration of recognition of the installment gain from the first sale will generally result only to the extent additional cash and other property [4] flows into the related group as a result of a second disposition of the property.

The excess of any amount realized from resales over payment received on the first sale as of the end of a taxable year will be taken into account. If, under these rules, a resale results in the recognition of gain to the initial seller, subsequent payments actually received by that seller will be recovered tax-free until they equal the amount realized from the resale which resulted in the acceleration of recognition of gain.

In the case of property other than marketable stock and securities, the resale rule will apply only with respect to second dispositions occurring within 2 years of the initial installment sale. In the case of marketable stock and securities, the resale rule will apply without a time limit for resales occurring before the installment obligation is satisfied.

The bill also contains several exceptions to the application of these rules. Since gain from the sale of a corporation's treasury stock is nontaxable and therefore its basis in the stock is irrelevant, the related party rule will not apply to any sale or exchange of stock to the issuing corporation. In addition, there generally will be no acceleration of recognition of gain as a result of a second disposition which is an involuntary conversion of the property or which occurs after the death of the installment seller or purchaser. Finally, the resale rules will not apply in any case where it is established to the satisfaction of the Internal Revenue Service that none of the dispositions had as one of its principal purposes the avoidance of Federal income taxes.

For purposes of the related party rules, the bill adopts a definition of related parties which will include spouses, children, grandchildren, and parents but will exclude brothers and sisters. It is to be understood that the Internal Revenue Service is not precluded from asserting the proper tax treatment to transactions that are shams. A corporation will be considered to be related to another taxpayer if stock of another corporation which is or might be owned by it would be treated as owned by the taxpayer under the general corporate attribution rules. Generally, a related corporation will be one in which a person directly or indirectly owned 50 percent or more in value of the stock in the corporation. Also for this purpose, the principles of the general corporate stock ownership attribution rules will apply in determining the related party status of partnerships, trusts, and estates.

Sales of depreciable property between certain closely-related parties.—Under the bill, the accrual method of accounting in effect is required for deferred payment sales of depreciable property between certain closely-related parties.

In general, this rule is intended to deter transactions which are structured in such a way as to give the related purchaser the benefit of depreciation deductions (measured from a stepped-up basis) prior to the time the seller is required to include in income the corresponding gain on the sale. For these transactions the deferred payments will be deemed to be received in the taxable year in which the sale occurs.

This special rule will apply only to deferred payment sales between a taxpayer and the taxpayer's spouse, the taxpayer and a partnership [5] or corporation which is 80-percent owned by the taxpayer and/or the taxpayer's spouse, and between partnerships and corporations which are 80-percent owned by the taxpayer and/or the taxpayer's spouse.

The rule will not apply if it is established to the satisfaction of the Internal Revenue Service that the sale did not have as one of its principal purposes the avoidance of Federal income taxes. Thus, the rule will not apply with respect to a sale incident to a divorce or separation or generally when no significant tax deferral benefits will be derived from the sale.

(7) Treatment of third party guarantee.—Under the bill, a third party guarantee (including a standby letter of credit) used for security of a deferred payment sale will not be treated as payment received on an installment obligation.

(8) Like-kind exchanges.—The bill provides that the receipt of like-kind property in connection with a disposition will not be taken into account in determining gain recognized for installment sale reporting purposes. Under the present Internal Revenue Service position, the receipt of like-kind property results in the recognition of installment gain before cash is received by the taxpayer because the value of such property is treated as a payment received. The bill reverses this rule.

(9) Installment obligations distributed in a corporation liquidation.—In general, the bill provides nonrecognition of gain treatment for a shareholder who receives installment obligations as liquidating distributions from a corporation liquidating within 12 months of adoption of a plan of complete liquidation. In general, this rule will apply to obligations arising from sales by a corporation during the 12-month period. Obligations from the sale of inventory will qualify only if the inventory of that trade or business is sold in bulk. The gain realized by the shareholder on his stock will be recognized as payments are received on the installment obligation. Thus, in most significant aspects, the tax consequences to a shareholder will be essentially the same whether the corporation sells its assets and then distributes installment obligations in complete liquidation or the shareholder makes an installment sale of the stock.

Under the bill, nonrecognition treatment will not be available to the extent the obligation is attributable to sales of depreciable property by the corporation if the installment purchaser is either the shareholder-distributee's spouse, or a corporation or a partnership which is 80-percent owned by the shareholder-distributee and/or his spouse.

(10) Sales subject to a contingency.—The bill permits installment method reporting for sales for a contingent selling price. Under present law, these sales are not eligible for installment reporting. In extending eligibility, the bill does not prescribe specific rules which would apply to every conceivable transaction. Rather, the bill provides that the specific rules will be prescribed under regulations.

However, it is intended that, for sales under which there is a stated maximum selling price, the regulations will permit basis recovery on the basis of a gross profit ratio determined by reference to the stated maximum selling price. In cases where the sales price is indefinite but payable over a fixed period of time, it is generally intended that the basis of the property sold would be recovered ratably over that fixed period. In cases where the selling price and payment period are both indefinite, it is intended that the regulations would permit ratable [6] basis recovery over some reasonable period of time. Also, in appropriate cases, it is intended that basis recovery would be permitted under an income forecast type method.

(11) Election of installment method by accrual method dealer.—Under the bill, an election of installment method reporting by an accrual method dealer would apply only to payments received from sales made on or after the effective date of the election and thereby eliminate the possibility of double taxation which exists under present law.

(12) Transfers of installment obligations to life insurance companies.—Under the bill, the special disposition rules for triggering the recognition of gain for obligations transferred to a life insurance company in an other-

wise tax-free transfer will not apply if the transferee company elects to report any remaining gain as investment income as payments are received.

(13) Cancellation of installment obligation.—The bill makes it clear that the cancellation of an installment obligation is treated as a disposition of the obligation by the holder of the obligation.

(14) Bequest of obligation to obligor.—The bill provides that the installment obligation disposition rules cannot be avoided by the bequest of an obligation to the obliger.

(15) Foreclosure of real property sold on installment method by deceased taxpayer.—The bill provides that an executor or beneficiary who receives a secured installment obligation from a decedent will succeed the decedent for purposes of qualifying for nonrecognition treatment if the real property sold by the decedent is reacquired in cancellation of the obligation.

(16) Treatment of gain from sales of depreciable property between related parties.—Under the bill, the ordinary income characterization rules for sales of depreciable property between related parties would be revised to generally apply the usual corporate constructive ownership rules and to prescribe new rules for transactions with entities which are 80 percent controlled by a taxpayer and his spouse. For purposes of this provision, the attribution rules would be narrowed to exclude attribution from a family member other than the taxpayer's spouse.

(17) Effective dates.—In general, the bill is effective for sales, dispositions, cancellations, bequests, and reacquisitions of real property, as the case may be, occurring after the date of enactment. The provisions which eliminate the 30-percent initial payment and the two or more payments requirements are effective for transactions occurring in taxable years ending after the date of enactment. However, the related party installment sale rules apply to installment sales after May 14, 1980. The provision relating to the distribution of installment obligations in connection with a 12-month corporate liquidation apply with respect to installment obligations distributed after March 31, 1980.

(18) Revenue effects.—Due to the interaction between the provisions of this bill, revenue effects for each specific provision cannot be determined independently. It is estimated that on balance the provisions of this bill (except related party sales) will not have a significant revenue effect on budget receipts.

Due to the extensive litigation and controversy concerning the treatment of related party sales under present law, the revenue gain for the related party provision of the bill is indeterminant.

[7] II. EXPLANATION OF THE BILL

A. Installment Sales Generally (sec. 2 of the bill and sec. 453 of the Code)

Present law

Generally, under present law (Code sec. 453), income from a sale of property on the installment basis may be reported as the payments are received. If the installment method is elected for qualifying sales, the gain reported for any taxable year is the proportion of the installment payment received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price. In general, the contract price is the amount which will be paid to the seller.

The function of the installment method of reporting income is to permit the spreading of the income tax over the period during which payments of the sales price are received. Thus, the installment method alleviates possible liquidity problems which might arise from the bunching of gain in the year of sale when a portion of the selling price has not been actually received.

Reasons for change

The committee believes that present law would be simplified by making structural improvements to existing law so that the basic rules relating to nondealer transactions would be contained in one section of the Code, the basic rules relating to dealer transactions in another section, and the special rules relating to dispositions of installment obligations in a third section.

Explanation of provision

In general

Although the bill makes structural revisions of existing law and makes the specific changes described below, most of the basic concepts of existing law are continued. As under present law, the provisions relate to installment reporting of gains and do not affect the time for recognizing losses from the sale or exchange of property for deferred payments.

Except as otherwise provided for sales subject to a contingency or for sales to certain related persons, gain from an installment sale would continue to be recognized for any taxable year with respect to the payments received in the year in the same proportion as the gross profit from the sale bears to the total contract price. The payments taken into account as being received in a taxable year would not include the purchaser's obligation of future payment, whether dischargeable in money or other property (including foreign currency), unless that obligation is a bond or other evidence of indebtedness which is either payable on demand or has been issued by a corporation or government and is readily tradable.

[8] *Structural improvements*

Under present law, a single provision (Code sec. 453) prescribes rules for installment method reporting for dealers in personal property, for sales of real property and nondealer personal property, and special disposition rules. Under the bill, the rules for nondealer transactions are contained in one Code section (sec. 453), the rules for personal property dealer transactions are contained in another section (sec. 453A), and generally applicable installment obligation disposition rules are contained in a third section (sec. 453B).

Generally, in making these structural changes and certain language changes are intended to be made by the bill with respect to the provisions relating to installment sales by dealers in personal property. Except for an amendment relating to the election of the installment method by an accrual basis dealer, the substantive changes under the bill relate only to sales of realty and casual sales of personal property.

Under the bill, gain from the sale of property which is not required to be inventories by a farmer under his method of accounting will be eligible for installment method reporting as gain from a casual sale of personal property even though such property is held for sale by the farmer. The committee also intends that deferred payment sales to farmer cooperatives are to be eligible for installment reporting as under present law (Rev. Rul. 73-210, 1973-1 C.B. 211).

B. INITIAL PAYMENT LIMITATION (SEC. 2 OF THE BILL AND SEC. 453(B)(2) OF THE CODE)

Present law

Under present law, gain from the sale of realty or nondealer personal property may not be reported under the installment method if the payments received in the taxable year of sale exceed 30 percent of the selling price.

Reasons for change

A number of problems have arisen in connection with the 30-percent initial payment requirement which was designed to limit installment sale reporting to transactions where hardships might result from current imposition of tax on uncollected amounts. Some have argued that it is an arbitrary limitation which has unduly complicated and interfered with normal business transactions. In addition, it has been argued that the limitation has operated as a trap for the unwary. If a taxpayer fails to secure competent advice and inadvertently exceeds the 30-percent limitation, however slightly, the entire gain must be recognized in the year of sale. The limitation has produced an inordinate amount of litigation and confusion.

In applying the 30-percent limitation, the problem areas generally involve interpretations of the terms "selling price" and "payment." Where the imputed interest provision applies (Code sec. 483), the limitation may not be satisfied if the selling price is reduced by the amount required to be treated as unstated interest (Treas. reg. § 1.453(b)(2)). Thus, after reduction of the selling price for unstated interest, the payments received in the year of sale may exceed 30 percent of the selling price although the limitation appeared to be satisfied on the basis of the written sales agreement. A similar disqualification [9] can arise when the installment obligation is a corporate obligation issued at a discount because the amount treated as original issue discount is not included as part of the selling price (Treas. reg. § 1.453-1(b)(3)).

Another problem arises under present law in connection with the sale of property which is subject to an existing mortgage which is assumed by the installment buyer. Generally, the amount of the mortgage is taken into account as part of the selling price but is not taken into account for purposes of determining the contract price or the amount of payments received by the seller. However, to the extent the mortgage exceeds the seller's basis in the property, the excess is considered as a payment received and correspondingly is included in the contract amount. (Treas. reg. § 1.453-4(c)). The problem arising from this treatment does not involve its correctness but rather the inadvertent disqualification of the sale for installment method reporting for failing to take the amount of the mortgage in excess of basis into account for the 30-percent initial payment requirement. Where the taxpayers are cognizant of problems of this type, the 30-percent requirement has fostered ingenious "wraparound" mortgage arrangements to qualify for installment method reporting.[1]

Under the wraparound arrangement, the buyer does not assume the mortgage and agrees not to make direct payments to the mortgagee but agrees to make the payments to the seller who will continue to pay the mortgage debt. In one case, the wraparound technique was used by having the seller retain title to the property for a period of years so there would be no transfer of property "subject to" the existing mortgage.[2] If title passes in the year of sale, the Internal Revenue Service will treat the mortgage debt in excess of basis as a payment received in the year of the sale.[3] This issue is said to be another instance of the 30-percent initial payment rule fostering uncertainty and litigation.

Another problem area relates to the treatment of selling expenses when determining whether the mortgage assumed by the buyer exceeds the adjusted basis of the property sold. Under the regulations, commissions and selling expenses are taken into account as an offset to selling price for purposes of determining the gross profit from a sale by a nondealer (Treas. reg. § 1.453-1(b)), but do not reduce the amount of the payments, the total contract price, or the selling price (Treas. reg. § 1.453-4(c)). However, the Ninth Circuit has held that selling expenses are to be added to basis for this purpose.[4] The Internal Revenue Service has announced that it will not follow the Ninth Circuit's decision on the treatment of selling expenses.[5] Thus, this is another area where the 30-percent initial payment requirement may foster litigation and confusion.

Another problem area involves the case where the buyer pays some of the seller's obligations in the year of sale. The Service has ruled that, in the case of a casual sale of personal property, the assumption [10] and payment of secured and general unsecured liabilities by the purchaser will not be considered as a payment to the seller for installment sale reporting qualification purposes if the seller establishes that the liabilities were incurred in the ordinary course of business and not for purposes of avoiding the 30-percent initial payment limitation.[6] The avoidance test under the ruling would involve a subjective determination of motive. Thus, this is another area where the initial payment rule may foster litigation and confusion.

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[1] Wyndelts and Campbell, "Installment Reporting Need Not Be Lost When Year-Of-Sale Payments Are More Than 30%," *20 Taxation for Accountants* 328 (1978); Ginsberg, "Taxing the Sale for Future Payment," 30 *Tax Law Review* 469, 488 (1975).

[2] ***Stonecrest,*** 24 TC 659 (1955) ***nonacq.*** 1956-1 C.B. 6.

[3] Letter rulings 7814010 and 7814011.

[4] ***Kirschenmann v. United States,*** 488 F.2d 270 (9th Cir. 1973).

[5] Rev. Rul. 74-384, 1974-2 C.B. 152.

For these reasons, the committee believes that the 30-percent initial payment limitation should be repealed.

Explanation of provision

The bill eliminates the 30-percent initial payment limitation for reporting gain on the installment method from the disposition of real property or nondealer personal property.

C. Two-Payment Rule (sec. 2 of the bill and sec. 453 of the Code)

Present law

Under present law, it is the position of the Internal Revenue Service that a taxpayer may not elect to report income from the sale of real property on the installment method if the total purchase price is payable in a lump sum in a taxable year subsequent to the year of sale.[7] The same issue may arise with respect to casual sales of personal property. The rationale for the ruling is that the installment concept generally calls for two or more payments of the purchase price in two or more taxable years and that a single payment sale cannot be considered to be payable in installments. The courts have agreed with the Service's interpretation.[8]

Reasons for change

The two-payment rule is a trap for the unwary and results in different tax results for transactions that are substantially similar. For example, installment method reporting would be available for a taxpayer who sells for a modest down payment with the balance due in 5 years but would not be available for a taxpayer who receives no down payment with the entire balance due in 5 years. In these situations, the ability to pay income taxes from the sales proceeds is essentially the same. Thus, to the extent the rationale for installment method reporting is based on ability to pay concepts, both sales should qualify for installment reporting.

Accordingly, the committee believes that the two-payment requirement should be repealed.

Explanation of provision

The bill eliminates the requirement that a sale must be for two or more payments to qualify for installment method reporting. Thus, under the bill, income from the sale of qualifying property for a purchase price payable in a lump sum in a taxable year subsequent to the year of sale may be reported in the year in which payment is received.

[11] It is anticipated that the Treasury Department will prescribe regulations to extend a similar rule to deferred payment sales by dealers in personal property.

D. Selling Price Limitation for Casual Sales of Personal Property (sec. 2 of the bill and sec. 453(b)(1)(B) of the Code)

Present law

Under present law, a casual sale of personal property must be for a selling price in excess of $1,000 to qualify for installment reporting.

Reasons for change

In certain situations, the selling price requirement may be difficult to apply because questions may arise as to whether there is a single sale of several items for more than $1,000, which satisfies the requirement, or a number of sales of individual items for $1,000 or less for each item. In addition, the committee believes that taxpayer compliance will be facilitated by repealing this requirement.

Explanation of provision

The bill eliminates the selling price requirement to qualify for installment reporting.[9]

E. Election of Installment Reporting (sec. 2 of the bill and new sec. 453(d) of the Code)

Present law

Under present law, an election may be made to report gain from an installment sale on a timely filed return, a delinquent return, or on an amended return for the year of sale not barred by the statute of limitations, if the facts indicate no position inconsistent with the installment election had been taken with respect to the sale (Rev. Rul. 65-297, 1965-2 C.B. 152). If a return is filed which includes in gross income the entire gain from an installment sale, an amended return or claim for refund cannot be used to elect installment sale reporting for the sale because the election to report the gain in full is treated as a binding election not to report on the installment method.[10]

Reasons for change

The committee believes that the present law requirements for electing installment reporting may represent a trap for taxpayers who attempt an election which is invalid because of technical deficiencies. Further, the committee believes that present law creates a whip-saw problem for the Internal Revenue Service, e.g., where the taxpayer does not report gain from a sale for the year of sale but later attempts to retroactively elect installment treatment if the omission is discovered on audit, or, if the statute of limitations has run, contends that the full amount of gain should have been reported for the year of sale.

Explanation of provision

The bill eliminates the present law requirement that the installment method must be elected for reporting gains from sales of realty and nondealer personal property. Instead, installment reporting would [12] automatically apply to a qualified sale unless the taxpayer elects not to have the provision apply with respect to a deferred payment sale. Generally, the election not to have installment method reporting apply to a deferred payment sale must be made in the manner prescribed by regulations on or before the due date (including extensions of time for filing) for filing the income tax return for the year in which the sale occurs. It is anticipated that reporting the entire gain in gross income for the taxable year in which the sale occurs will operate as an election not to have installment sale reporting apply. It is anticipated that, under regulations, late elections will be permitted in rare circumstances when the Internal Revenue Service finds that reasonable cause for failing to make a timely election exists under the particular circumstances of each case.

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[6] Rev. Rul. 73-555, 1973-2 C.B. 159.

[7] Rev. Rul. 69-462, 1969-2 C.B. 107, amplified by Rev. Rul. 71-595, 1971-2 C.B. 223.

[8] *Baltimore Baseball Co., Inc.,* v. *U.S.,* 481 F.2d 1283 (Ct. Cl. 1973); *10-42 Corp.,* 55 TC 593 (1971).

[9] If, for practical reasons, it is not feasible to report gain from sales for relatively small amounts, a taxpayer could elect not to report gain under the installment method and thereby eliminate compliance burdens. See the following discussion relating to installment sale elections under the bill.

[10] *Robert F. Kock,* T.C. Memo 1978-271; *Pacific National Co.* v. *Welch,* 304 U.S. 191 (1938).

Generally, an election made under this provision is to be irrevocable. However, an election may be revoked with the consent of the Internal Revenue Service. Generally, it is anticipated that consent would be given by the Internal Revenue Service in circumstances when a revocation does not have as one of its purposes the avoidance of income taxes. Also it is anticipated that consent to revocation will generally be granted in cases involving a contingent selling price if the election is made prior to adoption of final regulations under the provisions of the bill relating to contingent selling price sales and the request for revocation is filed within a reasonable time after the regulations are adopted.

It is anticipated that the regulations will prescribe election rules relating to the treatment of gains from deferred payments sales of property by a nonresident alien. Under the installment method rules of present law, these gains do not become taxable as payments are received after the seller becomes a resident or citizen subject to U.S. income tax for a taxable year subsequent to the year in which the sale was made. It is intended that the election regulations will continue this treatment in appropriate cases. Further, it is intended that similar treatment will be provided for a deferred payment sale made by a tax-exempt organization which later receives payments after losing its tax-exempt status.

F. Related Party Sales (sec. 2 of the bill and new sec. 453(e), (f), and (g) of the Code)

Present law

Under present law, the installment sale statutory provision does not preclude installment sale reporting for sales between related parties. Further, the statutory provision does not preclude installment sale reporting for sales of marketable securities although the seller might readily obtain full cash proceeds by market sales.[11]

Under the existing statutory framework, taxpayers have used the installment sale provision as a tax planning device for intra-family transfers of appreciated property, including marketable securities.[12] [13] There are several tax advantages in making intra-family installment sales of appreciated property. The seller would achieve deferral of recognition of gain until the related buyer actually pays the installments to the seller, even if cash proceeds from the property are received within the related party group from a subsequent resale by the installment buyer shortly after making the initial purchase. In addition to spreading out the gain recognized by the seller over the term of the installment sale, the seller may achieve some estate planning benefits since the value of the installment obligation generally will be frozen for estate tax purposes. Any subsequent appreciation in value of the property sold, or in property acquired by reinvestment of the proceeds from the property sold on the installment basis, would not affect the seller's gross estate since the value of the property is no longer included in his gross estate.

With respect to the related buyer, there is usually no tax to be paid if the appreciated property is resold shortly after the installment purchase. Since the buyer's adjusted basis is a cost basis which includes the portion of the purchase price payable in the future, the gain or loss from the buyer's resale would represent only the fluctuation in value occurring after the installment purchase. Thus, after the related party's resale, all appreciation has been realized within the related group but the recognition of the gain for tax purposes may be deferred for along period of time.

In the leading case, *Rushing* v. *Commissioner*,[13] the test was held to be that, in order to receive the installment benefits, the "seller may not directly or indirectly have control over the proceeds or possess the economic benefit therefrom." In this case, a sale of corporate stock was made to the trustee of trusts for the benefit of the seller's children. Since the sales were made to trusts created after the corporations had adopted plans of liquidation, the Government made an assignment of income argument. The Court upheld installment sale treatment for the stock sold to the trustee under the "control or enjoyment" test because the trustee was independent of the taxpayer and owed a fiduciary duty to the children. The Court rejected the assignment of income argument because it found that no income was being assigned.

The *Rushing* case has been followed in another case where the stock sold to a family trust was that of a corporation which was to be liquidated after the sale.[14] The liquidation was formally authorized after the sale to the trust. In other cases, the Tax Court has rejected the Service's substance over form and constructive receipt arguments and held that sales to a family trust qualified for installment method reporting.[15] In the *Pityo* case, the taxpayer's wife was the beneficiary of one of the trusts to which the installment sale was made. In the *Roberts* case, the trustees were the seller's brother and personal accountant. In both cases, installment sale reporting was allowed because the Tax [14] Court held that the trustees were independent of the seller and satisfied the *Rushing* control or enjoyment test.

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[11] The receipt of the buyers obligation payable on demand or a readily tradable evidence of indebtedness is treated as the receipt of payment by the seller. For this purpose, readily tradable items include bonds and notes issued by a corporation or governmental unit with interest coupons attached or in registered form or in any other form designed to make the bond or note readily tradable in an established securities market.

[12] Another technique used for intra-family transfers involves the so-called "private annuity" arrangement. The bill does not deal directly with this type of arrangement.

[13] 441 F. 2d 593 (5th Cir. 1971), *aff'g*, 52 T.C. 888 (1969).

[14] *Carl E. Weaver*, 71 T.C. 443 (1978).

In another case, installment method reporting was allowed for a sale of marketable stock by a wife to her husband although a resale by the husband was contemplated.[16] In this case, the Court held that the husband could not be considered a mere conduit for the wife's sale of the stock since both were "very healthy economic entities" and the husband had an independent purpose for obtaining needed funds for an investment at a low rate of interest.

In the few cases in which the Service has prevailed, installment method reporting has been denied with respect to transactions involving a controlled corporation,[17] a sale to a son where the son was forced to resell the stock and invest the proceeds in other securities held in escrow,[18] and, in the case of a sale by a husband to his wife where the Court found there was no bona fide purpose for the transaction other than tax avoidance.[19]

Reasons for change

The committee appreciates the fact that denial of installment sale treatment may be harsh for a shareholder who receives liquidating distributions of the installment obligations received by the corporation from the sale of its assets. In that case, the shareholder may incur a substantial tax on the gain from the stock without having received current funds from the corporate liquidation with which to pay the tax. Accordingly, the committee's bill, as later described, includes a provision to deal with that potential hardship. However, the committee believes that the application of the judicial decisions, involving corporate liquidations, to intra-family transfers of appreciated property has led to unwarranted tax avoidance by allowing the realization of appreciation within a related group without the current payment of income tax.

Explanation of provision

The bill prescribes special rules for situations involving installment sales to certain related parties who also dispose of the property and for situations involving installment sales of depreciable property between a taxpayer and his spouse or certain trusts, and 80-percent owned corporations or partnerships.

Sales other than sales of depreciable property between certain closely-related parties

Under the bill, the amount realized upon certain resales by the related party installment purchaser will trigger recognition of gain by the initial seller, based on his gross profit ratio, only to the extent the amount realized from the second disposition exceeds actual pay- [15] ments made under the installment sale. Thus, acceleration of recognition of the installment gain from the first sale will generally result only to the extent additional cash and other property flows into the related group as a result of a second disposition of the property. In the case of a second disposition which is not a sale or exchange, the fair market value of the property disposed of is treated as the amount realized for this purpose. For these purposes, the portion of the amount realized from a second disposition will not be taken into account to the extent attributable to any improvements which had been made by the related installment purchaser.

The excess of any amount realized from resales over payments received on the first sale as of the end of a taxable year will be taken into account. Thus, the tax treatment would not turn on the strict chronological order in which resales or payments are made. If, under these rules, a resale results in the recognition of gain to the initial seller, subsequent payments actually received by that seller would be recovered tax-free until they have equaled the amount realized from the resale which resulted in the acceleration of recognition and gain.

In the case of property other than marketable securities, the resale rule will apply only with respect to second dispositions occurring within 2 years of the initial installment sale. For this purpose, the running of the 2-year period would be suspended for any period during which the related purchaser's risk of loss with respect to the property is substantially diminished. This rule will apply with respect to the holding of a put, the holding of an option by another person, a short sale, or any other transaction which has the effect of substantially diminishing the risk of loss. However, for this purpose, a typical close corporation shareholders' agreement is not intended to be taken into account. Further, the holding of an option is not to be considered to have the effect of substantially diminishing risk of loss if the option purchase price is to be determined by reference to the fair market value of the property at the time the option is exercised.

In the case of marketable securities, the resale rule would apply without a time limit for resales occurring before the installment obligation is satisfied. For this purpose, the term "marketable security" means any security for which, as of the date of disposition, there was a market on an established securities market, [or] otherwise.[20]

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[15] *William D. Pityo*, 70 T.C. 225 (1978); *Clair E. Roberts*, 71 T.C. 311 (1978). Also, in *William J. Goodman*, 74 T.C. No. 53 (July 16 1980), a prearranged resale was made by the trustees of a family trust one day after the installment sale were made to the trusts of which the installment sellers were the trustees. The two-step installment sales were used because the taxpayers believed that "a cash sale was not attractive because of the income tax liability on such a sale."

[16] *Nye* v. *U.S.*, 407 F.Supp. 1345, 75-1 USTC ¶ 9150 (M.D.N.C. 1975).

[17] *Griffiths* v. *Helvering*, 308 U.S. 355 (1939). This case involved the creation of a corporation to receive the assignment of a settlement owed to the taxpayer with the corporation agreeing to pay the money received from the settlement to the taxpayer over a 40-year term. The Court held that there had been an anticipatory assignment of income and therefore the income was taxable to the shareholder rather than the corporation.

[18] *Paul G. Lustgarten*, 71 T.C. 303 (1978). The Court held that the taxpayer had constructively received the proceeds from the "resale."

[19] ***Phillip W. Wrenn***, 67 T.C. 576 (1976).

The bill also contains several exceptions to the application of these rules. Since gain from the sale of a corporation's treasury stock is nontaxable and therefore its basis in the stock is irrelevant, this related party rule will not apply to any nonliquidating installment sale of stock to the issuing corporation. In addition, there would be no acceleration of recognition of gain as a result of a second disposition which is an involuntary conversion of the property if the first sale occurred before the threat or imminence of the conversion. Further [16] there would be no acceleration of recognition of gain from a second disposition which occurs after the death of the installment seller or purchaser. Generally, it is intended that this exception will apply after the death of either spouse when the spouses hold their interests in the installment obligation or the purchased property as community property or as equal undivided joint interests. Finally the resale rules will not apply in any case where it is established to the satisfaction of the Internal Revenue Service that none of the dispositions had as one of its principal purposes the avoidance of Federal income taxes.

In the exceptional cases to which the nonavoidance exception may apply, it is anticipated that regulations would provide definitive rules so that complicated legislation is not necessary to prescribe substituted property or taxpayer rules which would not be of general application. In appropriate cases, it is anticipated that the regulations and rulings under the nontax avoidance exception will deal with certain tax-free transfers which normally would not be treated as a second disposition of the property, e.g., charitable transfers, like-kind exchanges, gift transfers, and transfers to a controlled corporation or a partnership. Generally it is intended that a second disposition will qualify under the nontax avoidance exception when it is of an involuntary nature, e.g., foreclosure upon the property by a judgment lien creditor of the related purchaser or bankruptcy of the related purchaser. In addition it is intended that the exception will apply in the case of a second disposition which is also an installment sale if the terms of payment under the installment resale are substantially equivalent to, or longer than, those for the first installment sale. However, the exception would not apply if the resale terms would permit significant deferral of recognition of gain from the initial sale when proceeds from the resale are being collected sooner.

Under the bill, the period for assessing a deficiency in tax attributable to a second disposition by the related purchaser will not expire before the day which is 2 years after the date the initial installment seller furnishes a notice that there was a second disposition of the property. The notice is to be furnished in the manner prescribed by regulations. Under the bill, a protective notification may be filed to prevent the tolling of the period of limitations for assessing a deficiency in cases where there are questions as to whether a second disposition has occurred (e.g., a lease which might be characterized as a sale or exchange for tax purposes) or whether there is a principal purpose of Federal income tax avoidance.

For purposes of the related party rules, the bill adopts a definition of related parties which will include spouses, children, grandchildren, and parents but will exclude brothers and sisters.

In the case of a corporation, it will be considered to be related to another taxpayer if stock which is or might be owned by it is or would be treated as owned by the other taxpayer under the general corporate attribution rules (Codes sec. 318).. Generally, a related corporation will be one in which a person directly or indirectly owns 50 percent or more in value of the stock in the corporation. Also for this purpose, the principles of the general corporate stock ownership attribution rules (Codes sec. 318) will apply in determining the related party status of partnerships, trusts, and estates.

[17]It is to be understood that the provisions governing the use of the installment method to report sales between related parties, and the definition of such relationships, are not intended to preclude the Internal Revenue Service from asserting the proper tax treatment of transactions that are shams.

Sales of depreciable property between certain closely-related parties

Under the bill, the accrual method of accounting in effect is required for deferred payment sales of depreciable property between certain closely-related parties.[21] In general, this rule is intended to deter transactions which are structured in such a way as to give the related purchaser the benefit of depreciation deductions (measured from a stepped-up basis) prior to the time the seller is required to include in income the corresponding gain on the sale. For transactions to which the special rule will apply, the deferred payments will be deemed to be received in the taxable year in which the sale occurs. In the case of sales for contingent future payments, it is intended that, in general, the amount realized in the year of sale will be equal to the value of the property sold.

This special rule will apply only to deferred payment sales between a taxpayer and the taxpayer's spouse; the taxpayer and a partnership or corporation which is 80-percent owned by the taxpayer and/or the taxpayer's spouse; and between partnerships and corporations which are 80-percent owned by the taxpayer and/or the taxpayer's spouse. The rule will not apply if it is established to the satisfaction of the Internal Revenue Service that the sale did not have as one of its principal purposes the avoidance of Federal income taxes.

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[20] The term "marketable securities" includes securities which are listed on the New York Stock Exchange, the American Stock Exchange, or any city or regional exchange in which quotations appear on a daily basis, including foreign securities listed on a recognized foreign national or regional exchange; securities regularly traded in the national or regional over-the-counter market, for which published quotations are available; securities locally traded for which quotations can readily be obtained from established brokerage firms; and units in a common trust fund. Mutual fund shares for which redemption prices are published would also be considered marketable securities.

[21] In the case of transfers which are treated as tax-free transfers to a controlled corporation or to a partnership. (Code secs. 351, 362, 721, and 723), the provisions of present law would continue to apply and would not be affected by the provision. Also, in the case of transactions which are governed by the doctrine of liquidation-reincorporation under present law, the tax treatment for those transactions would continue to be governed by present law and would not be effected by the provision.

Thus, the special rules will not apply if, at the time of the installment sale, the husband and wife are legally separated under a decree of divorce or separate maintenance. Also, they will not apply if the installment sale occurs pursuant to a settlement in a proceeding which culminates in a decree of divorce or separate maintenance. Further, the rule will not apply if no significant tax deferral benefits will be derived from the sale.

Statement of committee intention

The committee intends that no inference be drawn from these provisions as to the proper treatment of any related party installment sale occurring prior to the effective date provided under the bill.

The Committee on Finance believes that, as a principle of tax policy, a taxpayer should be permitted to contest on an equal footing in the appropriate courts matters in dispute with the government. The Committee recognizes that two sections of the pending legislation (new Code secs. 453 (e)(7) and (g)) put a taxpayer at a disadvantage if he or she should seek a court ruling on the merits of the issue.

The Committee accepts the pending legislation only with the specific understanding that—

[18] (1) The foregoing sections are designed to give an opportunity to taxpayers to qualify who might otherwise not be able to qualify under this legislation for the reporting of income on the installment method,

(2) Under the preceding sections in determining the question of tax avoidance, the Commissioner shall treat taxpayers fairly and equitably in light of all the facts and circumstances of each particular case in a manner consistent with the remedical intent of the preceding sections, and

(3) The preceding sections are not to be considered as a precedent for future legislation.

The Committee shall monitor closely the administration of the sections and the Commissioner shall report annually its actions to the appropriate Congressional committees. Further, the General Accounting Office shall not later than two years after the enactment of this legislation report to the Congress on the manner in which the preceding sections are being administered.

G. Treatment of Third Party Guarantee (sec. 2 of the bill and sec. 453(f)(3) of the Code)

Present law

Generally, under present law (Code sec. 453), income from a sale of property on the installment basis may be reported as the payments are received. If the installment method is elected for qualifying sales, the gain reported for any taxable year is the proportion of the installment payment received in that year which the gross profit, realized or to be realized when payment is completed, bears to the total contract price. In general, the contract price is the amount which will be paid to the seller. The payments taken into account as being received in a taxable year would not include the purchaser's obligation of future payment, whether dischargeable in money or other property (including foreign currency), unless that obligation is a bond or other evidence or indebtedness which is either payable on demand or has been issued by a corporation or government and is readily tradable.

In a recent case, the Tax Court held that, by reason of a standby letter of credit used to secure future payment for the sale of a cotton crop, the taxpayer had received full payment in the year of sale and could not report the transaction on the installment method.[22] However, the Tenth Circuit Court of Appeals has recently held that a letter of credit used to secure payment for the sale of stock did not constitute payment for purposes of the installment sale provisions.[23]

Reasons for change

The committee believes that a third party guarantee (including a standby letter of credit) used as security for a deferred payment sale should not be treated as a payment received on an installment obligation.

Explanation of provision

Under the bill, a third party guarantee (including a standby letter of credit) will not be taken into account in determining if the [19] buyer's evidence of indebtedness constitutes payment to the seller. For this purpose, a guarantee which is not treated as payment would not include a third party note (or any other type of third party obligation which is transferable or marketable prior to default in payment by the installment purchaser).

H. Receipt of Like Kind Property (sec. 2 of the bill and new sec. 453(f)(7) of the Code)

Present law

Under present law, the transfer of property for cash payments and like kind property may qualify both for installment method reporting and, with respect to the gain attributable to the like kind exchange, nonrecognition treatment (Code sec. 1031 and Rev. Rul. 65-155, 1965-1. C.B. 356). In this case, the gain to be recognized under installment method reporting is the total gain realized on the transaction less the gain eligible for nonrecognition under the like kind exchange provision. However, the value of the like kind property received by the seller is taken into account in determining the amount of the selling price, the contract price, and payments received for purposes of the installment sale provision.[24] The value of the like kind property received in the taxable year in which the sale or exchange is made.

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[22] *J. K. Griffith*, 73 T.C. No. 76 (Feb. 28, 1980).

[23] *Sprague* v. *U.S.*, — F.2d — (10th Cir., Aug. 14, 1980).

[24] Rev. Rul. 65-155, 1965-1 C.B. 356; *Clinton H. Mitchell*, 42 T.C. 953, 965 (1964); *Albert W. Turner*, TC Memo 1977-437. A similar case under present law involves the treatment of an installment obligation received as "boot" in exchange by a shareholder under a plan of corporate reorganization (sec. 356(a)(1)). Present law is unclear whether the exchange qualifies for installment sale reporting.

Reasons for change

The committee believes that, when like kind property and an installment obligation are received, the like kind property should not be treated as payment in order to achieve the basic purpose of installment sale reporting, i.e., gain should be recognized as cash (and other property with respect to which gain is recognized) is received.

Explanation of provision

Under the bill, property permitted to be received without recognition of gain in an exchange described in Code section 1031(b)[25] will not be treated as payment for purposes of reporting income under the installment method.

Thus, in reporting the gain on the exchange under the installment method where an installment obligation is received in addition to the like kind property, the gross profit will be the amount of gain which will be recognized on the exchange if the installment obligation were satisfied in full at its face amount. Also, the total contract price will not include the value of the like kind property but instead will consist solely of the sum of the money and fair market value of other property received plus the face amount of the installment obligation.

The basis of the like kind property received, (determined under section 1031(d)) will be determined as if the obligation had been [20] satisfied at its face amount.[26] Thus, the taxpayer's basis in the property transferred will first be allocated to the like kind property received (but not in excess of its fair market value) and any remaining basis will be used to determine the gross profit ratio.

The bill also provides that similar treatment applies in the case of an exchange under a plan of corporate reorganization described in section 356 (a) which is not treated as a dividend.

These provisions may be illustrated by the following example. Assume that the taxpayer exchanges property with a basis of $400,000 for like kind property worth $200,000, and an installment obligation for $800,000 with $100,000 payable in the taxable year of the sale and the balance payable in the succeeding taxable year. The example compares present law, which takes like kind property into account as payment, with the bill which reverses this rule.

	Rev. Rul. 65-155—Like kind property taken into account	*Like kind property not taken into account*
Contract price	$1,000,000	$800,000
Gross profit	600,000	600,000
Gross profit ratio (percent)	(60)	(75)
Gain to be reported for:		
1. Taxable year of sale:		
(a) 60% of $300,000 (payments "received" of $100,000 cash and $200,000 value of like property)	180,000	
(b) 75% of $100,000 (cash payments)		75,000
2. Succeeding taxable year:		
(a) 60% of $700,000 (cash received)	420,000	
(b) 75% of $700,000 (cash received)		525,000
Total gain recognized	600,000	600,000
3. Basis of like kind property received	200,000	200,000

I. Installment Obligations Distributed in a 12-Month Corporate Liquidation (sec. 2 of the bill and new sec. 453(h) of the Code)

Present law

Under present law, gain or loss is not generally recognized at the corporate level for sales and exchanges occurring during the 12-month [21] period after the corporation has elected a plan of complete liquidation (Code sec. 337). A special rule provides that in this situation gain or loss generally is not recognized to the liquidating corporation for distributions of installment obligations (Code sec. 453(d) (4)(B)). Gain or loss is recognized by the shareholders with respect to the liquidating distributions. No special exception applies for the distribution of installment obligations to shareholders so that the shareholders may defer reporting gain from the obligations.

Reasons for change

The committee believes that the treatment of a shareholder receiving installment obligations from a liquidating corporation should be generally similar to the treatment accorded a shareholder selling stock to an unrelated third party purchaser on the installment method. The bill is intended to facilitate the purchase of a corporate business by providing similar installment treatment to the seller whether or not the corporate assets or stock in the corporation is sold.

Explanation of provision

Under the bill, in the case of a corporate liquidation the receipt by a shareholder (under Code sec. 331) of an installment obligation which was received by the corporation during its 12-month liquidation period (under Code sec. 337) generally will not be treated as the receipt of payment by the shareholder.[27] Instead, the shareholder may report gain from the exchange of stock on the installation method, taking gain into account as payments are received on the installment obligation received as a liquidating distribution. Where a parent liquidating corporation had a subsidiary which received an obligation during the subsidiary's liquidation (to which sec. 337(c)(3) applied) that obligation also will qualify for installment reporting by the shareholders of the parent corporation. However, in no event will obligations received by the liquidating corporation from the sale of inventory, other than from the bulk sale, qualify for installment treatment by the shareholder.

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[25] This provision includes like kind exchanges (sec. 1031), exchanges of certain insurance policies (sec. 1035), certain exchanges of stock of the same corporation (sec. 1036), and certain exchanges of United States obligations (sec. 1037).

[26] This is the same rule as presently set forth in Rev. Rul. 65-155, *supra.*

[27] This treatment will apply to the target company in an acquisition if it is treated as having liquidated under Code section 337 (Rev. Rul. 69-6, 1969-1 C.B. 104). Further, in the case of a corporate acquisition involving the use of a "transitory" or "phantom" company, the obligations issued by the acquiring parent company would be considered issued by the "purchaser", although the assets of the acquired company are technically transferred to the transitory company set up to effect the acquisition, if that company is disregarded for Federal tax purposes under present law.

Where liquidating distributions are received by a shareholder in more than one taxable year, the shareholder will be required to recompute the gain reported from the liquidation by allocating basis in the stock pro rata over all payments received (or to be received). This may require amended returns if all of the liquidating distributions are not received during the same taxable year of the shareholder.

The following example will illustrate the operation of this rule. Assume that the taxpayer is the sole shareholder of a corporation with an adjusted basis of $200,000 in the stock (all of the stock (all of the stock having been acquired in the same transaction at the same cost), and is a calendar year taxpayer. Also, assume that the corporation adopts a plan of liquidation in July 1982, that the corporation sells all of its assets in August 1982 to an unrelated purchaser for $1 million, consisting of [22] $250,000 in cash and an installment note for $750,000, that the entire gain qualifies for nonrecognition under section 337, that there is no imputed interest income or original issue discount, that the corporation distributes the cash in November 1982 and that the note is distributed in complete liquidation in June 1983. The taxpayer would initially report a gain of $50,000 in 1982 ($250,000 cash received less $200,000 basis in the stock).

After the distribution of the note in 1983, under the installment method, the taxpayer would recompute the gain reported in 1982 by allocating basis according to the installment sales rules. Thus, 75 percent ($750,000 (face amount of installment obligation) divided by $1 million (total distribution)) of the taxpayer's basis in the stock, or $150,000 (75 percent times $200,000) would be allocated to the installment obligation. Further, 25 percent ($250,000 divided by $1 million) of the taxpayer's basis in the stock or $50,000 (25 percent times $200,000) is allocated to the distribution of the cash. The taxpayer thus is required to file an amended return for 1982 to reflect an additional $150,000 of gain (cash received of $250,000 less the sum of $50,000 basis and $50,000 gain initially reported). Eighty percent of each payment on the note (other than interest) must be reported as gain by the taxpayer (gain of $600,000 ($750,000 face amount of obligation less basis of $150,000) divided by $750,000 (contract price)).

Under the bill, nonrecognition treatment will not be available to the extent the obligation is attributed to a sale of depreciable property by the corporation if the installment purchaser is either the shareholder-distributee's spouse, or a corporation or a partnership which is 80-percent owned by the shareholder-distributee and/or his spouse.[28] This provision applies if the property sold by the corporation is depreciable in the hands of the purchaser. Under the provision, gain will be recognized by the shareholder for his taxable year in which the installment obligation is distributed.

Finally, if another related party (a person who is not covered by the preceding special recognition rule but who is related within the meaning of new sec. 453(f)(1)) purchases the corporate assets and then disposes of them, the related party disposition rules (as previously described under part F of this report) will apply to the shareholder who received the related party's installment obligations as a liquidating distribution. In other words, in these cases, the shareholder-distributee will be substituted for the liquidated corporation for purposes of applying the related party resale rules provided under the bill.

J. Sales Subject to a Contingency (sec. 2 of the bill and new sec. 453(i) of the Code)

Present law

As a general rule, installment reporting of gain from deferred payments is not available where all or a portion of the selling price is subject to a contingency. The case law holds that the selling price must be fixed and determinable for section 453(b) to apply.[29] An agreement, however, to indemnify the purchaser for breach of certain [23] warranties and representations by offset against the purchase price will not disqualify an installment sale under section 453(b).[30] Exactly how broad such contingencies can be is unclear.

Where an installment sale is subject to a contingency with respect to the price and the installment method is not available, the taxpayer is required to recognize all of the gain in the year of the sale with respect to all of the payments to be made, even though such payments are payable in future taxable years. In the case of a cash-method taxpayer where the future payments have no readily ascertainable fair market value, the taxpayer may treat the transaction with respect to those payments as "open" and use the cost-recovery method under *Burnet* v. *Logan,* 2830 U.S. 404 (1931).

Reasons for change

The committee believes that a taxpayer should be permitted to report gain from a deferred payment sale under the installment method even if the selling price may be subject to some contingency.

Explanation of provision

The bill permits installment sale reporting for sales for a contingent selling price. In extending eligibility, the bill does not prescribe specific rules for every conceivable transaction. Rather, the bill provides that specific rules will be prescribed under regulations.

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[28] In the case of transactions which are governed by the doctrine of liquidation-reincorporation under present law, the tax treatment for those transactions would continue to be governed by present law and would not be affected by this provision.

[29] *Gralap* v. *United States,* 458 F.2d 1158 (10th Cir. 1972); ***In re Steen,*** 509 F.2d 1398 (9th Cir. 1975).

[30] See Rev. Rul. 77-56, 1977-1 C.B. 135.

However, it is intended that, for sales under which there is a stated maximum selling price, the regulations will permit basis recovery on the basis of a gross profit ratio determined by reference to the stated maximum selling price. For purposes of this provision, incidental or remote contingencies are not to be taken into account in determining if there is a stated maximum selling price. In general, the maximum selling price would be determined from the "four corners" of the contract agreement as the largest price which could be paid to the taxpayer assuming all contingencies, formulas, etc., operate in the taxpayer's favor. Income from the sale would be reported on a pro rata basis with respect to each installment payment using the maximum selling price to determine the total contract price and gross profit ratio. If, pursuant to standards prescribed by regulations, it is subsequently determined that the contingency will not be satisfied in whole or in part, thus reducing the maximum selling price, the taxpayer's income from the sale would be recomputed. The taxpayer would then report reduced income, as adjusted, with respect to each installment payment received in the taxable year of adjustment and subsequent taxable years. If the maximum price is reduced in more than one taxable year, *e.g.*, because of successive changes in the status of the contingency, each such year of reduction would constitute an adjustment year.

Where the taxpayer has reported more income from installment payments received in previous taxable years than the total recomputed income, the taxpayer would be permitted to deduct the excesses in the adjustment year as a loss.

In cases where the sales price is indefinite and no maximum selling price can be determined but the obligation is payable over a fixed period of time, it is generally intended that basis of the property sold would be recovered ratably over that fixed period. In a case where the selling price and payment period are both indefinite but a sale has in [24] fact occurred, it is intended that the regulations would permit ratable basis recovery over some reasonable period of time. Also, in appropriate cases, it is intended that basis recovery would be permitted under an income forecast type method.[31]

The creation of a statutory deferred payment option for all forms of deferred payment sales significantly expands the availability of installment reporting to include situations where it has not previously been permitted. By providing an expanded statutory installment reporting option, the Committee believes that in the future there should be little incentive to devise convoluted forms of deferred payment obligations to attempt to obtain deferred reporting. In any event, the effect of the new rules is to reduce substantially the justification for treating transactions as "open" and permitting the use of the cost-recovery method sanctioned by *Burnet* v. *Logan,* 283 U.S. 404 (1931). Accordingly, it is the Committee's intent that the cost-recovery method not be available in the case of sales for a fixed price (whether the seller's obligation is evidenced by a note, contractual promise, or otherwise), and that its use be limited to those rate and extraordinary cases involving sales for a contingent price where the fair market value of the purchaser's obligation cannot reasonably be ascertained.

K. ELECTION OF INSTALLMENT METHOD BY ACCRUAL METHOD DEALER (SEC. 2 OF THE BILL AND SECS. 453(C) AND 481(D) OF THE CODE)

Present law

Under present law (Code sec. 453 (c)), an accrual basis dealer in personal property who elects to change to the installment method of accounting must include in income the gain attributable to payments received with respect to sales which had been included in income for taxable years prior to electing the installment method. In mitigation for double inclusion of income from the sales, an adjustment to tax is permitted. However, the amount of the adjustment is limited to the lesser of the portion of income tax attributable to inclusion in income for the taxable year of sale or the portion of income tax attributable to inclusion of the gross profit for the taxable year in which installment payments are received. The formula for determining the tax "attributable to" the inclusion of the gain in income results in a higher total tax for both years taken together than if the gain had been reported only once.

Reasons for change

The committee believes that the mechansim for adjustment of tax under present law imposes unnecessary complexities upon dealers who [25] elect the installment method of reporting. Further, the committee believes that previously reported gains should not have to be reported for another taxable year because the second inclusion in income is a form of double taxation, notwithstanding the tax adjustments permitted under present law.

Explanation of provision

Under the bill, an accrual method dealer who elects the installment method of reporting will report gain as payments are received only for sales made on or after the effective date of the installment method election (Code sec. 481(a)).

It is intended that, under Treasury regulations, a failure to report the full amount of gain from sales may be treated as an election of the installment method. For example, it is intended that a dealer, who treats a transaction as a lease of personal property and only reports the payments received as rental income, may be eligible for installment reporting under the regulations if the transaction is recharacterized as a sale rather than a lease in an audit by the Internal Revenue Service. However, it is intended that no taxpayer who has reported sales under the accrual method will be required to change from that method under the regulations.

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[31] In general, the income forecast method for basis recovery is considered appropriate for a transaction with respect to which it may be demonstrated that receipts will be greater for the earlier years of the payment period and then decline for the later years of the payment period. It is intended that the regulations will deal with the application of this method with respect to sales of property qualifying for depreciation under the income forecast method (e.g., movies), mineral rights when the selling price is based on production, a sale under which the amount payable to the seller is based on a declining percentage of the purchaser's revenues, and similar sales. In developing these regulations, the committee intends that the Treasury Department will prescribe rules for this method to avoid, whenever possible, leaving a seller with an unrecovered basis in the obligation, and thereby creating a capital loss, after the final payment is received. For qualifying transactions, a more rapid basis recovery under this method is to be allowed even if there is a fixed period over which payments are to be received.

L. Transfers of Installment Obligations to Life Insurance Companies (sec. 2 of the bill and new sec. 453B(e)(2) of the Code)

Present law

Generally, under present law, any unreported gain must be recognized when a taxpayer disposes of an installment obligation. However, in the case of certain tax-free transfers, disposition of an installment obligation will not trigger the recognition of gain. In these cases, the transferee succeeds to the basis of the installment seller and reports the remaining gain as payments are received. Under a special rule (Code sec. 453(d)(5)), transfers of installment obligations to a life insurance company are not eligible for nonrecognition treatment for otherwise tax-free transfers.

Reasons for change

The committee believes that transfers of installment obligations to life insurance companies should be eligible for the same nonrecognition treatment provided for transfers to other taxpayers if any remaining gain will be taken into account by the life insurance company as taxable investment income.

Explanation of provision

Under the bill, the special disposition rules for transfers of obligations to a life insurance company will not apply if the life insurance company elects to report any remaining gain as investment income (under Code sect. 804 (b)) as payments are received.

M. Cancellation of Installment Obligation (sec. 2 of the bill and new sec. 453B(f) of the Code)

Present law

Under present law, some have argued that the installation obligation disposition rules can be avoided by making gift cancellations of the obligation or the installments as they come due. In other words, by making an installment sale and then cancelling the obligation or a [26] number of installment payments, it is argued that the seller will incur no income tax liability, but possibly some gift taxes, and the buyer will have a cost basis in the property sold although no income tax cost will have been incurred on the transaction. If a direct gift is made, the donee's basis is generally the same as the donor's basis rather than a "cost" basis which reflects future payments which will never be made.

This cancellation technique is based on a District Court's decision in *Miller* v. *Usry.*[32] In that case, the court held that the disposition rules for obligations disposed of other than by sale or exchange were directed at corporate transfers and should not be applied to a cancellation of the obligation where there has been no actual, real, or material gain to the taxpayer. The court did not consider the possible benefit to the donee from acquiring a cost basis through the installment sale. Next, the court held that the disposition rules for satisfaction at other than face value did apply to a cancellation but no tax was incurred because no amount was realized by the taxpayer.

Reasons for change

The committee believes that present law should be clarified to make it clear that the installment obligation disposition rules cannot be circumvented by cancelling the obligation.

Explanation of provision

The bill makes it clear that the cancellation of an installment obligation is treated as a disposition of the obligation. In the case where the obligor is a related party, the amount taken into account as a disposition triggering recognition of unreported gain attributable to the obligation is not to be less than the face amount of the installment obligation.

N. Bequest of Obligation to Obligor (sec. 3 of the bill and new sec. 691(a)(5) of the Code)

Present law

Under present law, the installment obligation disposition rules do not apply to the transmission of installment obligations at death (Code secs. 453(d)(3) and 691(a)(4)). However, unreported gains, attributable to installment obligations are treated as items of gross income in respect of a decedent so that the recipient in taxed upon receipt of the installment payments in the same manner as the deceased seller would have been had he lived to receive the payments. A special rule allows a deduction for the estate taxes attributable to the unreported gain on the installment obligation (Code sec. 691(c)).

Another provision (Code sec. 691 (a)(2)) provides that the transfer of an installment obligation to the estate of the deceased seller will not be treated as a transfer requiring the reporting of gain. In addition, this rule applies to a transfer to a person pursuant to the right of such person to receive the installment obligation by reason of the death of the seller or by bequest, devise, or inheritance from the seller.

Reasons for change

Because of these rules, it has been argued that any unreported gain remaining at the death of the seller will never be taxed if the installment obligation is left to the obligor. In this case, it is argued that [27] there will never be a disposition or collection of the unpaid balance because there has been a merger of interests of obligor and obligee. In other words, the obligor will have acquired a cost basis for depreciation and resale purposes prior to the seller's death, but no income tax cost will have been incurred with respect to the gain unreported by the seller at the time of his death.

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[32] 160 F. Supp. 368, 58-1 USTC ¶ 9393 (W.D. La. 1958).

The committee believes that present law should be clarified so that the installment obligation disposition rules apply with respect to a cancellation by reason of death of the holder of the obligation.

Explanation of provision

The bill provides that any previously unreported gain from an installment sale will be recognized by a deceased seller's estate if the obligation is transferred or transmitted by bequest, devise, or inheritance to the obligor or is cancelled by the executor.

In the absence of some act of cancelling the obligation by distribution or notation which results in cancellation under the Uniform Commercial Code or other local law, the disposition will be considered to occur no later than the time the period of administration of the estate is concluded.

If the cancellation occurs at the death of the holder of the obligation, the cancellation is to be treated as a transfer by the estate of the decedent. However, if the obligation were held by a person other than the decedent, such as a trust, the cancellation will be treated as a transfer immediately after the decedent's death by that person.

If the decedent and the obligor were related persons (within the meaning of new Code section 453(f)(1)), the fair market value of the obligation for disposition purposes is not to be treated as less than its face amount.

For purposes of this provision, if an installment obligation becomes unenforceable, it will be treated as if it were cancelled.

O. Foreclosure of Real Property Sold on Installment Method by Deceased Taxpayer (sec. 4 of the bill and sec. 1038 of the Code)

Present law

Under present law, the recognition of gain upon a reconveyance of real property to the seller in partial or full satisfaction of purchase money debt is limited (Code sec. 1038). Losses, including bad debt losses, are also not recognized upon a reconveyance of real property. With respect to gains, the amount of gain required to be recognized upon reconveyance of the real property sold generally is limited to the lesser of the amount of any remaining unreported portion of the original gain or the amount by which the sum of the money and fair market value of property received prior to the reacquisition exceeds the amount of gain previously reported. The Internal Revenue Service has ruled that this provision does not apply to a reconveyance to the estate of a deceased taxpayer who made the original sale (Rev. Rul. 69-83, 1969-1, C.B. 202). In other words, a decedent's estate is not permitted to succeed to the tax treatment which would have been available to the decedent had he lived to receive, the reconveyance because the estate is considered to be a separate taxable entity.

Reasons for change

The committee believes that a decedent's estate (or other person inheriting a decedent's installment obligation) should be entitled to [28] the same limitations on recognition of gain upon the reconveyance of real property in satisfaction of an obligation to which the decedent would have been entitled if the decedent had survived.

Explanation of provision

Under the bill, the estate or beneficiary of a deceased seller will be entitled to the same nonrecognition treatment upon the acquisition of real property in partial or full satisfaction of secured purchase money debt as the deceased seller would have been entitled.

The basis of the property acquired will be the same as if the property had been reacquired by the original seller, increased by an amount equal to the section 691(c) deduction for estate taxes which would have been allowable had the repossession been taxable.

The committee intends that no inference is to be drawn from this provisions as to the application of present law.

P. Character of Gain from Sales of Depreciable Property Between Related Parties

(Sec. 5 of the bill and sec. 1239 of the Code)

Present law

Under present law, gain from the sale or exchange of depreciable property between certain related parties is denied capital gains treatment (and is taxed as ordinary income). Related parties include husband and wife, an individual and an 80-percent controlled corporation, and two 80-percent controlled corporations. The attribution rules of Code section 318 are generally applied to determine ownership in a corporation.

Reasons for change

The committee believes that the same related party rules should apply with respect to the characterization of income from sales of depreciable property between a husband and wife or their controlled entity and to the special installment sale rules for sales of depreciable property between husband and wife, or their controlled entity. For these purposes, the committee also believes that the attribution of ownership rules should be narrowed to exclude family members other than husband and wife.

Explanation of provision

Under the bill, the provision of section 1239(a) denying capital gain treatment on the sale or exchange of depreciable property will apply to sales between husband and wife, between the taxpayer and a partnership or corporation which is 80-percent owned by the taxpayer and/or the taxpayer's spouse; and between partnerships and corporations which are 80-percent owned by the taxpayer and/or the taxpayer's spouse. For these purposes, the person treated as the owner of a trust under the grantor trust rules is to be treated as the owner of the assets in the trust.

Under the provision, ownership, is to be attributed in accordance with the principles under the general corporate ownership attribution rules (Code sec. 318) except that an individual's family will only include a spouse and the entity attribution rules will be applied without regard to the percentage of ownership limitations.

[29] Q. Effective Date (sec. 6 of the bill)

In general, the provisions of the bill are effective for dispositions of property, cancellations and reacquisitions of real property, as the case may be, occurring after the date of enactment. The provisions which eliminate the 30-percent initial payment and the two or more payments requirements are effective for transactions occurring in taxable years ending after the date of enactment.

However, the related party installment sale rules would apply to installment sales (first dispositions) after May 14, 1980. The provision relating to the distribution of installment obligations in connection with a 12-month corporate liquidation would apply with respect to installment obligations distributed after March 31, 1980. (A liquidating distribution made after March 31, 1980, will qualify for nonrecognition treatment to a shareholder even if the obligation is from a sale which is ineligible for installment reporting by the corporation because the sale occurred before the effective date of the other rules revised or eliminated under the bill.)

* * * * *

Part III. Administrative, Procedural, and Miscellaneous

Delegation Order No. 51 (Rev. 5) (Effective September 29, 1980)

Proofs of Claim in Insolvency Proceedings

1. Pursuant to the authority vested in the Commissioner of Internal Revenue by 26 CFR 301.7701-9 and 26 CFR 301.6871, the authority to sign proofs of claim and other documents asserting the obligations incurred under the Internal Revenue laws (including taxes, penalties and interest), in order to claim and collect such obligations in any proceeding under the Bankruptcy Act, Bankruptcy Code and any receivership, decedent's estate, corporate dissolution, or other insolvency proceeding is hereby redelegated to the following officers:

Chief, Special Procedures Staff
Chief, Technical and Office Compliance Branch
Chief, Technical and Office Compliance Group in streamlined districts

2. The authority in Section 1 may be redelegated but no lower than the following:

Special Procedures Officers
Advisors no lower than grade 12
Advisor/Reviewers no lower than grade 12

This Order supersedes Delegation Order No. 51 (Rev. 4), issued March 21, 1979 [1979-1 C.B. 475].

Jerome Kurtz
Commissioner.

(Filed by the Office of the Federal Register on October 2, 1980, 8:45 a.m., and published in the issue of the Federal Register for October 3, 1980, 45 F.R. 65763)

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26 CFR 601.105: Examination of returns and claims for refund, credit or abatement; determination of correct tax liability.
(Also Part I, Section 167; 1.167(a)-11.)

Rev. Proc. 80-58

SECTION 1. PURPOSE

In this revenue procedure, the Assistant Secretary (Tax Policy) of the Treasury prescribes certain changes in the Class Life Asset Depreciation Range System. The purpose is to delete existing asset guideline classes 15.1 (Contract Construction Other than Marine) and 15.2 (Marine Contract Construction), which also includes assets used in offshore oil and gas drilling, and to establish two new classes with new depreciation periods and ranges, and annual repair allowance percentages for assets used in construction and in offshore oil and gas drilling. These changes are adopted pursuant to section 1.167(a)-11 of the Income Tax Regulations.

The new asset guideline classes, and associated asset guideline depreciation periods, asset depreciation ranges, and annual asset guideline repair allowance percentages are set forth in Section 2 of this revenue procedure.

SEC. 2. ASSET GUIDELINE CLASSES, ASSET DEPRECIATION RANGES, AND ANNUAL ASSET GUIDELINE REPAIR ALLOWANCE PERCENTAGES

The asset guideline classes, asset guideline periods, asset depreciation ranges, and the annual asset guideline repair allowance percentages are prescribed as set forth below.

Asset Guideline Class	Description of Assets Included	Asset Depreciation Range (in years) Lower Limit	Asset Guideline Period	Upper Limit	Annual Asset Guideline Repair Allowance Percentage
13.0	*Offshore Drilling:* Includes assets used in offshore drilling for oil and gas such as floating, self-propelled and other drilling vessels, barges, platforms, and drilling equipment and support vessels such as tenders, barges, towboats and crew boats. Excludes oil and gas production assets	6	7.5	9	3
15.0	*Construction:* Includes assets used in construction by general building, special trade, heavy and marine construction contractors, operative and investment builders, real estate subdividers and developers, and others except railroads	5	6	7	9

SEC. 3. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 77-10, 1977-1 C.B. 548, as modified, is further modified by the deletion of existing asset guideline classes 15.1 (Contract Construction Other than Marine) and 15.2 (Marine Contract Construction) and the prescription of two new asset guideline classes 13.0 (Offshore Drilling) and 15.0 (Construction) with new asset guideline periods and asset depreciation ranges and annual asset guideline repair percentages. To be consistent with the aforementioned modifications, the reference to Class 15.2 in asset guideline class 13.2 should now read Class 13.0.

SEC. 4. EFFECTIVE DATE

The revisions set forth in this revenue procedure are effective as of December 29, 1980, the date of publication in the Internal Revenue Bulletin.

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26 CFR 601.602: Forms and instructions.
(Also Part I, Section 6012; 1.6012-1.)

Rev. Proc. 80-59

SECTION 1. PURPOSE

The purpose of this revenue procedure is to establish the conditions under which a Presidential appointee who has an interest in a blind trust that meets the requirements of section 202(f)(4)(B) of the Ethics in Government Act of 1978, P.L. 95-521, 92 Stat. 1825 (1978), will be granted permission to have a trustee file the appointee's income tax return and to state the procedure that the trustee must follow in filing the appointee's income tax return.

SEC. 2. CHANGES

This revenue procedure modifies Rev. Proc. 79-43, 1979-2 C.B. 507, by setting forth the requirement that the letter granting permission for the trustee to make the appointee's return and a power of attorney both accompany the appointee's income tax return. It also sets forth the effect the Internal Revenue Service will give the power of attorney.

SEC. 3. BACKGROUND

.01 Section 202(f)(4)(B) of the Ethics in Government Act of 1978 provides that in the case of a trust created for the benefit of an individual appointed by the President, by and with the consent of the Senate, an asset placed in trust will not be considered a financial interest of the individual for purposes of section 208 of title 18, United States Code, and any other conflict of interest statutes or regulations if certain requirements are met including giving the trustee the power to prepare on behalf of the individual the personal income tax return and similar returns which may contain information relating to the trust.

.02 Section 1.6012-1(a)(5) of the Income Tax Regulations, concerning returns made by agents, permits a return to be made by an agent if the taxpayer requests permission, in writing, of the appropriate district director and the district director determines that good cause exists for permitting an agent to make the return. That section provides that whenever a return is made by an agent it must be accompanied by a power of attorney (or copy thereof) authorizing the agent to represent the principal in making the return.

.03 Section 601.502(c)(1) of the Statement of Procedural Rules provides that a power of attorney which specifies the specific act to be performed is required if a taxpayer wishes to authorize his or her representative to perform any of the following acts: (1) Receive (but not endorse or collect) a check in payment of any refund of taxes, penalties or interest; (2) Execute a waiver of restriction on assessment or collection of a deficiency in tax, or a waiver of notice of disallowance of a claim for credit or refund; (3) Execute a consent to extend the statutory period for assessment or collection of a tax; or (4) Execute a closing agreement under section 7121 of the Code.

.04 Section 601.506(a) of the Statement of Procedural Rules provides that any notice or communication (or a copy thereof) required or permitted to be given to a taxpayer in any matter before the Service shall be given to the taxpayer's recognized representative. However, if such notice or communication contains confidential information with respect to the taxpayer, the notice or communication will be given to the representative only if there is on file with the Service a power of attorney or a tax information authorization in the matter signed by the taxpayer.

SEC. 4. PROCEDURE

.01 A presidential appointee who has an interest in a blind trust that meets the requirements of section 202(f)(4)(B) of the Ethics in Government Act of 1978 and who requests permission, in writing, of the appropriate district director, for the taxpayer's federal income tax return to be filed by the trustee of the blind trust, will be considered to have shown good cause for receiving permission to have the return filed by the trustee, and will automatically be granted such permission. A separate request must be made for each taxable year.

.02 The trustee must submit with the return a copy of the letter from the Internal Revenue Service granting the trustee permission to sign the appointee's return. In addition, the return must be accompanied by a power of attorney (or copy thereof) that grants the trustee authority to sign the return, to receive (but not endorse or collect) a refund check, to execute a waiver of restriction on assessment or collection, to execute a waiver of notice of disallowance, to execute a consent to extend the period for assessment or collection, and to execute a closing agreement.

.03 All notices or other written communication required or permitted to be given to the appointee will be given to the trustee.

SEC. 5. EFFECTIVE DATE

This revenue procedure is effective as of December 29, 1980, the date of its publication in the Internal Revenue Bulletin.

SEC. 6. EFFECT ON OTHER DOCUMENTS

Rev. Proc. 79-43 is modified and superseded.

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26 CFR 601.602: Forms and instructions.
(Also Part I, Section 3302; 31.3302(c)-1.)

Rev. Proc. 80-60 [1]

SECTION 1. PURPOSE

The purpose of this revenue procedure is to bring up to date the procedure to be followed in computing reductions in the credit against the tax reportable on Form 940, Employer's Annual Federal Unemployment Tax Return, for 1980.

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[1] Also released as News Release IR-80-131, dated December 17, 1980.

SEC. 2. BACKGROUND

.01 Section 3301 of the Internal Revenue Code imposes an excise tax on employers based on wages paid to employees. Section 3306(a) defines the term "employer" for purposes of the tax imposed by section 3301.

.02 Section 3302 of the Code provides for credits against the tax imposed by section 3301. Reductions in the amount of credit otherwise allowable are provided for in section 3302(c). Section 3302(c)(2) provides that reductions shall occur if an employer pays wages for services performed in a state that has not restored amounts that were advanced under title XII of the Social Security Act, 42 U.S.C. sections 1321-1324(1976).

.03 Section 3302(c)(2)(A) of the Code, in conjunction with section 3302(d), provides that for each consecutive calendar year beginning with the second consecutive calendar year in which the advances have not been repaid, the reduction is equal to 0.3 percent of the wages (as defined in section 3306(b)) paid.

.04 Section 3302(c)(2)(B) of the Code provides for an additional reduction for the third or fourth consecutive year in which the advances have not been repaid if the average employer contribution rate for such state for the preceding year is less than 2.7 percent. Section 3302(d)(7) provides that the percentage of the additional reduction is determined by the Secretary of Labor.

.05 Section 3302(d)(3) of the Code provides that credit reductions for any year may be forestalled if a state restores to the United States Treasury, before November 10 of that year, the full amount of the advances.

.06 For purposes of the tax imposed by section 3301 of the Code, section 3306(j)(1) provides that the term "State" includes the District of Columbia, the Commonwealth of Puerto Rico, and the Virgin Islands.

SEC. 3. CREDIT REDUCTIONS FOR 1980

.01 As of November 10, 1980, the Commonwealth of Puerto Rico, the Virgin Islands, and the States of Illinois, Maine, and New Jersey had not repaid the advances for the second consecutive year, within the meaning of section 3302(c)(2) of the Code. Therefore, the credit reductions will take effect in the amount of 0.3 percent of the wages (as defined in section 3306(b)) paid by employers during 1980 that are attributable to those "States."

.02 As of November 10, 1980, the District of Columbia and the States of Delaware, Pennsylvania, Rhode Island, and Vermont had not repaid the advances for the third consecutive year, within the meaning of section 3302(c)(2) of the Code. Therefore, the credit reductions will take effect in the amount of 0.6 percent of the wages (as defined in section 3306(b)) paid by employers during 1980 that are attributable to those "States."

.03 As of November 10, 1980, the State of Connecticut had not repaid the advances for the third consecutive year, within the meaning of section 3302(c)(2) of the Code. Also, the Secretary of Labor has timely certified to the Secretary of the Treasury that in accordance with the provisions of section 3302(c)(2)(B) an additional credit reduction will apply. Therefore, the credit reduction will take effect in the amount of 0.7 percent (0.6 percent for the two consecutive years plus an additional 0.1 percent) of the wages (as defined in section 3306(b)) paid by employers during 1980 that are attributable to the State of Connecticut.

SEC. 4. PROCEDURE

.01 If a credit reduction applies, it is computed on Part I, lines 6 and 7, of the Form 940 for 1980.

Social Security Contribution and Benefit Base

Under authority contained in the Social Security Act, the Secretary, Department of Health and Human Services, has determined and announced (F.R. 76252, dated November 18, 1980) that the contribution and benefit base for remuneration paid in 1981 and self-employment income earned in taxable years beginning in 1981 is $29,700.

Part IV. Items of General Interest

Form 6478, Credit for Alcohol Used as Fuel

Announcement 80-158

Form 6478, Credit for Alcohol Used as Fuel, has been developed to figure the credit for alcohol used as a fuel after September 30, 1980.

The credit is allowed for sales or uses of alcohol mixed with other fuels and for straight alcohol fuel.

The credit is 40 cents a gallon for 190 proof alcohol. A lesser credit of 30 cents a gallon is allowed for alcohol that is at least 150 proof but less than 190 proof.

The form is now available at Internal Revenue Service offices.

Foundation Status of Certain Organizations

Announcement 80-160

The following organizations have failed to establish or have been unable to maintain their status as public charities or as operating foundations. Accordingly, grantors and contributors may not, after this date, rely on previous rulings or designations in the Cumulative List of Organizations (Publication 78), or on the presumption arising from the filing of notices under section 508(b) of the Code. This listing does *not* indicate that the organizations have lost their status as organizations described in section 501(c)(3), eligible to receive deductible contributions.

Former Public Charities. The following organizations (which have been treated as organizations that are not private foundations described in section 509(a) of the Code) are now classified as private foundations:

Action from Chinese Teens, Inc., Boston, MA
Adams Scholarship Fund, Inc., Christopher J., Cheshire, CT
Allen County Emergency Assistance, Inc., Arcola, IN
Alumni Association of the Columbus School for Girls, Inc., Columbus, OH
Association of Home Community Services for Disabled Citizens, Columbus, OH
Bergen Street Block Assn., Newark, NJ
Brown Memorial Convalescent Center, Inc., Royston, GA
Calvert City Convalescent Center, Inc., Calvert City, KY
Cedar Ridge High School Band Parents, The, Old Bridge, NJ
Christian Answers, Inc., Atlanta, GA
Christian Freedom Ministries, Columbus, OH
Christian Singles Foundation, Inc., South Hamilton, MA
Cincinnati Chamber Orchestra, Cincinnati, OH
Coastal Theatre Workshop, Inc., Brunswick, ME
Corbin Senior Citizens Center, Inc., Corbin, KY
Cultural Arts Council of East Haven, Inc., East Haven, CT
Cupola, Inc., Columbus, OH
Elderlove, Inc., Evansville, IN
Families and Friends of Prisoners, Inc., Dorchester, MA
Franconia Children's Center, Inc., The, Franconia, NH
Friends of Vietnamese Refugees, Inc., Louisville, KY
Frontier Community Services, Chillicothe, OH
Goals for Raleigh/Wake, Raleigh, NC
Greencroft Assisted Living, Inc., Goshen, IN
Hiltown Transportation Service, Inc., Cuminington, MA
Hollon House, Inc., Georgetown, KY
Home Health Services of Greater Dekalb County Inc., Tucker, GA
Housatonic Art League, New Milford, CT
Housing Services of the Philadelphia Region, The, Philadelphia, PA
Human Support Network, Inc., Muncie, IN
Indiana Citizens Council on Alcoholism, Inc., Indianapolis, IN
Institution Educational Services, Inc., Concord, NH
Internatioinal Adoptions, Inc., Newton, MA
Kids that Care, Incorporated, Dayton, OH
Lawrence High School Athletic Booster Club, Lawrenceville, NJ
Living Waters Christian Singers, Bristol, CT
Loft Horizons Ltd., Providence, RI
Lutheran Education Charitable Trust, Fort Wayne, IN
Lynn Dally Dance Company, Columbus, OH
Messianic Center of New England, Inc., Lynn, MA
Mt. Healthy Athletic Boosters Club, Mt. Healthy, OH
Music Theatre of Boston, Inc., The, Boston, MA
N.A.C.C.A.N., Inc., Nashua, NH
New Life Ministries, Inc., Louisville, KY
North Carolina Foster Parents Association, Charlotte, NC
Old Stoney, Inc., Frankfort, IN
Randolph Youth Services, Inc., Winchester, IN
SREA Memorial Scholarship Fund, Inc., Dayton, OH
St. Johnsbury Television Cooperative, St. Johnsbury, VT
Servants of the Cross, Brunswick, MA
Southern Lancaster County Community Fair Association, The, Quarryville, PA
Spencer County Association for the Retarded, Inc., Rockport, IN
Stow Youth Hockey, Inc., Stow, MA
Strafford County Human Services Coordinating Council, Dover, NH
Vermont Chapter of the National Wild Turkey Federation, Inc., Wallingford, VT
Walterboro Police Pistol Club, Inc., Walterboro, SC
Wells Day Care Center, South Toms River, NJ
West Hartford Volunteer Ambulance, Inc., The, West Hartford, CT
Retirement Society, Inc., Whitinsville, MA
William Shakespeare Co., Camden, ME
Worcester Forum for the Study of Values, Inc., Worcester, MA

If an organization listed above submits information that warrants the renewal of its classification as a public charity or as a private operating foundation, the Internal Revenue Service will issue a ruling or determination letter with the revised classification as to foundation status. Grantors and contributors may thereafter rely upon such ruling or determination letter as provided in section 1.509(a)-7 of the Income Tax Regulations. It is not the practice of the Service to announce such revised classification of foundation status in the Internal Revenue Bulletin.

New Short Form Gift Tax Return

Announcement 80-161

A new Form 709-A, United States Short Form Gift Tax Return, will be available for filing in 1981 to cover gifts made in calendar year 1980. For many taxpayers, Form 709-A will be easier to complete than the longer Form 709. For example, the form may be used in situations where a gift tax return is required to elect gift splitting, but no gift tax is due because of the spouses' combined annual exclusions.

Revised Extension Forms 2350, 2688, and 4868

Announcement 80-162

Forms 2350, Application for Extension of Time to File, 2688, Application for Extension of Time to File, and 4868, Application for Automatic Extension of Time to File U.S. Individual Income Tax Return, have been revised to reflect the provisions of Pub. L. 96-167, 1980-1 C.B. 483, which amended section 6075(b) of the Code. That section, as amended, provides that any extension of time granted a taxpayer for filing a calendar year income tax return also extends the time granted the taxpayer for filing a gift tax return that is due by April 15th following the close of the fourth calendar quarter.

A line has been added to Form 4868 so the taxpayer can enter and pay any expected gift tax that will be due on the gift tax return.

Forms 2688 and 2350 have been changed from continuous-use forms to annual forms. They will therefore now have a year designation. Form 2688 (Revised October 1978) and Form 2350 (Revised January 1980) should not be used for tax years beginning in 1980.

The revised forms will be available at Internal Revenue Service offices after January 1, 1981.

Applications for recognition of Exemption Under Section 501(c)(22) of the Internal Revenue Code

Announcement 80-163

The Multiemployer Pension Plan Amendments Act of 1980, Pub. L. 96-364, 1980-51 I.R.B. 14, provides tax exemption to trusts organized to accumulate funds in order to provide withdrawal liability payments to multiemployer pension plans.

To have tax exemption recognized by the Internal Revenue Service, a trust representative (an officer of the trust or a trustee) should write to the District Director of the Service key district for the trust's main office or place of business. No form has been provided for this purpose. The request should include a copy of the trust instrument and ask for a ruling under section 501(c)(22) of the Internal Revenue Code. The key District Directors and the areas they cover are listed in section 4 of Rev. Proc. 80-25, 1980-1 C.B. 667.

Separate Statement of Amount of Windfall Profit Tax Deductible No Longer Required

Announcement 80-165

Announcement 80-150, 1980-45 I.R.B. 31, listed new filing dates for annual statements and returns concerning the windfall profit tax. That announcement also required purchasers (or in some cases operators) to submit a separate statement of the amount deductible for income tax purposes to producers, operators, or partnerships by January 31, 1981.

The Service has received many comments from first purchasers and other windfall profit tax withholding agents concerning the difficulty encountered in providing the January 31, 1981, statement in a timely manner. Additionally, receipt of the separate statement showing this information in most instances will not provide royalty owners with the information needed to compute the new windfall profit tax credit. In fact, it may cause some royalty owners to attempt to complete the windfall profit tax credit Form 6249 prematurely. Accordingly, the separate statement cited in the above paragraph will not be required in the changes to the regulations mentioned in Announcement 80-150, but the information will be required to be furnished on Form 6248. Form 6248 will be due to royalty owners, producers, operators, or partnerships by March 31, 1981.

Announcement of the Disbarment, Suspension, or Consent to Voluntary Suspension of Attorneys, Certified Public Accountants, Enrolled Agents and Enrolled Actuaries from Practice before the Internal Revenue Service

Under 31 Code of Federal Regulations, Part 10, an attorney, certified public accountant, enrolled agent or enrolled actuary, in order to avoid the institution or conclusion of a proceeding for his disbarment or suspension from practice before the Internal Revenue Service, may offer his consent to suspension from such practice. The Director of Practice, in his discretion, may suspend an attorney, certified public accountant, enrolled agent or enrolled actuary in accordance with the consent offered.

Attorneys, certified public accountants, enrolled agents and enrolled actuaries are prohibited in any Internal Revenue Service matter from directly or indirectly employing, accepting assistance from, being employed by or sharing fees with, any practitioner disbarred or under suspension from practice before the Internal Revenue Service.

To enable attorneys, certified public accountants, enrolled agents and enrolled actuaries to identify practitioners under consent suspension from practice before the Internal Revenue Service, the Director of Practice will announce in the Internal Revenue Bulletin the names and addresses of practitioners who have been suspended from such practice, their designation as attorney, certified public accountant, enrolled agent or enrolled actuary, and the date or period of suspension. This announcement will appear in the weekly Bulletin at the earliest practicable date after such action and will continue to appear in the weekly Bulletins for five successive weeks or for as many weeks as is practicable for each attorney, certified public accountant, enrolled agent or enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

The following individuals have been placed under consent suspension from practice before the Internal Revenue Service:

Name	Address	Designation	Term of Suspension
H. Jim Uchida	Oakland, CA	Certified Public Accountant	Indefinite effective November 5, 1980
Stanley E. Galkin	Fort Worth, TX	Attorney	Indefinite effective November 17, 1980

Announcement of the Suspension, Termination, or Consent to Voluntary Suspension or Termination of Enrollment to Perform Actuarial Services Under the Employee Retirement Income Security Act of 1974

Under 20 Code of Federal Regulations, Part 901, an enrolled actuary, in order to avoid the initiation or conclusion of a suspension or termination proceeding, may offer his/her consent to suspension of enrollment. The Executive Director, Joint Board for the Enrollment of Actuaries, may suspend enrollment in accordance with the consent offered. An enrolled actuary whose enrollment is suspended is prohibited from performing actuarial services under the Employee Retirement Income Security Act of 1974 (ERISA) during the period of suspension.

To enable employees of the Internal Revenue Service and others to identify enrolled actuaries under suspension, the Executive Director will announce in the Internal Revenue Bulletin the names and addresses of enrolled actuaries who have been suspended. This announcement will appear in the weekly Bulletin at the earliest practicable date following suspension and will continue to appear in the weekly Bulletin for at least three successive weeks for each enrolled actuary so suspended and will later be consolidated and published in the Cumulative Bulletin.

Mr. Charles L. Cormack, Birmingham, Alabama, has been placed under consent suspension from enrollment to perform actuarial services under ERISA. An announcement of his reinstatement will be placed in the Bulletin at the end of the period of suspension.

Announcement Relating to Proposed Regulations Published With Notice of Proposed Rulemaking

Changes in regulations as announced below have been published in the Federal Register in tentative or proposed form to provide interested parties with an opportunity to file their objections or suggestions for consideration prior to final adoption of such regulations. These announcements will appear in the Bulletin during the period which has been prescribed for the submission and consideration of any views, arguments, or suggestions pertaining to the proposed regulations so published. Statement of such views, arguments or suggestions should be submitted in writing, preferably six copies, to the Commissioner of Internal Revenue, Attention: CC:LR:T, Washington, D.C. 20224.

Section affected	Subject	Published in Federal Register dated—	Expiration date for submission of views
26 CFR 150.4995-3, 150.4997-1, 150.6402-1 amended; published as temporary regulations in T.D. 7732, 1980-48 I.R.B. 19.	Tax deposits and refunds based on net income limitation.	Nov. 5, 1980	Jan. 5, 1981
26 CFR 150.4989-1(c)(1), 150.4989-1(c)(2), 150.4989-1(c)(3), 150.4989-1(c)(7), revised.	Base prices of tier 2 and tier 3 oil.	Nov. 14, 1980	Jan. 13, 1981
26 CFR 1.164-2(d) amended; 1.901-4 added.	Payments to foreign countries for oil and gas that are not considered taxes.	Nov. 17, 1980	Jan. 16, 1981
26 CFR 1.907-0 through 1.907(f)-1, added; 1.78-1(a), 1.901-1(a), 1.904-2(a), 1.904-3(e), 1.904-4(a), 1.904-5(a), 1.960-1(g), 1.1248-1(d)(1)(i), amended.	Limitation on foreign tax credit for foreign oil and gas taxes.	Nov. 17, 1980	Jan. 16, 1981
26 CFR 301.7701-2 amended.	Classification of limited liability companies.	Nov. 17, 1980	Jan. 16, 1981
26 CFR 1.901-2, 1.903-1, deleted; 4.901-2, 4.903-1, added.	Creditability of foreign taxes against U.S. income tax liability.	Nov. 17, 1980	Jan. 16, 1981
26 CFR 1.960-1 through 1.960-3, 1.960-7, revised.	Foreign tax credit for domestic corporate shareholders of certain third-tier corporations.	Nov. 19, 1980	Jan. 19, 1981
26 CFR 1.162-20, 1.6001-1(c), 1.6033-2, 53.4945-2, amended.	Treatment of expenditures for attempts to influence legislation.	Nov. 25, 1980	Jan. 26, 1981

Definition of Terms

Revenue Rulings and Revenue Procedures (hereinafter referred to as "rulings") that have an effect on previous rulings use the following defined terms to describe the effect:

Amplified describes a situation where no change is being made in a prior published position, but the prior position is being extended to apply to a variation of the fact situation set forth therein. Thus, if an earlier ruling held that a principle applied to A, and the new ruling holds that the same principle also applies to B, the earlier ruling is amplified. (Compare with *modified, below*).

Clarified is used in those instances where the language in a prior ruling is being made clear because the language has caused, or may cause, some confusion. It is not used where a position in a prior ruling is being changed.

Distinguished describes a situation where a ruling mentions a previously published ruling and points out an essential difference between them.

Modified is used where the substance of a previously published position is being changed. Thus, if a prior ruling held that a principle applied to A but not to B, and the new ruling holds that it applies to both A and B, the prior ruling is modified because it corrects a published position. (Compare with *amplified* and *clarified*, above).

Obsoleted describes a previously published ruling that is not considered determinative with respect to future transactions. This term is most commonly used in a ruling that lists previously published rulings that are obsoleted because of changes in law or regulations. A ruling may also be obsoleted because the substance has been included in regulations subsequently adopted.

Revoked describes situations where the position in the previously published ruling is not correct and the correct position is being stated in the new ruling.

Superseded describes a situation where the new ruling does nothing more than restate the substance and situation of a previously published ruling (or rulings). Thus, the term is used to republish under the 1954 Code and regulations the same position published under the 1939 Code and regulations. The term is also used when it is desired to republish in a single ruling a series of situations, names, etc., that were previously published over a period of time in separate rulings. If the new ruling does more than restate the substance of a prior ruling, a combination of terms is used. For example, *modified and superseded* describes a situation where the substance of a previously published ruling is being changed in part and is continued without change in part and it is desired to restate the valid portion of the previously published ruling in a new ruling that is self contained. In this case the previously published ruling is first modified and then, as modified, is superseded.

Supplemented is used in situations in which a list, such as a list of the names of countries, is published in a ruling and that list is expanded by adding further names in subsequent rulings. After the original ruling has been supplemented several times, a new ruling may be published that includes the list in the original ruling and the additions, and supersedes all prior rulings in the series.

Suspended is used in rare situations to show that the previous published rulings will not be applied pending some future action such as the issuance of new or amended regulations, the outcome of cases in litigation, or the outcome of a Service study.

Abbreviations

The following abbreviations in current use and formerly used will appear in material published in the Bulletin.

A, B, C, etc.—Names of individuals.
Acq.—Acquiescence.
A.R.R.—Committee on Appeals and Review recommendation.
A.T.—Alcohol and tobacco tax ruling.
B.T.A.—Board of Tax Appeals.
C.B.—Cumulative Bulletin.
CFR—Code of Federal Regulations.
C.T.—Carriers Taxing Act of 1937.
Ct.D.—Court Decision.
Del. Order—Delegation Order.
D.C.—Treasury Department Circular.
DISC—Domestic International Sales Corporations.
E.O.—Executive Order.
ERISA—Employee Retirement Income Security Act.
E.T.—Estate and gift tax ruling.
Em. T.—Employment tax ruling.
F.A.A.A.—Federal Alcohol Administration Act.
FICA—Federal Insurance Contributions Act.
F.R.—Federal Register.
FUTA—Federal Unemployment Tax Act.
G.C.M.—Chief Counsel's memorandum (formerly General Counsel's memorandum).
I.R.B.—Internal Revenue Bulletin.
IR-Mim. — Published IR-Mimeograph.
I.T.—Income tax ruling.
M, N, X, Y, Z, etc.—Names of corporations, places or businesses, according to context.
M.T.—Miscellaneous tax ruling.
Mim.—Published mimeograph.
Nonacq.—Nonacquiescence.
O.D.—Office Decision.
P.T.E.—Prohibited Transaction Exemption.
Pub.L.—Public Law.
PS—Pension, profit-sharing, stock bonus or annuity plan ruling.
R.E.I.T.—Real Estate Investment Trust.
Rev. Proc.—Revenue Procedure.
Rev. Rul.—Revenue Ruling.
R.S.—Revised Statute.
S.M.—Solicitor's Memorandum.
Sol. Op.—Solicitor's Opinion.
S.P.R.—Statement of Procedural Rules.
S.R.—Solicitor's Recommendation.
S.S.T.—Social Security Tax.
S.T.—Sales Tax Ruling.
Stat.—Statutes at Large.
T.C.—Tax Court.
T.D.—Treasury Decision.
T.I.R.—Technical Information Release.
U.S.C.—United States Code.
x and *y* represent numbers and sums of money.

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[1] See footnote at end of list.

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[1] A cumulative list of all Revenue Rulings, Treasury Decisions, etc., published in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27 dated July 7, 1980.

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71-16
Modified & Superseded by
80-51, 1980-48 I.R.B. **23**

71-16, Amendment 1
Modified & Superseded by
80-51, 1980-48 I.R.B. **23**

72-18
Amplified by
80-55, 1980-50 I.R.B. **20**

72-24
Superseded by
80-51, 1980-48 I.R.B. **23**

74-51
Modified & Superseded by
80-51, 1980-48 I.R.B. **23**

75-18
Superseded by
80-51, 1980-48 I.R.B. **23**

76-8
Modified & Superseded by
80-51, 1980-48 I.R.B. **23**

Rev. Procs.—Continued

77-47
Modified by
80-45, 1980-45 I.R.B. **26**

78-35
Modified by
80-35, 1980-37 I.R.B. **17**

79-1
Modified & Superseded by
80-54, 1980-49 I.R.B. **40**

79-26
Modified by
80-33, 1980-33 I.R.B. **21**

79-35
Modified by
80-33, 1980-33 I.R.B. **21**

79-57
Superseded by
80-47, 1980-46 I.R.B. **11**

79-58
Superseded by
80-48, 1980-46 I.R.B. **21**

79-66
Superseded by
80-52, 1980-49 I.R.B. **20**

80-7
Modified by
80-32, 1980-29 I.R.B. **27**

80-13
Superseded by
80-45, 1980-45 I.R.B. **26**

80-22
Amplified by
80-34, 1980-36 I.R.B. **34**
80-37, 1980-39 I.R.B. **22**
80-38, 1980-39 I.R.B. **22**
80-41, 1980-41 I.R.B. **18**

Revenue Rulings:
87
Modified by
80-273, 1980-41 I.R.B. **15**

54-152
Superseded by
80-306, 1980-46 I.R.B. **6**

54-167
Distinguished by
80-338, 1980-50 I.R.B. **6**

55-60
Superseded by
80-229, 1980-34 I.R.B. **8**

55-428
Amplified by
80-267, 1980-41 I.R.B. **5**

55-532
Obsoleted by
80-243, 1980-36 I.R.B. **32**

56-213
Revoked by
80-349, 1980-51 I.R.B. **6***

56-672
Amplified by
80-267, 1980-41 I.R.B. **5**

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58-214
Obsoleted by
80-237, 1980-35 I.R.B. **9**

58-310
Obsoleted by
80-243, 1980-36 I.R.B. **32**

58-502
Clarified by
80-294, 1980-44 I.R.B. **9**

59-60
Amplified by
80-213, 1980-32 I.R.B. **7**

59-185
Superseded by
80-350, 1980-51 I.R.B. **7***

59-241
Superseded by
80-229, 1980-34 I.R.B. **8**

60-161
Amplified by
80-210, 1980-31 I.R.B. **14**

61-170
Distinguished by
80-287, 1980-43 I.R.B. **12**

62-139
Modified by
80-349, 1980-51 I.R.B. **6***

62-213
Distinguished and clarified b
80-173, 1980-27 I.R.B. **8**

63-167
Obsoleted by
80-325, 1980-50 I.R.B. **6**

63-168
Obsoleted by
80-325, 1980-50 I.R.B. **6**

63-169
Obsoleted by
80-325, 1980-50 I.R.B. **6**

65-234
Obsoleted by
80-243, 1980-36 I.R.B. **32**

65-294
Superseded by
80-229, 1980-34 I.R.B. **8**

66-61
Superseded by
80-353, 1980-51 I.R.B. **9***

66-205
Superseded by
80-306, 1980-46 I.R.B. **6**

66-286
Clarified & Modified by
80-347, 1980-50 I.R.B. **18**

66-324
Superseded by
80-269, 1980-41 I.R.B. **9**

67-165
Superseded by
80-258, 1980-39 I.R.B. **6**

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[1] See footnote at end of list.

Finding List of Current Action on Previously Published Rulings[1]—Continued

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67-327
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68-300
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80-314, 1980-47 I.R.B. **8**

69-217
Superseded by
80-350, 1980-51 I.R.B. **7***

69-261
Modified by
80-189, 1980-29 I.R.B. **7**

69-414
Superseded by
80-276, 1980-42 I.R.B. **6**

69-442
Revoked by
80-199, 1980-30 I.R.B. **11**

70-114
Modified & Superseded by
80-311, 1980-47 I.R.B. **5**

70-126
Revoked by
80-349, 1980-51 I.R.B. **6***

70-262
Amplified by
80-191, 1980-29 I.R.B. **18**

70-597
Modified by
80-345, 1980-50 I.R.B. **11**

71-94
Superseded by
80-277, 1980-42 I.R.B. **7**

71-147
Superseded by
80-276, 1980-42 I.R.B. **6**

71-191
Distinguished by
80-176, 1980-27 I.R.B. **10**

71-257
Superseded by
80-252, 1980-38 I.R.B. **14**

71-315
Modified by
80-254, 1980-38 I.R.B. **15**

71-580
Distinguished by
80-302, 1980-45 I.R.B. **7**

72-58
Superseded by
80-307, 1980-46 I.R.B. **6**

72-351
Revoked by
80-349, 1980-51 I.R.B. **6***

Rev. Ruls.—Continued

72-372
Revoked by
80-175, 1980-27 I.R.B. **18**

73-306
Distinguished by
80-206, 1980-31 I.R.B. **11**

73-340
Superseded by
80-351, 1980-51 I.R.B. **7***

74-308
Distinguished by
80-287, 1980-43 I.R.B. **12**

74-577
Obsoleted by
80-256, 1980-38 I.R.B. **16**

75-403
Revoked by
80-251, 1980-37 I.R.B. **5**

76-402
Amplified by
80-297, 1980-44 I.R.B. **11**

76-508
Amplified by
80-231, 1980-34 I.R.B. **14**

77-290
Amplified by
80-332, 1980-49 I.R.B. **8**

77-395
Modified and clarified by
80-176, 1980-27 I.R.B. **10**

78-201
Amplified by
80-246, 1980-37 I.R.B. **7**
80-247, 1980-37 I.R.B. **9**
80-293, 1980-44 I.R.B. **8**

78-209
Modified & Superseded by
80-348, 1980-51 I.R.B. **6***

78-260
Distinguished by
80-227, 1980-34 I.R.B. **6**

79-189
Superseded by
80-179, 1980-27 I.R.B. **20**

79-231
Revoked by
80-289, 1980-43 I.R.B. **16**

79-320
Clarified by
80-227, 1980-34 I.R.B. **6**

79-394
Amplified by
80-181, 1980-28 I.R.B. **14**

80-28
Distinguished by
80-264, 1980-40 I.R.B. **18**

80-62
Modified by
80-203, 1980-29 I.R.B. **6**

Rev. Ruls.—Continued

80-301
Distinguished by
80-302, 1980-45 I.R.B. **7**

80-302
Distinguished by
80-301, 1980-45 I.R.B. **6**

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[1] A cumulative finding list for previously published rulings mentioned in Internal Revenue Bulletins 1980-1 through 1980-26 will be found in Internal Revenue Bulletin 1980-27, dated July 7, 1980.

NOTES

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____ 1927–1	$6.90
____ *1927–2*	*2.95*
____ 1928–1	6.95
____ 1928–2	9.50
____ 1929–1	12.00
____ *1929–2*	*3.15*
____ 1930–1	7.30
____ 1930–2	9.50
____ *1931–1*	*3.60*
____ 1931–2	13.00
____ *1932–1*	*2.80*
____ 1932–2	8.65
____ *1933–1*	*3.35*
____ *1933–2*	*3.45*
____ *1934–1*	*3.70*
____ 1934–2	14.00
____ 1935–1	6.90
____ *1935–2*	*14.00*
____ *1936–1*	*3.55*
____ *1936–2*	*14.00*
____ *1937–1*	*13.00*
____ 1937–2	7.70
____ *1938–1*	*16.00*
____ *1938–2*	*13.00*
____ 1939–1–1	8.25
____ 1939–1–2	10.90
____ 1939–2	9.40
____ 1940–1	5.55
____ 1940–2	14.00
____ 1941–1	*6.95*
____ *1941–2*	*$3.55*
____ 1942–1	7.25
____ *1942–2*	*5.55*
____ *1943*(*)	*9.55*
____ *1944*(*)	*7.85*
____ 1945(*)	9.40
____ *1946–1*	*2.55*
____ 1946–2	5.20
____ *1947–1*	*1.80*
____ 1947–2	3.40
____ *1948–1*	*3.15*
____ 1948–2	7.50
____ *1949–1*	*6.90*
____ *1949–2*	*2.80*
____ 1950–1	6.35
____ *1950–2*	*4.70*
____ *1951–1*	*12.00*
____ *1951–2*	*5.05*
____ *1952–1*	*2.55*
____ 1952–2	7.05
____ *1953–1*	*4.25*
____ 1953–2	12.00
____ 1954–1	12.00
____ 1954–2	12.00
____ 1955–1	10.25
____ 1955–2	13.00
____ 1956–1	15.00
____ 1956–2	18.00
____ 1957–1	16.00
____ 1957–2	$13.00
____ 1958–1	9.60
____ 1958–2	13.00
____ 1958–3	15.00
____ 1959–1	15.00
____ 1959–2	9.60
____ 1960–1	19.00
____ 1960–2	11.50
____ 1961–1	14.00
____ 1961–2	10.00
____ 1962–1	14.00
____ 1962–2	13.00
____ 1962–3	20.00
____ 1963–1	9.00
____ 1963–2	10.75
____ 1964–1–1	10.00
____ 1964–1–2	11.00
____ 1964–2	9.80
____ 1965–1	10.70
____ 1965–2	12.25
____ 1966–1	14.00
____ 1966–2	14.05
____ 1967–1	10.00
____ 1967–2	14.00
____ 1968–1	14.00
____ 1968–2	11.75
____ 1969–1	14.00
____ 1969–2	6.50
____ 1969–3	12.50
____ 1970–1	$11.00
____ 1970–2	14.00
____ 1971–1	10.55
____ 1971–2	8.50
____ 1972–1	13.50
____ 1972–2	13.70
____ 1973–1	16.00
____ 1973–2	8.30
____ 1974–1	11.00
____ 1974–2	9.95
____ *1974–3*	*8.20*
____ 1974–3 Supp.	10.00
____ 1975–1	13.25
____ 1975–2	13.00
____ 1976–1	11.00
____ 1976–2	10.25
____ 1976–3–1	9.50
____ 1976–3–2	16.00
____ 1976–3–3	10.00
____ 1977–1	10.75
____ 1977–2	11.75
____ 1978–1	11.75
____ 1978–2	13.00
____ 1978–3–1	12.25
____ 1978–3–2	9.00
____ 1979–1	14.00
____ 1979–2	15.00
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